Economic Growth and Social Capital: a critical reflection

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The literature on economic growth has increasingly come to emphasise the importance of social capital as a potential determinant of long run economic performance. This paper provides a conceptual examination of the concept of social capital, and the functions it can be assumed to perform in relation to economic growth. We point out that the concept as it has been advanced thus far in the literature is subject to some ambiguity - leaving unaddressed the questions of how much social capital is optimal, of whether all forms of social capital are equally desirable, and of whether all stages of economic development require the same forms of social capital. We argue that in order to provide answers to such questions, it is important to understand a number of distinct functions of social capital - and discuss two, transparency and rationalisation, in some detail. In doing so, we come to reflect on the linkage between social capital and other social institutions such as the state, as well as the role of human capital in economic development. Finally, we suggest that the functional characterisation of social capital, serves to explain the dynamic in terms of which the social capital of a society comes to evolve over time.

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1 Introduction

With the resurgence of interest in economic growth and its determinants, attention has come to be focused on factors beyond those more narrowly identifiable as "economic". One argument has been that societies may be endowed with social as well as physical and human capital, and that the form and strength of social capital is an important potential predictor of long run economic performance. The World Bank Development Report 1997 notes:

> The debate about the contribution of social capital to economic and social development is just beginning, and the early evidence is by no means unambiguous. But some studies are already demonstrating its potential impact on local economic development, on the provision of local public goods, and on the performance of public agencies (p114)

and:

> A recent study of villages in rural Tanzania found the households in villages with high levels of social capital......have higher adjusted incomes per capita than do households in villages with low levels of social capital. When other non-social capital determinants are controlled for, there also appears to be a strong correlation between a village's well being and its level of social capital. (p115)[1]

The suggestion is that social association includes informal rules, norms, and values that facilitate coordinated action for the members of the society, and enables cooperative ventures that would otherwise be unfeasible. It therefore becomes a matter of considerable importance to economic development both that the form such rules take be appropriate, and that such social capital be recognised as an asset or factor of production in the developmental process in its own right.

The present paper takes such suggestions seriously. In particular, the concern of the present paper is with the question of how social capital bears on economic growth, and how social capital itself may come to endogenously

[1] See also the concrete examples in Woolcock (1998).

change over time. In so formulating this question we note that the concern is with economic growth narrowly understood (for instance in terms of per capita GDP), though we recognise that human development has other, equally important dimensions.

While the identification of social rules, norms and values as significant for economic activity is plausible when posed at high levels of generality, this very generality poses a number of important questions regarding the concept of social capital. The present paper raises three puzzles we associate with the concept of social capital (though there exist others).[2] These puzzles concern: first, the question of whether social capital is homogenous within societies - and whether it matters for purposes of economic development which form of social capital comes to be pre-eminent; second, the question of whether the same sort of social capital will be equally appropriate for all stages of economic development; and third, the question of whether more social capital (of whatever sort) is always necessarily better (can there be too much of a good thing?).

The argument we present here will be that a resolution of such difficulties requires greater clarity and specificity on a number of functionally distinct aspects of social capital. In order to render the concept useful in the context of economic growth, the impact of these functionally distinct dimensions must be explicitly recognised.

2 The Concept of Social Capital

Inevitably for a concept that has achieved the profile that social capital has, divergent meanings have emerged in the literature. While Seralgeldin and Grootaert (1997) define social capital very broadly as the "glue that holds society together", or as the norms, networks and organisations through which agents gain access to resources, they suggest that there are at least three types of definitions of social capital in the literature: (a) norms of horizontal association, as typified by the work of Putnam; (b) more broadly, social structures that facilitate collective action, as typified by Coleman's work; and (c) most broadly of all, the social and political environment that enables norms to develop and shape social structure. They suggest that an appropriate formulation of the concept requires all three. We demur, since any one of these three elements contains sufficient ambiguity to require

[2]See Woolcock (1998).

extensive exploration.[3] It may well be the case that any explanation of economic and social development requires reference to all three dimensions - but this does not require a conflation of the distinct dimensions into a single concept.

The concept can also be said to have extensive historical antecedents. Thus Woolcock (1998: 160-1) traces the roots of the concepts through a number of alternative intellectual histories: Marx-Engels' concept of "bounded solidarity"; Simmel's "reciprocity transactions"; Durkheim and Parson's "value introjection"; Weber's "enforceable trust"; in addition to the utilitarian rational choice tradition with its culmination in Coleman.

Economics has similarly recognised the importance of institutional contexts to economic development, though typically such institutions are more narrowly defined. Property rights, and their role in lowering the uncertainty associated with the interaction between economic agents, have been accorded a central role in both theoretical and empirical analyses of economic growth.[4] However, the prevalence of cooperative behaviour beyond the contexts justified by rational choice theory narrowly defined, suggests that the range of transactions cost reducing institutions may extend beyond property rights. One suggestion as to what form such additional institutions might take has emerged from recent analyses by Coleman (1988, 1990), Putnam (1995) and Fukuyama (1995):

> by analogy with notions of physical capital and human capital.....'social capital' refers to features of social organization such as networks, norms, and social trust that facilitate coordination and cooperation for mutual benefit (Putnam, 1995: 67).

The hypothesis has similarities with that advanced in connection with property rights, but is more broadly based. A range of social practices, values and institutions are held to serve the purpose of lowering transactions costs of interaction between agents. As a result norms of generalised reciprocity emerge between agents, what we might loosely term social trust. Such social trust facilitates coordination, communication and thus resolves

[3] For an examination of some such ambiguities relating to the social and political environment, see Klitgaard and Fedderke (1995); Fedderke and Klitgaard (1996); Fedderke and Klitgaard (1998); Fedderke (1997).

[4] See the discussion in Knack and Keefer (1995); North and Thomas (1970); North and Thomas (1973); North (1981); North (1990); Scully (1988); and Scully (1992).

dilemmas surrounding collective action, reducing the incentives for opportunism (free riding).[5] The consequence is greater certainty in transactions, making possible not only a more extensive array of social and economic activity, but allowing for more complex forms of organisation to emerge, forms capable of acting in contexts which require economies of scale, or long time horizons. The corollary is that societies with high levels of social capital in the long term are more likely to experience economic success (and be better governed, safer, cleaner, even 'happier'), than those with low levels of social trust (Woolcock, 1998: 155). We note at the outset that the concept of social capital that has come to be most widely used in economics is thus more narrowly defined than that used by most other social sciences. The focus is on transactions cost reduction, and not any further normative, or integrative functions that might otherwise be incorporated into the concept. Moreover, since our concern is to highlight that even within this narrowly defined concept of social capital, there exist significant puzzles and ambiguities, our attention for the remainder of the paper will be on the transactions-costs based view of social capital.

The question of course is what precise concrete forms such social capital might take, and how it might come to emerge. Coleman (1990: ch12) argues that social capital might include:

- obligations and expectations - which serve as a form of credit agents in societies with social trust may draw upon
- information potential - informal social relations which store and impart information
- norms and effective sanctions - which serve as regulatory devices to constrain agents to act in the public interest, increasing the predictability of actions and lowering uncertainties in action
- authority relations - which prevent agents from engaging in free riding
- appropriable social organisation - social organisations formed with a specific (limited) objective, which come to outlive that objective and

[5] By collective behaviour we refer to cooperative behaviour, not coercive behaviour, with one qualification. Coercive behaviour may have as a consequence cooperative behaviour. Thus the actions of concentration camp guards may foster cooperative behaviour amongst inmates that might not otherwise have taken place.

serve as more generalised organising mechanisms for a wider range of objectives;

- intentional organisation - specifically created to reduce transactions costs.

All of these forms of social capital (and there may be more) serve to reduce the transactions costs of interaction between agents, and thus facilitate exchange.

3 Three Puzzles associated with the Concept of Social Capital

The extension of the basic insight of institutional economics, viz. the pervasiveness and importance of transactions costs and of organisational responses to such costs, to recognise the existence of a range of additional institutional measures beyond property rights designed to lower transactions costs, is plausible. Yet we point to the presence of at least three puzzles raised by the introduction of social capital: whether it is plausible that more social capital is always better for purposes of economic growth which we term the non-linearity puzzle; that over time economic development may bring the need for different forms of social capital which we term the dynamic puzzle; and that any society at a given point in time is likely to be characterised by rival, competing forms of social capital, and that it matters which comes to predominate which we term the local optima puzzle. If true, these problems raise the question of how to conceptualise the developmentally functional significance of social capital that demonstrates strong variations over space (intra- as well as inter-societal) and time. We now address each of these in turn.

