

BUILDING SOCIAL CAPITAL AND REDUCING TRANSACTION COSTS

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Abstract- Building social capital in a capitalist society with the rising aspirations favors trust building attitude and thus diminish any misfortune in claiming an inability to better economic welfare. Following the concept of transaction costs as well as shared norms and anticipated attitudes one brings the idea of social capital into the context of economic pay off and mutual gains achieved by accepting the collective marginal utility function. Trust perceived then as indispensable to progress responsibly establishes moral obligations towards society and in particular to other individuals in the network that participate in enhancing such activities.

Keywords- New Institutional Economics, trust, transaction costs, networks, institutions, culture JEL Classification: O10, J17, P10, N35, D31, D23

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I. INTRODUCTION

The concept of trust and transaction costs is an inevitable element of every analysis concerning the economic development. Relatively stable economy and high level of social capital is a desired state of any society. However such pursuit visible on the common ground of western economies regards the centuries' long expansion and current threads, while it differs for the newly emerging markets and those already attempting to gain status of fully developed. Malaysia is among those that strive to set standards creating economy based on human capital. Still at the level of catching up, Malaysia becomes a hub for international companies and entrepreneurs as well as policy makers that wish to mirror some of the successfully implemented programs. Gradually, social capital built on multi-threaded and multi-ethnic networks becomes a main determinant of socio-economic success. Collaborative networks, communities and groups of common interest are therefore left with freedom to express their needs for welfare. Such understood social system relies on inter-personal relationships, utility function and rational, in the context of bounded rationality, exploration of new opportunities. Distinguished and underlined as the fundamental factor of economic success, social capital can be then reduced to trust, norms and networks. Within this framework I strive to follow Putnam's definition of social capital and hence seek to conceptualize its elements (Putnam, 1995). Therefore the structure of this analysis is focused around broader distinction of social capital with trust, transaction costs and networks in particular. The co-joint analysis along with the Malaysian entrepreneurship and constant desire to progress may provide more insight into the multi-layered success of economic development. Privileged networks, bonding groups and spontaneously established business relations are the

sole of Malaysian success. While norms and attitudes established and executed towards fulfilling the God's will to progress are often misunderstood, they are an inevitable subsystem for Malaysian economic environment. Norms and their rapidly changing perception by reflecting the often discussed Calvinist approach set the demanding prerequisites for welfare. Norms defined by both formal and informal institutions set by those with the authority rights are the subject of control and submission and therefore encompass people from various social groups (Coleman, 1994).

In this paper the idea of social capital is understood in the context of networks and society, however does not stand in complete opposition to the model of optimal individual decisions. Approach where community is the subject of the analysis emphasize the importance of norms and conventions, while aggregated outcomes are the sum of preferences and internal utility functions. Thus I follow Lakoff & Johnson to ask whether choices and decision are made under the embodied cognition conditions or vary (Lakoff & Johnson, 1999).¹ Thus by providing theoretical background for the social capital and its composites I seek for transmission channels and necessity to reduce transaction costs. The aggregation of individuals' preferences and attitudes might be

¹ In the context of conscious approach of the self-interested individuals, where decisions are made within particular institutional framework, please refer to Hayek, F. (1973). *Rules and Order*. In F. Hayek, *Law, legislation and liberty: a new statement of the liberal principles of justice and political economy* (Vol. 1, pp. 17-39), London: Routledge & Kegan Paul.

generalized, but optimal for broader understanding of economic success and current development. Therefore exploring the obligations and virtues as well as common utility functions may elaborate the need for accumulating social capital and thus create necessary incentives to progress through cooperation and innovation in the Schumpeterian view (Schumpeter, 1934).

II. SOCIAL CAPITAL AND PURSUIT OF WELFARE

Social capital in a form of aggregated sum of individual preferences and existing norms can be generally divided twofold. Distinguished by the strength of ties, it can be either bonding or bridging. Whereas bridging capital encompasses weak ties and therefore ties people from various social groups and enable to possess new information relatively easy, bonding capital associates high quality knowledge with the demand of structured relations. Tacit knowledge and necessary adjustments are made inside groups focused on long-term targets with both economic and social relations. The bonding capital in particular homogenizes group members and thus increases level of trust between them. By unifying existing norms, individuals tend to act more cooperatively and reach for consensus in order to support mutual benefits. While economic welfare becomes a by-product of socially beneficial cooperation, networks are internally bonded. In this context entrepreneurship and pursuit of welfare is fully integrated with personal beliefs and cultural background – what cannot be changed is transposed and adjusted, so the community beneficial behaviour is in favour over opportunistic behaviour.

