

Social Capital and Economic Growth

(Job Market Paper)

Nov 21st 2011

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Abstract

This paper presents a new framework to analyze the dynamic relationship between social capital and economic growth. This relationship has been analyzed in a quality-ladder growth model where only a few sectors experience technological shock every period leading to labor reallocation within the economy. Social capital (trust, norms, networks) increases as people socialize and decreases with labor migration as social capital is person and place specific. We characterize the equilibrium in which a higher level of social capital increases growth through higher investment but at the same time higher growth weakens social capital due to an increase in labor reallocation rate and less socialization. We show that in the absence of formal institutions, a higher rate of innovation (or adoption of newer technologies) lowers R&D investment as it weakens existing informal institutions. For a country to experience sustained higher growth rate, alternative formal institutions must be improved. A poor country lacking in resources or will to develop formal institutions will be caught up in poverty trap even if they transplant technologies of rich countries. The model, therefore, provides another explanation of why poor countries do not catch up.

JEL Classification:

Keywords: Social Capital, Trust, Economic Growth, Technological Growth, Institutions

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