Chapter 2

Social Capital:
A Key Ingredient for Clusters in Post-Communist Societies

by Dina Ionescu

This chapter explores the role of social capital in shaping inter-firms relations within local clusters and identifies whether a lack of social capital can be considered an impediment to cluster formation and development in post-communist countries.

It is important to note that despite offering a definition, this chapter does not provide one model of social capital, nor define one type of impact on cluster performance. Social capital is one element among many other determinants and studying the link between social capital and cluster performance does not mean asserting that social capital is a positive value *per se* for clusters.

However, attention is focused on some major features that characterise social capital and that positively impact on business clusters development: a sound base of trust among economic and institutional actors, together with valued and acknowledged co-operation.

The chapter is structured as follows: First, parallel definitions of social capital and clusters are provided; second, the links between the two concepts are analysed (in particular the impact of social capital on cluster building and performance); third, specific issues to post-communist countries are raised; and lastly, a policy debate is initiated.

Subject to contradictory definitions, problems of measurement and efforts to analyse its relation to economic growth, the concept of social capital runs the risk of being rejected because of its conceptual limitations.

This chapter aims to offer to offer a better understanding of the social capital concept in its relation to business clusters, through better defining and analysing the concept of social capital and its potential translation into policies. To do so, the following questions are addressed:

- Why is the concept of social capital relevant to the study of business clusters?
- Do business clusters with high levels or specific types of social capital perform better? Can social capital contribute to cluster construction?

- What are the specific challenges in relation to social capital in post-communist countries?

- Is it possible to translate the social capital concept into explicit recommendations for cluster policies?

The relevance of social capital to cluster building

How can social capital be defined?

The OECD has defined social capital in the publication *The Well Being of Nations* (OECD, 2001) as "networks together with shared norms, values and understandings that facilitate co-operation within and among groups." The main interest in studying social capital from the economic and social point of view is that social relations among individuals can represent a positive resource for the economy and society.

This definition calls for two clarifications in the context of this publication: first that we apply this definition to a very particular group, the "business cluster" which comprises a whole range of specific stakeholders (entrepreneurs, enterprises, intermediaries, local authorities, suppliers, distributors etc.) and second that the notion of "trust" is indirectly conveyed by this definition. Trust expresses reciprocity and confidence, both among enterprises and institutions. In particular, in the case of clusters, individual trust in other entrepreneurs and appreciation of the way they "do business" directly impacts on the decision to engage in collaboration.

According to Putman (2000), "the central idea of social capital is that networks and associated norms of reciprocity have value." One question that immediately arises from this definition is what kind of value does social capital give rise to? Diverse research projects have tried to provide answers in the social and economic fields. The World Bank defines social capital as "institutions, relationships, networks and norms that shape the quality and the quantity of a society's interactions", and places the focus on the social dimension. This means that social capital can contribute to fighting poverty and to increasing well-being, thus having an economic impact beyond social objectives.

There is an important step to take from studying social capital from a sociological and societal perspective to reaching the economic and firm level. Research has been undertaken to understand the impact of social capital on economic growth and whether the 'value' Putman speaks of can be translated into increased competitiveness and growth. Many of these studies are undertaken at the economy-wide level, but we aim to look at the particular role of social capital at the micro level, namely its impact on the performance of firms in local clusters. Social capital is then viewed as more than the sum of different social interactions, but as a source of competitiveness.

Why is the social capital concept relevant to the study of clusters?

Business clusters are based on specific interactions among firms and other organisations, involving a mixture of co-ordination, co-operation and competition and extensive use of market exchanges. If it seems so interesting to look into detail at how social capital can influence business cluster formation and development, it is because of this intriguing nature of clusters, which mix both competition and collaboration ties.

There is a temptation to assert that social capital is inherently part of cluster formation given that enterprises in clusters often develop co-operative relations. However, this would lead to a dilution of the concept of social capital, because social capital is more than social interactions, and to a misunderstanding of the cluster concept, because clusters can exist mainly based on competition. Moreover, co-operative behaviours are not necessarily driven by social interactions and personal knowledge but can be the result of market processes. It is often difficult to identify the limit between co-operative behaviours and social capital, as enterprises and clusters can be embedded in a social, cultural and local fabric. The question that needs to be raised is therefore whether social capital is an advantageous or even necessary ingredient for business clusters.

Recent policy interest in clusters is driven by research and theory suggesting that firms can achieve increased efficiency and competitive advantage through cluster formation, which can translate into economic advantage for the localities and regions concerned. Specific interest in the role of social capital in clusters is also motivated by the argument that social capital can favour the competitiveness of enterprises. For example, the OECD publication *The Well-Being of Nations* asserts that “firms can benefit from norms of co-operation and trust embodied in various types of intra-firm and inter-firm networks”. How can social capital concretely contribute in a positive way to a business cluster’s results?

Social capital can directly impact on cluster performance in two key ways: (i) supporting innovation and (ii) lowering transaction costs, potentially increasing efficiency and growth.

