Social Economics: A Brief Introduction to the Handbook

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Social economics is the study, with the *methods of economics*, of social phenomena in which aggregates affect individual choices.[1] Such phenomena include, just to mention a few, social norms and conventions, cultural identities and stereotypes, peer and neighborhood effects.

A central underpinning of the methods of economics is methodological individualism. In particular, explanations based solely on group choice are unusual and aggregates are generally studied as the result of individual choices. Furthermore, the methods of economics rely mostly, although not exclusively, on a rational choice paradigm. *Social economics* is to be distinguished therefore from *Economic sociology*, which may be thought of as the study, with the methods of sociology, of economic phenomena, e.g., markets. Although there is increasing overlap in these areas of study as it is quite evident in some of the chapters that follow, they are still quite complementary.

The aim of this handbook is to illustrate the intellectual vitality and richness of the recent literature in *social economics* by organizing its main contributions in a series of surveys. Any organization of this literature is somewhat arbitrary. Social economics, for instance, does not lend itself naturally to a classic distinction along the theory/ empirical work line, as concepts and measurements are often developed in tight

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[1] The term *social economics*, in this sense, was introduced in a collection of essays by Gary S. Becker and Kevin J. Murphy (2000) by the same title.

connection with each other. We have chosen instead to distinguish three subfields, which we call *Social preferences, Social actions*, and *Peer and neighborhood effects*.

SOCIAL PREFERENCES

Traditionally, economists have considered preferences as exogenous parameters for the study of individual choice. This is a tradition rooted in the work of Milton Friedman (1953). Furthermore, economists are typically shy about allowing for heterogeneous preferences. A very influential Occam Razor's argument in favor of restricting economic analysis to identical preferences is e.g., in Stigler and Becker (1977). Finally, economists eschew explanations based on arbitrary beliefs, but rather impose the constraint of rational expectations.[2]

These self-imposed constraints have traditionally limited the scope of economic theory outside of purely economic phenomena, e.g., markets. Most recently, however, many economists have successfully studied various processes of preference formation; that is, have developed theoretical models of endogenous preferences and beliefs. Perhaps, even more foundationally, economists have contributed to the age-old question of identifying nature from nurture effects in individuals' psychological characteristics and attitudes. These contributions are surveyed in Chapter 1 by Bruce Sacerdote.

With regards more specifically to social preferences (preferences which depend on population aggregates), two complementary approaches can be distinguished. Social preferences can be studied either by incorporating social aspects directly in agents' preferences or by explicitly studying mechanisms which induce indirect (reduced form) preferences that depend on population aggregates. Chapter 2, by Andrew Postlewaite, discusses these modeling choices and surveys the literature which obtains social concerns in preferences endogenously from "standard" preferences. Chapter 3, by Robert Frank and Ori Heffetz, surveys instead the theoretical implications of incorporating social status directly into preferences and reports on empirical work, especially with experimental data, supporting such implications. Chapter 4, by Alberto Alesina and Paola Giuliano, reviews the available evidence for the most studied determinants of preferences for redistribution from the General Social Survey and the World Value Survey. They consider both studies in which (income or wealth) inequality enters directly in individuals' utility function as well as studies in which inequality enters indirectly by means of, for instance, externalities in education. Hanming Fang and Andrea Moro, in Chapter 5, study models of statistical discrimination in which social discrimination, segregation, and group inequality result from individuals rationally using observable characteristics of others as a proxy for unobservable ones, as opposed to

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[2] A fundamental argument for rational expectation is in Lucas and Sargent (1981).

models in which they obtain as a result of preferences for in-group interactions. Jess Benhabib and Alberto Bisin, in Chapter 6, provide a formalization of the concept of "social construction of preferences," common in social circles outside of economics. In this literature, while individuals display standard preferences in terms of consumption, they are subject to societal influences mainly through advertising.

A different approach to the study of the endogenous formation of preferences is to characterize those systems of preferences that are stable under some specific dynamic selection mechanism. Chapter 7, by Arthur Robson and Larry Samuelson, surveys studies of indirect preferences that survive explicit evolutionary selection mechanisms. Peyton Young and Mary Burke, in Chapter 8, study the evolutionary stability of norms and conventions in coordination games when subjected to adaptive dynamic processes. Chapter 9, by Alberto Bisin and Thierry Verdier, surveys instead theoretical and empirical contributions regarding the transmission of cultural traits, with particular emphasis on the ability of these models to explain the observed cultural heterogeneity.[3] Lugi Guiso, Paola Sapienza and Luigi Zingales, in Chapter 10, survey the literature on social capital, defined as "the set of values and beliefs that help cooperation," which they prefer to label civic capital. The main object of this literature is to study the long-run persistence of differences in social/civic capital and their effect on economic performance. Relatedly, Raquel Fernandez, in Chapter 11, surveys results obtained by the application of an empirical methodology, referred to as the epidemiological approach, designed to identify and measure the persistence of original cultural traits after migration, and hence in a different environment and under a different set of institutions.