3.1 The Local Optima Puzzle

The first we refer to as the local optima puzzle. The issue here is that societies have evolved many different forms of rules, norms and values that serve to increase the likelihood of cooperative behaviour. Indeed, one might be tempted to argue that in the absence of such mechanisms, something recognisable as a "society" would not emerge, and that interagent association would be "anarchic" instead. In short, all societies have normative structures that regulate cooperative behaviour. Two corollaries follow:

- While all societies have some form of social capital, the social capital of different societies may be heterogeneous, just as human or physical capital may be heterogeneous. There is every reason to suppose that societies come to develop different sorts of social capital - witness the change in social rules as one moves from Tokyo, to Johannesburg, to Berlin, to London, to New York and San Francisco.[6]

- Given such heterogeneity, one pressing question must be whether economic growth is stimulated by more social capital regardless of the form it takes, or whether what is important for economic growth is the form of cooperative agency social capital enables. In effect, the question is whether it is the quantity or the quality of the social capital that matters, or whether it is both quantity and quality and in what proportion which is important for the purposes of economic development.

At least for the purposes of economic growth, cooperative behaviour may perhaps always be preferable to "anarchic" forms of association.[7] In this sense then, more rather than less social capital is desirable. However, the question here is whether resolution of anarchic association by means of social rules, norms and values may not lead to what is properly understood as a local optimum. While providing for cooperative behaviour, the form of cooperative behaviour enabled by different forms of social capital may not be equally desirable, or at least not equally desirable for a specified context. This point is central to Fukuyama's (1995) explicit recognition of a contrast between the social trust that emerges in societies such as the USA, Japan

[6] This is not to deny that some of the differences to be observed between societies are of a "surface" rather than "deep" or fundamental nature, or that perhaps social capital internationally is becoming increasingly homogenised over time. However, the existence of specialised courses on management styles in different countries, advisers on deportment and etiquette required for business success in different cultures makes it clear that fundamental differences in social capital are present between countries.

[7] To reiterate, our concern here is with economic growth narrowly defined. This is not to imply that deep ethical (and other) issues are insignificant to the question of what form social capital is desirable. Nazi Germany arguably had significant stocks of social capital, but is difficult to view as unobjectionable, regardless of the integrative functions of its social capital. For a more detailed discussion of links between modernisation and moral progress see De Kadt (1994); De Kadt (1995); De Kadt (1997).

and Germany, with that of societies such as Korea, China, middle Italy and Singapore. The former allows for generalised social trust, and is therefore able to realise large corporate entities divorced from family control. The latter also have trust relationships, but instead of generalised social trust, cooperative behaviour does not extend readily beyond narrowly defined kinship structures. The result is firms defined in terms of family ownership, and hence of considerably smaller scale than the corporations to be found in the USA, Japan and Germany.

Fukuyama suggests that generalised social trust and its associated large corporations manifests superior long run economic performance characteristics to that of kinship trust structures. Large corporations are capable of realising economies of scale not accessible to smaller family-based firms. Yet the ranking between the two forms of social trust is surely not so unambiguous. For instance, small firms such as those found in societies with kinship-trust may manifest a dynamism and flexibility not feasible for large corporations. Indeed, some industries such as fashion, high-tech engineering design, software development amongst others, may conceivably be more efficient at small scales of production rather than large.[8] If so, the implication is that the distinction between different forms of social capital merely serves to identify different comparative advantages for the associated societies, rather than any absolute advantage. It does not extend to a demonstration that some forms of social capital are more beneficial to economic growth than others. Economies organised around small efficient dynamic companies may grow as rapidly (perhaps even more rapidly under some circumstances) as economies that rely on large conglomerates for their core economic activity. What counts is the efficiency of production and the capacity for innovation that economic activity manifests, and Fukuyama's argument does not establish that small-scale production is indeed less efficient or innovative. The question of how to distinguish between social capital that is "better" or "worse" for the purposes of economic growth is thus effectively left open.

There is a deeper analytical point to be made here. If we are to rescue the intuition that not all forms of social capital are equally beneficial for economic growth, the requirement is for greater clarity on precisely how or why social capital can come to be functionally beneficial for economic

[8]Consider the fact that Microsoft has often bought in innovation from smaller firms, rather than undertaking path breaking product development of its own accord. Similar examples are available from the pharmaceutical industry.

growth.[9] In order to see why some constellation of norms and values either is or is not functional for the purposes of economic growth, the nature of its impact on productive activity has to be fully understood. Such a functional approach avoids the identification of specific concrete forms of social capital with economic development (such as the Protestant work ethic, or Confucian values - associations which have proved historically flawed at best, if not embarrassingly limited in retrospect).[10] Instead, different forms of social capital may be either economic growth enhancing or inhibiting, depending on their functional impact on economic activity.

The examination of different forms of social capital, with potentially distinct impacts on long run economic performance, is likely to be relevant not only for inter-societal comparisons, but also for intra-societal comparisons. Societies are rarely homogenous to a degree that norms and values are completely uncontested, that alternative modes of behaviour do not vie with one another. This raises a number of additional questions in the quest for an understanding of the relationship between social capital and economic growth. How do the different forms of social capital compete with one another, with some coming to be of greater significance than others? Is it possible, moreover, that the different forms of social capital which coexist in a particular society come to play a dominant or leading role at different stages along the trajectory of economic growth, and if so, how do they come to do so?

3.2 Dynamic Puzzle

We subsume such questions under our second puzzle with the social capital concept, which we refer to as the dynamic puzzle. The concern here is with whether certain forms of social capital can be thought of as universally desirable regardless of historical context. Much is currently made of the congruence of Japanese (and other eastern) culture with economic development, to the extent that Japanese management and work practices form the subject of intense study by Western rivals wishing to emulate the competitiveness of Japanese corporations. Yet one century ago Western assessment

[9] We note in passing that this functional focus is consistent with Coleman's original approach in the introduction of the concept of social capital (see Coleman; 1988).

[10] For instance, societies quite devoid of Weber's Protestant work ethic have been capable of strong economic development. A similar fate may well befall attempts to suggest that societies with Confucian value structures have a comparative cultural advantage for economic growth - witness recent East Asian developments.

of Japanese culture was that it constituted a serious barrier to sustained economic development.[11] Much of this discrepancy may be due to declining prejudice and hermeneutic insensitivity,[12] but it also raises the question of whether a particular form of social capital will be congruent with economic development throughout the trajectory of industrialisation and beyond. The question in concrete terms is whether, for instance, the same forms of social capital that are optimal for agrarian subsistence economic activity are optimal for industrial production, and whether the movement from agrarian to industrial economic activity may not itself come to change the form of social capital? We will argue that the introduction of the analytical distinction between transparency and rationalisation, can make sense of the phenomenon of societies caught in stasis for protracted periods of time, and yet which suddenly appear to be galvanised into rapid development, employing the same social capital as springboard, but coming to transform the social capital in the process of development.

3.3 Non-linearity Puzzle

The preceding dynamic questions introduce a third puzzle, which we term the puzzle of potential non-linearity.[13] This relates to the question of whether more social capital (of whatever form) is necessarily always better? Conceivably one might suggest that China from 1500 to 1900 had access to significant social capital. Indeed social capital may have been so well defined that the scope for entrepreneurial and innovative activity was constrained to the detriment of technological progress and improvements in economic well being. Lowering of transactions costs in exchange may be desirable, but complete certainty may also come to constrain innovation and entrepreneur-

[11] See the discussion in Sheridan (1993). The turmoil on international financial markets from 1997-98, and the impact it has had on East Asian growth rates has already led to a new reversal: the identification of a "myth of Asian values", and the suggestion that Asian values may (after all) be a hindrance to economic development. We suggest that greater caution is appropriate. Too mechanistic a link between culture and economic development is likely to get things wrong - just as the examples in the text above illustrate. Far more appropriate is the development of a functional characterisation of cultural practices in terms of the transparency and rationalisation dimensions that we develop below.

[12] A further possibility is that Japanese culture may have been subject to considerable change.

[13] See also Woolcock (1998) on this point.

ship.[14] In a slightly different vein, social norms certainly fulfil an enabling function with respect to some actions; but equally, they constrain actions in dimensions deemed undesirable by the society. The question then is necessarily whether the actions that are enabled by a set of norms, and those which are constrained are functionally appropriate for the purposes of economic and social development. More generally, the implication is that what may be required is neither too much nor too little social capital - in short, that the association between economic growth and social capital may contain an important non-linearity.

Non-linearity, added to the possibility that different forms of social capital may be appropriate at different stages of economic development carries with it the implication that the association between social capital and economic development may be relatively complex. In effect, the need is not to maximise the quantity of social capital, but that the quantity of social capital should be optimised - and potentially that it be the right kind of social capital that should be optimised.

