Social Capital, the Economy and the Third Way

Dr Simon Szreter
St John's College,
Cambridge CB2 1TP
Tel. 01223 338613
email: SRSS@joh.cam.ac.uk

23rd May 1998

Draft in confidence- no citation or circulation without author's permission.

Download Word 6.0 Version

Social capital, the economy and the Third Way

Dr Simon Szreter, St John's College, Cambridge CB2 1TP 23rd May 1998

Main points:

- the Third Way must encompass a new vision of the economy appropriate for the next 25 years
- the concept of social capital provides the basis for an entirely new approach to the economy
- social capital emphasises the importance of participatory citizenship and mutual respect as the basis for building the most economically effective knowledge economy and learning society
- social capital emphasises the importance of the equality of communicative competence throughout the economy, with radical implications for a range of policies, including education

Executive Summary:

During the 1997 general election campaign it became Tony Blair's stated ambition to divine a Third Way in British politics. Similar aspirations have been expressed by President Clinton in U.S.A. There has been a lively and innovative citizens' virtual debate on the internet over what this means (summarised by NEXUS, 7/5/98), recently leading to a seminar in 10, Downing Street chaired by the Prime Minister (*Observer*, 10/5/98, p.23; *Sunday Times News Review* 10/5/98, p.6).

It will no doubt be some time before a 'Third Way' can be confidently delineated. This paper's contribution is to argue that the newly-emerging concept of social capital offers important assistance with that task, by providing a unifying rationale which gives philosophical coherence and intellectual conviction to the Third Way's political economy. The policy implications of social capital are entirely consistent with the central thrust of New Labour's most radical initiatives so far, which have related to constitutional affairs and the democratisation of the organs of governance. Social capital provides the intellectual means to generalise the principles lying behind these first steps into a more ambitious programme aimed at transforming Britain into a dynamic society of active and responsible citizenship, appropriate to the challenges of the knowledge and information-based economy of the future. This is the Third Way.

Social capital focuses on the importance of relationships in economic affairs. The social capital perspective is now based on a diverse body of evidence which confirms that companies, towns, industrial regions, and national economies all function more efficiently in the market place for goods and services when they have a rich endowment of mutually respectful, trusting relationships among the citizens who compose their work-forces. This facilitates active dialogue, optimal sharing of relevant information, and the maximum of willing participation. In short, social capital is the essential ingredient which promotes confidence and goodwill, those two most ancient economic precepts which traders have valued above all else since time immemorial. Social capital is equally significant because of its synergistic relationship with human capital- the expertise and

skills which economists now recognise as essential to productivity, especially in increasingly knowledge-based, service-oriented economies. Social capital is critical to the optimum development, nurturing and deployment of human capital.

Social capital is, thus, a political and social phenomenon with powerful economic virtues. It concerns the way in which citizens behave and interact with each other. The form and character of institutions and organisations are therefore important. Social capital is created by citizens willingly participating with each other in mutually respectful dialogue to achieve shared goals. The greater the variety of citizens who can so participate, the greater is the economy's stock of working social capital. This latter point means that true equality of communicative status has to be extended to the greatest variety of participants in order to maximise the virtues and gains from social capital. This requires genuine tolerance among individuals and absence of social exclusionist institutions. This can only be achieved through political change. The formation of the Social Exclusion Unit signifies that New Labour have grasped the significance of this issue. But the social capital perspective indicates that it can be conceived in a still more general form and that it has great importance for the dynamism of an increasingly information and knowledge-based economy of the future.

In its emphasis on active, participatory citizenship, social capital is also at one with New Labour's policies to reinvigorate active and responsive local government, a key form of organisation. However, again, the social capital perspective indicates the generalisation of this principle. All the nation's key civic institutions need to be assessed in terms of their contribution to social capital, including schools, voluntary and charitable associations, firms and businesses.

The policy of extending 'partnerships' between public and private sector in order to get things done in Britain has its corollary in the social capital literature in the concept of 'co-production' across the mythical divides between 'the state' and the 'market'. The relevance of social capital here is that it is essential to the success of such partnership efforts. It is only where the various different parties to such an enterprise- central or local government agencies, small or large businesses, representatives of communities or pressure groups, and the varied individual citizens involved- participate together on the basis of mutual respect and communicative equality, that a 'partnership' to negotiate and achieve some joint goal will really mean just that. A nation that does not breed social capital will not be able to work partnerships effectively. This notably includes those which are of increasing economic importance: where the public sector (typically local or regional government) can facilitate economic growth through the provision of expensive collective services (e.g. communications infrastructure) for the small growing firms in its locality.

To maximise social capital in the economy, the highest political priority of the Third Way should be that of creating an active participatory citizenship right the way across British society, in which all are capable of dialogue with each other on a basis of communicative equality. To take this aim seriously will entail taking a long hard look at all British civic institutions, starting with the nation's educational system. While it performs tolerably well in producing high-grade human capital among a restricted section of the nation, it has been badly failing to create social capital. This is attributable to two compounding features of recent British educational history. The private versus state school divide represents an unfortunate institutional inheritance from the point of view of the nation's social capital, in that it has been the principal perpetuator of Britain's famed 'class' system, a fundamentally divisive phenomenon, which is antithetical to true social capital. Secondly, this inheritance has been exacerbated for an entire generation due to the Tory governments' misunderstanding of economics (lacking a social capital perspective). The government itself prosecuted a devastating campaign against the state education system, which involved both public denigration of individual teaching staff and schools and the systematic long-term starvation of basic resources; whereas virtually all other advanced economies have continually enhanced their citizens' educational provision during the last two decades. Education will, therefore, be a crucial, short-, medium-, and long-term social capital priority for the practical policies of the Third Way.

Social capital, the economy and the Third Way

1. The Third Way: a moral, ideological and political programme for a new generation

From an historical perspective the search to define the Third Way represents the birth pangs of a new political generation with its own new political ideology. In post-war history there have been two clear cycles (approximately 20-30 years apart) in which a new generation has forged its own new political ideology to deal with the novel domestic and international problems it faced. The first was the social democratic cycle of c.1945-1975, the second was the neo-liberal cycle of c.1975-2000. In each case it was not so much that the previous political programme had 'failed' in an absolute sense, but rather that it had succeeded to a considerable extent in changing the economy and society (partly in intended and partly unintended ways), so that the premises- the social and economic conditions- on which it had been formulated no longer applied. Furthermore, as always time moves on, the wider world and technology changes. In these circumstances new principles and policies are sought out. It seems to take about a quarter century for the cycle of each successive political programme to pass from youthful vigour and growth through maturity to exhaustion and political irrelevance.

We are now in the most intellectually exciting and open phase of the new cycle that is upon us. It is a time of genuine political opportunity for new ideas and the really interesting and exciting question of the day now is: 'What is, or rather what shall be (for it is in our own hands to mould and fashion it) the Third Way?' Partly its character will emerge from the rough and tumble and the marvellous contingencies of political events themselves, beyond the directing control of even the most astute thinkers and political managers. But nevertheless there is much that we can and must do to give the Third Way its clearest and most cogent formulation at this moment of its birth.

To acquire the solid backbone necessary to become an effective and lasting new political programme which will guide the next generation, the Third Way will need the following three structural elements to be soundly constructed and mutually articulated:

1. its moral principles and priorities (the axioms of the programme: 'what we believe in and where we are going')
2. a more fully elaborated ideology which convincingly argues and demonstrates in more detail how these principles and priorities can be practically related to the workings of 'the real world', real people and their relationships to each other and to the economy
3. the specification of the practical policies and measures which are required in order to change current British society and economy towards the desirable model of social and economic relationships that has been elaborated. This, of course, is the most exclusively 'political' of the three elements, in that it involves critical issues of policy-presentation and judgements regarding electoral sensitivities.

Obviously, this is an extremely schematic representation and does not accurately describe the way in which the development of the Third Way is currently occurring. There is progress in all three areas simultaneously with a large number of players inside and outside government all contributing. The principal problems being experienced, as a result of this multiple and uncoordinated process, are uncertainty, confusions and genuine disagreements over the content of each of the three elements.