- **Innovation** in clusters is often based on collaboration, proximity and networks, involving processes of mutual learning, emulation and personal contacts, which in many ways are dependent on the presence of social capital.

- Firms in clusters also benefit from **lower transaction costs** due in some cases to personalised negotiations, fewer bureaucratic procedures, lower information costs stemming from local and personal information flows, better co-ordination because of direct contacts, social exchange and often trust-based relations among economic agents. Again the ability to access lower transaction costs would seem to be closely related to the presence of social capital in a cluster.

But does this mean that social capital is a necessary ingredient for cluster building?

Variety of cluster types: diversity of social capital types

It is important to underline that studying the link between social capital and cluster performance does not mean asserting that social capital is a positive value per se for clusters. There is a multitude of factors influencing cluster performance and examples of successful clusters with limited social exchanges also call for caution so as not to overemphasise the role of social capital in cluster formation.

Enright (2000) proposes a cluster classification that is extremely useful for understanding that the presence of social capital can strongly differ from cluster to cluster:

1. Working clusters (well-developed and industrial districts);
2. Latent clusters (with a high number of firms but a low level of interaction due to the lack of trust, low co-operation and high transaction costs);
3. Potential clusters;
4. Policy-driven clusters; and
5. Wishful thinking clusters (uncompleted as often policy has failed).

In his typology, the ‘latent clusters’ with a high level of concentration of firms fail to become ‘working clusters’ because of a low level of interactions due to a lack of trust among other factors. This analysis has implications for cluster policies and the attention that should be devoted to social capital issues, because increasing the level of trust and co-operation among actors might transform latent clusters into working ones. This typology and that of Markusen (1996) referred to in Chapter 1, also underline the fact that there are different types of clusters and different stages of cluster development. It is likely that each will require different policies and that role of social capital will vary between them.

Social capital as one variable among others

Linking social capital and clusters should not lead us to excessively value the role of social capital in cluster expansion. In fact there are contradictory conclusions about the origin of external economies in clusters. According to Rosenfeld (2002), "some external economies are driven purely by the size of the market created by the scale of business and job opportunities and not by trust based relationships or organisational membership commonly termed social capital". For other authors, such as Storper (1997), trust and conventions are critical.

Clearly in some contexts social capital can generate important external economies for firms, associated with personal relations, communications and shared knowledge among cluster participants, and Rosenfeld also notes that in clusters with strong social capital, knowledge and innovation are transferred more readily.

Nonetheless, in comparing Silicon Valley and Route 128, Putnam (2000) notes that two different types of clusters, one with horizontal and university-based links among entrepreneurs and a second with more traditional hierarchical and professional relations, involve two very different different types of social interactions. Moreover, performance seemed to be independent of the nature of social interrelations among entrepreneurs.

These observations illustrate the complexity of the issue and call for deeper analysis at local level. **There is not one model of social capital and not one type of impact on cluster performance.**

Social capital and clusters: a local story?

The OECD LEED programme has been interested in the local dimension of social capital and how it influences cluster development for some years and an important milestone in LEED's work in this field was the international conference organised by LEED in Mexico in 1999, entitled *"Local Economic Development: Social capital and Productive Networks"*. One of the critical concepts underlined in that conference is that social capital can be treated as a "resource" that is less tangible than physical capital but is nevertheless productive because it facilitates the completion of certain objectives, in particular relating to the ability of individuals to undertake entrepreneurial activities and become involved in inter-firm relations at local level.

Two of the conference speakers, Steven Cohen and Gary Fields, backed up this argument with a valuable account of social capital in Silicon Valley, arguing that social capital is a multi-faceted concept subject to interpretations…but key to cluster development. These commentators argued that the success of Silicon Valley was based on a specific mixture of co-operation and competition, cultural attitudes (employees moving from one firm to another, openness to foreign talents), strong connections with high-level research universities, engaged national authorities supporting high tech solutions, active legal practices and venture capital corporations. All these elements together have created a "local culture" and an original type of social capital. This local identity and way of functioning is very different from how social capital is described in other places, serving to highlight the local nature of social capital.

Thus social capital should be seen as a "local resource" that can differ in content from one location to another. It therefore represents a specific mixture of social, personal, institutional and professional interactions. This raises the question of whether social capital can be created in places where the local conditions are not favourable and as a consequence whether policy can or should build social capital at local level. In order to respond to these policy questions it is first useful to look at the other side of the coin, to the potential negative impacts of social capital on clusters.

Negative impacts of social capital on clusters

Analysing the degree of social capital at cluster level can lead to paradoxical results. On the one hand, it can explain particular local features that are instrumental to cluster formation and competitiveness. On the other hand, it can show up limits of the cluster approach to economic development.