The argument of the present paper is that all three puzzles noted point to the need for greater analytical clarity on the concept of social capital. This request is satisfied at least in part by three analytical dimensions, which we label transparency, rationalisation, and institutional disjuncture, in terms of which to assess rules, norms and values for their likely functional congruence with economic development. The distinctions will also prove useful in dealing with the three puzzles with the concept of social capital identified above.

4 Transparency and Rationalisation

The starting point of our contribution is that the concept of social capital, in identifying rules, norms and values that increase the likelihood of cooperative activity, is too blunt an analytical instrument. In order to generate a more modulated conception of social capital, we introduce an analytical distinction between two dimensions of "social capital" which fulfil functionally distinct roles in the process of economic development. These two dimensions need to be understood not as kinds or forms of social capital, but as aspects of social capital.

[14] Particularly if one views Schumpeter's process of "creative destruction" as central to the process of economic development. The demise of Chinese and Iberian technological leadership in historical terms supports this view - see Landes (1998).

4.1 Transparency

The first dimension represents an extension of the functional role now archetypically attributed to social capital, the lowering of transactions costs, such that the probability of cooperative behaviour amongst agents is increased. Since the function of social capital here is an increased predictability in the actions of agents, and greater certainty about the form that the interaction between agents will assume, we specify this functional aspect of social capital in improving social interaction as its transparency. We define transparency as the comprehensibility of the rules, norms and values of an institution or society to its members. Transparency continues to be grounded in the rules, norms and values of a society, but the emphasis here lies in the improved information agents have about both the behaviour other agents in society will engage in, and about the forms interaction between such agents will assume.[15] Such information improves the certainty of outcomes for individual agents, increases the likelihood of cooperation between agents, and hence increases the scope and range of possible forms of social interaction. We illustrate this in Figure 1 along the vertical axis, with increased transparency being associated with a higher probability of cooperative behaviour.

It is important to note explicitly that the concern here is with the functional delivery of information concerning the behaviour and choice sets of agents who are members of a particular society by the social capital. Such information delivery is compatible with a wide range of alternative substantive social practices, values and norms. In short, it is immaterial whether the information concerning agent's choices and behaviour is couched in terms of a Protestant work ethic, or in terms of a set of Confucian values. Instead, the concern is with the extent to which the behaviour of agents who act in terms of the relevant social capital becomes transparent, understandable, and predictable. It also suggests that proponents (or opponents) of any one specific cultural template are missing the point, and are likely to be embarrassed by historical developments. What counts is functional information-transmitting consequences not whether Luther or Confucius informs one's values.

Transparency thus identifies the functional impact of social capital that has been argued to be beneficial to economic activity in the literature: providing the means by which solutions to social action problems can be found. Yet equally this does not provide purchase on the puzzles with which we

[15] Coleman (1988: 104) does identify information as one form social capital may take - we suggest that it is foundational to all forms of social capital.

began our discussion: the question of whether social capital is always desirable, no matter what form it takes. All we have is an identification of the information-transmitting capacity of social capital, and the improved probability of cooperative behaviour that results from such lowering of information costs.

4.2 Rationalisation

In a second functionally distinct dimension we therefore distinguish the mode of delivery by which social capital generates greater transparency. We have already noted improved cooperation between agents as the possible outcome of a variety of quite different combinations and forms of social rules, norms and values. We introduce the concept of rationalisation as a means of distinguishing between different modes by which transparency can be delivered by social capital. We define the "rationalisation" of social capital as the degree to which it is embodied in formally codified rules, norms and values. The more highly rationalised the social capital, the greater the extent to which such rules, norms or values assume a procedural as distinct from substantive form, and the more they assume the form of abstract rules with universal scope.

With social capital which emphasises substantive content there is scope for cooperative behaviour, but it is flexibility constrained, such that its functions are not readily universalisable. For instance, dietary rules cast in concrete terms excluding the consumption of particular concretely specified foodstuffs, which in one climatic setting serve the function of precluding food with a high probability of rapid bacterial infection, come to be functionally disjoint under climatic conditions which do not favour rapid bacterial infection. As such, the social rule with strong substantive content is characterised by low functional universalisability. By contrast, social rules that are procedural rather than substantive in character do have strong functional universalisability. A dietary rule that excludes foodstuffs with a high probability of rapid bacterial infection, and identifies procedures that serve to identify and exclude sources of bacterial infection, is readily transferable between climatic conditions, and thus has greater information transmitting capacities. Similarly, rationalisation is evident in the gradual replacement of informal associations and networks by formal administrative structures, and the impersonal market mechanism no longer tied to individual identities of trading agents. Such markets, as long as they are appropriately developed, are more efficient at generating the prices that transmit the appropriate signal as to the relative scarcity of the resource being traded.

Increased rationalisation of social capital carries strong advantages. The most palpable is greater flexibility of the social capital, and thus its adaptability to alternative environmental circumstances. In effect, greater rationalisation of social capital emphasises the function the social capital plays, and views the substantive content which is attached to social rules, norms and values as contingent, subject to evolution and change as the environmental demands on the social capital alter. The consequence is that social capital cast in procedural rather than substantive form carries improved information transmitting capacity. Social rules come to have the capacity to transmit a greater quantity of information, while also improving the quality of the information being transmitted. To return to our illustration of dietary rules: substantive dietary restrictions (the exclusion of specific foods) may carry pertinent information about the infection risks associated with specific foodstuffs in specific climatic conditions. But they cannot readily incorporate either new foods, nor can they accommodate new environmental conditions, except under the addition of lengthy ad hoc modification and augmentation. By contrast, procedurally conceived dietary rules (excluding foods that raise the risk of bacterial infection, say) are generaliseable across a wide range of foodstuffs, and climatic conditions. The emphasis is placed on the risk of infection, and the identification of the sources of such risk, rather than on the proscription of specific foods. As such, the dietary rule conveys increased information, in the sense that it covers more foodstuffs, under a wider range of circumstances. Moreover, the dietary rule also improves the quality of information being transmitted, since the source of infection comes to be more precisely identified and excluded than in the case of the substantive dietary rule. Action premised on social capital with a rationalised mode of delivery is rendered more flexible, and stands a greater chance of successful adaptation to a wide range of environmental circumstance.

We illustrate the point in Figure 1 along the horizontal axis, with increased rationalisation being associated with increased quantity and quality of information transmission.

The point can be cast in terms of the capital analogy. Social capital with low degrees of rationalisation is analogous to fixed coefficient production functions; individual components of the social capital can be employed only in specific and fixed combinations with other elements of social capital. The society is not able to change the mix of social capital factors of production as the relative "prices" of the alternative factors change, given the absence of all substitutability of the factors of production. By contrast, social capital with high degrees of rationalisation is malleable and divisible. Hence the scope for substitutability between various elements of the social capital factors of production is greater, providing the society with a greater capacity to respond to what amounts to relative price changes in various components of social capital.[16]

We thus have a characterisation of the concept of social capital both in terms of its function of influencing the probability of cooperative behaviour on the part of agents, and in terms of the mode of delivery of that transparency and the associated information carrying and distribution capacity of the social capital:

5 Linking Transparency and Rationalisation: Some Dynamic Considerations

While we have separated the transparency and the rationalisation of social capital for analytical purposes, the two dimensions are not independent of one another. We suggest that for any given level of transparency there is an upper bound to the degree of rationalisation which is feasible, and similarly for any given level of rationalisation there is an upper bound to the degree of transparency which may be attained.[17] The consequence is that there is

[16] Our distinction between the rationalisation and transparency of social capital has some affinity to Woolcock's distinction between the autonomy and embeddedness of social capital. However, while Woolcock's distinction relates more explicitly to the concrete social practices (such as familism, or the need for broader social ties beyond the family), ours is more unambiguously functional in character. Note for instance:

For development to proceed in poor communities, the initial benefits of intensive intra-community embeddedness......must give way over time to extensive extra-community autonomy: too much or too little of either dimension at any given moment undermines economic advancement (Woolcock, 1998: 23)

The advantage of the approach adopted here, is that analytical distinctions that appear elsewhere in the literature receive a clear functional interpretation. Thus, for instance, Woolcock's distinction between "predatory" and "collapsed" states, may be captured by social institutions which are in disjuncture with the degree of rationalisation or transparency of prevailing social capital - see below.

[17] We will argue that the prospect is for the bounds to have greater "depth" for increasing transparency at a given level of rationalisation, than for increased rationalisation at a given level of transparency.