Overall, there has been a somewhat clearer lead from the Prime Minister and the Cabinet on the first of the three elements of the Third Way than in the other two areas. This could be seen as being entirely as it should be, with the Prime Minister trying to play his part in setting out the core beliefs and goals of the Third Way, leaving it to his advisors and other Ministers to flesh out the closely related second and third elements. However, the policies of individual ministries and Cabinet ministers still seem to be giving out quite varied and even flatly contradictory messages (the 'lone parent' episode for instance). This indicates that, as yet, considerable thinking remains to be done, in further clarifying the core moral position and, especially, in finding the concepts for building the ideological model, the second area, in the above scheme. This is the vital engine room of political transmission, comprising the intellectual work which links primary principles and goals with the devising of effective policies. The purpose of this article is to argue that endorsement of the social capital perspective can offer critical assistance to the Third Way in this area because it can provide the intellectual resources to analyse rigorously the practical workings of economy and society in a genuinely new way, superior to both the social democratic and the neo-liberal models, by avoiding, respectively, the de-motivating centralism of democratic socialism, and the abdication to the injustices of the market courted by the neo-liberals.

Contributors to the recent Nexus debate and seminar have found it easier to set out the first of the above elements than the others. Charles Leadbetter, for instance, felt able to define the core beliefs and values as 'co-operative self-help', premised on a belief in 'individuality', rather than individualism (the important ethical and practical point of the latter distinction being that each person's individuality means that we are all interdependent on each other). However, when he came to the crucial and central questions of a new ideology and practical politics to be built on these moral principles, the second and third areas in the above scheme, Leadbetter could only offer his diagnosis of a lacuna:

'Does the Third Way have a distinctive economics? This is the largest gap. The answer is: no. This is troubling. No political position has long commanded British politics without a distinctive account of how the economy should be organised.' (*Observer*, 10/5/98, p.23)

This paper argues that the social capital approach to the economy does, indeed, provide the basis for a radically new view of how the economy works, which will be of direct use to the Third Way. Indeed, I would go as far as to state that it has the capacity to comprise a rigorous and challenging analysis, which may in due course (and provided that its philosophical potential is fully developed and its practice then taken up by a new generation of economists) come to be seen as being as important as the Keynesian revolution, in providing an alternative theoretical and practical guide to the economy.

Isn't that rather over-egging the pudding? Not necessarily. The scope and provenance of social capital needs to be appreciated. Although social capital is a relatively new term, the perspective it invokes is far from novel and has been a sub-plot in the history of economic thought, silently stalking the 'mainstream' from the earliest times. As the doyen of the history of economic philosophy, A.O. Hirschman, pointed out in his celebrated study, *The Passions and the Interests: political arguments for capitalism before its triumph*, the idea that collective norms of co-operation were needed to guide the invisible hand of market transactions was a fundamental theme of debate among the Scottish Enlightenment thinkers who were the progenitors of classical liberal economics, and was endorsed by Adam Smith himself. Social capital was first clearly and extensively formulated in a publication in the *American Journal of Sociology* in 1988 by the late James Coleman, Professor of Sociology at Chicago University; though it should be acknowledged that the doyen of French sociology, Pierre Bourdieu, has a prior claim to its discussion in print. As with most important ideas in the social sciences, it is clear there are, in fact, many earlier precursors of the concept, such as the notion of 'social capability' in development economics, or the idea of 'civic virtue', which Macchiavelli derived from the Greeks (Michael Woolcock, *Theory and Society*, April 1998). The specific set of ideas from which social capital has sprung as a formulation in the 1980s can in fact trace a clear line of intellectual ancestry back to Ronald Coase's extraordinary article of 1937 which, by asking the astoundingly obvious question, 'Why do firms exist?' and by providing a revolutionary, innovative answer, founded the modern field of 'transaction costs' (the study of the critical importance of information in the functioning of economic systems).

Social capital is not, then, a mere novelty or recent intellectual fad. It has an intriguing genealogy and it represents the coming together of a number of important strands in the field of economics itself and in the wider social and historical sciences. Deep philosophical and methodological reservations have long troubled the liberal social sciences over the intellectual, moral and political opportunity costs of its most favoured brainchild, *homo economicus*. This Frankenstein (an equally fictional creation of the same generation of Malthus and Ricardo, Smith's great disciples) of the political world has been constructed with severe self-imposed limitations: the highly abstracted model of human behaviour as a dessicated, non-social, calculating machine. *Homo economicus*'s great claim to fame and power has been the analytical clarity and practical utility with which he endows conventional economic analysis. Now, with mass stress and overwork for many and un-employment and social exclusion for others in the west, with financial maelstroms in the east, and chronic poverty and famines in the south, allied to ubiquitous environmental degradation and pollution, all sane citizens are asking: isn't there a better practical guide to economics? Is it not time- high time- for a more human, less rapacious, and, ultimately less self-defeating economic paradigm? A previous generation, faced with a similar international breakdown in the practical credibility of neo-classical economics, invented and applied the multiplier as a central mechanism for a new economics, Keynesianism, which successfully provided for the needs of a whole, lucky generation, which we now look back on as the post-war golden age. Now it is time to develop social capital as the focus for another new economics to serve another generation, facing the self-created global hell of allowing the Frankenstein of *homo economicus* too free a rein.

2. What is Social capital?

Why should social capital contain a revolutionary potential for economics? One way of grasping this is to reflect on the highly unusual nature of the term itself. 'Social' and 'capital' are the central, key concepts in the disciplines of sociology and economics, respectively. How can the 'individualist' calculus of neo-classical economics be effectively married with a 'social-ist' approach? The distance between these two disciplines, as they have developed in the postwar world, was pithily expressed as long ago as 1960, when James S. Duesenberry commented, after hearing the young Gary Becker, the Nobel prizewinner who has become a leading academic practitioner of the neo-classical approach which has provided the neoliberal political ideology of the last 20 years with its intellectual touchstone, that 'Economics is all about how people make choices. Sociology is all about why they don't have any choices to make.'

Social capital is implicitly arguing that these two great, distinctive approaches to the workings of human groups, so different and opposed in so many ways, can somehow be bought together as a single intimately integrated approach. If this can, indeed, be achieved, it will provide the cogent intellectual and philosophical basis for a genuinely new political economy, the Third Way. Social capital is the central concept within a much greater intellectual package, which offers a thoroughgoing and radical re-think of the relations between economy, society and polity. It represents a project which implies and leads to a complex programme of reforms. It does not merely offer a single policy or slogan, such as the notion of 'stakeholding', which was recently touted as an important reforming principle, but which is a more limited and specific proposal, lacking the radical analytical power represented by the concept of social capital.

So what is social capital? Social capital comprises the endowment of mutually respecting and trusting relationships which enable a group to pursue their shared goals more effectively than would otherwise be possible. Social capital therefore concerns the quality of the set of relationships of a social group. It can never be the possession or attribute of an individual. It concerns the communicative capacities of a group- something shared in common and in which all participate. A fundamental point is that the relationships must be of a form that entails the active and willing (un-coerced) participation of all members in their shared activity or goal, on a basis of formal equality and mutual respect (though they may freely choose to organise themselves with leaders and representatives and endow themselves with some form of communication or authority structure). It is only when participants in some joint venture or activity are negotiating with each other on the basis of the explicit understanding that they are simultaneously working to maintain or enhance each other's mutual respect that we can speak of true social capital (both being used and being generated). Thus, the late James S. Coleman, one of the principal progenitors of the concept, wrote in 1990 that: '…social capital…is embodied in the relations among persons…a group whose members manifest trustworthiness and place extensive trust in one another will be able to accomplish more than a comparable group lacking that trustworthiness and trust.' (Coleman, *Foundations of Social Theory*, p.304).

There is, therefore, a sense in which social capital is about operating with a code of honour with one's fellow citizens. The code of honour is an intensely humanist one (though its precepts can be found in the doctrines of all the most enduring codes of conduct, which is to say in the moral teachings of the world's religions): that you actively seek to promote your fellow-citizen's welfare in all that you do. You are, publicly, a shameful being to the extent that your behaviour does not honour this code: *noblesse oblige* as the normal practice of good citizenry between equals. Note that this formulation presupposes a knowledge of what the welfare needs and aims of one's fellow citizens actually are, which cannot simply be assumed to be identical with one's own, especially in a multicultural society. Social capital therefore requires open, tolerant and mutually-respectful dispositions and dialogue among those who know themselves to be different. It is not merely a cosy agreement among like-minded beings, the caricature of 'community' as something which is easily achieved and doesn't have to be worked at. It is actually an intrinsically fragile and difficult achievement, a negotiated performance requiring excellent social skills. However, most people do find that it comes surprisingly naturally and that it gives its own rewards in the reciprocally gracious behaviour it elicits. It is valued everywhere as the character qualities of maturity, kindness, and considerateness.

