



New housing supply and the dilution of social capital

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ABSTRACT

This paper examines the role of local housing supply conditions for social capital investment. Using an instrumental variables approach and data from the Social Capital Community Benchmark Survey, it is documented that the positive link between homeownership and individual social capital investment is largely confined to more built-up neighborhoods (with more inelastic supply of new housing). The empirical findings provide support for the proposition that in these localities house price capitalization provides additional incentives for homeowners to invest in social capital. The findings are also largely consistent with the proposition that built-up neighborhoods provide protection from inflows of newcomers that could upset a mutually beneficial equilibrium involving reciprocal cooperation. However, the results do not appear to be driven by selection based on inherent differences in social aptitudes or by Tiebout sorting.

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1. Introduction and background

The monitoring of one's property by friendly neighbors or watch groups, a neighbor holding one's spare key, BBQ-parties among close neighbors, or a pool of trusting parents that look after each other's children are all examples of club goods that are essentially the result of accumulated social capital among a group of involved neighbors. In this context, DiPasquale and Glaeser (1999) have argued that homeowners are "better citizens" because homeownership creates barriers to mobility and gives individuals an incentive to invest in local amenities and social capital since community quality is capitalized into property values.

Although several studies (e.g., DiPasquale and Glaeser, 1999; Rossi and Weber, 1996) have indeed documented a positive link between homeownership and measures of individual investment in social capital, stylized facts from the Social Capital Community Benchmark Survey (SCCBS, 2000) suggest that homeowners may not always be "better citizens". For example, while homeowners on average socially interact 30% more often than renters with immediate neighbors in essentially built-up neighborhoods (more than 85% developed), the difference between the two groups is only about 9% in an average neighborhood (45–55% developed) and there is virtually no difference between the two groups in little developed neighborhoods (less than 15% developed). These

numbers change little when other factors – including the population density in the developed area – are controlled for. In a similar vein, homeowners are even less likely to socially interact with co-workers outside work. This result holds even when commuting distance and other factors are taken into account.

How can these stylized facts be explained? More generally, what are the underlying motives or incentive mechanisms that drive homeowners and renters to behave differently in some but not all instances? DiPasquale and Glaeser (1999) suggest that *house price capitalization* effects may explain the diverging behavior of homeowners and renters (Explanation 1). Consistent with this line of reasoning, one might also expect that the wedge in investment behavior between the two groups is comparably larger in more built-up places with more inelastic long-term supply of new housing, where house price induced incentives can be expected to be stronger (e.g., Hilber and Mayer, 2009).

However, there are other plausible explanations for why homeowners and renters behave differently and why such differences depend on the degree of physical development. The stylized facts could portray a mutually beneficial equilibrium involving *reciprocal cooperation* (Explanation 2). Homeowners may have stronger incentives to engage in reciprocal cooperation because high costs associated with housing sales make them less mobile and, therefore, increase the potential benefits from an equilibrium where people help each other. In more built-up places there are fewer potential newcomers that could upset such an equilibrium. The stylized facts could also be the outcome of a selection process or of Tiebout sorting. Inherently

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more sociable individuals may *select* more developed or more densely populated places and these sociable people could also have a comparably greater propensity to own in more urban settings (Explanation 3). Similarly, households may Tiebout sort based on their preferences for social interactions (Explanation 4).

The empirical findings presented in this paper provide strong support for the proposition that individual investment in social capital is facilitated by house price induced incentives (Explanation 1). The findings are also largely consistent with the proposition that social interactions at the neighborhood level are driven by benefits arising from reciprocal cooperation (Explanation 2). However, reciprocal behavior alone cannot explain all of the results. Moreover, the findings appear to be neither consistent with the outcome of a selection process nor with that of Tiebout sorting (Explanations 3 and 4).

The findings have important implications for the literature on the accumulation of social capital and the provision of social capital induced club goods. Previous studies suggest that house price capitalization may provide a mechanism to induce homeowners to take into account preferences of future homebuyers when voting on durable local public goods, even when residents are mobile (see e.g., Brueckner and Joo, 1991; Sonstelie and Portney, 1978; or Wildasin, 1979 for the theory and Hilber and Mayer, 2009, for evidence).¹ However, in the case of neighborhood-specific social capital, investment decisions are not reached at the ballot. Instead they are individual verdicts, potentially encouraging free riding behavior. One countervailing argument is that free riding (by selling the house) may be an unattractive option if access to benefits from social capital induced club goods are partially excludable and transaction costs associated with the sale of a property exceed the benefits derived from the improved neighborhood quality. The empirical evidence in this paper implies that housing transaction costs may indeed prevent free riding and may, therefore, encourage the provision of neighborhood-specific social capital. Moreover, housing transaction costs may also encourage reciprocal cooperation, further reinforcing social capital accumulation.