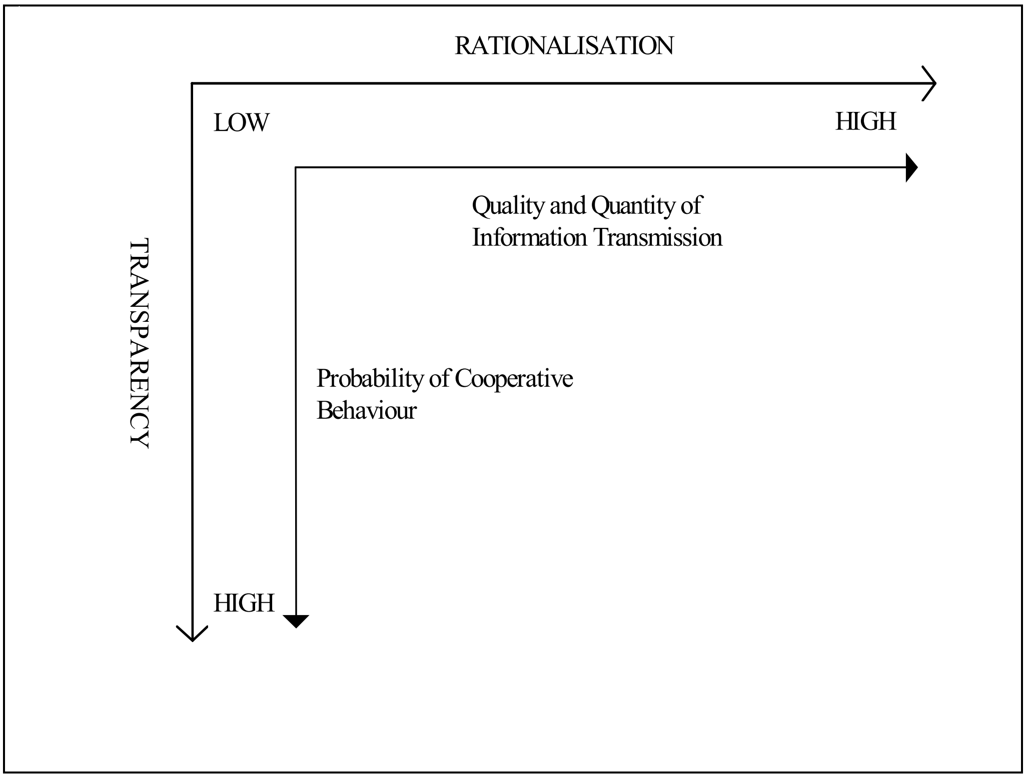

Figure 1: Rationalisation and Transparency

a bounded region for which the combination of transparency and rationalisation is stable. Outside the scope of this bounded region either the degree of transparency or the degree of rationalisation of the social capital will be subject to change.

For a given level of transparency, increasing the level of rationalisation indefinitely is not sustainable. Increased rationalisation is premised on the abandonment of social rules, norms and values anchored in substantively concrete persons and modes of behaviour, in favour of the formulation of procedurally defined social capital. The process is associated with the need for formalisation, the codification of the rules by which procedures in society are bound, such that increasingly autonomous domains of action become institutionalised. For instance the juridical and other administrative spheres within society each come to be characterised by their own highly specific procedural rules, cognitive content and criteria of performance assessment. In this way trust is encoded in the formal principles of organisation and functioning of such spheres, and is underwritten by increasingly universalisable practices of efficiency measurement and quality control. In effect trust is rendered abstract rather than concrete. The adoption of procedurally defined social values and norms renders social rules functionally transparent, thereby making the functional output of the norms and values explicit. The explicit identification of functional output in turn makes the monitoring of the efficiency with which such output is delivered easier.

Rationalisation understood in this sense requires increasing levels of reflexivity.[18] By this we mean that the more universal are organisational and procedural rules, the more widely accessible to interpretation and reformulation they become in principle. Thus the performance of those acting under such rules becomes progressively more scrutable, and the rules and practices themselves more open to understanding and acquisition by any agent. Pari passu with the development of ever more complex systems of expertise and role differentiation, there is in principle a wider range of agents able both to assess and to influence the performance of agents and systems, and greater scope for doing so. The formulation and interpretation of social rules and values is no longer the preserve of a privileged caste or estate (a priesthood, aristocracy), but of any agent who acquires the expertise necessary for an understanding and application of the rules relevant to a specific area of ac-

[18] The argument here and in what follows pursues late-Weberian themes. Readers are referred to Collins (1980: 925-42), for a good overview.

tion.[19]

The implication is thus that inherent in the process of rationalisation of social capital, is an associated increase in its transparency: both in terms of the functional content of social rules, and in terms of the accessibility in principle of such social rules to any agent of the society, rationalisation heightens the transparency of the social capital. Transparency is effectively a positive externality to the process of rationalisation of social capital. It is this transparency externality which constitutes a bound on the scope of increased rationalisation for any given level of transparency. Rationalisation will automatically serve to generate increased transparency. In effect there is a "positive externality" bound to deepening rationalisation without deepening the transparency of social capital. While the transparency and rationalisation dimensions thus capture distinct functional impacts of social capital, increased rationalisation has as a necessary but "unintended" consequence a further deepening of the transparency dimension. It is this interaction between the two functional impacts of social capital, and that which we identify as emerging from increased levels of transparency of social capital, that will serve to generate a dynamic aspect to the development of social capital over time.

Moreover the externality bound, since it is activated through the very process of increased rationalisation itself, is one which places stringent limits on the extent to which rationalisation can increase without improving transparency. The externality bound is a "close" one, in that transparency increases are immanent to increasing rationalisation. An example of such a

[19] In this respect, trust in rationalised societies comes to be crucially associated with the "reduction of complexity" (see Luhmann, 1984; Misztal, 1996). By this we mean not that organisational structure is less complex - indeed we have argued above that the opposite holds. However, increased complexity of organisation is achieved by breaking down the constituent components into more simple (and explicit, say rule-defined) processes. The point is akin to industrial production: industrialisation enables the production of more complex output, by more complex (in aggregate) production processes, but only because individual steps in the production process are simplified and routinized. Social systems with low degrees of rationalisation (such as caste systems or systems of racial estates) are more static, and ultimately unable to indefinitely accommodate the dynamics of societal modernisation. Such static systems, while perhaps displaying some evidence of satisfying local optimum requirements in terms of improved transparency, are unable to institutionalise the means for managing complexity. It is for this reason, too, that dispensations corresponding to the "liberal democratic" form of government have become predominant in all the more advanced industrial economies.

development is the transition to democracy in Spain. While the early Franco period is characterised by low transparency and rationalisation, in the late Franco period technocrats working to rationalise the state system, come to facilitate the transition to liberal democracy with its higher levels of rationality and transparency.[20]

In Figure 2 we illustrate by imposing a "bound" on the stable combinations of transparency and rationalisation imposed by the transparency externality. While the social system may move outside this stable region, the transparency externality would serve to gravitate the system back to higher levels of transparency.

By contrast to the limited opportunity for increasing rationalisation without improving transparency of social capital, for a given level of rationalisation there is some considerable scope for increasing the degree of transparency associated with that form of social capital.[21] Increasing the clarity and ease of access to social rules, norms and values, whatever form those rules may take, and ensuring that the rules are consistently reinforced by negative and positive sanction, serves to improve the predictability of behaviour on the part of agents, and will thus increase transparency of the social capital. The experience of pre-Meiji Japan, and China from 1500 to the 1900's serves to illustrate that the scope for improved transparency for a given level of rationalisation may be substantial, and sustainable for protracted historical time-windows. However, deepening transparency indefinitely for a given level of rationalisation is not sustainable. As a society locked into a given level of rationalisation but with ever improving transparency, encounters societies with alternative rules, norms and values, the need for flexible social capital becomes imperative. The absence of social capital that maximises adaptability, with the capacity to operate effectively across social and cultural boundaries, becomes a significant competitive disadvantage. Such a disadvantage can take the extreme form of a Commander Perry or the Opium Wars, but also more subtly the disadvantage for long run development of being unable to countenance an economy open to the world, so as to be able to reap the benefits of comparative advantage.[22]

[20] We note that this is an example of a coercive system having a co-operative solution as an outcome.

[21] We do not suggest that the boundaries of these two constraints are uniform at all stages of development. They may vary in "depth" at different stages of development.

[22] Openness incorporates many aspects: openness to trade, capital flows, technology transfers, etc.