Annual meetings of the management bodies of civic and publicly-owned institutions, such as schools or quoted companies are a common experience which the great majority of citizens will have had at one time or another in their lives. Their aim is to provide a channel for communication between the entrusted (and sometimes remunerated) managers and those with a direct interest in the institution's performance. But it is only when there is a relationship of mutual trust and respect that the communication channel works well, or at all. Furthermore, it is all the more difficult to conduct a proper dialogue between the two parties which focuses on the disinterested promotion of the health of the school or of the business in question, if there is lack of mutual respect within the diverse body of parents or shareholders themselves, on the one hand; or faction and division among the managing group on the other hand. In these circumstances meetings can become side-tracked by 'personalities' or acrimonious 'politics', as it is somewhat euphemistically termed by those who experience this kind of breakdown in communication, and in social capital, at such meetings.

This example (drawn from my own experience) underlines the critical point that social capital depends primarily on a community's or group's capacity to generate and maintain mutual respect and trust among its participating members. A social group or institution which is potentially capable of generating social capital may be composed in almost any conceivable way: a neighbourhood, those in a business company, a set of companies doing business with each other, an occupational or employment association, a choral meeting, a group of bird watchers, the crew of a boat, a political party or its local branches, an academic institution or a school, a 'social class' (in the Marxist or Weberian senses), an ethnic group, a nation, a congregation, a religion. But it is not simply the fact of the existence of these civic institutions or voluntary associations or networks of personal contact in society which generates social capital, but their functioning in certain ways, including important 'details' of the way in which their participants communicate with each other. In Britain, many sports clubs are endemically socially-exclusionist and some are also internally authoritarian and hierarchical, notoriously so with the most famous one of all, the M.C.C. Thus, Britain, the society of clubs and voluntary associations par excellence, might at first sight appear to have a claim to be the Utopia of social capital. But it is the quality of the relationships which they engender among their members and in their relations with the wider society which is critical in determining whether or not these institutions truly promote social capital. Their capacity to promulgate respect and trust, both within and without, is of fundamental importance.

Thus, social capital refers to a set of respectful and trusting relationships which represent a generalised norm of goodwill and mutual confidence among the participating members of a social group. Such a norm enables multilateral dialogue and information- sharing to occur among the widest variety of individuals in the most efficient manner permitted by the available communications technology (hence the economic virtues of social capital). However, to be able to measure, study and analyse empirically this normative dimension of a social and economic system is not quickly or easily done. This is undoubtedly one of the reasons why such an interesting concept as 'social capital' has taken some time to gain the attention of the social sciences and humanities. However, it is heartening and relevant to point out that in the recent history of economic thought, the formidable difficulties involved in measuring the other forms of capital to did not prevent economists from trying; and that it took about a quarter of a century before the 'growth accounting' methods of Edward Denison achieved a degree of disciplinary consensus.

The early problems involved in how to study social capital have undoubtedly led to, and probably will continue for some time to produce important confusions of its meanings among those who want either to study or to attempt to use social capital in some way. It would require painstaking, comparative qualitative work to study directly and rigorously the sets of dynamic relationships and norms which are social capital. To perfect this will have to remain a long-term academic goal, as with Denison's work on national accounts. However, this need not, and has not prevented more approximate methods and practical development of this new approach to the economy to proceed in the meanwhile, exactly as in the history of the use of national accounts. Since it is reasonable to argue that social capital manifests itself through certain kinds of attitudes and dispositions towards fellow-citizens and civic institutions, through networks of contact and association and through participation in civic and public institutions, it can, in principle, be indirectly studied through examining these phenomena. Thus, there has been plenty of fruitful research documenting the inferred formation and deployment of social capital in different contexts (or the consequences of its relative absence or under-development), an approach which permits a range of already available information for many communities and countries to be analysed. Robert Putnam's research, initially on Italy and latterly on U.S.A., has been consistently the most impressive and innovative in this vein, though certainly not without its critics.

However, with these early empirical studies necessarily giving prominence to such measures as the number and membership of voluntary associations over time in different places, to the density of networks of exchange between individuals, or to the frequency with which social surveys document, for instance, the giving of dinner parties or statements about whether politicians can be trusted, there has been an unfortunate tendency for the already-disputed meaning of 'social capital' to become prey to further confusions. Hence, the broad currency outside the specialist research community itself, of the rather simplistic, and behaviouralist notion that social capital is solely concerned with the existence or not of 'networks' and 'voluntary associations' (with the concept of 'trust' sometimes being tagged on). There has also, unfortunately, been a spurious right-wing, libertarian attempt crudely to hijack the idea of social capital to buttress undiscriminating hostility to 'the state', by arguing that the central state is inimical to the vitality of social capital because it 'crowds out' voluntary associations (Francis Fukuyama's popularisation of 1995, *Trust*, tended to encourage this tendency, though he has been back-pedalling since; while David Green of the right-wing Institute of Economic Affairs has been the most obvious exponent in Britain in a pamphlet on 'rebuilding civil society'). This is a naïve simplification: as the above analysis points out, voluntary associations are as capable of damaging as contributing to social capital. In a polity actively nurturing its social capital, 'the state' (though not in the demonised 'central bureaucratic' form of right-wing fantasy) has to perform a vital partnership and facilitation role. It has particular significance in its devolved form: as participatory, local self-government.

A further important confusion among students of social capital has been the notion, sometimes associated with a strand of thought labelled 'communitarianism' (as advanced by Amatai Etzioni in, for instance, *The Spirit of Community*), that tight-knit communities, composed of individuals sharing similar property and employment-related interests (even similar socio-ethnic backgrounds or collective biographical histories in extreme cases of residentially, stable small towns), must be the paradigm of social capital. They are not necessarily any such thing. Because of their common background and interests, it may well be that the individuals in such a context exhibit shared norms, expectations and a way of thinking and therefore 'know' each other well. However, whether or not this in turn leads to effective negotiation and respectful collaboration with each other is an entirely contingent matter (the feuding and distrust of tight-knit 'Hill-Billy' Appalachia or the quiet, claustrophobic 'tyranny of village vexation', to quote Edmund Burke, being equally possible outcomes). Furthermore, with respect to the wider society within which such a tight-knit community is located, although its internal relationships may be conducive to intense and 'close' relationships among its citizenry, these may quite possibly contribute to important negative externalities for the social capital of the encompassing polity. This is a classic political problem of regions or states within a federation, something which can become critical to their survival in the face of an external security threat, as the historical examples of the city-states of Ancient Greece or of early modern Italy both demonstrate.

These considerations lead on to an absolutely central and general logical problem, which theorists of 'social capital' must successfully and plausibly resolve. This is the need to maintain a clear distinction between true social capital and a wide range of more sectional and potentially divisive kinds of relationship, which are only concerned with the promotion of fellow-feeling and the interests of a privileged in-group, and which are unconcerned if this is done at the expense of others in the wider polity. The kinds of trusting relationships and joint participation which characterise such associations when examined from the inside superficially look exactly like social capital; and certainly for those involved their shared activities may be experienced as socially rewarding and emotionally satisfying, just as with true social capital. But social capital is not merely a quality of psychological experience or the fact of participation per se, or the existence of a social group. The issue of purposes, involving both means and ends of the group concerned, is of central importance. For any group or institution, if it is to be evaluated in terms of social capital, then it must be assessed with reference to its relationship to the wider polity of which it forms a part, and not merely in terms of the internal relationships and benefits of its members as if it can 'free-ride' on the wider social context.

This logically impeccable point does, however, create problems of practical translation. Is true social capital a possible political aspiration and guide? Since it is merely fanciful and Utopian to talk of forms of activity and association which can somehow simultaneously involve the equal and respected participation of everybody in a national polity (or, by extension, everybody in the world, since this would also seem to follow as being desirable, in principle, from the above analysis), isn't it just the case that social capital is always as divisive as it is unifying in the final analysis? Real people, in their many forms of association that are taking place all over the face of Britain every day, are, as well as promoting their own collective interests, also inevitably acting in any number of relatively socially-exclusionist ways, with respect to those many 'others' who are outside their particular group or club (and whom they may have actively excluded), or whose interests they have not served (they may even have attacked) by their activities (often the case with sectional property-owners' associations, for instance). In that case, apart from pointing to an interesting socio-cultural or psychological phenomenon (the insight that people invest emotionally in what they do and who they associate with and this can have real, longer-term economic and political effects), does the concept of social capital have any useful potential as a guiding light for the Third Way?