For example, in some cases strong social capital could make it difficult for people lacking the right connections to become integrated in the cluster labour market. This can translate into exclusion of outsiders, limited mobility, poor socio-economic advancement and lack of adaptability to change in clusters. Thus Rosenfeld (2002) notes that cluster development in a given area can transform a neighbourhood, raise the price of property, lead to protecting the local community from outsiders, exclude people who don't have the 'right' connections and impact especially on low or middle income people. As Portes and Landolt (Portes and Landolt, 1996) put it: "The downside of social capital is that the same strong ties which are needed for people to act together can also exclude non-members such as the poor."

In other cases strong ties may lock firms into particular technologies and markets and lead to stagnation. Thus research in OECD countries has shown (Cooke, 2003; Traxler and Psilos, 2004) that successful clusters, are often those open to external markets and competitors and not limited to a very tight local scope. This might imply that policies should seek to favour measures that open clusters and help them connect with the outside world, rather than support measures that strengthen the local culture and internal social exchanges. However it is difficult to reach such a conclusion since it is likely that both local ties and external ties are important to cluster success.

What is important to retain is that the concept of social capital alone cannot explain the success or failure of clusters. It is only in the light of interaction with many other influential factors that it can be valuable.

How is it possible to single out the role of social capital independently from other factors and thus evaluate its impact on business clusters? Trying to measure and define reliable indicators of social capital is a first challenge.

Measuring social capital

Three key difficulties arise when attempting to measure the contribution of social capital to cluster development. First, a lack of data and problems of definition are major impediments to grasping the significance of social capital in clusters. Second, problems appear when defining and limiting the boundaries of clusters since clusters are often entities in flux and difficult to delimit. Third, measuring the impact that social capital has on the performance of firms and of clusters as a whole is a complex exercise which has to take into account many other factors that impact on cluster performance. All these issues make the subject of 'social capital and clusters' complex and quite difficult to approach.

A conference organised by the OECD in 2002 in London on *"Social Capital: The Challenge of International Measurement"* raised many significant questions on the comparability of existing data on social capital across countries and fields of investigation (e.g crime prevention, education, local development), making a very useful update on where different countries stand regarding measurement of social capital. It appeared that for instance, the national statistical authority of Finland had already developed a database on social capital, the New Zealand Statistical Office had an agreed framework of measurement and that the UK Office for National Statistics was leading a harmonisation programme. Other countries were undertaking specific surveys measuring social capital among other variables or were executing small scale studies. There was a clear interest in the subject and participants agreed on some key aspects that need to be included in social capital measures, including community participation, informal networks, trust and political participation.

Many issues are left open, such as the most appropriate unit of analysis (social capital can be measured at different levels such as local neighbourhoods, families, schools, or the work place), the impact of measurement on policy and the international harmonisation of notions such as 'volunteering' that have diverse connotations. However, efforts are being made to measure social capital, usually mixing quantitative and qualitative data. The World Bank Social Capital Initiative for example is currently funding projects that will help define and measure social capital, its evolution and its impact, where: "The proposed analytical methods cover a wide range of qualitative and quantitative approaches. These include quantitative methods in formal research designs with use of control groups, econometric analyses calling on instrumental variables and principal component approaches, as well as case studies, qualitative and inductive methods."

The sources of social capital are multiple, as shown for example in (OECD, 2001), which cites the influences of family, school, local community, firms, civil society, public sector institutions, gender and ethnicity. Many of these sources of social capital are also central elements in cluster formation and development: for example firms, family links, education, community, women's networks, ethnically related groups, public, private and non-governmental institutions. It is important to develop reliable indicators related to the factors that could express the level of social capital in clusters. Some potential indicators might include membership of associations, use of informal networks in business transactions, participation in advisory or mentoring programmes, use of communication tools (news letters, phone lists, web-based discussion boards), belonging to a school or university network, voluntary activities, degree of trust in institutions, willingness to work and collaborate with other companies and the feeling of belonging to a specific entity. Further research is needed to make the link between the presence of these factors in clusters and cluster performance.

Understanding criticisms of the social capital concept

In the following paragraphs, we briefly address the main points of criticism raised against the concept of social capital. It is important to address these criticisms in order to progress and refine the concept and its measurement.

- **"If you can't measure it, it isn't reliable"**: A major criticism of social capital comes from the difficulty of measuring such a concept and especially measuring its impact on economic performance. It portrays reality in motion, surveys are often based on questionnaires trying to capture beliefs and behaviours and indicators measuring social interaction or civic attitudes might not be conclusive in explaining economic interactions. OECD work on measuring social capital clearly shows the challenge for the development of harmonised indicators. However, problems of measurement should not be an impediment to social capital research. On the contrary they should motivate it.

- **“Social: Yes. Capital: No.”**: The notion of social capital suffers from the extended use of the term “capital” as an analogy to other types of capital (physical and human). The success of the concept has been associated with a double use: both in a purposefully economic sense and metaphorically. The “capital” nature of social capital is increasingly documented through economic analysis dealing with its accumulative nature and its key role in lowering transactions costs. Meanwhile, the term is also used metaphorically, aimed at underlining the critical significance of social interactions. This leads to the popularisation of the concept together with a certain dilution of the original economic perspective.