Such institutionally designed framework where binding capital is the sum of mutually beneficial actions is the base for trust building behaviour. Where any boundaries exist to minimize opportunistic costs, trust is the binding element of complex negotiation and becomes the reaffirmation of social capital as the main source of progress. Generally divided into four broad categories, trust can be discussed under risk and uncertainty, shared values, willingness to accept vulnerability and perception of other's expected dependency. Expected payoffs and minimized transaction costs lead however to justification trust as an internal belief in good will of the counterparty that maintains mutually beneficial behaviour under uncertainty (Child, 1998). Trust perceived then as indispensable to progress responsibly establishes moral obligations towards society and in particular to other individuals in the network that participate in enhancing such activities. Entrepreneurial culture and need for self-improvement being the base of economic success of rapidly developing economies and Malaysia in particular, exhibits rational calculation in the formation of networks and groups of common

interest. Discussed and shared endless possibilities of cooperation and constant exchange of ideas with other individuals, conceptualize the idea of egalitarian approach and puts trust as not only the internal value, but moral obligation to share success. Thus good faith and shared norms are anticipated when commencing transactions (Dyer & Chu, 2002). Virtues and sense of duty direct transactions to fulfill social needs.

In the context of needs and obligations, where shared norms and anticipated attitudes are the regulators of social and economic relations, trust conceptualizes and makes cooperation profitable for mutual gains. Shared past and commonplace as in the case of Malaysia and Malay identity in particular is the starting point of every business related activity. This brings trust and enhancing social capital to concentrate on re-establishing collective approach that once moved Malaysia into the independence and brought rapid economic development. Hence values and obligations, social commitments and cooperation based on ascriptive trust underlie the collective (and individual) behaviour and place opportunistic actions aside (Lorenz, 1998). Thus social capital can be understood as a sum of network (community) capital and human capital, it is often more a synergy effect than simple calculation.

III. TRANSACTION COSTS AND MORAL OBLIGATIONS

Discussed and shared information, challenging opportunities and sense of duty towards a society pose for social capital in the forms networks a solid justification. By limiting external costs associated with possessing all the required knowledge as well as monitoring and enforcing the agreed conditions of running a project, networks transpose specific roles on other participants of such exchange. Such exchange and entrepreneurship perceived in the form of social action, where importance of group lays before and brings the concept of transaction costs into one already described by North (North, 1990): "costs of measuring the valuable attributes of what is being exchanged and the costs of protecting rights and policing and enforcing agreements."

Transactions costs can be defined in the various ways, however for the purpose of better understanding the importance of social capital and networks in Malaysia, I group them in two broad categories: ex-ante costs and ex-post costs. Determined by searching and negotiation costs ex-ante costs are the prerogative of networks. Establishing new contacts and expanding know-who group of allies set the initial phase of sharing ideals and seeking new opportunities (Dudek & Weiner, 1996). Through sociable reasons to grow, entrepreneurs seek for partners that might enhance their invitations to new or existing ventures.

Commencing such ventures start the negotiation phase, where both expectations and misunderstanding suggest the direction of future relations. The costs of negotiation phase base on mutual understanding of the project and acceptance of moral obligations towards other and in the case of Malaysia do not base on simple and fully rational calculations, but are rather the outcome of internal need to expose traditional social values through engaging broader community and improve their welfare.

Once the ex-ante costs are incurred and the entrepreneurs reach the consensus, where mutual obligations are shared and accepted, one has to focus on ex-post costs. Costs that include verification, implementation, enforcement and insurance costs are therefore the base to establish any successful partnership. While verification and certification costs are in theory associated with the regulatory framework and government acceptance through a specific agency, in the case of Malaysia these costs are mostly divided inside the network and its ability to level it to the right person with governance connection. In that sense group empowering force to bring into existence new projects is often the subject of know-who expansion, rather than to comply with the bureaucratic procedures. Associated with the venture costs covering the monitoring and enforcement are therefore to verify the administration and compliance to the agreed conditions.

IV. TRUST, TRANSACTION COSTS AND SOCIAL CAPITAL BUILDING

Open, informal and simple Malay networks bring the moral discourse to look upon each other as equals and reduce the need to maintain formal and institutional governance. Because of the sociable reasons and strong belief in moral and just society, any engagement is set among partners who seek for alliances and therefore expand their business opportunities. These networks based on trust and agreement to act responsibly towards one another with the ultimate goal of helping others. As ambiguous as it is, networks based on trust reduce transaction costs in a significant way and enhance entrepreneurial capacity.

Why trust in the networks imply the level of transaction costs and why building social capital based on trust lead to long-term egalitarian approach? It unifies marginal utility function and substitutes for rules. Where formal framework lower the chances for cooperation and where contracts are the subject of time consuming regulatory incentives, trust and mutual obligation as well as feeling of moral duty towards a society reduce the unnecessary transaction costs. In that context trust and all-encompassing networks may partially substitute the need for formal institutions (Arrow, 1974).