Evidently, I believe there is a strongly affirmative answer to this. The point about social capital is that it is not simply another word for the sum of the self-interested 'connections' and the sectional special interests of each and every club or neighbourhood in society. It is only where participation in the activities of such associations and groups is undertaken on conditions of mutual respect, trust and equality, <u>both</u> in relations with other members of the organisation in question <u>and</u> in the disposition of the association towards all others in society, that there is the capacity for true social capital to be generated. All forms of voluntary association are potentially productive of genuine social capital because they provide learning and demonstration opportunities for citizens to gain experience of participation in the pursuit of collective goals; but the counter-effect of their exclusionary potential (either through sectional goals or selective membership) needs to be carefully evaluated and guarded against. By contrast there are a number of official and state-organised or state-funded institutions, such as the NHS or the Royal Mail for instance, where the commitment to social inclusion is relatively unequivocal. Here the social capital perspective might, however, indicate a more negative assessment in terms of the participatory and 'empowering' dimension of these institutions' net contribution to the formation of social capital in the nation (hence the long-running discussion within medicine on the importance of doctor-patient relationships and the implications this has for the effective use of medical services by citizens).

These considerations reveal that the set of relationships which comprise social capital should have two key qualities, relating, respectively, to the internal and to the external relations of the institution or group in question: that they entail active participation on a basis of formal equality; and that they do not contribute to forms of social exclusionism and closure of lines of communication and fellow-feeling with other citizens. On the contrary, true social capital is built from practical lessons and experience in dialogue with as wide a variety of others as possible. There is, therefore, an important principle of 'communicative equality', upon which social capital is premised. Thus, the leading empirical exponent of social capital, Robert Putnam has always emphasised that it is 'horizontal' contacts of association between equals, rather than 'vertical' networks (which imply inequalities of power or authority- he used the example of the Mafia in his studies of Italy), which represent true social capital.

Indeed, following Eva Cox's focus on this problem (*A truly civil society*, 1995 Australian Broadcasting Corporation's Boyer Lectures), Putnam is now emphasising in his most recent empirical work, the importance of documenting an extensive and dense range of 'weak' ties, establishing multi-lateral lines of communication between the maximum number of citizens, as being the key sign of well-developed social capital, rather than the demonstration of 'strong', intensive and binding ties among the members of certain sectional groups, since the latter may actually impede the more extensive links and sympathies which is true social capital (R. Putnam, Plenary Address, 'The distribution of social capital in contemporary America', Michigan State University international conference on 'Social Capital', 21st April 1998). A finding of recent research on social capital and social exclusion in U.S.A. has been that the very poor in inner city ghettoes have a relatively small number of claustrophobically intense family and neighbourhood/gang ties and loyalties which effectively lock them into their poverty and lack of opportunities with those in similar positions, whereas those with a wider pool of 'weaker' contacts fare better; while it has long been known that relatively 'mobile' (socially and geographically) middle class people typically benefit from their participation in a relative abundance of networks of such 'weak' ties.

Thus, the extent to which there are wide 'bridges' of understanding and contact between all the various associations and institutions in civil society is now coming to be seen as an important indicator of their capacity to sponsor social capital and counter the forces of social exclusion. As a political programme, therefore, if the Third Way is to endorse social capital as a principle for transmission of its values within the economic and social sphere, it is not just a matter of piggy-backing on the panoply of voluntary associations that exist in Britain or of simply extending their number. Nor, at the opposite ideological extreme, is it simply a matter of expanding the ‘public’ sphere of state-sponsored institutions. There will need to be a long, hard look at the rules of association and operation, the purposes, and the criteria for membership of these precious ‘public’ and ‘private’ institutions in order to ascertain to what extent they are truly assisting with the creation of social capital in Britain, or may in fact be among its most insidious and subtle enemies. Britain’s formal institutions, organs of local government, public organisations, private sector businesses, and voluntary associations can all be assessed in terms of the extent to which they genuinely preach and actively practice mutual respect and trust for all citizens and encourage their active participation, regardless of age, sex, creed, colour, wealth; and the extent to which their internal structures and external relations promote formal equality among all citizens.

There may be many cases where it is considered legitimate for certain institutions to be partially exempted from these criteria. For instance, to take an obvious difficult case, there is the question of evaluating the current manner of operation of some private sector businesses, in hiring and firing low-paid workers without offering any sense of security or commitment to them, while possibly at the same time paying out extremely large (and sometimes equally insecure) salaries nd bonuses to those individuals doing the hiring and firing. From a purely social capital point of view such an institution is in serious deficit with the wider polity in which it is located because of the distrust it is generating, along with the authoritarian relationships and the inequality of financial treatment being offered to different categories of employee. Now, of course, there will typically be a counter set of arguments put forth on the part of such a firm and its owners, which will relate to their primary need to survive and make a profit in a competitive market for the particular commodities in which they are involved. There may, indeed, be some legitimate commercial validity in these arguments, especially given the realities of the prevailing state of the economy (in the absence, for instance, of minimum wage legislation). There are obvious analogies here with the issues involved in environmental pollution by commercial operations, another example of a previously-unmeasured negative externality, which is now considered too important to ignore.

The social capital approach does not therefore seek to prejudge this issue and would not be used in an economically naïve way to insist on immediate changes in any specific company’s practices, possibly with damaging effects to its short-term survival. It aims, rather, in the first instance, to make more transparent the nature of the economic costs and benefits that are in fact involved in the way that different institutions operate, as has happened with environmental accounting. Provided this information was fully and graphically publicised (a legitimate and crucial role for central government), at least some managers would themselves begin to conclude that alternative practices were commercially valid, in view of social capital considerations. The point is that once social capital has been genuinely recognised as a crucially important element in this new economics, monitoring its construction and destruction by all organisations will itself constitute an information revolution which will be vital to implementing the Third Way as a successful political programme, by facilitating the capacity and desire of citizens themselves, including managers in the private and public sector, to improve the overall social efficiency of the economy.

3. Social capital and the economy

We have now entered, through these examples, the absolutely central heartland of the area in which social capital can make its positive and load-bearing contribution to the flowering of the new political movement which the Prime Minister seeks in the Third Way: a new political economy. In terms of the scheme set-out above, it is in sketching the outline for a new economics derived from the insights of social capital that the crucial second and third elements of the new political programme, the intimately articulated ideological and political areas, can be given content and conviction.

According to the proponents of social capital, a proper understanding of the workings of a market-oriented economy requires the recognition of four essential analytical categories :

- financial capital (including appropriately valued industrial plant)
- bio-physical capital (‘land’ and the environment, more widely conceived)
- human capital
- social capital.

From an economics viewpoint social capital can be defined most briefly as that general set of relationships which minimise transaction costs all across the economy. Given the fundamental importance of transactions costs, social capital has equivalent productive significance to the other recognised forms of capital. There can be both synergistic relationships and negative trade-offs, depending on how, in what contexts, and to what purposes these different forms of capital are deployed in any economic system. In particular, it is likely, *ceteribus paribus*, that over-emphasis on maximising only one, or a limited range of the four forms of capital may incur what are ultimately self-defeating penalties, in terms of deteriorations in the endowment of the system with each of the other forms of capital. Sustainable, optimal economic growth and development requires giving approximately equal weight and attention to the deployment and reproduction of all four forms of capital together.

The issue of information is now generally recognised in economics to be a central one. The emphasis on social capital ultimately traces its intellectual roots to work within the liberal economics tradition which has focused on the vital importance of information in the workings of the economy. It is only through information that we can make a judgement of the value of anything in a market economy. Information both about what the thing in question can do for us and, especially, information about what other alternatives are available currently or in the near future. Anybody who has tried to buy a car knows that it is important to invest some time compiling information on the range of prices from different sources for all the models which satisfy your requirements of size, age, etc before you are in a position to judge whether you're getting a reasonable deal or not. The sellers in the market do not guarantee to offer you that fair deal.

