

The Hidden Asset

How relationships
impact economic
outcomes

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Economic analysis generally assumes that individual decision-making is based purely on the motive of personal welfare maximization. It neglects relational issues which are foundational to inter-personal trust, collaboration and ultimately economic performance itself. The complexity of relational considerations has limited policy analysis in this area. This essay shows how preferred development outcomes require that individual freedoms are constrained by consideration for others. It recommends quantifying the degree to which people take others into consideration by the resources – the time and money gifts - that people voluntarily allocate to relational activities. This approach not only sheds light on how one might invest into relationships, it also bypasses many measurement complexities by targeting the flow to and from the relational stock rather than the stock itself. With a reliable measure of just how considerate (and therefore, how beneficial) relationships are, policy makers have a basis for target setting and policy adjustment.

1. Introduction

'Predator capitalists' and plans to 'curb the snouts-in-the-trough greed of corporate executives' were the words used by the Labour party in the lead-up to their 2012 conference (BBC, 2012); greed is commonly perceived to be a factor precipitating the 2008 financial crisis. On the other hand, every textbook on neo-classical economics teaches that individuals pursuing their own private interests in a free-functioning market gives us the best possible allocation of resources and is a driving force for efficiency, implying that the pursuit of private gain will result in social good. In cases where the theory does not apply, the problem is attributed to imperfect markets, not to the centrality of self-interest as a driving force.

This essay examines whether 'self' interest is an over-simplistic foundation for economic theory, and why paying more attention to the 'other-centred' interests that individuals might have is helpful. It suggests that relational drivers have a significant additional impact on human behaviour. Consideration for others as well as oneself also represents a more desirable basis than individualistic self-interest on which to found the development of society.

2. Revealing the Hidden Asset

2.1 The limitations of self-determination and external controls

The political right values self-determination – the energizing drive that freedom to pursue one's own interest brings. The free market provides a framework within which millions of individuals can choose to interact in ways which suit each one the best. The individual decisions act on prices to send just the right signals to match feasibility with desire, and thus each person is enabled to make the best of what they have, given what everyone else has. Such a market gives out what you put in with complete impartiality, and in this sense is phenomenally efficient and motivating. No other system has proven to be more efficient at wealth creation.

The political left point out that the distribution of that wealth under such systems becomes inexorably more unequal however. Not as an intentional and preconceived plan, but as the inevitable result of a system in which, in the course of maximizing their advantage, the powerful have the ability to accrue and the weak are at their mercy. Money is power, and without power, the weak are included in a system that crushes them (Du Toit, 2004; Sauper, 2005; Callinicos, 1983). Fig.1 shows just how polarized global wealth distribution has become. In 2007, the wealthiest 1% of individuals in the world had the same amount of income as poorest 56% (Ortiz and Cummins, 2011).

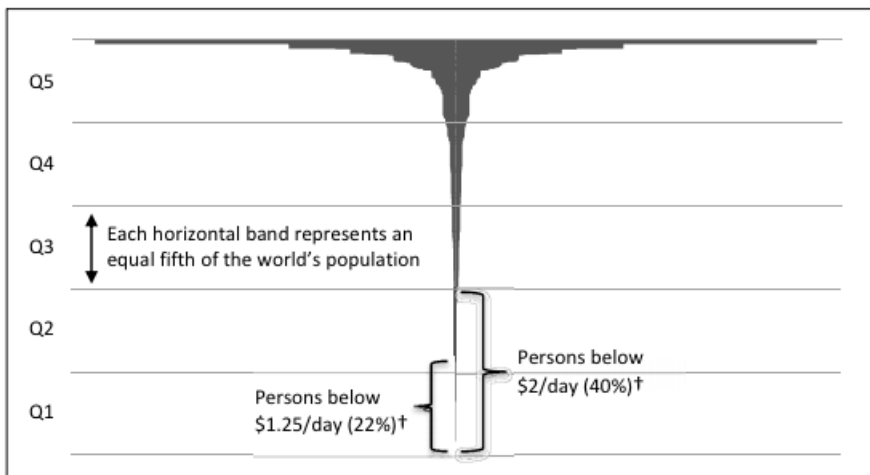


Fig.1: Global income distributed by percentiles of the population in 2007 (or latest available data) in PPP constant 2005 international dollars. Source: Ortiz and Cummins, 2011 using figures from the World Bank (2011), UNU-WIDER (2008) and Eurostat (2011)

