1 Why interpersonal relations matter for economics

Benedetto Gui and Robert Sugden

1. Introduction

Is sociality decaying? Are the hidden foundations of society silently crumbling beneath the ever more complex institutional buildings we are busy constructing or repairing on top of them? That many people are concerned about these questions is obvious from the response evoked by Robert Putnam's (1993b, 1995, 2000) recent claims that, at least in the United States, the last thirty years have seen a steady downward trend in many different kinds of formal and informal social engagement. An explosive number of articles, books, speeches, conferences and Web pages witness that Putnam has touched a sensitive nerve.[1] Many social scientists and politicians have taken his arguments very seriously. Others have rejected them in ways that suggest that something more than intellectual disagreement is at stake (see, for instance, Fine, 2001). Among some of Putnam's opponents, there is a fear that he is providing ammunition for a conservative or communitarian backlash against the liberal social trends of the late twentieth century. But, even if this fear is understandable, it seems to betray an uneasy sense that Putnam's arguments have some credibility.

In trying to understand these concerns about trends in social engagement, it is useful to compare the environmental concerns that began to assume salience in public debate in the 1970s. People gradually came to realise that many of the processes through which economic wealth is created – more generally, many of the processes that contribute to human well-being – depend on inputs from the natural environment; in economic and political analysis, these inputs were being treated as permanent background features of the world, but their sources were being systematically degraded by the wealth-creating processes that ultimately depended on them. Current concerns about sociality have a

[1] See, for instance, Durlauf (2002) and the 'Symposium' in *Contemporary Sociology* (2001, no. 3).

similar character. Do certain forms of social engagement provide essential inputs to economic processes, and are these not being accounted for in conventional economic analysis? Is social intercourse an important source of well-being in its own right? And could it be that the social environment we are used to is not a permanent background feature of the world, but something that is being degraded by economic developments?

The starting point for this book is our shared sense that these are important questions, and ones that intersect with the domain of economics – the discipline to which we both belong. Our aim is to explore some of the connections between social interaction and economics. In taking this as our objective, we are contributing to an already large literature (see the brief review by Gui in chapter 2). The principal new concepts we find in (and draw from) this literature are 'social capital' and 'social interactions'. The former is a very insightful concept, although its being interpreted in many different ways makes it too loose a theoretical tool.[2] The latter has been defined more sharply, to include agents' non-contractual influences on others' preferences, information or constraints.[3] However, what we do not find sufficiently stressed are some peculiar elements that come into play when interactions are highly personalised. This is why we make recourse to the concept of *interpersonal relations* to refer to forms of human interaction in which the identity of the participants *as particular human beings* has affective or cognitive significance. In doing this we refer not only to informal interactions occurring in contexts such as families, neighbourhoods, associations or churches, but also to personalised interaction connected with (or entailed by) the performance of typical economic roles in contexts such as firms or markets.

For example, if you buy a travel package by going to an airline Web page, clicking the right button and entering your credit card number, you are initiating a transaction that has consequences for other people (other would-be customers who may have wanted to use the flights that you have booked on, shareholders in the airline, and so on); but there is no interaction with specific people as specific people. If instead you go to your local travel shop, and, while booking a travel plan from one of the agents, exchange views about the current state of congestion at your local airport, or perhaps just chat about the weather outside, you are

[2] Martin Paldam (2000) provides a useful survey of the social capital literature. The looseness of the concept of social capital is criticised by, among many others, Samuel Bowles (1999) and Edward Glaeser, David Laibson and Bruce Sacerdote (2002).
[3] See Manski (2000) and Blume and Durlauf (2001).

engaging in a minimal form of interpersonal relation. The more so if you go there to discuss a less routine matter, such as the proposal of a group tour, which requires explanations, a discussion of alternatives and bargaining. A similar distinction is made by Putnam (2000, pp. 48–64) when he contrasts the *membership* of voluntary organisations with *participation* in meetings or other events in which members come into face-to-face contact with one another. According to Putnam's data, there has been little change in overall rates of membership of voluntary organisations, but there has been a very marked decline in participation. The trend is towards voluntary organisations such as Greenpeace or the (American) National Rifle Association, organised on a national or even international scale, with large numbers of members whose engagement takes the form of contributing money in response to mailshots, reading newsletters and expressing their attachment to the organisation's ideals by buying affinity products such as T-shirts and car window stickers. It goes without saying that such organisations are a significant form of social capital (one has only to think of the disparate impacts of Greenpeace and the National Rifle Association on political decisions); but a response to a mailshot is not a full-fledged interpersonal relation.