SOCIAL ACTIONS

Economists have traditionally studied externalities as well as strategic interactions, that is, environments in which the actions of some agents affect either the set of feasible actions available to other agents or their preferences. Most recently, economists have also made great progress in the study of interactions between agents in small groups or networks. In all these contexts, agents interact "socially," and their actions at equilibrium are *social* in the sense that they are not mediated exclusively by markets. In other words, the literature on *social actions* takes the agents' preferences as given and studies their actions as the equilibrium result of social interactions.

The structure of social interactions, in this literature, typically takes the formal representation of a network. Social interactions are then studied as the equilibrium effect of specific properties of the network. Strategic network formation is the subject of a

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[3] While this chapter also surveys the economic literature on identity formation, the reader might also refer to the recent book by George Akerlof and Rachel Kranton (2010).

complementary literature, and there is also a nascent literature on the coevolution of social structure and behavior. In Chapter 12, Matthew Jackson provides an overview of the analysis of social networks, including how social network structure impacts behavior, and how networks are formed. The chapter includes some discussion of relevant results in the mathematics of networks and of the statistical techniques involved in measurement of social network phenomena. Onur Ozgur, in Chapter 13, surveys a class of models, derived from the study of interacting particle systems in statistical mechanics, in which a simple and stark exogenous network structure of social interactions is coupled with fully dynamic equilibrium models that allow for the characterization of the statistical correlation of individual choices. Matthew Jackson and Leeat Yariv, in Chapter 14, survey models of the diffusion of social phenomena, with particular interest on the role of exogenous social structures on diffusion. They discuss contributions from the epidemiology and random graph literatures that help shed light on the spread of social phenomena as infections throughout a society. Relatedly, Sanjeev Goyal, in Chapter 15, surveys the theoretical literature on learning on networks. In this class of models, the precise structure which governs the interactions between individuals affects the generation and dissemination of information that individuals exploit to guide their choices. Chapter 16, by Francis Bloch and Bhaskar Dutta, provides a detailed survey of the theoretical literature regarding endogenous network formation in the context of group (coalition) formation games. Chapter 17, by Tayfun Sonmez and Utku Unver approaches the issue of group formation from the point of view of matching theory. It contains, in particular, a survey of the literature on allocation and exchange of indivisible goods, which has applications e.g., to house allocation, kidney exchange, and school admissions.

PEER AND NEIGHBORHOOD EFFECTS

The peer and network effects induced by social interactions have been studied empirically for several socio-economic phenomena, e.g., crime, school achievement, addiction, employment search, neighborhood segregation, income stratification and several others. This empirical evidence has also spurred a methodological literature regarding the identification of peer and neighborhood effects. This literature opens with Charles Manski(1993)'s paper showing restrictions and assumptions necessary to recover the structural parameters of economies with relevant social interactions from observable behavior.[4]

However, recently several contributions to the literature have developed econometric models, in specific contexts, which are in fact identified under weaker conditions. Larry Blume, William Brock, Steven Durlauf, and Yannis Ioannides survey

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[4] See also Glaeser and Scheinkman (2001) for a survey of this issues.

this literature, in Chapter 18, considering linear and discrete choice models as well as social networks structures, accounting for experimental and quasi-experimental methods. Bryan Graham, in Chapter 19, complements the previous chapter by studying the collection of econometric methods for characterizing the distributional effects of policies, which induce changes in peer group structure, as e.g., partner reassignment in one-on-one matching models and social experiments in geographic integration.

Finally, various chapters in the Handbook provide detailed surveys of empirical results regarding peer, family, and neighborhood effects in specific socio-economic contexts of interest. Dennis Epple and Richard Romano, in Chapter 20, survey peer effects on educational outcomes, stressing the theoretical underpinning of identification and empirical analysis. Roland Fryer, in Chapter 21, reports more specifically on the relative importance of various factors, including segregation, discrimination, and peer effects, in explaining the racial achievement gap in the U.S. Giorgio Topa, in Chapter 22, highlights the most robust results in the large literature in economics and sociology concerning peer effects in the labor markets, with special regard to the issue of job referrals. Kaivan Munshi, in Chapter 23, surveys the empirical literature on the relevance of labor and credit networks in shaping economic development, discussing the inefficiencies associated with community-based networks as well as their effect on growth and mobility in developing countries. Marcel Fafchamps, in Chapter 24, concentrates more specifically on identifying the different roles that family and kinship networks play in sharing risk and in entering binding informal arrangements. Yannis Ioannides, in Chapter 25, surveys the literature on neighborhood effects on housing markets, emphasizing how location decisions of individuals implicitly contain a choice component over neighborhood effects, or more generally over social interactions.

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