- **“Limited impact on economic performance”**: Because of the large number of factors that impact on SME performance or play a role in cluster development it is indeed difficult to single out and isolate social capital. However, this does not mean that social capital has a limited impact on economic performance.

- **“Conceptual inflation: Social capital is THE missing link”**: Again, it is the success of the concept that has brought this criticism. Social capital is now an integral part of the study of migration, criminality, education, gender, micro credit and poverty, to name just a few. But the use of the concept tends to take on slightly different meanings in each case and cannot be measured along the same indicators, thus resulting in an understandable confusion.

- **“Fuzzy and chaotic concept”:** Despite its success, the concept of social capital is still in its early stages. Over the last ten years, a number of studies using social capital to explain economic performance and regional development have led to an increasingly refined concept. Authors such as Putman built upon their early definitions. More consideration is given to the interaction of social capital with other factors, such as foreign direct investment or exports. Studies looked at the regional versus global nature of social capital, raising the issue of embeddedness of SMEs in the local environment versus autonomy and external links. The vocabulary expressing the concept has greatly evolved and is symbolic of the search for a nuanced understanding. Variations are numerous: ‘Pecuniary social capital’ (Cooke and Clifton, 2002), “bridging and bonding social capital” (Putman, 2000), “old boys social capital”(Raiser 1999) etc.

- **“Circular thinking”:** Criticism has been raised concerning the difficulty of differentiating between the causes and effects of social capital. Thus Portes and Landolt (1996) point out that studies tend to amalgamate social capital and the benefits derived from it, whilst Ponthieux (2003) denounces the circularity of the concept, with social capital being an input and an output. The ambiguity of the "egg and chicken" story of social capital shows the complexity but also the richness of the concept.

- **"An interdisciplinary challenge"**: The interdisciplinary nature of social capital nourishes its originality and intricacy. A sociological concept at first, it is now often used in economics, entailing conflicting definitions and measurements. As Landabaso (2003) reminds us, "The contributions (on social capital) often come from regional development specialists that have a soft spot for a multidisciplinary approach to understanding economic development, in the best political economy tradition, which incorporates geography, sociology, institutions, culture and politics into it. One of the good things about them is that they do not excuse themselves for doing so."

- **"A collective or individual notion?":** By its 'social' nature, social capital tends to be considered as a collective phenomenon. It is expressed at the regional or national level, which leads indeed to generalisations. However, it seems imperative to remind ourselves that social capital is about social interactions and collective behaviours, but it expresses individual beliefs and attitudes.

Can social capital contribute to cluster construction?

Social capital and economic performance

Social capital has been identified as an integral component of social and economic development at both macro and micro levels. At macro level, Putman (1993), Helliwell (1996) and Fukuyama (1995) have found that regional measures of social capital correlate positively with various indices of economic performance. These studies seem to show that greater social capital translates into improved economic performance, although these conclusions have nevertheless been contradicted by research done in the Denmark, Ireland and Wales, which shows the complexity of the social capital notion applied to regional performance, and will be discussed further below (Cooke and Clifton, 2002).

At micro level, Paldam and Svendsen (2000) argue that social capital can be important for production in three ways: i) as a factor of production in parallel with physical and human capital; ii) as a determinant of transaction costs; and, iii) as a determinant of monitoring costs. According to this economic rationale, entrepreneurs would make the rational choice to maximise their personal profit by deciding to interact and invest in social relations.

Social capital, SME performance and clusters

The results of extensive research conducted in Denmark, Ireland and Wales led by Philip Cooke and Nick Clifton (Cooke and Clifton, 2002) showed that social capital is consistent with high performance, innovation and knowledge intensity. The research looked at government programmes promoting collaboration among SMEs with the objective of improving the capacity to innovate through increasing social capital by supporting networking among SMEs. According to Cooke and Clifton, "social capital in the world of the real economy is a kind of entry ticket to doing business."

Nevertheless, it does not appear to be a necessary condition. The results showed that the most competitive regions are indeed the most pronounced users of social capital. Firms with greater innovation capacity tended to show higher trust in collaborators, to exchange information outside the normal commercial links, to rate external information higher, to develop strategic contacts and to consider co-operation as more beneficial than other SMEs. However, from a cluster perspective it appears that these highly innovative SMEs are global rather than local in the social and professional contacts they develop. Hence, innovative SMEs are high users of social capital but not necessarily at the local level.

Further evidence on the effects of social capital on SME performance is provided by Cooke (2003) researching twelve UK regions. The author led a large scale survey putting together social capital indicators (mutual trust, exchanging favours, judging reliability, credibility and reputation) with performance indicators (profitability, turnover, innovation and employment growth). The significance of this study is to outline that social capital seems to be an important factor in innovation and improved performance. But this seems to be especially true when a business is less locally focused and more internationally oriented. Social capital also seems to be highly valued in less well performing areas of the economy, but is **not a sufficient** variable to lead to improved economic performance.