A remarkable economic theorist, Ronald Coase, pointed-out in an article originally published in the journal *Economica* in 1937, but rather overlooked by the economics profession for decades, that in fact the only economic reason why such a thing as a 'firm', the most basic element in the production side of the economy, exists at all is because of the need to minimise the 'transaction costs' of the information needed to make anything. By employing everybody within a 'firm' the owners routinise and reduce all these information costs by creating a set of 'experts' (the workers), who, in return for the security and recompense of their regular wages and salaries, all share continuously, and without having to be hired each time their input is needed, all their knowledge of how best to find and process the raw materials and then sell the products at the best prices. Thus, the problem of how to manage the costs of information lies at the very heart of economic organisation into firms in a market system. Those companies which can maximise their access to and control over the relevant, high quality information for the minimum economic outlay will triumph over their competitors. Most successful companies have found, over the years, that the most effective strategy for achieving this <u>and</u> maintaining it over the long term, includes ensuring the commitment and goodwill of an experienced and trusted workforce, by offering them a good deal (James C. Collins and Jerry I. Porras, *Built to last*; John Kay, *Foundations of Corporate success*).

This insight has led a number of studies to explore the reasons for economic success and failure in these terms. In particular, one phenomenon that had always puzzled economists and economic historians was the existence of what Alfred Marshall called 'industrial districts', such as, in his time around the turn of the present century, the Potteries earthenware industry or the Black Country making nuts, bolts, chains and springs, or Sheffield's cutlery workshops, In each case a large number of small, medium-sized and even large firms clustered together all manufacturing similar products for decades on end without apparently driving each other out of business but, rather, prospering or declining all together. A similar phenomenon has been noted in the 1980s and 1990s with Silicon Valley in California, and with the computing and biotech 'Cambridge phenomenon' in England, and several such districts in south Germany and north-central Italy, for instance (R.D. Putnam, *Making Democracy Work*, p.160). It has been found that in these cases the companies exist in clusters , enjoying the benefits of 'competitive co-operation' by flexibly sharing and subcontracting with each other a pool of specialist knowledge of the state of the market and the technologies, a pool of workers and their skills, and a local infrastructure of communications and social services that their industry and work-forces require to work and live efficiently but which any one firm or small number of firms could not provide on their own.

It is actually 'the state', typically in the form of the local government administration, which organises and provides the latter (and of course, the central state also provides further facilitating support of a more general kind in terms of the wider infrastructure supporting the locality in its relations with the rest of society and in maintaining confidence in the rules of the market). This is an example of what is called 'co-production', a partnership across the public-private divide, showing that success in the global market often depends on 'the state' nurturing its industries and companies, and vice-versa, in that the productivity of the companies then nourishes the state and society. (Peter Evans, *Embedded Autonomy,* 1995). In addition to their embeddedness in a long-term mutually beneficial relationship with state agencies, it is pointed out that the long-term interdependence of all the companies means that there is little sense in naked commercial opportunism on the part of any one company trying to profit unduly at the expense of the others because it thereby risks consequent ostracism and breakdown of high quality communications with the other companies in the industrial community. There are, instead many incentives to co-operation and there is also often a rich shared associational life among the employers and among the employees outside work in these industrial districts. Together the firms in the industrial district with their joint resources and high quality, shared information can compete on price and quality against anything else in the rest of the world.

This is an example of the socially and economically beneficial effects flowing from social capital and the central importance for both firms and their workers of access to high quality information in order to make effective choices and decisions in any market context. But information can also, of course, be used and controlled by restricted sections of the population so as to have less generally beneficial, more socially and economically divisive effects. Thus, it is the principle of the transaction costs of valuable information which explains why young traders not long out of Oxbridge or, occasionally, the famed 'barrow boys' from the East End, are paid such enormous salaries and bonuses in the city, apparently in defiance of the conventional laws of supply and demand. There is no problem with labour supply, as many of the best graduates (and many others) are- not surprisingly- queuing-up for these high-paying jobs. This should exert strong downward pressure on levels of remuneration according to conventional economic theory. The point is that the high value of the informal information, which is the primary commodity which individuals working in this market deal in, makes it vital for companies to command the loyalty of the workers, in whose heads the precious information-processing capacity resides. The only tool they have to discourage defection of workers with their valuable commercial expertise is to pay them sufficiently handsomely to make it too expensive to run off with their precious knowledge and information. There is nice irony in all this: that the conditions governing the labour market of the City itself, the paradigm 'free market', is a leading example of the fact that economic relationships in a free market are <u>not</u> determined primarily by the competitive pricing laws of supply and demand but by the more complex implications of the transaction costs of managing and deploying high quality, informal information.

This example of the city trader illustrates a highly significant implication of one of the most important general properties of information in the market context: its fundamental asymmetry. Not all information is equally valuable. The conventional wisdom of economic liberalism is that the great virtue of markets is that they obey the price laws of supply and demand and therefore there is always automatic pressure to reduce any temporary imbalances, so that no seller or buyer can establish a self-perpetuating advantage in the market which would lead to gross imbalances of power. But the information theory of the free market predicts, to the contrary, that its operation is actually conducive to the opposite tendencies. This follows from the combination of the two truisms that 'Time is money' and 'Knowledge is power' when applied to the asymmetry of information. As Coase realised, in order to acquire high quality information about anything of value it is necessary to invest time in the process of finding-out. The quintessential virtue of social capital is that it facilitates this, broadly, for everyone, dramatically reducing all the transaction costs across the economy. In its absence, however, it is principally the rich alone who can benefit from this. Typically they pay others to do it for them. As a moment's reflection will confirm, in a competitive market economy the most commercially valuable information (that which can put an individual in a position to gain substantial money and power from knowing it) must be of an informal nature, rather than public or published information or formal knowledge. The firm is one example of the way in which the wealthy (the owners of the firm) systematically harness and harvest this informal, esoteric information, by giving employment contracts to a group of specialists in a particular field of activity on the understanding that they use their collective special knowledge to increase the value of the firm.

The more we create markets in everything important in our lives, the more this can compound differences between the wealthy and the poor, if there is no attempt to equalise their communicative competence. The rich can create an ever greater distance between themselves and the rest of society through superior access to the most privileged information, which enables them to play these markets better. The wealthier you are in a market society, the better position you are in to harness and harvest the commercial value of specialist, informal information in various fields of activity. This can be both through employing more and better-informed people to use their information in your interests (because by paying them you establish quasi-property rights over their knowledge); but an equally important method is by 'swapping' informal information with others in a similar privileged position to yourself. This, of course, is why the rich and powerful place such emphasis on the importance of exclusive informal social interactions with their peers. It is at the clubs, parties, charity events, public school functions and holiday visits of the wealthy and the super-wealthy that they do some of their most important business. They know that establishing friendship and relations of trust with a network of others who are in a position to share and exchange the most valuable informal information is one of the most efficient and reliable ways to make spectacular gains in a market economy.

Friendship, trust, parties, charity events and marriage alliances all seems rather a long way from the New Right's emphasis on how to get the market economy working right, through maximising competition and removing all regulations and impediments to free markets in all commodities. And so it is! This is because the implications of Coase's highly original insight all those years ago about the true, information-based nature of the working of a market economy produces some very different conclusions and policy implications to those which have been pedalled by The Adam Smith Institute, the Centre for Policy Studies, and the Institute for Economic Affairs. Where policy prescription has been concerned the New Right's ideas have fundamentally boiled-down to advocating a set of measures which placed their faith in a radically free market in all grades of labour as the primary means to make the economy efficient. This meant the deregulation of the labour market so as to allow dynamic individual managers and entrepreneurs to be incentivised with high salaries and low taxes in return for which they would hire and fire at will a flexible workforce, no longer artificially cushioned by both a too-generous welfare state and over-mighty trade unions. Both managers and workers were envisaged to be forever moving from one company to another as the market conditions of world consumer demand changed, always favouring the most productive current sectors of industry and the most efficient firms. During the late 1980s the New Right became so confident of the rectitude of these principles that they started trying to apply them to classic public goods, such as health and education provision.

The New Right view of the economy has no room for the promotion of friendship, trust, fellow-feeling with other citizens who are strangers, local networks of co-operation and voluntary association among employers and employees in communities specialising in certain goods or services. The economic agenda is supposed to be all about consumer choice, ruthless competition, rationalising and downsizing, reducing costs, driving deals, winners and losers. Individual consumers or 'firms', are viewed as independent, unconnected, sovereign, rational decision-makers. But that's not the way people or firms are, nor is it the way they make the most effective and important economic decisions. The fact that it is information-processing and assessment which is in fact the essential activity being performed, where economics is concerned, means that we really need to think about what it is that influences access to and interpretation of relevant information if we want to understand how economies work and how people can perform most effectively in the economy. This is a truth about maximising your economic opportunities that the wealthy instinctively understand and practise.