So it is that the political left emphasises the need for a more controlled maximization of welfare for society as a whole, rather than leaving individuals to each maximize their own wealth. Their primary strategy is to change the rules of the game. At the extreme, Marx believed that changing the social environment changes the person. By redistribution and market intervention, an individualist prepared to gain at another's expense becomes a socialist willing to work for the good of the whole (Callinicos 1983). The social environment *does* shape our private decisions (Kolm and Ythier, 2006), but the experience of centrally planned economies proves that a change of institutions does not transform individuals from self-centred to other-centred. Rules encroach on personal liberties, inhibiting efficiency as people lose control over the product of their own efforts. And the coercive interplay between the powerful and the weak does not end; it simply expresses itself in alternative ways. Suppressing individual pursuits for the sake of the whole via institutional change ultimately tends to result in subversion of law and demotivation of the workforce.

Uphoff (1986) and North (1990) explain that effective institutional change arises from the formalization of generally accepted informal norms. The pressure of rules and sanctions *do* complement the efforts of a group generally willing to conform, but they fail to extract good outcomes from groups who for some reason resist their dictates. Cooperation *cannot* be achieved by force, even when the outcome appears better for everyone. Articles by Putterman (2006), by Rotemberg (2006) and by Fong *et al.* (2006) prove this in the workplace, and Adhikari and Goldey (2010) and Vajja and White (2008) show it through failed development programmes.

Change to the way people interact cannot be mechanically adjusted by a change of rules. It is a relational issue, and change requires that the individuals involved take on new attitudes and behaviour patterns. But where economic theory is based solely on the presupposition of individual self-interest, there is no recognition of these relational variables. Ignoring the economic impact of consideration for others or 'love for one's neighbour' in society is a grave miscalculation.

2.2 Recognizing the impact of consideration for others

Firstly, relational motivations exist; the maximization of private advantage is not the only criteria for decision making. A collection of papers compiled by Kolm and Ythier (2006) show from recent advances in behavioural economics that most people *do* also consider the relational aspects of their decisions. A mix of enlightened self-interest (knowing the benefits of reciprocal generosity), altruism (valuing others in their own right), and the constraints or expectations of what other people are going to do (reinforced by rules and sanctions) all work *together* to bring us to choose outcomes that are not based on the maximization of private interests alone (Kolm and Ythier, 2006; Gui and Sugden, 2010; Zischka, 2013; Ariely, 2008).

Secondly, the degree to which people take others into consideration has a crucial impact on resource distribution and welfare outcomes. Social capital literature, which examines the effect of relational considerations on economic development, shows that the relational networks specific to individuals and groups, and the norms of behaviour exercised through those connections essentially affect a community's ability to trust and therefore to collaborate. Collaboration is foundational to productivity and resilience; the capacity to adapt to change, overcome shocks and thrive (Coleman, 1988; Putnam, 1993, 2000; World Bank, 2000; Krishna, 2002; Grootaert and Van Bastelaer 2002). Positive relationships also have intrinsic value. They make people happier, and therefore healthier (Dew and Wilcox, 2013; cpwlab, n.d.; CNCS, 2007). Halpern (2005) pulls together dozens of papers illustrating that cooperative relationships are associated with happiness, peace and prosperity.

And thirdly, if policy makers ignore relational motivations and focus only on appealing to self-interest, the essential relational motivations can actually be squeezed out, with day to day decisions assuming an ever more individualistic character. An oft-quoted case-study illustrating the point is of six day-care centres in Haifa which imposed a fine on parents who picked up their children late. As soon as the fine was introduced, parents doubled the fraction of time they arrived late. Bowles (2008) suggests that the introduction of monetary incentives undermined the sense of ethical obligation towards the teachers. Although monetary incentives are motivating, they also led the parents to believe that lateness was a commodity which they could purchase. The damage this did to the sense of moral-obligation far outweighed the motivating force of the fine. After 12 weeks the fine was revoked, but the relational motivations had been permanently lost; parents continued to come twice as late as they did at first. Bowles (2008); Frey and Oberholzer-Gee (1997); Ariely (2008); Sacco *et al.* (2006) and Fehr and Schmidt (2006) give many other examples in which 'public spirit' brings individuals to sacrifice their short-term interests for the good of the whole, but appealing to monetary incentives or competitive frameworks of thought crowd these incentives out. Policies that treat human beings as selfish *make* them selfish! A recognition and understanding of relational motivations and their impact on the economy is required before decision makers will be able to get policy right.