Overall, social capital seems to be a significant factor for SME and cluster performance because it produces untraded benefits. Thus formal and/or informal partnerships, networks and cluster-based initiatives that promote mutual trust, credibility, reputation and the exchange of personal favours can contribute to SME profitability, turnover and innovation. However, this social capital is not necessarily always local and is not necessarily sufficient to drive strong cluster performance.

Social objectives and economic performance

Until now we have considered cluster performance as an objective and social capital as a possible tool to achieve it. However, we can also take a different perspective considering clusters as privileged places to create social capital, with social capital building becoming the objective and not the means.

In the publication *"The Well Being of Nations"*, the OECD (2001) recognised that social capital contributes to realising human potential and social cohesion and to fighting poverty. Stating the importance of social capital as a component of clusters raises the question of whether cluster policies should broaden their scope and put forward the objectives of social cohesion and equity in addition to entrepreneurial innovation and performance.

The literature on social capital usually deals with civic engagement, community building, corporate social responsibility, housing schemes, neighbourhood regeneration programmes, partnerships, safety and health projects or education and non-governmental activities. Studying social capital in clusters therefore opens up the debate beyond clusters as motors for economic growth and innovation, to clusters as places for civic engagement and community building. It raises questions about the possible scope and role of clusters beyond the economic rationality of entrepreneurs. This is particularly interesting for post-communist countries that have undertaken a major economic and political transformation, where the civil society has recently been rebuilt or is still "under construction". However, it is important to decide whether the cluster policy is part of a business or social agenda, or both, and to avoid overburdening the cluster approach with social goals that might be difficult to achieve.

The challenges of social capital in post-communist countries

Why does social capital matter in post-communist countries?

The discussions at the conferences and seminars that led to this publication all put forward the idea that trust, collaboration and social-civic exchange can be keys for cluster development. Furthermore, case studies from Ukraine, Lithuania, Latvia and Estonia pointed to the lack of a "culture of collaboration" as an important barrier to cluster formation. More recently, the LEED programme has extended its work on enterprise clusters to Romania and Croatia with seminars in 2004 in Timisoara, Romania, and Hrvatska Kostajnica, Croatia. Both countries feature particular challenges, due in the case of the first to the tough authoritarian regime that deeply destroyed social and civic bonds, and for the second to the impact of the civil war in the early 1990s. These seminars raised again the issues of lack of trust and collaboration as major barriers to cluster development. Thus despite the great economic and political advances that have been made in Central and Eastern Europe, it seems that the former centralised regimes, in spite of some being more open than others, left a common legacy: a lack of trust and a fear to collaborate in business.

On the other hand, however, there also appear to be very close family or private ties in the countries examined. The **paradox is that these two opposed tendencies can both be considered as social capital**. This dual phenomenon, which appears to be widespread in transition economies requires deeper analysis and understanding.

Socialist and communist regimes have contributed to the destruction, or at least the inhibition of key elements of a culture of entrepreneurship with consequences for SMEs and cluster development today. A centralised economy, an all but exclusive public sector (even if some countries such as Hungary and the Czech Republic experimented with loosening the reins of central control), an unenthusiastic working class ("they pretend to pay us, we pretend to work"), soft budget constraints and economic and political power concentrated in the hands of a powerful nomenklatura have left their mark.

Two phenomena developed as a response to a system of total state control. At the politico-economic level, privileged informal relations were built to navigate the command economy and to procure political and economic favours. Outside of the party structure, closely-knit relations among an inner circle of friends and family were developed as an antidote to state intrusion. In addition, a host of social interactions were devoted to the fulfilment of every day needs, as almost everything had to be negotiated and bartered in intricate ways.

After the downfall of communism, there was an unravelling of the forced culture of co-operation and reciprocity, as the market economy was now delivering all kinds of goods and services without lengthy transactions. What remained from socialist times however was a lack of trust in institutions, politicians and laws, as well as some extremely opportunistic behaviour often needed in a shortage economies. With regard to political networks, the preferential relationships developed during socialist times often remained to secure a head start over newly emerging entrepreneurs.

This has often translated into great isolation of newly emerging private firms and entrepreneurs who find themselves isolated from other firms and entrepreneurs, as well as isolated from the public sphere and the academic world. The volatile environment during transition, with changing rules and insufficient legal framework have further fed mistrust. Entrepreneurs became suspicious that the public sector was not supporting them, firms were afraid to have their ideas and capital stolen, while the population reacted negatively towards these new profit-making entities.

Trust in transition economies has been studied empirically at the European Bank for Reconstruction and Development (EBRD) by Martin Raiser together with a group of researchers (Raiser et al, 2001) based on data from the World Values Survey 1990-1995 and compared with the EBRD's Business Environment Survey. The study showed **significant lower degrees of trust** and civic participation in post-communist countries, although trust in public institutions was positively correlated with growth.