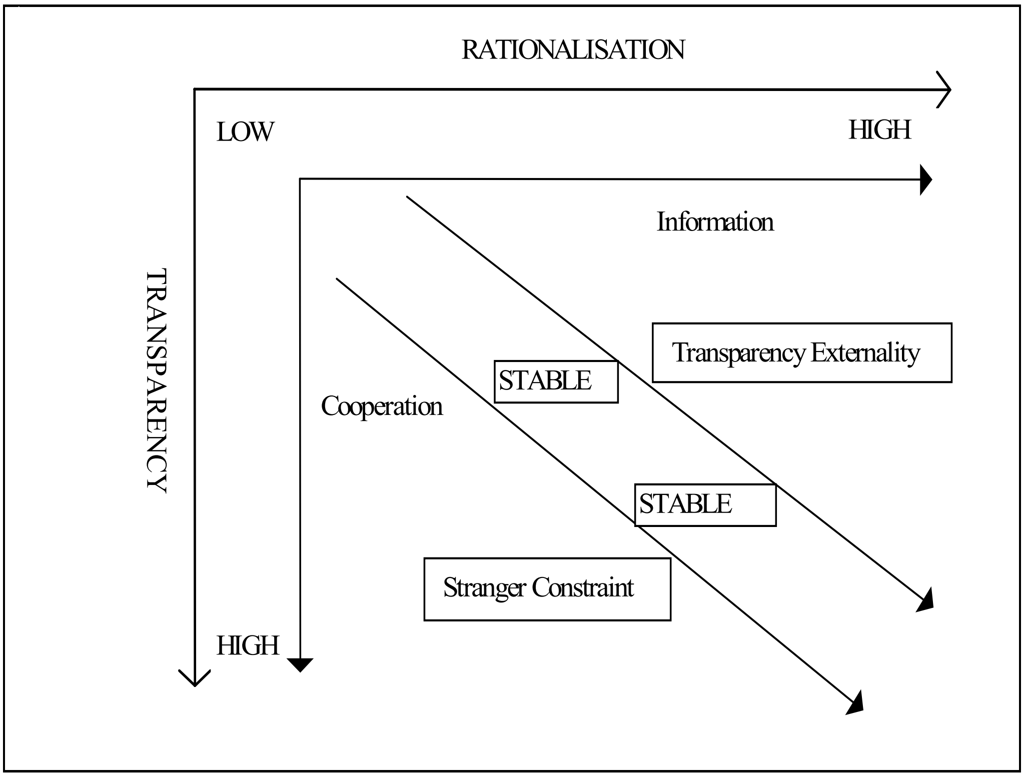

Figure 2: Rationalisation and Transparency: the transparency externality and stranger constraints

The literature emphasising the importance of technology to economic development, and in particular its private good characteristics, has pointed out that it may well be vital that the characteristics of critical social institutions (education, commercial and financial systems to name a few) be congruent with the demands generated by the need to absorb new and more complex technology.[23] Similar demands are placed on social groupings that encounter societies with differing values, norms and rules of engagement. Under forms of social capital in which high transparency is not matched by high rationalisation, the rules by which decisions are made are not globally known,[24] and indeed are often resistant to interpretative engagement beyond the boundaries of the society in which it is located. The knowledge relevant to making choices and acting is often arcane, since much depends upon the circles in which people move, their private debts, affections and personal histories. Information costs in such systems are high and tend to strongly favour "insiders" with special interpretative or hermeneutic advantages, rendering the system conducive to patronage of different kinds. Moreover, the social capital built up in such systems will tend to be of a "bounded" kind. It might perhaps be particularly effective in securing group loyalty, but in the presence of other groups may prove to be conducive to sustaining long term conflicts between ethnic, linguistic or religious communities. The information and transactions costs of interaction with such societies will be higher than with societies with a "Rechtstaat" culture hospitable to universalisable and abstractly formulated rights claims. Over sustained time frames this is likely to lead to competitive disadvantage in terms of access to new technology, economic efficiency, and concomitant military power, and thus will render the society susceptible to external shock. In effect, while increased transparency may lower intra-societal transactions costs of interaction, in the absence of increased rationalisation inter-societal transactions costs rise, thereby making technology transfer and trade less likely over time. The examples of

[23] See Abramovitz (1956); Abramovitz (1986); Abramovitz (1993); Nelson and Wright (1992).

[24] It is crucial to note that by "globally" we mean extra-societally/culturally. Transparency applies intra-socially/culturally. Thus increased transparency involves greater accessibility to the "rules of the game" for members of that specific society/culture. This does not necessarily mean that the rules are accessible to outsiders. The point draws on the Winchian interpretation of Wittgenstein - though we are less certain about the hermetic sealing off of meaning between language games that might be read from Winch's argument - see Winch (1958).

China and Japan already cited are seminal in this regard. Consolidation of a particular form of social capital, with associated increases in transparency (lowered intra-societal transactions costs) were sustainable only by virtue of relative isolation. The consequence was a steady increase in inter-societal transactions costs over time, with a final "catastrophic" external shock that could not be averted given the accumulated technological backlog. The effect of such external shocks serves to disrupt the form of social capital, particularly in terms of its substantive content, and by forcing engagement with the "stranger", generates an impetus to greater rationalisation in the social capital.[25]

We term this the stranger constraint on the scope for indefinite improvement in transparency without associated increased rationalisation of social capital. All societies face the need for rules of interaction with alternative societies.[26] Social capital that improves only its transparency indefinitely without ensuring a continued increase in its rationalisation would face constraints to the form, depth and extent of the links that it can maintain with alternative societies. Societies with universalisable and abstractly formulated rules, by virtue of offering lower transactions costs of engagement, will have the capacity to maintain a wider range of associations, and thus have a competitive advantage in being exposed to technological advances in a wider range of locations and applications. It follows from this argument that the stranger constraint becomes less binding, the greater the rationalisation of the social capital. The more rationalised the social capital, the greater its ability to engage other forms of social capital, and to communicate effectively across social capital boundaries. In effect, with increasing rationalisation of social capital, the stranger constraint becomes increasingly weaker and less binding.

Figure 2 illustrates by imposing the stranger constraint as a mirror to the transparency externality. Again, the social system has a limited capacity to move away from some bounded, stable set of combinations of rationalisation and transparency. Any attempt to increase transparency indefinitely without a concomitant increase in rationalisation will sooner or later encounter external shocks that will serve to move the system toward higher levels of rationalisation.

[25] Endogenous to the argument is a weakening of the constraint under increasing rationalisation of social capital. As rationalisation rises, so the "stranger" constraint becomes less binding, since rules of engagement with other societies are more readily flexible.

[26] By extension the argument applies to all social groupings and organisations.

We have thus suggested the existence of two bounds on patterns of development: an externality bound defined by the inherent tendency toward greater transparency immanent to rationalisation, and the stranger bound defined by the limited flexibility of any given form of social capital in the face of other social forms. The joint effect of these two bounds to the feasible combinations of rationalisation and transparency of social capital is to generate a dynamic implication. Unless a society maintains complete stasis, or at least rigidity within relatively narrow bounds, over time social capital will be subject to continuous change as increased transparency sooner or later is associated with the need for greater rationalisation, and increased rationalisation again tends to issue in greater transparency. The net effect is that social capital evolves toward greater rationalisation and greater transparency over time. To continue the analogy prompted by the social "capital" label, social capital is effectively subject to technological progress.[27] Figure 2 illustrates by showing a dynamic to the combination of transparency and rationalisation that points to higher levels of both over time. There is thus endogenous change to the level of rationalisation and transparency that societies are subject to.

A word of warning is in order at this point. The above schema should not be thought of as anything as overreaching as a theory of history or a general theory of social development. Our intention is considerably more modest, and aims at an analytical device which serves to illuminate some patterns or regularities of development. Infallibility and the impossibility of exceptions are not anticipated.

Nevertheless, a number of points are worth noting. First, the dynamics that arise out of the interaction between transparency and rationalisation have both similarities and differences with those associated with modernisation theory of the Lipset variety.[28] The similarity rests on the broadly "modernising" or "progressive" character of the dynamics - though we wish to modulate this implication in the subsection that follows. The difference that arises with modernisation theory is perhaps of greater interest, however. Modernisation theory in its Lipset-variant attributes the source of change in political and social institutions to economic development. By contrast, the

[27] While we consider the dynamics noted above to be the "default" mode, it is possible for societies to generate countervailing dynamics - which we explore in greater detail in the following subsection.