According to conventional interpretations of the thematic and methodological boundaries of economics, interpersonal relations may seem not to be the business of economists at all. So – some could legitimately wonder – are we trespassing beyond our disciplinary competence? We think we are not, as we explain below. And, at the same time, we want to reassure the reader that our project is not one of scientific imperialism. Our aim is not to explain interpersonal relations by the straightforward application of conventional modes of economic explanation. As our choice of title – Economics *and* (not *of*) Social Interaction – is intended to signal, the aim is to shed light on how the interpersonal realm intertwines with the economic realm.

We do not presuppose that any particular form of theorising is *the* way to understand these interrelationships. Indeed, one fruitful strategy is to represent and analyse some of the components or features of interpersonal relations, and how these are affected by standard economic choices, within the established conceptual framework of economics; this is the theme of section 3 of this introductory chapter, and the approach of choice for some of the contributions in this book. On the other hand, however, the inability of conventional economic theory to provide a satisfactory account of how personalised interaction affects economic variables points to the need for far-reaching methodological changes, supported by the insights of other disciplines; this strategy, sketched in section 4 below, is also adopted in several chapters.

Nor do we presuppose here any judgements about the ultimate value of sociality. On some philosophical accounts – particularly those influenced by utilitarianism – social relations, like any other thing that might be supposed to be good for people, are valuable only to the extent that people actually desire them: to the extent that trends in patterns of social interaction simply reflect changes in preferences, they are to be neither approved nor disapproved. Viewed in other philosophical perspectives, rich interpersonal relations are essential for human fulfilment: a major decline in their intensity, continuity and degree of involvement, if real, is necessarily a matter for concern. We are not at all indifferent to these fundamental questions, as our own chapters reveal, but we recognise that we cannot contribute much to their debate as economists. Thus, when jointly undertaking the editing of this book, we gave ourselves the preparatory task of contributing to a better understanding of how interpersonal relations connect with economics.

In what follows we begin, in section 2, with an overview of the various connections between the economic and the relational realms. Successively, in section 3 we utilise three established categories – namely non-rivalry, excludability and non-contractibility – for discussing whether recent trends in spontaneous sociability are really a reason for concern. In section 4 we observe that something extraneous to established economic theory is also involved, namely communication at the emotional or affective level, and show that this has implications to which economics needs to give attention. In doing so we make reference to the works of authors who have ventured into these unsettled territories. These include the contributors to this book, whose chapters are briefly presented and situated in section 5.

2. How interpersonal relations connect with the economic sphere: an overview

In the scientific excavation to which this book is devoted, not only do different authors have different ideas as to the most promising tunnelling pattern (as we mentioned above), but they also employ different technologies and, furthermore, work at different parts of the field. In this section, we try to convey a sense of the third type of diversity in the analysis of economics and social interaction. For the sake of brevity we proceed schematically, pointing out the most important causal links that connect interpersonal relations with the economic sphere (and vice versa), each of which deserves careful investigation. In so doing we make reference to examples mentioned in the still-thin literature that examines these links.

For a first overview of the terrain of economics and social interaction, we draw a distinction between the 'economic' and 'non-economic' spheres of social life. In reality, however, there is no sharp divide between those parts of the social world that are economic and those that are not. To the contrary, the more one thinks about how interpersonal relations impact on economics the more artificial this distinction comes to look.