The seminars and case studies of five countries presented in this publication did not explicitly prompt discussion and analysis of social capital. However, in all of the countries there is evidence that points to the significance of the "cultural" and "social" setting as one of the many factors that influence cluster development. The importance of social capital is evoked in situations ranging from firms being unable even to envisage possible co-operation to companies fearing collaboration because of expected breaches of trust or in other cases, firms being more likely to co-operate due to historical links, individual leadership or entrepreneurs simply knowing each other. Overall, a general conclusion can be depicted; co-operation might be valued in post-communist countries but seems difficult to achieve as a strategy.

Reconstructing and deconstructing social capital: The paradox of post-communist countries

Countries involved in conversion at political, economic and social levels face a paradox. They need, on the one hand, to rebuild social capital at the level of associations, networks and foundations rekindle trust among individuals and in public institutions. On the other hand, they need to control certain existing forms of harmful social capital described above, such as informal political and economic 'old boys' networks sometimes with links to organised crime and over-reliance on personal connections and family ties. This **dual social capital challenge** is relevant to all transition economies, to different degrees.

Mateju (2002) writes that indeed two types of social capital are present in transition economies: One type of social capital drawing from general trust and a second one stemming from informal networks and exchanges among people. Corruption and opportunistic behaviour directly feed into the second type of social capital. If the first type of social capital is rather weak in transition countries, the second one, on the contrary, is strong.

This dual vision corresponds to the sociological approach to social capital that distinguishes between social capital as a 'collective attribute' (trust in institutions, media, reciprocity) and an 'individual attribution' (one person linked with a ring of acquaintances, family and friends). It also matches Putman's dual vision of social capital as 'bridging' (across groups) versus 'bonding' (within groups, affective dimension).

A parallel can also be drawn to the political science debate on private and public spheres: The first type of social capital is public (the individual within society, relations with institutions and public organisations) and the second one is private (among people you know). Communist regimes intended to control the private sphere. However, the economic deficiencies of the system gave rise to informal networks for exchange goods and services as an alternative to state structures.

The two types of social capital can have contradictory effects, the first contributing to a well-functioning market economy, the second impeding market mechanisms via parallel networks and black market exchanges. Both types of social capital need further research and documentation.

However, a caricaturised presentation of two opposed types of social capital might lead to an oversimplification of the debate. Informal social capital that occurs within the family circle could be transformed into a source of extended social trust if the general economic and institutional environment evolves. In a recent study on the formation of social capital in Eastern Europe having recently joined the Europea Union, Fidrmuc and Gërxhani (2004) found that the gap in social capital can be largely attributed to economic and institutional difficulties. This suggests that improving the economic and institutional contexts is likely to have positive impacts on trust and social capital. The authors also found a clear link between human and social capital, suggesting that increasing human capital may also have positive impacts on social capital.

Overall, social capital building is a very slow process and while it appears that policies may be able to encourage and accelerate this process in transition economies it is crucial to research further how public authorities can engage productively while leaving enough space for self-enforcement.

Recommendations for social capital and cluster policies

The final part of this chapter discusses how to translate the positive potential of social capital into cluster policies. To do so, three questions are successively raised:

- Can social capital be created?
- What are the means and tools available to policy makers to build social capital?
- If social capital can be built, what kind of business clusters strategies should policy makers embark on?

A set of proposed policies for social capital building as part of cluster development strategies in Central and Eastern Europe are then put forward.

Can social capital be created?

Research shows that social capital, like clusters, is difficult to 'construct' and top-down policies aiming at building clusters from scratch are often unsuccessful. Rather, public intervention should play a catalyst role, supporting existing or emerging clusters. Like clusters, social capital stems from a particular historic, cultural and social context. Thus Putman (1993) focuses on a non-hierarchical social organisation, Fukuyama (1995) on decentralised governments and Evans (1996) on competent public administration as explanations of strong levels of social capital in some regions and localities. Clusters and social capital are both deeply rooted in a local culture where overlapping social and business ties create a complex social fabric.

Nevertheless, other empirical studies have shown that public support to social capital through promotion of business networks can have a positive impact on cluster building and on the performance of firms (Cooke and Clifton, 2002). Wales, for instance, sought to create supplier clubs and business networks to compensate for a lack of spontaneously forming networks, and this with a positive response. The Hungarian case study in this publication outlines how the national cluster development policy has successfully improved co-operation and exchange among Hungarian firms.

Approaches to building social capital in clusters

As existing cluster examples seem to show that trust and co-operative behaviour can be encouraged and that that those strategies can have a positive economic impact, what does this mean for local development policy? What kind of tools can be used by policy makers to support positive social capital building both in nascent and working clusters?

The municipality of Philadelphia, Pennsylvania, United States, through the Philadelphia Industrial Corporation identified social capital as a key issue to industrial revival and targeted social capital building in its local development programme. The programme (see Box) had the double objective of improving the competitiveness of firms and encouraging their embeddedness in order to support local revitalisation through business development. The local development strategy of Philadelphia is of great interest to policy makers in transition countries, as it proposes concrete measures targeting social capital as part of a local development strategy.