[28] See Lipset (1959: 69-105); and Fedderke (1997), for a more comprehensive outline of different formats of modernisation theory

interaction of transparency and rationalisation generates dynamic implications for social capital independently of economic development, and solely as a result of the interplay of two functionally distinct dimensions of social capital. Institutional change thus becomes endogenous to the institutional characteristics of a society, rather than being generated by exogenous shocks from the economic sphere.[29]

Second, the two dimensions we have identified are functionally conceived. Thus the concrete form in which improved transparency and/or rationalisation find expression may differ widely between historical and cultural location. In short, it is not the concrete form that occidental or oriental values, norms and practices assume that is critical, but the extent to which they facilitate transparency and rationalisation. The critical issue is not the specific substantive form in which the social capital comes to be formulated, but rather that whatever the concrete form of the social capital, there are inherent forces at work generating change in the social capital. Social capital, rather than being static and unchanging, is inherently mutable. History far from being closed, is subject to unbounded change.[30]

There is a need to clarify a response to a possible rejoinder to the suggestion that increased rationalisation leads to greater flexibility in inter-societal interaction. The recasting of a tribe of cannibals' dietary rule of the form "Do not eat Tom, Dick, Harry, etc." to the more rationalised form, "Do not eat members of your own tribe", might be argued to generate little flexibility in inter-social transactions. However, we argue that with increased rationalisation a rule (even in abstract formulation) that allows for cannibalism is simply less likely, since its ability to be universalised is limited. It is for this reason that cannibalism becomes rare at relatively early stages of social rationalisation. The point is fundamental, and more general than our example might suggest. Rationalisation entails more than abstract formulation of rules - it rests fundamentally on the universalisability of the principle of organisation or action at issue. The formulation of rules, however abstractly formulated, that elevate contingent characteristics to form the foundation of (moral) value and meaning are severely constrained in their universalisability. It is for this reason that practices such as cannibalism, and ideologies such as Nazism, both of which may be abstractly formulated, invoke strong

[29] Of course this does preclude the possibility that economic development may also contribute to institutional change.

[30] In effect the picture which emerges is a world quite distinct from that suggested by Fukuyama (1992).

and widespread opposition beyond the target groups at which they may be aimed. But there is a second rejoinder, which is conclusive even where the first is questioned. Accessibility to meaning does not entail non-adversarial engagement. The adversarial/non-adversarial nature of engagement is more usefully understood as the outcome of a particular constellation of interests. Thus in our example we suggest that the cannibalistic principle in abstract formulation is more accessible to outsiders (the risk to them is immediate, since they do not have to check for their names on the list), though accessibility to the meaning of the principle does not entail that the relation between outsiders and the cannibals is likely to be peaceful.

Finally, the analytical distinction between the transparency and rationalisation of social capital goes some way toward resolving the three puzzles with which our discussion began. There may well exist social capital local optima for a specific group, organisation, movement or society (its locale), which might not be functional beyond the boundaries of its specific locale. While appropriate to its locale (which might be a political party, religious sect, social caste or any of a large number of different collective entities) in the sense of permitting the solution of relevant collective action problems, such local optima may also constitute an impediment to adaptation to changing circumstances. For instance, in order to maintain the cohesion of "radical" oppositional groups, the solution of the group-specific collective action problems may often come at the expense of more effective mobilisation and influence across other "locales". Thus the social capital of militant, left-wing sects may well be non-convertible (and, by implication, non-rationalisable), and could explain their failure to secure power in highly differentiated, modern industrial societies - just as the non-convertibility of the social capital of marginalised "traditional" groups might explain their tendency to be "left behind" in the modernisation process.

The distinction between transparency and rationalisation thus gives some analytical purchase on how to distinguish between different local optima and their likely impact on wider forms of social development. Moreover, the stranger principle provides an account of why societies, which have apparently achieved some stable steady state (such as the examples of Japan and China already mentioned), can come to be displaced from such stasis, and realise rapid transformation through the rationalisation of their stock of social capital. In effect, we have a solution to the dynamic puzzle. Similarly, the existence of a stable band of combinations of transparency and rationalisation provides some indication that indefinite increases in social capital in any one dimension may not be either desirable and/or feasible. In effect, the non-linearity puzzle finds some resolution in the present approach: there is simply limited potential for continued development of social capital in any one dimension.

However, the "progressive" dynamics implied by the interaction of transparency and rationalisation raises an immediate puzzle of its own. If social dynamics are indeed "progressive", how are countervailing developments such as those in Nazi Germany, Bosnia, or Rwanda to be accounted for? One response might be that such aberrations are temporary, and without significance to the long run dynamics of such societies. However, such a response does not give sufficient weight to the frequency and the severity of counter-"progressive" historical episodes. Rather, we suggest that they can be accounted for at least to some degree, by recognition of an additional analytical distinction of relevance to social capital: that of the role and impact of social institutions.

6 The Possibility of Institutional Disjuncture: the impact of social agents

By social agents we refer to the existence of formal social institutions which are themselves attempts to overcome collective action problems, independently of social norms, values and rules which facilitate "spontaneous" cooperative solutions. The state and multinational corporations are obvious though by no means the only examples of such institutions.[31]

The increased capacity for organisation and of directed intervention in social processes of the modern state and other loci of collective agency such as large private corporations, trade unions and special interest groups, carries specific implications for the social dynamics we have outlined above. The current strength of such loci of collective action does not have substantial historical precedent. A cursory contrast of the percentage of total social output appropriated by the modern as opposed to earlier forms of the state in tax revenues, is an indication of this increased capacity for intervention in social processes by at least some social agents.

Given this strength of various loci of social collective action, it follows that social agents can come to intervene in social processes, transforming at least some social institutions so as to be at odds with the level of transparency and

[31] For viewing the firm as a solution to social action problems, see Coase (1937).

rationalisation of the social capital of the broader society. The danger here is that if the intervention on the part of a social agent develops institutions with a degree of rationalisation or transparency at odds with the nature of the wider social capital, such institutions may prove to be unsustainable, or at least unstable. The absence of clear foundations of the institutions in social norms and values with wide currency leaves the institutions in disjuncture with the requirements of broader social capital. Action in the context of the over-rationalised or over-transparent institution would be cast in terms that would not find resonance with wider social norms and values. While in principle capable of lowering transactions costs for agents acting in terms of such institutions, the disjuncture of the requirements of action in the "imposed" institutions with the standardised norms and practices contained in social capital, may in fact serve to raise the transactions costs as perceived by the agents who have to straddle the divide. The legitimacy, and hence stability of such social institutions would suffer in consequence.

Examples of such disjunctures between social institutions and the nature of social capital might be the Weimar republic in Germany, and more recently the potential "over-democratisation" of some developing countries.[32] Perhaps most topical of all, may be the example of the "hour-glass" society in Russia (see Rose, 1995). At the base, Russia experiences a rich civic social life, with strong social trust between friends and in familial interaction. Similarly, the very top of the society has a rich political and social life, with strong bonds of trust amongst those co-operating in the quest for political power and for wealth. Yet the links between these two spheres are limited and weak, and characterised by strong distrust of the elite by the base (the most trusted Russian social institution is said to be the post office). A similar characterisation might be said to apply to South Africa since its first democratic elections in 1994.

The implication of such examples is that where social institutions "outstrip" the degree of rationalisation and/or transparency of the social capital hinterland, their general acceptance, and the extent to which agents within the societies bearing over-rationalised or over-transparent institutions are prepared to defend the institutional framework they find themselves in, is

[32] By this term Barro refers to political systems that are "more" democratic than justified by their level of economic development. The argument presumes that there exists a link between economic development and political development. "Overdemocratisation" is held to lead to unstable democratic institutions - see Barro (1994). This view is, unsurprisingly, contested.

impaired. External shocks to such institutions, or even temporary inability to deliver appropriate performance levels, might well prove terminal to such institutions. In effect, institutions are shifted away from the stable nexus identified in Figure 2 above, and thus prove to be inherently unstable.

Such instability is not restricted to institutions that are over-rationalised or -transparent. A corresponding argument can be applied to institutions that are under-rationalised or -transparent. For instance, one reason why affirmative action in the USA has proved vulnerable to attack over time, may well lie in the fact that the attempt to redress historical inequity has been couched not in terms of universalisable criteria of disadvantagement, but in concrete, contingent characteristics such as race. For a relatively highly rationalised society such as the USA, the negative consequence may well be to unnecessarily polarise society, not along the axis of privilege, but in terms of the concrete, contingent characteristics the affirmative action programme targets. The strong sense of exclusion reported by African-Americans, apparently quite independently of their socio-economic status, gives some indication of the extent to which American society remains divided despite the efforts of affirmative action campaigns. A more appropriate intervention given the USA's level of rationalisation, might have been affirmative action programs that did not have a contingent criterion such as race as the explicit target. Rather, emphasis might have been more appropriately focused on indicators of disadvantagement, defined in terms of income or wealth. Such criteria have the advantage of being explicitly targeted at the ultimate source of alienation on the part of disempowered communities, and hence identify that which is the object of redress. They are also abstract, preventing the "entrapment" of communities and individuals in categories, preventing the formulation of an identity of exclusion, in terms of categories which are immutable (such as race). Instead, the conception of disadvantage is focused on its true functional source, making redress more readily identifiable and universalisable.[33]

We suggest that it is instability in social institutions that are at disjuncture with their social capital hinterland, which can come to generate falling rationalisation or transparency within societies. Where over-rationalised, or over-transparent institutions prove to be unstable for the reasons outlined

[33] We do not wish to deny the complex nature of political conflicts around matters of distributive justice that transcend, or are perceived to transcend the distribution of material goods.

above, they may prove to be unsustainable, and hence "collapse" into institutional patterns consistent with the lower transparency or rationalisation contained within the surrounding social capital. Growth in transparency and rationalisation of the society is thus not always progressive, but may be regressive instead.

