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When sociable workers pay off: Can firms internalize social capital externalities?☆

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ABSTRACT

We use an endogenous growth model to contrast the socially optimal allocation of human capital with the decentralized solution, in a context where workers make the choices that determine social capital accumulation. As social capital is expected to increase productivity but is not traded in markets, a positive social capital externality is identified. We discuss the possibility that, in response to this externality, firms subsidize social capital accumulation activities, incurring into additional costs that are recouped through productivity gains. This reaction by firms may be seen as a justification for some corporate social responsibility actions targeted at workers, although a full internalization of the externality does not look achievable in practice.

1. Introduction

Worker productivity is crucial for economic growth. Traditional economic models consider the role of physical capital and labour in production, whereas the importance of human capital accumulation, in a wider sense, has been the focus of endogenous growth theory. Social capital is a fairly recent addition to growth models, where it can represent the impact of trust and social networks on productivity and hence on growth. Since there is no specific market for social capital, its decentralized accumulation will generally not be optimal, which means that a social capital externality exists. In fact, in a static world without capital accumulation, the firm could adjust wages so as to induce workers to choose their time allocation optimally. Thus, the social capital externality is essentially a dynamic phenomenon, in which firms and households benefit from an intangible investment for which a market does not exist. Roseta-Palma et al. (2010) develop an endogenous growth model with natural and social capital where the interaction between these types of capital is studied. In this paper, on the other hand, we investigate whether the social capital externality can act as an incentive for firms to increase their corporate social responsibility

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(CSR) activities in response to the market failure. In this sense our work fits Heal's (2005) suggestion that one of the roles of CSR is as "an institution that has evolved in response to market failures, a Coasian solution to some problems associated with social costs". Therefore, it is welfare-enhancing in all those sectors of economic activity where private and social costs are misaligned. In particular, the author specifically refers to "improved human relations and employee productivity" as one of the multiple benefits of CSR. This is the aspect we explore in the present work.

It should be stressed that ours is not the first attempt to link social capital and corporate social responsibility. Sacconi and Degli Antoni (2009) provide a conceptual discussion of this relationship, described as a "virtuous circle that creates favorable conditions for socio-economic development". Furthermore, these are multifaceted concepts and we do not aim to provide a complete framework that could fully explain the relationship between them. For that, the reader is well-advised to head to a recent book, edited by the same authors (Sacconi and Degli Antoni, 2011), whose chapters vividly illustrate both the possible interconnections between the two notions and the range of methodological approaches that can be brought to bear on the analysis. We do, however, offer a short primer on the potential role of social capital in the context of an endogenous growth model as well as a brief discussion of previous work that introduces various aspects of CSR into economic literature.

Although there are many ways to define social capital, the one that best adapts to economic models, as noted by Sobel (2002), is Bourdieu's 1986 explanation: "Social capital is an attribute of an individual in a social context. One can acquire social capital through purposeful actions and can transform social capital into conventional economic gains. The ability to do so, however, depends on the nature of the social obligations, connections, and networks available to you". A similar idea is expressed in Lin's notion of "investment in social relations with expected returns" (Lin, 1999). We interpret the concept as something that individuals must build up through their choices and whose accumulation increases their utility as well as their productivity, thereby benefiting firms. For example, people might invest time in building up or maintaining a network of people (e.g. by organizing a conference or participating in a team-building corporate activity). In our model, social capital is a single asset which enters consumer utility in a dynamic, representative-agent economy, and we introduce the assumption that in order to accumulate this asset agents incur an opportunity cost in terms of human capital use. In contrast, Sacconi and Degli Antoni (2009) use a game-theoretic approach to discuss the various dimensions of social capital, distinguishing cognitive elements, namely beliefs and dispositions, from structural elements that are cooperative linkages between agents. They propose that the general level of trust and cooperation, often associated with the concept of social capital at least since Putman et al. (1993) and Knack and Keefer (1997), should actually be seen as an effect of other elements. Alternative approaches to social capital include networks of relations, as in Lippert and Spagnolo (2011), where interactions between agents are modelled as repeated games with different channels of information between players, and linked social-exchange and economic-exchange games, as in Aoki (2010), which proposes that social norms are a result of the joint evolution of social networks and specific patterns of economic exchanges.

Corporate social responsibility (CSR), despite its prominence in management theory and business practice, is also a difficult concept to define. For instance, Lockett et al. (2006) suggest that even within the management literature CSR knowledge can be described as "a field without a dominant paradigm". Moreover, the use of a given definition for CSR implies a normative choice regarding the goals of corporations. Many economists, famously led by Friedman (1970), have held the view that corporations in competitive markets should only focus on profit-maximization, as that is their purpose, enabling them to serve consumers as well as to provide jobs. Linked to a traditional belief in the rationality of economic agents, so that any profitable actions are expected to be identified and implemented by competitive firms, this view minimizes the potential role of CSR and even deems it a harmful endeavour. Likewise, Jensen (2002) defends maximization of the long-run value of the firm, equivalent to the discounted value of the future profit stream, as the single-valued objective that should be pursued, albeit taking into account the impact on all the firm's constituencies (stakeholders) so as to promote better management decisions. He does recognize, however, that externalities hamper the maximization of social welfare and recommends that Coasian solutions be found to correct for these deviations.[2] Our model fits in this framework of analysis.

There has been much less development of CSR in the economic literature than in management, and most of what there is microeconomic in focus. A few papers model CSR as an instance of private provision of public goods. Besley and Ghatak (2007) introduce "caring" consumers who value the public good, whereas Baron (2008) adds manager and shareholder preferences as well, in a principal-agent framework. Brekke and Nyborg (2008) show that the existence of morally motivated workers (who prefer to work at a "green" firm and will have a higher productivity when they do) can justify firms' efforts to be socially responsible. There are also papers which focus on the relationship between CSR and economic performance as measured by existing productivity indicators (see Paul and Siegel, 2006 and other articles in the same issue of the *Journal of Productivity Analysis*). In this paper we explore the role of CSR in growth models, a relatively neglected angle of analysis. The only other works that we are aware of are Dam (2011) and Dam and Heijdra (2011), which look at the implications for growth of socially motivated investors. The first paper shows that stock markets can deal with intergenerational environmental externalities, while the second finds that the presence of socially responsible investors lower the

[2] Other popular views of CSR are stakeholder theory (see Freeman et al., 2010) and the contractarian approach (which is described, among other approaches, in Sacconi et al., 2011). A summarized review of the competing theories can be found in Melé (2008).