2.3 Love: Important but controversial

It is clear that the individual and their freedom to pursue their own private objectives matters, but positive welfare outcomes require that individuals use those freedoms with consideration for impact their choices have on others. Sen (2009) attempts to formalize this concept into a 'capabilities framework'. He says that the universal right to pursue one's own objective involves also an

obligation not to infringe on other people's rights, and the obligation to defend those whose rights are being infringed. Inevitably when in competition for scarce resources, one person's objective is going to come into conflict with another person's objective. The criteria by which to decide between competing claims is not always obvious, but in order to exclude the least fair abuses, Sen recommends public scrutiny to check that the right claim is being upheld subject to the priorities generally agreed in that particular time and place.

Unfortunately, reason and broader based decision-making are insufficient to overcome the tension between fairness and self-interest. The fact is that the powerful (who make the rules) do better out of unfair systems than fair ones, and it is *irrational* for them to alter a stable system that favours their own interests above those of others (Kanbur, 2009; Acemoglu *et al.*, 2004; Zischka, 2013).¹ Thus Sen acknowledges the existence of undefined 'relational motivations' that make his framework practicable.

Christ and his followers condense these relational components to their essence in the maxim, 'love your neighbour as yourself' (Matthew 22:36-40; Romans 13:8-10). Love attributes intrinsic value to other persons. This is necessary to induce an individual to take action for the benefit of someone else even at risk of personal cost (norms governing reciprocation are not impregnable). The 'as yourself' clause emphasises equality of value and offers an appropriate balance to the relationship. All over the world, powerful people may be found who are pro-redistribution, contrary to the interests of personal income maximization (Fong *et al.*, 2006; Blanchet, 2006; Durlauf and Fafchamps, 2004; DeWeerd and Fafchamps, 2011). The cpwlab (n.d.); Dew and Wilcox (2013); and Becchetti *et al.* (2013) all illustrate how other-centred motivations are central to healthy relationships and thereby improve wellbeing. Zischka (2013; 2014) also shows that social cohesion requires consideration for others that runs deeper than institutional pressures or the promise of reciprocal favours. Rottemberg (2006) points to forgiveness as the purest indicator of altruism (love). Where offence is acknowledged and compensation is inadequate, forgiveness is the only way to halt a withdrawal of cooperation or a tit-for-tat cycle of retaliation. Collard (1978) concludes that although there are plenty of incentives for selfish people to simulate altruism in order to maintain a preferred social environment, there has to be a dash of the real thing for that environment to be created in the first place.

Distinguishing where altruism ends and where expedience begins is an ambiguous undertaking. Because of this, there remains some controversy in the literature about the existence of altruism (pure love) at all (e.g. Bergstrom, 2002). Be this essentially atheistic viewpoint what it may, there is consensus that people do, for one reason or another, factor in the interests of other people in their own decision making. It is also clear that the extent to which people exercise this consideration is a key determinant of trust, collaboration and, eventually, the development outcome.

Social capital literature attempted to aggregate these mixed relational factors into a single term, but became embroiled in controversy over how to define, measure and influence relationships. (Bebbington *et al.* 2004; Portes and Landolt, 2000; Quibria, 2003). Sen's capability framework also

¹ Opportunism is not just someone else's problem. Despite our finely honed sense of what is a fair deal (highly developed even in small children!), how many of us pass up a little extra for ourselves simply because we know the rest are not getting the same opportunity? And it is an imperceptibly small step from there to accepting a little extra even if others have a little less because of it.

fails to help policy makers, since ‘avoiding the infringement of freedoms’ is an elusive policy objective. As soon as authors like Nussbaum try to establish some rights to defend, the richness of the perspective is lost to reductionist guidelines (Sen, 2005).