The argument also carries the important implication that the debate surrounding the extent of state intervention in economic development requires modulation at the very least. What may be important is not (only) the extent to which the state should intervene in market processes. The nature and form of state intervention must be of the right kind, be of the appropriate degree of transparency and rationalisation for the level of development of the society in which the intervention is to take place. Where the intervention is of the inappropriate degree of rationalisation, for instance, the effectiveness of the intervention may be compromised not because the objective was inappropriate, but because the form in which the intervention proceeded did not mesh with the relevant prevailing social capital.

Yet social institutions do not only fulfil constraining or destabilising functions with respect to social capital. Frequently their role is more productively interactive with social capital, both improving social capital, and in turn being positively influenced by social capital in turn. State institutions form only one example of such symbiosis, but one we focus upon in some greater depth.

7 The Significance of the State and Political Culture

We suggest that there are good reasons to believe that social capital and the form of state institutions and the political culture of a society are systematically related to one another.[34]

In the first possible link between social capital and the state we suggest that the state may play an important role not only in the formation of social capital, but also in its maintenance. An example may illustrate our suggestion. In some measure social rules, norms and values come to perpetuate themselves, and members of a civil society themselves apply sanctions and incentive mechanisms in order to encourage members of society to conform to such normative structures. However, this is not the only means by which

[34] See Luiz (1999), for an analysis of how state capacity is affected by state-society dynamics.

investment in social capital can take place. Particularly under circumstances where the structures of civil society are under strong threat, the state may have to provide a regulatory function in fulfilling an enforcer of last resort function, to ensure that those members of society who wish to free ride on the cooperative behaviour of others face expected costs of doing so which are sufficiently high to render free riding unappealing. One salient example here is South Africa and its high current levels of crime. Given that the state at present is widely viewed as being incapable of dealing with crime, the consequence is effectively an increased privatisation of policing functions through the proliferation of private security firms. While this may not represent a problem in itself and may possibly lead to some efficiency gains, where the privatisation of security is linked to a perceived and perhaps real incapacity of the state to act as the enforcer of last resort, the consequence for social capital may be damaging. First, the ultimate result may be the Balkanisation of civil society, such that the prospects for cooperative activity between members of society beyond very limited domains are significantly reduced. Second, there may be serious distributive implications, since wealthy sections of society will have greater capacity to protect themselves against crime than poorer sections of society, and given the assumed absence of state capacity regulation would not provide a means of addressing such imbalances. Neither scenario is conducive to what Fukuyama has termed social trust, and may serve to seriously depreciate the social capital the society has at its disposal.

The implication that follows is that it is desirable for the state to continue to fulfil what amounts to a Hobbesian role of acting as enforcer of last resort, and importantly to be seen to be so acting.[35]

Yet it is not only the state that is likely to influence social capital. The form of social capital a society has may well come to carry implications for the form which state institutions assume. The rationalisation of social capital is premised on a movement from substantive rules, norms and values, to a procedural form of social capital with less substantive content. There is no reason to suppose that the process of rationalisation need be confined only to the rules and norms binding civil society. Rationalisation can extend to the political culture of a society also, moving from a polity defined in terms of traditional, ethnic, or caste association for instance, to association based

[35]Note that this does not extend to an argument for "substantial" state intervention - merely that there are some minimal functions that are essential for the state to fulfil. Indeed, too centralised a state may be counterproductive for the purpose of long run economic development.

not on substantive identity, but to contingent association based on mutual interest, with diverse alliances and with shifting patterns of allegiance.

The capacity of states to exercise arbitrary discretionary power renders their impact subject to time inconsistency problems. No matter what the quality and import of government policy intervention may be today, in the presence of discretionary power by the state the possibility of a policy reversal tomorrow exposes any activity to fundamental uncertainty. Thus an investment undertaken under secure property rights today, as long as the state has strong discretionary power without regard to checks and balances that embody a means for securing the effectiveness of universal rules of right action can always be subjected to expropriation tomorrow, and hence the probability of such investment being undertaken in the first place is significantly reduced. Moreover, the presence of discretionary power without regard to checks and balances that embody a means for securing the effectiveness of universal rules of right action, increases the scope for the pursuit of sectional interests.

Thus, inasmuch as systems characterised by high levels of discretionary power of the state have "trust", this trust will depend in substantial measure on the beliefs that people have about the (always questionable) dispositions of other people. Bonds of personal loyalty, devotion and friendship will tend to be stronger than the capacity of abstract, formal institutions to override actions taken in the context of such bonds. To the extent that trust exists, it will tend to exist in personalised forms; it will be invested in people rather than procedures, institutions or office, and will be shaped by the vagaries of group or individual circumstances. Political agents will be disposed to defend persons rather than the offices of which they are incumbents, and the political culture will tend to endorse the activity of agents on account of their personal substantive characteristics, rather than the quality of their performance. In this way, incumbents will be able to "own" and be identified with their offices in a degree that a properly legal-rational order prohibits.

It was precisely the costs of the arbitrariness inherent in high degrees of discretionary power of states that led to the supersession of feudal and monarchical state forms by liberal democracy. Traditional and personalist state forms do not display the degree of accountability that limits the discretionary power of the state. Such limits were generated, first, by the liberalisation of the state and, subsequently, its democratisation. The establishment of a liberal state entailed the establishment of a set of abstract rules characterised by formal neutrality and disinterestedness. The democratisation of the liberal state has involved the formal inclusion of all social classes into the liberal state system, such that the abstract, universal rules and their application have, at least formally if not always substantively, come to apply to everyone. This reduces the transactions costs across the whole economy, since the basic structure of the system encodes information that is, in principle, equally accessible to all parties.

A central organisational feature of the liberal-democratic state is the institutionalisation of systems of checks and balances. Such dispersal of power between different parts of the state systems, provides ways of reducing its discretionary application, placing constraints on the scope for personalist forms of governance, and increasing levels of accountability of the state. Classically checks and balances rely on:

- Horizontal divisions of power between the executive, legislature, and judiciary, limiting the possibility of arbitrary action on the part of any one branch of government, and by extension other social institutions.

- Temporal division of power through the electoral process, allowing for the transparent formation of and lobbying for interest groups. Trust in the procedural aspects of the state is thus underwritten by the guaranteed transience of government, in contrast to the durability of the state itself.

- Vertical divisions of power within organisations by means of formal rules of interaction, again limiting the possibility of arbitrary action by any part of the hierarchy.

The formal limits placed on personalist forms of rule - such as divisions between legislature, judiciary and executive, regular elections governed by precise voting rules, the limits to tenure in certain offices, limits to the scope for "spoils" and the juridically guaranteed right of a multiplicity of interest groups and parties to exist - increase the credibility and predictability of governmental performance not only across the relevant territory but also across time. Thus the state form itself comes to be invested with credibility. The populace comes to have performance or outcome expectations of the state which, when not met, permit of corrective action. In this sense, one might speak of the "intelligence" of liberal democracy. State forms of this kind have high levels of social capital of an inherently rationaliseable form. They provide a solution to problems of order and cooperation that is not arbitrary and that allows for the relatively efficient transmission of information both within the state and between the state and society. It is a form of state that favours a plurality of autonomous decision-making nodes in the society, and which allows the solution of coordination problems to be cooperative and interest-negotiating rather than coercive.[36]

A final relevant feature of modern liberal democracy is the extent to which state functions are specialised. Such state systems - especially their highly evolved and complex bureaucracies - depend on functionaries with high levels of differentiated and effective skills. Such state systems are technologically more developed than less rationalised states. This high level of skill and knowledge differentiation issues in a significant degree of independence or autonomy on the part of specific state institutions. This results in a high level not only of functional differentiation but also of a functional interdependence that is conducive to broad stability and predictability in the way the state operates. The state - as distinct from government - thus consists of a complex system of highly specialised and intricately interlocking parts that renders it relatively immune to wild fluctuations in public sentiment. It thereby serves the ends of credibility better than an undifferentiated, "monolithic" state system would. Such a "rational" state necessarily contains a very high level of human capital in the form of meritocratically selected elites subject to stringent tests both in recruitment and performance.