(i) Interpersonal relations inside the economic sphere can affect economic performance. Good interpersonal relations among economic actors may reduce transaction costs and facilitate mutually beneficial interaction. For example: habits of cooperation allow some agricultural communities to manage common-pool water resources effectively, without recourse to costly technological devices (Ostrom, 1990, ch. 6); enmity is a barrier to trade (Schmid, 2000); groups of workers with favourable mutual feelings can better solve dilemmas of collective action (Rotemberg, 1994a); mismanagement of interpersonal rapport has a distinct negative effect on the continuation and fruitfulness of inter-organisational collaborations (Jap and Anderson, 1998).

(ii) Economic choices can affect interpersonal relations inside the economic sphere. Intra- and inter-organisational practices can impact on interpersonal relations among the actors involved. For example: incentive, consultation and monitoring arrangements affect relations among peers and between superiors and inferiors within enterprises (Aoki, 1984; Barkema, 1995; Gibbons, 1998); the design of development projects may promote or hinder the creation and maintenance of patterns of collaboration among members of rural communities (Fox and Gershman, 2000).

(iii) Interpersonal relations inside the economic sphere can affect well-being. Positive interpersonal relations among economic agents may provide intrinsic benefits (and negative relations may cause direct welfare losses). For example: ties of solidarity improve employees' satisfaction with the social aspects of their jobs (Flap and Volker, 2001); bullying and sexual harassment significantly affect job satisfaction (Laband and Lentz, 1998); shopping in local stores is associated with intangible benefits stemming from involvement in meaningful relations (Miller, 2001).

(iv) Interpersonal relations outside the economic sphere can affect economic performance. Mutual familiarity, norms of cooperation and other features of interpersonal relations can bring instrumental benefits, in both formal and informal economic contexts. For example: in closely knit neighbourhoods, bystanders tacitly cooperate in looking after the children playing in the streets, relieving mothers from a time-consuming engagement (Coleman, 1988, p. 99); strong social networks provide material and emotional support for starting entrepreneurial initiatives (Allen,

2000); attitudes of trust among citizens can lead to faster economic growth (Zak and Knack, 2001). Informal interpersonal relations may also act as channels for the transmission of economically valuable information. This helps explain differences in unemployment rates among socially separated, although geographically contiguous, neighbourhoods (Topa, 2001).

(v) Economic choices can affect interpersonal relations outside the economic sphere. The creation and consolidation of personal relationships can be facilitated or hindered by individual and collective economic choices. For example: the integration of markets across geographical space induces high job and residential mobility, making long-term relationships more difficult to sustain (Gui, 1996; Folbre and Nelson, 2000); innovations in consumer goods may substitute individual for collective forms of consumption, shrinking the social spaces in which personal relationships can be formed and sustained (see section 3 below); the location of service facilities such as schools has an appreciable effect on patterns of informal relations (Bogart and Cromwell, 2000); fiscal decentralisation appears to favour social cohesiveness and the strengthening of associative life (de Mello, 2000).

(vi) Interpersonal relations outside the economic sphere can affect well-being. Family, friendship and associative relations may bring intrinsic benefits. For example: even though migrant workers often earn greater income than those who stay behind, their quality of life suffers from poor interpersonal relations (Schiff, 2002); the characteristics of the networks of personal relations in which people are involved have significant welfare effects (Diwan, 2000). Such effects have economic significance if networks of interpersonal relations are themselves affected by economic variables.