Building Social Capital : A new strategy for Retaining and Revitalising Inner-City Manufacturers

Philadelphia Industrial Development Corporation, USA

The Urban Industry Initiative (UII) was designed as a three-year pilot project of the Philadelphia Industrial Development Corporation (a partnership between the City of Philadelphia and the Greater Philadelphia Chamber of Commerce). The mission is to retain and strengthen neighbourhood-based manufacturing businesses in Northeast Philadelphia USA (330 firms, employing 13,000 people, selling over USD 3 billion worth of products and services). In 1997, UII identified local economic needs through firm interviews. This work led to the design of the “New Strategy for Revitalization” directly based on building social capital among firms.

Among the issues identified by UII as problematic to the industrial development in the area was that fact that: “firms are extremely isolated, the social and economic threads that once existed in the area have come undone as many firms moved or closed their doors, as a result of isolations firms have no reference points by which to measure current performance, ability and willingness to change is low, second and third generations do not have the same entrepreneurial spirit“. A “lack of trust” was identified as a limit to enterprises using business services, despite being well aware of their existence.

The conclusions drawn from the research were that “relationships of trust must be created” and firms must be helped to “become more competitive and strengthen their roots to neighbourhoods”.

Key elements of the approach used to building social capital are as follows:

- Entrepreneurs were amazed to discover that they shared the same problems. The programme helped identify common needs specific to a region that has suffered from industrial transformation. It initiated inter-firm projects such as a joint electricity purchasing programme, resource borrowing etc.

- A number of initiatives for social capital building were set up: Manufacturers’ Meetings, quarterly open networking forums with firm-to-firm interactions, Plant Manager Networks to break isolation among middle management, a Supplier Alliance, an Industrial Marketing Programme, a Shared Source Initiative for SMEs, an Industrial Park initiative, Matchmaking Local Expertise, Mentorship efforts, and linkages with other networking initiatives.

The key message is that:

“Building social capital requires a different kind of effort, with what we call industrial organising, we are creating the conditions that enable firms to work collectively to achieve a multiplicity of ends.”

Source: Lichtenstein (1999)

Some cluster "success stories", in which local social capital was identified as a key element, offer further food for policy thought, even though cluster formation derived from private initiatives and not through policy guidance.

For example, the Scottish Digital Media and Creative Industries Cluster Initiative, studied by Sölvell (2004) attracts attention to a simple but central feature of building social capital: help dialogue, personal communication and a common language. Two hundred representatives of creative companies were asked in 1999 at a plenary symposium: "If there was one single thing that Scottish Enterprise could do to promote the growth of this cluster, what should this be?". Their answer was: "**Keep us talking to each other**."

In the case of the Pre-Fabricated Log Homes and Complementary Products Cluster in Western Montana, USA (Rosenfeld and Swanson, 2004), the cluster structure developed as a result of private sector decisions. In the Bitterroot Valley, because of a very close-knit community, social capital featured in the shape of exclusive relationships. This initially acted as an impediment to co-operation, as competitors used to think that they were all 'enemies'. Some personal decisions to start co-operation overcame this state of mind through the building of new neutral structures. As an entrepreneur said: "The best thing about our organisations is in learning what someone else is doing and what may be beneficial to you. We still compete but we understand the value of co-operation". Policy action can contribute to changing negative dimensions of social capital into positive ones through education and training measures as well as through the creation of neutral communication spaces for entrepreneurs.

The example of the Southern Italian Jewellery Cluster (see Box) attracts attention to some elements instrumental to cluster development such as the right assessment of common needs and active leadership. It was not a social connection that started the cluster but the shared risk related to the jewellery industry, leading enterprises to take the decision to share some of their security costs. This common need set in motion a process that led to results surpassing any of the initial expectations. This could happen only because, in addition to the risk, the entrepreneurs shared norms, values and understandings that facilitated their co-operation.

Southern Italian Jewellery Cluster: Challenges and benefits of social capital in a high risk industry

Centro Orafo Il Tari (Marcianese Region)

Close to Naples and born “by chance”, the Orafo cluster is a most interesting model for policy action and the issue of social capital. The cluster is formed of 320 goldsmiths and workshops which produce jewels with a yearly turnover of approximately EUR 1 billion. The cluster core is Il Tari, a Consortium of 320 associate companies that share common services and an exhibition area, organising a biannual fair bringing together more than 20,000 people. The Foundation Il Tari (Goldsmith association) has been active since 1991 in training the young. Tari Industriale is a structure that offers resources in technology, professional skills and creativity.

The cluster was born through the decisions of many already existing small companies that decided to pool resources to protect themselves against the frequently occurring break-ins and hold-ups. The success of the cluster is based on a very unambiguous **identification of requirements** and needs which permitted the **design of appropriate instruments and measures**. The second key for success is the involvement of **all significant actors** at local level, SMEs, decision makers, local bodies, the provincial government, the regional government and industry associations.