Any firm's or community's or nation's endowment with social capital critically influences the communicative capacities of its human members and working parts, because it refers to the quality of the relationships between them: to what extent they have sufficient confidence in each other that they can informally associate together, voluntarily participate in collective aims and activities, express, mutually acknowledge and affirm shared sentiments. Such quality of interaction and communication can create a skein of obligations and expectations in the relations between individuals- forms of commitment, which foster the development of trust, friendship, and co-operation. It is this which facilitates the sharing and community pooling of that high quality, informal information and knowledge which is most relevant to the participants' most effective discharge of their economic functions. Relative stability and continuity of contact between the people within a firm or industrial district can therefore enable it to benefit to the maximum from its social capital. On the other hand, chronically high levels of turnover in managers or employees, as demanded by the insistence on labour market flexibility in New Right thinking, can prevent social capital from flourishing because it becomes impossible for relationships of trust and commitment to be formed under these circumstances.

Thus, until relatively recently mainstream economics had addressed itself primarily to land, capital and labour as the three essential factors of production and, in its drive for deductive elegance and analytical rigour, gave far too much attention only to the material, tangible dimensions of assets. Since the 1960s the more intangible dimension of human aptitudes has increasingly gained recognition through the concept of 'human capital'. The politics of ecology has also forced a dramatic widening and 'greening' of perspective, with progressive economists now accepting in principle that environmental costs and depreciation must somehow be brought into cost-benefit analyses and the trading accounts of companies and national economies. But the proposition that 'social capital' and its principle of communicative equality, should also be considered as an integral part of a new economics represents a further, much more radical intellectual revision, with profound moral and political implications for our understanding of liberal, market economics.

4. Policy implications for the Third Way: Social capital, human capital and the education system

As stated at the outset, social capital is in many ways broadly consistent with a number (though not all) of the policies already initiated by the Labour government. There are good social capital reasons to back a minimum wage, to support the rationale of welfare to work, to promote lifelong learning and training in the workplace, to back regional devolution, to indicate that elected city mayors along with re-invigorated mechanisms for more participatory local governance are extremely important, to extend nursery and after-school care, and to mount an attack on social exclusion as if it were a socio-political cancer (which it most certainly is- a society which has learned to walk past fellow-citizens lying on the pavement, because it does not want to spend the money necessary to provide them with assistance to enable them to stand once again, has crossed a dangerous moral threshold and is certainly deficient in social capital).

The concept of social capital can help New Labour to specify more fully and coherently the ideological links between many of these policies and to spell out the political programme, which Tony Blair has provisionally labelled the Third Way. Social capital has the capacity to provide both the Labour government and the populace with a much greater degree of conviction that the direction in which Tony Blair's government is hesitantly and cautiously beginning to take Britain is, indeed, a worthwhile path to follow, through its illumination of a radical new vision of the way in which society and economy function best. To adopt the social capital perspective should also make it clearer to the Labour government what some of its most important policy priorities should really be, concentrating minds on the political strategy required. In this concluding section I want to emphasise one central policy implication in particular, an area in which Tony Blair himself has famously declared high intent, but in which there has been inexcusable timidity, lack of imagination and little leadership so far: 'Education,

education, education'. This can serve as an important example of the way in which the social capital perspective can put real backbone and radical rigour into the meaning of the Third Way.

In advanced economies, such as Britain's, services already account for almost two-thirds of the value produced, which means that the economy is ever-increasingly knowledge and information driven. Ideas, culture, and science matter ever more directly to the productivity of the economy (even more than 'technology', that great buzz word of the 1960s). It has become uncontentious among economists that this means that a key issue for the future success of advanced economies will be developing and nurturing human capital. One, fairly straightforward way of looking at human capital is simply as a set of individuals' aptitudes or skills, in which case an emphasis on putting national resources into basic educational inputs and vocational training follows as a direct policy implication. This was more or less the thinking behind the almost universal educational expansion of the late 1950s and 1960s when human capital was a new and vigorous idea.

However, there is also the key issue of how human capital, once 'produced' through the education and training systems, is subsequently effectively combined in the market economy into creative and productive commercial partnerships and teams. This is where social capital is of crucial significance. It facilitates the maximum diversity and density of positive relationships, which permit human capital to achieve its most productive combinations and outcome for the economy. It is the oldest secret in the world (hidden by two centuries of an economics focused too exclusively only on how to transform inanimate matter into material 'products') that the greatest degree of trust and confidence among the greatest diversity of workers produces the most vibrant and productive economies. As efficiency in the simple processing of the material content of products becomes less central to the productivity of our economies, while the commercial value of their artefactual and creative content steadily grows, we must develop an economic analysis which gives correct weighting to this new economic fact of life. That means an economics focused around the promotion of social capital as the critical accelerator of the value of human capital investment. This has radical implications.

If the promotion of social capital is to become a central tenet and principle of a market-oriented economics of the Third Way, in its programme to assist the UK towards a knowledge-based, information-processing economy, maximising the potential of its human capital, then it follows that it is a crucial goal to maximise and equalise the social and cultural scope of information exchange among the economy's workers. It is access to and effective use of information by the greatest diversity of citizens which primarily drives a knowledge-processing creative economy, just as the cheap and accessible supply of coal, oil and electricity have successively driven, at a basic level, the material-processing economies of the past. It is the existence of social capital which means that all the human relationships in the economy, both those within and those between all its commercial and civic institutions, are of a form which will derive the maximum benefit from the available information, by using it and sharing it to the greatest commercial effect.

This has at least two direct policy implications. Firstly, the need to facilitate maximum social accessibility of information. Part of this will not be particularly contentious, in that we can all agree on schools and colleges getting their internet links and computing resources, and it is even possible to see why the private sector may find it commercially feasible to sponsor this to some extent. But it also requires the elimination of information obstacles and barriers. The latter will require greater political boldness because it will threaten certain vested interests, who currently draw a rent from their control of valuable information at the expense of the remainder of society. Of course, there are, and will remain many legitimate versions of profiting from restricted information, which are broadly speaking covered by the patent and copyright areas of the law and which relate to the need to provide an incentive and reward for socially and economically-productive risk-taking (an activity that it is intended will increase ever more, if social capital is successfully boosted). However, there are many other forms of rent-seeking activity in an economy; and the category, which is broadly termed arbitrage can have no special claims to protection, since it merely exploits, in a parasitic fashion, inequalities of information between different agents in the market.

Liberal economists, since at least John Stuart Mill, have recognised that 'imperfect' information radically distorts the practical workings of a market economy and that this is a regrettable feature of the real world. They are in favour of the maximum of 'transparency' of all relevant economic information to the agents in a market, since otherwise agents cannot exchange on the basis of knowing what their true economic options and opportunity costs are, which in turn makes a mockery of both the moral legitimacy of the operation of a market and its important claim to provide the most effective allocation mechanism. This 'transparency' imperative corresponds to the social capital principle of the need for the maximum of communicative equality and communicative competence among citizens, in order for the economy to derive maximum benefits from its human capital. Here we come to the second, and far more radical policy implication of the need to promote social capital.

As we have see, one of the most significant and powerful sources of distortion over the free flow, equal access to and equal understanding of commercially relevant information is an unequal distribution of wealth and income in society. The social capital perspective therefore alerts us to the fact that there is a sound reason, internal to the liberal economics view of the market as an optimal allocative mechanism, to favour policies which promote equality of income and wealth among the freely interacting information-processing citizens who comprise the workers in the market-place of the knowledge-economy of the future. That there is a compelling liberal economic argument for socio-economic equality may seem a somewhat heterodox conclusion to derive, in view of the plethora of apologies for inequality which have poured from right-wing liberal economy think-tanks during the last thirty years or more. However, without a social capital dimension these ideologists have been operating with a radically incomplete theory of the market economy. Indeed, the nation has paid a heavy price for this, in the absurd extensions of this under-theorised notion of market relations to public goods such as health care and education, without heed to the consequent damage to social capital that this has entailed.