2.4 A new approach to including relational factors in policy

Zischka (2013; 2014) proposes that because relational considerations affect resource allocations, then it should be possible to trace the extent to which one party takes another into consideration by the nature of the resource flows between them. The more time and money that individuals volunteer (give) to meet the needs and interests of persons other than themselves, the better are relationships and the more desirable the outcome for communities. How wide these benefits are felt depends on who is included in the resource flows. Wider levels of social cohesion is seen in giving that crosses social boundaries. This approach not only sheds light on how one might invest into relationships, it also bypasses many measurement complexities by targeting the flow to and from the relational stock rather than the stock itself; time and money gifts are easier to quantify than trying to analyse all the complex motivations, social pressures and networks that bring people to collaborate (or not).

Since giving is a proxy for private levels of consideration for others, then its implications are far greater than the giving flows themselves. Yamamura (2012a; 2012b) and Fong *et al.*, (2006) show that those with pro-social attitudes living in a pro-social environment not only give more, they are also more likely to support redistributive institutions. Thus private giving, tends to predict the evolution of state redistribution, the emergence of charities, and also the final distribution of resources in the formal economy (Kolm and Ythier, 2006). This is important, because it is at the institutional level that the greatest non-family transfers take place.

Zischka (2014) provides empirical evidence that giving (or rather, the relational influences manifest in giving) makes an important difference to development outcomes. At least in OECD countries, giving has an impact comparable in scale and statistical significance to big social issues like unemployment, education, low income, ill-health and ethnic groupings! In England and Wales multi-dimensional giving is associated with a household income differential of £5,000-£10,000/year; differences in generalised trust levels of 20%; differences in crime and deprivation levels of 10-20%; as well as tangible shifts in personal wellbeing.

So then, giving is both an expression of and an investment into the relational stock. With a reliable measure of just how considerate (and therefore, how beneficial) relationships are, it becomes possible for governments and decision makers to look out for them, to set targets that include them, and to produce credible know-how about what helps and what hinders them.

3. Policy implications

Behavioural economics provides convincing evidence that, to a greater or lesser extent, a person’s decisions factor in both the consequences to self *and* the consequences to other people. Although consideration for others arises from mixed motives, its presence impacts decision making and subsequently resource allocations (Kolm and Ythier, 2006; Gui and Sugden 2010; Ariely, 2008). By

tracing the pattern of resource allocations, particularly giving across social boundaries, we can therefore obtain information about the relationships behind them – whether they are individualistic or considerate. Considerate behaviour evokes trust, whilst an opportunistic approach quickly destroys it (Kolm and Ythier, 2006; Dasgupta, 2009; Adhikari and Goldey, 2010). Without trust, collaboration suffers and the economy cannot function efficiently (Krishna and Uphoff, 2004; Della Giusta, 2008). Since a resilient, cohesive society requires that individualistic pursuits are kept in balance with consideration for the effect those pursuits have on others, relational issues deserve a higher profile in economic theory.

Thaler and Sunstein (2008) and Ariely (2008) show that in order to process information quickly, humans tend to be guided by rough frameworks of understanding rather than thinking each decision through rationally. This being the case, then ‘focussing minds’ on relational issues makes it more likely that people will factor these things into their decision making process – just as an individualistic worldview has been proven to give our decisions a more individualistic character. A good place to start with ‘focussing minds’ would be to get the indicators of welfare right. Unless the correct contributors to welfare are measured, they will not get the attention they deserve in development efforts (Waring, 1989). For this reason giving indicators are useful. They shift the focus of attention from extraction out of society to investment into it; an emphasis that healthy relationships require (cpwlab, n.d.). Evidence would suggest that multi-dimensional giving flows (time and money invested into relational activities and across social boundaries) are a reliable measure of relational health/social cohesion. The measure provides a basis by which decision makers may monitor the impact of their policies on relationships, set targets that include them and create conditions that unambiguously support them.

Wilkinson and Pickett (2009) document enormous welfare benefits to be had from a more equal distribution of resources. The perspective of this essay suggests that these benefits cannot be obtained by an obligatory redistribution of assets, a move which incurs all the negative social consequences accompanying the use of force. Rather, it proposes that support for redistributive institutions and subsequent improvements in equality are driven by individual levels of consideration for others. The policy emphasis should rather be to measure, value and promote an understanding of the value of relationships, and to work on the institutions, networks and common interests which inspire people to take others into consideration.

Freedom of the individual matters to the economy. So do checks and balances to constrain those freedoms for the good of the whole. But consideration for others is a more hidden asset to society that has not received the recognition it deserves. Its time economists started to account for how these more relational motivations impact development outcomes.

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