In getting together, the SME part of the cluster achieved benefits going well beyond the level of security and safety originally sought, such as better quality of life, better negotiation power when asking for public funds, better logistics solutions, as well as an unexpected increase in real estate value. The economic performance of individual companies also increased. Today, the cluster has advanced resources such as information and communications technologies, training and marketing initiatives, legal and financial help that an SME alone could never afford. Moreover, the positive cluster experience radiated far beyond its core group having a strong regional development impact.

Source: Presentation by Carlo Borgomeo, Vice Chair, OECD LEED Committee, OECD LEED Directing Committee Meeting, November 2003

What should policy recommendations take into account?

‘Caution’ seems the key word to come to mind when cluster policies try to integrate social capital dimensions. Why?

- Designing policies targeting social capital in clusters seems a risky process because social capital building is a self-enforcing, culturally defined and long-term process.

- Social capital can be a negative variable responsible for immobility, exclusion and limitation of economic reforms.

- It is just one variable among many others that might improve cluster performance in a specific environment.

- From a social perspective, supporting social capital can become an objective in itself, therefore, policy makers must carefully evaluate its place in economic cluster policies.

Nonetheless, Rosenfeld (2002) considers that the case for social capital as a cluster policy tool is double. On the one hand, it has an institutional dimension: “The major economic policy issue facing those designing cluster-based development strategy, is evaluating the need and devising the best role for the public sector in creating a social structure for the cluster.” On the other hand, it has a social dimension: “The major social issue is taking some responsibility for ensuring that social capital is fairly distributed and accessible”.

Furthermore, encouraging results are conveyed by the research undertaken in Wales, Ireland and Denmark showing that “policies that aim to build up social capital for SMEs through encouraging and incentivising collaboration and networking produce results whereby significant portions of the surveyed SME population ascribe improvements in business performance, innovation and knowledge exploitation to the newly formed social capital.” (Cooke, 2003)

Policy recommendations should take into account the self-reinforcing and bottom-up dimension of both social capital and cluster building. Entrepreneurs are not very eager to see an institutionalisation of social capital, which takes value precisely from its informal nature. Thus policy makers face the challenge of striking a balance between offering support versus leaving space for an independently budding phenomenon.

Three main potential areas for policy intervention to build social capital in Central and Eastern Europe can be identified from the meetings and research that were carried out for this publication:

- Social capital means communicating across professional boundaries, exchanging with educational institutions and the public sector. This places partnerships among the public, private and non-profit sectors at the core of cluster policy.

- Concrete measures targeting social capital involve networking activities (e.g. professional cluster consultants and business support centres), civic involvement (e.g. supporting voluntary activities) and human capital building (e.g. capacity building, education).

- Building trust is at the heart of social capital issues and has a direct impact on economic relations (between suppliers, clients, partners etc.).

Paldam and Svendsen (2000) remind us that "governments and international organisations are third parties. They may aim at increasing social capital, but their interference might do more harm than good to social capital." Their action should therefore concentrate on indirect measures as facilitators and accelerators.

Recommended policy measures

The Box below sets out a proposed list of concrete measures that can contribute to social capital building within a cluster development strategy.

Proposed policy measures for social capital building in clusters

- Undertake research to identify and assess the level of social capital at regional level, through defining key indicators (mutual trust, role of credibility and reputation, belonging to networks, channels of information exchange, participation in associations, belonging to the same universities etc) and undertaking surveys.
- Assess the role of social capital in cluster creation (latent and potential clusters) and identify gaps.
- Evaluate performance of existing clusters and levels of social capital (in both spontaneous and policy-driven clusters) through linking indicators of social capital and performance.
- Target trust building by setting suitable framework conditions via property rights, codes of business ethics, procedures for licensing and registration, intellectual property rules, systems of taxation, rules for competition, commercial laws, as well as codes of conduct for the police, to name just a few.
- Encourage the rise of neutral cluster structures that support the process of needs assessment at regional and local levels.
- Support dialogue among entrepreneurs at local level through workshops, associations, fairs, events etc.
- Sustain negotiation among private and public actors as a way for overcoming bureaucratic attitudes.
- Professionalise the role of cluster facilitators who should have good working networks.

- Develop policies sustaining human capital development through education, training and leadership in order to retain young talents and to overcome the lack of engagement from management.

- Introduce networking objectives within local policies targeting SMEs.

- Encourage public private partnerships.

- Strive to limit negative features of social capital in clusters (exclusion of specific socio-economic groups, insularity, immobility and criminal networking) through supporting external co-operation, mobility, anti-corruption laws and clear rules.

- Pay specific attention to the issue of social capital in clusters built around large firms and in particular multinationals.

- Adopt an integrated socio-economic approach with both social (community building, social cohesion) and economic objectives (equitable growth, cluster sustainability).

- Conduct evaluation exercises of cluster policies that try to influence cluster results by social capital building.

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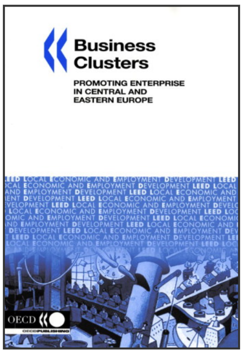

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