It would, of course, be impractical in both political and economic terms, to implement policies promoting equality of income and wealth in too literal and rigid a fashion. All liberal, market societies will have to continue to get by with a certain degree of inequality, an inevitability in the real world. However, what the social capital insight demonstrates is that there are very significant costs being incurred, in terms of a liberal economic understanding of the most efficient functioning of the market economy, in polities which tolerate extreme inequalities of income and wealth distribution among their citizens. This is because of the resulting gross distortions in access to and capacity for understanding the significance of potentially relevant commercial information, compromising the communicative competence of large sections of the citizenry. In simple terms, there is an important efficiency trade-off, therefore, between socio-economic inequality and a society's endowment in social capital. This creates a presumption in favour of equality <u>for</u> <u>economic efficiency reasons</u>, whereas previously it has typically been argued that liberal economic theory offers a primary presumption in favour of inequality; and that separate, social justice arguments are required to provide any significant reasons to countenance the moderation of economic inequality in a market-oriented society. But a polity which encourages too much accumulation of capital in the hands of too few of its citizens will be paying a high price in terms of social capital; and consequently its overall economic performance (even when measured in terms of its per capita stock of financial capital, let alone the other three dimensions of capital) will be significantly poorer than would otherwise have been achieved.

This is especially the case if the production of creative, knowledge-based and information-sharing commodities are becoming an ever-more important part of a modern economy's productivity in a competitive world market. This is an important point since it is always the case that at any time there is a balance in the economy between one set of companies which are mainly trying to deliver already established commodities and services at the cheapest possible price and another set which are innovating new kinds of products and services. This means that there is not in fact just one single kind of 'market competition' but at least two quite distinct forms. It is only the former kind of company which is competing with its rivals in the classic 'law of the jungle' sense, where ruthless managers must drive down the costs of the factors of production (including labour) to the minimum in order to survive against competition. A completely different kind of market competition obtains where companies are innovating new kinds of product; and again still another type where they are competing on quality- to produce the most stylish or effective product or service. In both these cases the creativity of the company and its competitiveness will critically depend on the careful nurturing of its human resources, quite the opposite of a cost-cutting approach. Broadly speaking it is only in the first kind of business where 'brutal' labour relations may receive some form of justification from the conditions of competition in the market (and hence the kind of individuals who speak up for this rather limited understanding of the laws of the market tend to come themselves from this kind of operation, like the new Director-General of the CBI). However in an economy which aspires to derive maximum benefit from the information revolution and from rising consumer incomes world-wide, both of which provide an ever more discriminating market for high-value-added, creative and new products, it will be increasingly competition of the latter kind which is of relevance and it will be companies of the latter kind which achieve ever greater importance in creating value for the economy. The government needs to encourage the latter, not the former form of competition.

The politicians of the Third Way will have an especial duty to be the custodians of the liberal economic principle of equality. This is because the rich and powerful individuals, who are the prime beneficiaries of such a distorted information distribution, will also have unequal access to political information and to the manipulation of political information. The history of ownership and influence (usually- subtly- exerted at arm's length only) over the popular press indicates that they are unfortunately likely to use this power to promote their own personal and sectional interests, undermining the independence of the 'Fourth Estate', which is so vital to the health of a democracy of participating citizens.

Of course, there will always be serious political limitations on the extent to which any liberal society will have the capacity or will to impose upon itself the income and wealth equality which the information theory of the market reveals to be desirable in order to promote economic efficiency (although it is relevant to note that there is considerable variation among the liberal democracies of the world in this regard and that the best long-term economic performers of the last 50 years, Germany, Japan and Denmark, have consistently been among the most egalitarian).This makes it all the more important that, in addition to any evening-out of the income and wealth distribution that may be politically attainable, that extremely serious attention also be given to the characteristics of the national education system, which is the other principal general influence upon the formation of social capital and the possibilities for equality of communicative competence. The scale of the problem with the British education system should not be underestimated. It is at this first hurdle that British society and the British economy falls, when judged from the viewpoint of the formation of social capital (and this may well, incidentally, be where the famed, much-studied but elusive German 'secret' of high industrial productivity chiefly lies). For British society, being one of the most elitist and class-based in the world, has conspired for generations to endow and re-endow itself with a highly selective and thoroughly divisive national education system, producing a small percentage of highly educated citizens and a relatively large percentage of seriously under-educated citizens, who have even been explicitly labelled as 'failures'. This is hardly likely to be conducive to the formation of social capital.

The precise way in which the selectivity of the education system operates has changed from one generation to the next, as has its rationale. It used to be the case that, relative to other advanced economies, a very small percentage of British pupils gained access to university education, which was disproportionately patronised by only the upper and middle classes and the accompanying ideology assumed 'a limited pool of ability'. While the recent Tory governments appeared to achieve a great increase in this percentage (partly, however, by definitional fiat, designating all polytechnics as universities), they simultaneously presided over a devastating relative down-grading in the nation's investment in its state primary and secondary schools. Here the accompanying ideology was 'value for money' and the over-riding political priority of reducing public spending to enable populist tax cuts to be made. After 20 years of this policy, pupils in state schools now have only half as many teachers per head as in private schools (previously they had two-thirds as many). The official statistics show that only for the 7% of the nation's children today educated in Britain's private schools does the ratio of teachers to pupils approach the average for the children of all citizens in most other west European countries. Thus, the nation's education system, that most powerful and formative institution for creating both the specific skills of human capital and the more general equality of communicative competence necessary for social capital in an advanced economy, has been used in Britain in more divisive ways than ever, representing and perpetuating the opposed sectional and class interests of a deeply divided citizenry. This is something which powerfully feeds and reproduces inequalities of communication, information and knowledge, by perpetuating the division of citizens from each other into distinct mental and social worlds, with very divided opportunities.

The lack of strong, socially unifying social capital in Britain particularly limits the potential for 'co-production'. One of the key propositions that is emerging from the empirical research that has been done within the social capital approach is the significance of 'co-production' and the capacity of social capital to facilitate effective co-production. Co-production refers to the way in which the supposed categorical divide between public and private, or between 'the state' and 'the market' is, in fact, not only breached but breached with highly productive results. This has been shown to be the case when many important examples of successful economic enterprise, both on a large and a small scale, are examined in detail, both in developing and in developed economies. Some of the earliest research to show this, to the initial disbelief of the New Right, concerned the successful Tiger economies of the Pacific rim. The key economic role played in fostering and supporting market activity by MITI in the Japanese success story and more recently by the government agencies of China, Thailand and Malaysia, for instance, as well as Korea, Taiwan and Singapore is now accepted and stands as a fact of economic history, regardless of the recent troubles which these economies have experienced (Chalmers Johnson's *MITI and the Japanese Miracle* 1982; Alice Amsden's *Asia's next giant* 1989; Robert Wade's *Governing the market* 1990). New detailed empirical studies are also demonstrating the importance of high quality communication between central and local government officials, local associations and individuals citizens, in explaining both the successes and the failures of development projects and the growth of enterprise in the developing countries today (*World Development*, June 1996 issue, pp.1033-1132, for a collection of case studies).

Where economic performance is concerned, the real issue for the politicians and the voters in any liberal democracy with a 'free market' economy is to divine the optimal way in which state and economy shall interact and how to utilise the economic powers of social capital and co-production to their best advantage. The reason that the over-simplified New Right ideology of radically 'rolling back the state' to liberate the enterprise of 'the individual' made political sense in Britain in the late 1970s and early 1980s was that the optimum relationship between state and economy had, indeed, become unbalanced, to the detriment of the nation's economic performance. However, the over-zealous application of the New Right corrective policies has now resulted, two decades later, in the impoverishment and demoralisation of our public services, with severe consequences for the nation's social capital and mutual trust networks, resulting in the chronic foregoing of strategies of co-production.

As a result of the damaging aspects of this one-sided policy, the electorate now feels that the country's most pressing general problem today is the question of how to achieve an adequate rate of economic growth, which maintains our nation's place among the fortunate few, without becoming a society that is profoundly uneasy with itself, primarily because of the great disparities visible between the lives of the poor and the rich. The New Right argued that we can only achieve the former at the expense of the latter, though offering the sop to a social conscience that wealth might somehow 'trickle down' (in a way that was never specified) to the disadvantaged in due course. However, having been allowed by the electorate almost two decades to see whether their theories worked, it has been found that wealth only seems inexorably to 'trickle-up'!