3. Economics and interpersonal relations: social engagement as a special kind of economic good

If, in the light of all these connections, we want to take account of interpersonal relations in economics, we immediately face a fundamental problem: in terms of the conceptual structure of economics, what do interpersonal relations consist of? Are they forms of production, or of exchange, or of consumption? And, if they are any one of these, just what is being produced, exchanged or consumed? To frame these questions and to explain their significance, we begin by considering how the evidence of trends in patterns of social interaction might be interpreted within economics. One possible interpretation of the evidence marshalled by Putnam is that it documents some of the many changes in production and consumption patterns over time that characterise all market economies. Improvements in technology, retailing and transport are making it more feasible to separate production from consumption, and to separate one person's consumption from another's, with the result that interpersonal interaction occurs less commonly as a by-product of ordinary production or consumption activities. For example, developments in electronics have made it much easier for individuals to choose their own forms of entertainment. A hundred years ago musical entertainment within the home required a collective act of production and consumption, perhaps around a piano; more complex musical experiences were possible only in public concerts or shows, often organised by voluntary societies. The development of the gramophone allowed production and consumption to be separated; the development of personal tape and CD players has allowed consumption to be further separated between individuals. Similarly, the development of microwave ovens and pre-cooked meals has made it possible for individuals to choose their own dishes and mealtimes, rather than, as members of families, eating common meals prepared just for the occasion. And new technologies and organisational practices in service delivery – for example, on-line consulting, Internet shopping and telephone banking – are separating the consumption of services among people and from their production in much the same way that the new technologies and organisational practices of the Industrial Revolution separated the consumption and production of many manufactured goods.

The market, it might be said, has expanded individual choice by unbundling what previously were indivisible packages of private and social characteristics of goods and services. As part of this unbundling, we should expect to find that interpersonal relations, to the extent that they are desired, are increasingly supplied on the market as distinct entities: think of the growth of dating agencies and of psychological and body care services. Similarly, we should find that interpersonal relations are bundled with the goods and services with which they are now most complementary – for example, organised travel for specific affinity or age groups, and training courses the value of which depends considerably on the professional prestige of the fellow students with whom a participant will interact. It could also be said that the reluctance to purchase social opportunities in these forms tends to fade as they become more widespread. When market transactions first enter any sphere of human life, they tend to be seen as incompatible with the ethos of that sphere; but this perception often dissipates with experience – think of the erosion of the distinction between professionals and amateurs in sport, or of the changing attitudes to the practice of entertaining guests by taking them out to restaurants rather than preparing a meal for them in one's home.

A similar interpretation might be offered of a decline in the role of interpersonal relations as channels for the generation and communication of valuable information. A common theme in the social capital literature is that dense networks of civic engagement provide the preconditions under which individuals have the incentive to build reputations for reciprocity and trustworthiness. The idea is that information about individuals' trustworthiness is transmitted through interpersonal interaction in civic society; the more social engagement there is the more valuable reputations become, and the greater the rewards for individuals who are trustworthy (Coleman, 1990; Putnam, 1993a). It might be argued, however, that new organisational and information technologies have led to new, market-based methods of monitoring reputations; these developments have been made necessary by (and have helped to make possible) the ever-increasing geographical integration of markets. For example, the use of brand names for manufactured goods (an innovation that diffused widely in the late nineteenth century) has allowed the reputation of a product to be separated from the personal reputations of its manufacturers and retailers. Assessing the creditworthiness of potential borrowers was once a task for local bank managers, who could make use of knowledge gathered through participation in civic life; this work is now done largely through computer-based credit ratings, using international data sets. The cumulative effect of such developments is to unbundle the transmission of information from a range of civic activities based on social interaction.

If declining trends in social engagement and involvement are attributable to improvements in technology and the expansion of the market, should we be concerned about them? Why should we *want* social interaction to be bundled with other forms of production and consumption? Why should we regret changes that make it easier for individuals to choose when and how they interact with one another?

Received economic theory offers some possible responses. The first is to ask whether sociality is a sufficiently private good for markets to be capable of supplying it efficiently. If, to the contrary, sociality is more appropriately understood as a *public* good then economic theory gives us reason to expect that it will be under-supplied in a competitive market: a peculiar instance of a well-known sort of market failure. In economic theory, a public good has two essential characteristics: non-rivalry (one person's consumption of the good does not prevent others from also consuming it), and non-excludability (if the good is supplied to one person, it is difficult to exclude others from consuming it too). Clearly, social engagement has at least some of the first of these characteristics: by its very nature, it is consumed jointly by more than one individual. Indeed, one could go further and say that, in this respect, interpersonal relations are public goods par excellence, since, in contrast to all other goods, no conceivable technological innovation can ever make it possible that they are individually 'consumed'. Another characteristic that adds to the nature of personalised interaction as a public good is the need for coordination among people involved (see, among others, Sobel, 2002). Appropriate behaviour (e.g. showing up at the right place and time) on the part of each is needed for the interaction to occur, so individual compliance has the nature of a voluntary contribution to an event from which others also expect to benefit.