Although such a state system is relatively stable and enjoys a form of legal-rational authority or legitimacy, it is also - in so far as it is articulated into the various institutions of civil society - responsive to the signals that issue from civil society. It is, in this regard, a reflexive state consisting of agents able to interpret signals with skill and finesse, and who through their informational capacity are able to respond with appropriate counter-signals. Such a state is thus "flexible" and can act in ways that are both informed and appropriately responsive. The rules by which such a state operates render it scrutable, constituting it as a stable and reliable framework within which to pursue, modulate or abandon public policy.

[36] This is not to say that the liberal democratic state is in some absolute sense a "perfect" state form.

8 The Significance of Human Capital

The newer growth literature has already paid some attention to the extent to which human capital contributes toward long run economic development of a society. While measurement of human capital is fraught with difficulty, and results are not uniformly positive, the general implication of the argument suggests that human capital does contribute significantly to long run growth.[37] The concept of social capital was introduced into the modern discussion by the argument in Coleman (1988) that social capital contributes significantly to the formation of human capital - the point being not only that the normative structure of the society is important in the transmission of human capital, but that family and community support has a stronger pay-off than investment in buildings and teacher salaries.

We suggest that the reverse direction of causation is also plausible: human capital may be significant for long run economic development by contributing to social capital formation also. The two dimensions of transparency and rationalisation suggest that it is not only the quantity of human capital at the disposal of the society that is significant. The form which human capital takes also carries important implications for the evolution of social capital over time - for the nature of the "technological progress" to which the social capital is subject.

The transparency associated with social capital rests on the presence of a set of social rules, norms and values that are shared by a set of agents. Without such commonality to the underlying rules, norms and values the consequence would not be a cooperative solution with lower transactions costs emphasised by the literature surrounding social capital. While there are many mechanisms by which social capital can be formed, one of these is provided by those social institutions that also serve to generate human capital. Subjecting the members of society to a common educational system, while not homogenising the value structure of the society, carries the potential of providing at least a common reference framework in terms of which cultural and ethnic differences can be mediated, and cooperative solutions made more probable.[38]

[37] See Hanushek and Kim (1995); and Mankiw, Romer and Weil (1992), for two discussions.

[38] We hasten to add a bevy of caveats against some obvious objections. The world abounds with examples where goodwill amongst people is not overwhelming despite the best possible pedagogical efforts. Bosnia provides a topical example. Yet the appropriate

One hastens to add that the sheer quantity of education might make little difference to the transparency of social capital. What might be of far greater significance is the sort of human capital that education fosters, and how that human capital is transmitted. In effect the quantity of human capital is only part of the story, and the quality of the human capital may well prove to be vital in determining its interaction with and formation of social capital.

But the importance of human capital might lie less in its contribution to increased transparency of social capital, than in its role in the rationalisation of social capital. Where social capital undergoes rationalisation, reliance increasingly shifts from a set of social practices which are substantively "thick", rooted in tradition and established practice, to social practices which are formally defined in connection with explicitly constructed institutions. Reliance comes to be placed less on routinised tradition and practice, and increasingly relies on explicit rules designed as functional requirements of formal social institutions. For instance, justice is administered not in terms of established social practice and tradition, but in terms of principles of justice and jurisprudence that are generalised across diverse circumstances, to which social practice, and historical precedent becomes subordinated. The implication is that for such social capital to be possible, agents who participate in the use and maintenance of such social capital cannot rely on induction into a set of cultural templates through birth and maturation. Instead, the formal rules and principles of social institutions and practices themselves become the subjects of rationalised and formal instruction. In effect, rationalisation of social capital is human capital intensive, and can only be achieved where investment in human capital accompanies rationalisation.

It is this second contribution of human to social capital that we regard as perhaps the most significant. While the link between education and transparency is relatively tenuous, the link between rationalisation and investment in human capital is functionally more immanent.

One might argue further that the link between human capital and social

response here is that the link between human capital provision and improved transparency cannot be conceived of as deterministically as the criticism implies. Human capital is not the only, indeed almost certainly not even the main determinant of the emergence of social transparency. Transparency is bound to have a multivariate explanation, with many contributing factors in its historical evolution, and the counterexamples in their macro focus face difficulties in controlling for all explanatory variables at once. A macro counterexample might also be Germany, where strong regional and cultural differences were circumvented in part through uniform education after nineteenth century unification.

capital is not unidirectional from human to social capital. Instead, we suggest that the efficiency of human capital formation may be improved under increasing rationalisation of social capital. Where higher levels of skills of guaranteed quality can be imparted on an increasingly universalisable basis (such that labour becomes increasingly mobile, and its performance more predictable), the transactions costs in the economy are lowered. A physician trained at Harvard can be expected to have broadly the same range of competencies as one trained at Oxford, Johns Hopkins or Sydney.[39] A situation of competency equivalence arises which implies a particular structure of expectations and credibility, reducing search costs and insider-outsider problems in the relevant labour markets. The implication is thus that the clarity of quality certification by human capital producing institutions improve with the rationalisation of social capital. However, since the rationalisation of social capital is associated with the institutionalisation of increasingly autonomous spheres of action already noted above, associated with specific procedural rules, cognitive content and criteria of performance assessment, the potential for performance assessment in terms of output criteria is improved also. In effect rationalisation of social capital allows for improved information transmission in terms of both prior certification of human capital inputs, as well as the assessment of the quality of the output of human capital employed in institutions.[40] Thus some institutional social forms permit of more efficient mobilisation of human capital.

As a last point in connection with the link between human and social capital we note that the costs of technology transfers between those societies with appropriately rationalised forms of social capital are reduced. Institutions characterised by more highly rationalised forms of social capital would thus be more readily able to deploy technological advances through the auspices of the human capital at its disposal. Highly rationalised social capital thus constitutes an efficiency advantage over less rationalised forms with respect to both the formation and efficient use of human capital.

[39] This is not to deny that there may be additional social capital reasons for preferring Harvard (say) to the other universities - the networks may be better suited to long term social advancement than Sydney (say). We owe this point to M. Woolcock.

[40] We are grateful to Robert Klitgaard for pointing out this additional feature in improved informational capacity of rationalised social institutions.

9 Conclusion: toward a theory of endogenous change in social capital

In introducing the concept of social capital, Coleman suggested that its public good characteristics resulted in systematic social underinvestment in social capital.[41] If this is correct, the argument of the present paper suggests that any subsidies to social capital require careful targeting. All forms of social capital are not equal - and certainly some forms of social capital are more suitable for the purposes of economic development than others. Where policy intervention can serve to promote the development of social capital, therefore, it must be certain to target the "right" capital.

The notion of social norms and practices that lower transactions costs in exchange is suggestive. Clarity about the rules that govern agency in a social setting certainly lowers the costs of exchange transactions between agents, increasing the information that agents have access to in evaluating the desirability and certainty of the returns to exchange transactions. Improved transparency of social capital in this sense is desirable. It is not only increased information delivery that lowers transactions costs however - the mode of information delivery, the rationalisation of the social capital affects not only the quantity, but also the quality of the information that comes to be transmitted. While the transparency of social capital acts like an additional factor of production, the rationalisation of the social capital carries with it the potential of increasing returns to scale to the factor of production. In effect, therefore, the argument of this paper has suggested that greater differentiation of the functional impact of social norms and values is desirable if the full analytical purchase of the concept is to be realised.

Understanding of the interaction between the functional dimensions of rationalisation and transparency in social capital introduces dynamics to the analysis. While modernisation theory understood the evolution of social and political institutions to be driven by economic development, the present analysis suggests that the evolution of social capital is immanent to the interaction of its functional components. Modern growth theory identifies the possibility of endogenous technological change - the present analysis notes endogenous evolution in social norms and practices.

[41] Though Coleman (1988), was incorrect in suggesting that the "social" was the only form of capital with public good characteristics. The new growth literature has explored the possibility of positive externalities in both physical (see Romer; 1986) and human capital (see Romer; 1990).

But recall that all forms of social capital are not equal. Of additional significance in this context, is that the introduction of social institutions at odds with the wider hinterland of social capital brings with it the possibility not only of the instability of such institutions, but of the implosion of such social institutions. The policy implication is thus that not only the social capital most conducive to economic development needs to be targeted (not all capitals are equal), but that different forms of social capital are appropriate as targets at different stages of development.

For us the concept of social capital remains tantalisingly suggestive at the analytical level. Yet its generality and breadth of coverage also renders it elusive, and raises ambiguities and questions to which the answers are not readily available, without greater disaggregation of the concept. We hope that the argument of the present paper has demonstrated that the identification of functionally distinct dimensions of social capital represent one route by means of which such an objective may be achieved.

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