This paper provides additional support for the proposition by Hilber and Mayer (2009) that house price induced incentive effects may be confined mainly to places where the supply of land available for new development is scarce. This finding has important implications for a wide range of studies, for example, studies that conclude that homeowners are somehow “better citizens” because homeownership encourages civic engagement (e.g., Hoff and Sen, 2005; DiPasquale and Glaeser, 1999) or because homeowners are more motivated to control local government (e.g., Fischel, 2001; Dehring et al., 2008).

2. Theoretical considerations and predictions

2.1. Definition and characteristics of neighborhood-specific social capital

Neighborhood-specific social capital is defined in this paper as a connection among neighbors, which enables them to cooperate and which subsequently facilitates the provision of a number of mutually beneficial club goods.² Neighborhood-specific social

¹ House price capitalization may even provide an incentive mechanism in an intergenerational sense. See, for example, Glaeser (1996), Oates and Schwab (1988, 1996) and Rangel (2005).

² Definitions of the term social capital differ across studies and across the social sciences. The origins of the term “social capital” are discussed, for example, in Manski (2000) or Durlauf (2002). For a discussion of the determinants of social capital and the role of social capital for economic outcomes and the well-being of people see, for example, Knack and Keefer (1997), Putnam et al. (1993) or Putnam (1995). See Glaeser et al. (2002) for a description of the “economic approach” to social capital. Manski (2000) or Durlauf and Fafchamps (2004) provide survey articles on the economic analysis of social interactions.

capital can be accumulated, for example, by socially interacting with neighbors or by participating in neighborhood clubs. These activities enable individuals to (a) develop a common language with one another so that communication is easier and (b) establish relationships, for example, in the form of organized or spontaneous shared social activities, so that neighbors will trust and like each other more. While shared social activities can themselves be interpreted as utility-generating club goods, other club goods are the result of social capital induced trust and friendship. For example, trust and sympathy among neighbors enables them to provide club goods that are simply the product of shared private or common property (e.g., shared or communal gardens). Trust and sympathy can also encourage the provision of benefits in the form of mutually beneficial reciprocal behavior (e.g., monitoring of one’s absent property, holding a neighbor’s spare key, or informal child care arrangements).

Neighborhood-specific social capital has some distinct economic characteristics. While the process of developing interpersonal links can itself offer utility to individuals, typically the generation of social capital involves an *investment/production* phase and a subsequent *maintenance/consumption* phase. A quite sizeable social capital investment is usually needed to initiate the process of generating trust and friendship among involved neighbors. This investment includes fixed costs associated with the set up of initial meetings and club structures and individual variable costs related to the time spent to establish relationships with the involved club members. Once trust and friendship is established, a maintenance effort is usually sufficient to ensure the provision of social capital induced club benefits in the longer run. The social capital induced consumption benefits typically increase at a decreasing rate with the number of club members. Take the example of childcare arrangements among trusting parents. Adding a mutually beneficial link to a small pool of parents substantially increases the likelihood of being able to make an arrangement when needed. Adding a link to a very large pool increases each member’s benefit only marginally.

A second distinct feature of neighborhood-specific social capital is that it is in practice *partially but not fully* excludable. Investors (club members) can exclude initial non-investors (outsiders) from access to certain benefits derived from social capital, for example, by not inviting them to join a club event.³ However, exclusion is in practice incomplete in that it is often not feasible, considered unfair or in some cases irrational to exclude *newcomers* to a neighborhood who are willing to cooperate and maintain social capital. One consequence of this partial excludability is that net benefits derived from *aggregate*⁴ neighborhood-specific social capital, after an initial investment period, make the location not only more attractive to existing residents but also to potential newcomers, increasing the demand for properties in the neighborhood, and – assuming that

³ Exclusion from some benefits is not sensible. For example, monitoring a property may not only benefit the absent owner but also the monitor because occurrence of crime might reduce the monitor’s own house value.

⁴ To the extent that investors can exclude non-investors from access to social capital induced club good-benefits, the aggregate level of social capital (within a club) should only be determined by club members. Various aggregation technologies (i.e., the mapping of individual investments into aggregate social capital) are conceivable. A plausible assumption may be that an individual threshold-level of trust needs to be established among each contributing member to facilitate the provision of a number of mutually beneficial neighborhood-specific club goods. Increasing the individual investment beyond the threshold (that ensures membership) may add progressively less to the overall level of social capital. This implies a sort of weaker-link technology in which the least effort has the greatest marginal impact on the aggregate level of social capital and the strongest effort has the smallest marginal impact (Cornes, 1993). One implication of this technology is that social capital investments of club members should be more or less similar in equilibrium (Sandler, 1998). As long as the presence of non-investors in the neighborhood does not undermine social capital accumulation, the precise aggregation technology is not crucial for the theoretical explanations discussed below.

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