This was entirely predictable, according to 'the information theory', which explains how a market economy works if left to its own devices, with increasing concentration of wealth leading to ever greater disparities of information, in turn further feeding the capacity of the wealthy to aggrandise themselves disproportionately. Meanwhile, it is now known that the neo-liberal policies of promoting private enterprise and cutting back on public services and public spending only succeeded in generating an overall rate of national economic growth of about 2% per annum over the two decades of Conservative rule: that is to say, something distinctly lower than that which was achieved during the preceding, classic period of 'Keynesian' managed economies and extensive public sector activity, 1950-73. The political party which represented the ideology of the New Right have now been voted out of office because people in Britain didn't like the results of these neo-liberal economics. For too many of them it seemed that, in return for no demonstrable improvement in our economic position in the world, we have been induced by the governments of the New Right to sacrifice the 'feel good' factor. A sense of personal security and domestic stability was undermined by the dogmatic insistence on labour market flexibility, as was the quality of relationships with seniors, juniors and colleagues at work, while the social environment has come to be perceived as less familiar and more threatening, accompanied by a range of uncomfortable and troubling feelings towards the behaviour of fellow citizens, particularly both the very poor and the very rich.

With the promotion of social capital and co-production as its guiding principles in economic policy, New Labour can look forward, with the conviction and confidence of a genuinely coherent new ideology, to the creation of a consistent set of new policies which will provide a more satisfactory answer to the new generation's most pressing problems today than the tired nostrums of extending the market. Social capital emphasises the significance of positive relationships of trust, commitment and mutual understanding between the individuals and among the institutions which compose the economic system. The top priority of the social capital perspective is, therefore, the long-term need to transform the nation's education system into one of the best, most highly resourced and most professional in the world, which provides not just those whose parents pay for private schools, but <u>all</u> citizens with confidence in their specific abilities and with the communicative competence to use these abilities to their maximum effect in both commercial and civic co-operation with their fellow-citizens' complementary range of abilities.

This follows from the realisation that the nation's education system plays a critical role in simultaneously producing not just one economic product, as previously understood by economists, but two: both human capital <u>and</u> social capital. While these two should be related, unfortunately they can be independent products. Individual good schools and good teachers can produce individuals with well-developed human capital characteristics, which they and the economy will both benefit from, *ceteris paribus*. But it is only a good overall education system, in which all have pride in their schools and from which all can derive a sense of personal achievement and worth, which can lay the necessary foundations for social capital (as opposed to the phenomenon of 'the old school tie'- the advantageous personal confidence and connections of the privileged few in society who went to 'a good school').

New Labour are showing glimmering signs of feeling their way towards this kind of policy but there is no doubt that they have not as yet grasped the scale of the programme that is required; and the need for a revolutionary overturning of the dogma of the last administration (that child-centred teaching is bad practice, and that material and human resources in the classroom don't especially matter provided there is efficient 'delivery' of a centrally-planned curriculum). Mr Blair has talked of his passion for education. But the evidence of Mr Blunkett's White Paper, *Excellence in Schools*, and of actual measures taken so far is that there is only half a policy in place. This is the inexpensive half to do with teaching practices, school management, and monitoring standards, things which will not require the government to find a large source of recurrent revenue and some of which bears a worrying similarity to some of the previous regime's dogma. Although it stretches the bounds of credibility, this seems to be partly because the New Labour government is genuinely unaware of the seriousness of the colossal scale of dis-investment in state education (relative to all our competitor economies and to the private sector) that was perpetrated by the Tory administrations. There is consequently a yawning gap that has to be addressed between the basic teaching resources (i.e the number of teachers per pupil) available to the 93% of Britain's future human and social capital which attends its state schools and the much more favourably-placed future citizens of virtually every one of our West European and North American competitors.

To put it bluntly, our state education system is struggling along with literally only about one half of the number of teachers per pupil that are available elsewhere in Europe and in the private sector. This an enormous scale of handicap and something that was certainly not true from the 1950s through to the end of the 1970s. It cannot be passed over simply by the diversionary tactic of seeking to place an academic question mark over the issue of exactly how strong the relationship is between class-size and pedagogic output, a diversion which some have allowed themselves to fall into. Of course, it is tautologically true that good, motivated teachers are the key to good teaching (the residual 'finding' of these diversionary studies)! But it is more relevant to ask: what are the conditions which facilitate or impede the capacity of good teachers to perform to their best? It is otiose to pretend that the number of pupils they must teach simultaneously is of no importance. It is certainly the case that the Tory ministers who were happy to play with this proposition were not happy to experiment with it for their own children, universally paying for the benefits of the smaller classes of private schools. After 20 years of neglect there is now a twin problem of both capital investment and teacher recruitment which are both on a scale and of an and urgency that New Labour appear to want to ignore (the latter will inevitably require the market signal of more favourable remuneration for teaching careers to give real substance to much-needed attempts to bolster the prestige of the profession). Yet this could be the great challenge and crusading opportunity which infuses Tony Blair's Third Way with the genuine radicalism and sense of moral purpose of which he likes to talk.

New Labour need to face up to some hard political decisions requiring genuine leadership if they are to implement the Third Way. However, it is one of the tenets of social capital and the Third Way that politics is participatory: the electorate must themselves endorse and practice the Third Way for it to become a successful political programme. This puts a lot of emphasis on the communicative powers of Ministers and the government. It is finding the correct means to present policies and messages which determines their acceptability and comprehension by the electorate and here social capital can help. New Labour have to find a way to tell the country, and especially its high and middle income citizens and its employers and business leaders, who have made hay since the early 1980s with all their tax cuts, that you don't get something for nothing and that they have responsibilities to be active and generous participants in the national community. The Tory governments have left more money in the pockets of the rich and in the balances of companies. But these beneficiaries have been very slow coming forward to shoulder their responsibilities for the range of public and community services that were consequently reduced. Business has not responded with alacrity or generosity to participation in training programmes, nor has it engaged significantly with PFI.

The superior rationality of the new economics, incorporating social capital and the all-important information perspective, is likely to be most obvious to the most advanced and sophisticated leaders of the business community- those who are most important to Britain's economic future- because they are already operating in increasingly knowledge-based innovative industries and can see that this approach to economics explicitly includes something central to their businesses. Indeed, it only corresponds to a formalisation of the way in which many of the most successful, creative companies have already been behaving towards their staff and the manner in which they are interacting with their local communities, and with the facilitating powers of local government and public institutions, where they are fortunate enough to benefit from enlightened local partners (something I can testify from direct experience and personal knowledge here in Cambridge).

But these localised bright spots exist despite, not because of the previous government's lack of real vision over the last 20 years. The dogma of allowing the market to decide has become a lazy alternative to strategy and innovative thinking in the crucial arena of political economy. The Tory experiment with letting the market provide has spectacularly failed with respect to public goods and has not produced a better society providing its own much-needed services but only the much-discussed phenomenon of private affluence amidst public squalor. In these circumstances the state must recover some of the resources necessary to enable it to offer a lead which will facilitate a new generation of more active and participatory citizens. This is what the electorate of Britain voted for in 1997: a rejection of the Fool's Gold of personal greed and 'cost-less' tax cuts and a new moral lead from central and local government to enable our communities to once again enjoy useful, properly-funded inclusive public services, to participate in civic life, to walk and play together in their local, public parks and rediscover and rebuild their social capital. Schools which are the pride of the parents in their neighbourhoods and the local focus for participatory citizenship; parks which are well-cared for and public transport which is safe; and an ethical policy for the poor, offering them caring assistance, not the arches under Waterloo Bridge.

Armed with the confidence of a superior understanding of how to promote the nation's economic efficiency in the world's markets, the New Labour government has to redefine the relationship between private and public, in the light of the importance of co-production (partnership) and investment in social capital (citizen participation). This means, firstly, more transparency in central government activities and the use of public resources. Secondly, much more authority and power devolved to properly representative and participatory organs of local government to enable them to energise local economies and clusters of companies by being sensitive and responsive to the requirements and needs of citizens, businesses and other local civic associations. Thirdly, a much enhanced and transformed national education system from nursery level upwards, creating the raw material for productive social capital as well as human capital: a highly-educated and widely-educated, mutually respectful citizenry, sharing an equality of communicative competence enabling it to combine its highly varied abilities, knowledge and skills in the most innovative and productive ways.

Return to Library