It is not quite so obvious that interpersonal relations are non-excludable. Some forms of social engagement are naturally analysed as *club* goods – that is, goods that, though non-rival in consumption, can be supplied in ways that prevent those who do not contribute to the costs of provision from enjoying the benefits. Such goods can often be supplied quite effectively in response to private incentives. Indeed, social intercourse is one of the forms of joint consumption that is most characteristic of the real clubs that provide the story behind the economic model of 'club goods'. Exclusive sports clubs provide an example of how the benefits of certain kinds of social engagement can be 'internalised' to organisations that can control access to those benefits. Similar mechanisms can work in organisations that are not so obviously clubs. For example, if people prefer to work in jobs that offer more opportunities for social interaction (and are willing to sacrifice income in return), employers have an incentive to adopt forms of workplace organisation that satisfy those preferences. (The empirical work by Borzaga and Depedri, chapter 6 in this book, documents that the trade-off between the wages and desirable social features of a job is exploited by real economic organisations.)

However, social engagement can have other, more genuinely public, benefits. For example, institutions that increase people's propensity to trust others *in general* to keep their commitments (and not just to trust *particular* others to do so) are classic examples of public goods. The maintenance of such a 'climate of trust' may depend not only on the formal institutions of civil and criminal law, which everyone recognises to be public goods, but also on norms that are reproduced in the interpersonal relations of civil society (Putnam, 1993a; Gambetta, 1993). Similarly, sentiments of approval and disapproval, conveyed in personal interactions, may play an important role in maintaining prohibitions on anti-social behaviour, such as shoplifting, tax evasion and driving while drunk. To the extent that it is a source of these kinds of diffused benefits, social engagement is a public good in the classic sense, and we should expect it to be under-supplied if decisions are made according to individual advantage. (The possibility of prisoner's-dilemma-like traps of 'relational poverty', ensuing from individuals allocating too much time to the production of private goods, is the main theme of Antoci, Sacco and Vanin, chapter 7).

If interpersonal relations are public goods, technological constraints that prevent their being unbundled from private goods may work in everyone's interests, since bundling counters the tendency to under-provision that characterises public goods. As an analogy, think how voluntary organisations finance activities that generate public goods. One of the commonest strategies is to provide donors with some private benefit as a partial return for their contributions. For example, political fund-raisers offer donors opportunities to meet leading politicians in exclusive social occasions; wildlife organisations allow their members special access to nature reserves; professional associations publish informative journals that are supplied free of charge to their members. By means of these devices, voluntary contributions to public goods are bundled with private goods (Olson, 1965; Cornes and Sandler, 1986). Of course, such mechanisms for the supply of public goods are potentially vulnerable to unbundling. Thus, many of the direct consumption benefits that visitors gain from a nature reserve might be supplied by a private firm (perhaps as a form of theme park), without its engaging in the full range of activities of a wildlife charity; a private publisher might supply technical journals without taking on the other activities of a professional society. But, whatever the various frictions are that resist the unbundling of private and public characteristics of goods, they are not simply deadweight costs; by providing a mechanism for the supply of the public characteristics, they allow common preferences to be satisfied in ways that would not be possible in a frictionless market.

Thus, an important question is placed on the agenda of economics and social interaction: is a social context that favours interaction a public good that is most effectively supplied as a joint product alongside other goods? Indeed, the idea that, in the economic sphere, goods of a 'relational' nature are produced jointly with more conventional outputs is just the starting point of Gui's (chapter 2) representation of economic interactions as 'encounters' – a concept that is broader than that of an exchange, or a transaction.

Intrinsic benefits from social intercourse may differ from more conventional market goods, not only by virtue of non-rivalry and non-excludability, but also because of the special difficulties that are involved