Following the suggested differentiation on ex-ante and ex-post costs, transaction costs can be analyzed through the existence of trust and trust in networks in particular. The accumulation of trust is therefore a continuous form of anticipation to act solidarity. For the ex-ante costs such solidary and the regular anticipation of altruistic approach of the counterparty structures incentives for collaboration and thus lower the need to accumulate information and reduces the need for ongoing negotiations. Due to the egalitarian approach as well as mutual consensus ex-ante costs are minimized to costs of enhancing the networks. It results with less interdependence and hence sets the collective goal as a priority. The replicable form of trust building over time attitude allows to flow privileged information and transpose costs to other fields (Dyer R. , 1997).

While the ex-ante costs may indicate whether the partnership (or venture) will be profitable (and socially desirable) it is the bounded rationality the holds off and rely only on trustworthiness of the counterparty (Rao, 2003). Low level of trust enhances opportunistic behaviour and thus increases the associated costs with monitoring and enforcing previously determined conditions. For the Malay networks, where openness and belief in success of collective is deep grounded, trust is often both the results and effect of such attitude. With high level of trust ex-post costs are reduced. Confidence in one another underlies the reputation and gives the privilege to act within informal structures of economic (and social) relations. However accumulation of trust does not contain any added value, any growth related activity cannot undermine its importance (Bodoh-Creed, 2014).

V. ANTICIPATION AND ECONOMIC OPPORTUNITIES

Entrepreneurship understood in the context of collective obligations towards other people is generally perceived as the demonstration of religious and therefore moral as well as social abilities to provide opportunities. While belief in the richness of Malaysian natural environment and visionary policies gave rise to utilitarian appraisal where every individual possesses enough resources to grow, it neglects passive acceptance of the current state. The confidence of the endless opportunities and anticipation to grow without providing any added value to the society provides however simple and ambivalent attitude of expanding the know who network and foregoing new relations instead of taking the risk to invent and innovate (Schumpeter, 1934). Why building social networks and striving to find niches, individuals empower their alliances and share information, they avoid the "production" part of any enterprise. In general networks may comfort its members and act against the altruistic openly

discussed claims. As in the case of Malaysia networks might become complex chains of inter-group arrangements and redefine their very existence. Existence of networks relies on expectations and anticipation. Considering networks as a mechanism for inter-group trust accumulation seems an expected result of their main purpose.

Thus trust depends on the quality of the interactions between members of the networks its quality can be measured by differentiating the purpose of the transaction – size and reward, risk, frequency and asset specificity. It is contradictory for the size and reward mark that relationships are often built with no prior knowledge of the counterparty. The reward is then the subject of a risk. A rational entrepreneur will calculate the long-term over short-term benefits and make a decision under the potential gain/loss analysis. In the networks however trust is often transmitted through established connections and shortens the respective decision. As for the Malaysia, complex interaction and social linkages may undermine the necessary rational calculation and overlap the learning process.

Involved risk, personalized socio-economic interactions and informal “trust-sensitive transactions” are the boundaries for the second dimension (Sloane, 1999). When risk is always present and any exchange of information can be the base for opportunism networks easily become a framework for trustworthy behaviour. Trust, anticipated and granted by the networks to its members, enhances credible commitments and reduces time devoted to various investment and assurance decisions (Yamagishi & Yamagishi, 1994). The ongoing understanding of socio-economic linkages, obligations and anticipated outcomes ground the individuals’ reputation and create social norms that often emerge as a result of imposed trustworthy behaviour. In this context “networks operate to improve outcomes” (Knack & Keefer, 1997), while trust as a continuous process binds them. Therefore frequency is the third dimension.

Through repetitive interactions and growing level of in-group trust, the quality of transaction arises and hence distributes new channels for economic opportunities. The entrepreneurial capacity is thus regarded as a positive outcome of constant trust building activities (and where in case of Malaysia social and economic relations are alternately. What is the subject of the interaction seems to matter less. The core of relationships is to enhance understanding of mutual needs. However the asset specificity requires networks to facilitate its resources and find relevant contacts. Encouraging is then a form of collective requirements towards engagement and active involvement. Trust as well as inhabited social norms enrolls for commitment and in-depth cooperation regardless particularistic interest.

CONCLUSIONS

Building social capital in a capitalist society with the rising aspirations favors trust building attitude and thus diminish any misfortune in claiming an inability to better economic welfare. Any deviation from the socially desired attitude focused on strengthening ties and fulfilling social obligations towards the community is perceived as neglecting its religious, family or inside group commitments.

Informal and all-econompassing group empowering informal institutions that arose in Malaysia are the result of the multilayered and comprehensive history of economic development. Granting independence and striving to reduce imbalances created a society primarily focused on enhancing collective and better their social and economic welfare. However with the social and economic heterogeneity and specific ethnopreneurial attitude it became quickly a mechanism to polarize self-realization motives with the social and moral obligations towards a society. While social capital and social norms are widely discussed and implied on the networks’ level, their effectiveness to ensure egalitarian and reachable opportunities may be discouraged by existing networks.

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