Social Preferences and the Third Sector: Looking for a Microeconomic Foundation of the Local Development Path

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Abstract:
The paper is mainly aimed at endorsing the principle, often recurring in literature, according to which the Third Sector is an institution that supports and contributes to the development process of economic systems. The theoretical basis of the study is represented by the idea that development paths of economy are directly linked to the underlying institutional framework (Engerman and Sokoloff 2000, North 1990, Hoff 2000). In this respect, the study of microeconomic foundations cannot be overlooked, starting from the importance of social preferences assumed to be endogenous.

To that aim, two stances of economic theory will be taken into consideration: (i) the theory of social preferences (ii) the modern theory of development. The institutions are supposed to bridge between these two stances. For the purpose of this study, the above theories will not be dealt with in a comprehensive way, but will be selected in a way that is coherent with the idea being developed.

Keywords: endogenous social preferences, third sector, local development, cumulative causation
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Introduction

Over the last decades, economic theory and policy have increasingly focused the attention on the third sector, presenting a series of relevant explanations on the subject. These concern either the microeconomic aspects related to the governance structure of different organizational typologies; or the macroeconomic impact of the third sector, often analysed from a comparative point of view; or the design and the implementation of welfare policies, such as the “welfare-mix” ones, focussing on the institutional relations between different decision-making bodies, both public and private. These explanations highlight the fact that, beyond the specificity of national case-studies, the third sector is an institution of the economy. But what does this specifically mean? The paper seeks a solution to this question: starting from the study of the third sector’s microeconomic foundations and, in particular, from the “non-selfish” nature of preferences, the study investigates how they can be affected by the context and, in turn, the way they can modify the economy’s path in the long-term.

The paper is structured as follows: § 1 introduces the paper’s topics; §.1.1 reconstructs the theoretical and political background; § 1.2 presents the paper’s idea and defines, in general, the concept of “institution”. § 2 deals with individual preferences: § 2.1 gives an insight into literature on other-regarding preferences; § 2.2 discusses issues related to the process of endogenous formation and transmission of preferences (Bowles, 1998), highlighting the role played by the institutions in this contest. § 3 deals with the development process; § 3.1 refers to some relevant contributions of the modern theory of development (i.e. “the new theory of growth”) (Banerjee and Duflo 2005, Burgess and Venables 2004, Hoff 2000, Ray 1998) and, in particular, to some of the most recent models of “poverty traps” (Bowles et al 2006); § 3.2 presents the role of history vs. the expectations in the definition of the development path (Ray 1998 and 2000). As concluding remarks, § 4 entwines the two theories of literature (see § 2 and § 3) in order to identify the role of the third sector as one of the institutions in the economy’s development. To conclude, the paper intends to emphasize the new challenge posed to economic theory: the definition of a new institutional framework, which recognizes and enhances the links of complementarity between the public and private institutions involved.

1. The third sector: an institution of the economy

The numerous explanations concerning its birth, role and sustainability in the different processes of the welfare reform (e.g. privatization, welfare-mix, welfare-community) demonstrate that that the third sector is increasingly considered as one of the institutions of the economy. In this respect, our general idea is that the “local embeddedness” of the third sector can be generally considered as a crucial aspect, both for its vitality and for the development of the economy in which it operates. § 1.1 describes the theoretical and political background reference and § 1.2 describes our idea.

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1 It is worth stating that the paper analyses the third sector as a whole, without specifically focussing on any of its prescriptive and organizational typologies.
1.1. The theoretical and political background

Since the second half of the ‘70s, the international scientific community has investigated, with growing interest and refined methods of analysis, the role played by the third sector in advanced capitalist economies, with particular attention to those existing within the European Union. The role of the third sector in different countries initially follows a similar path: it develops from the crisis of the traditional State-centred welfare model and becomes an adaptive solution for the twofold aim of minimizing the social expenditure and increasing its effectiveness in macroeconomic contexts affected by strong recession (up to the late ‘80s). However, as frequently occurs in other economic sectors, “adaptive solutions” designed by agents in response to exogenous shocks can play a different role in the medium term: they can either be transitional solutions, once the causes of the State failure have been removed (as in the case of the welfare policy), or, alternatively, become a new institution of the economy, governed by specific rules and objectives, provided that a process of consolidation follows their emergence.

On the basis of a comparative analysis, the recent history of the third sector seems to confirm this second solution. Since the ‘90s, the third sector as a whole has not only strengthened its relative economic weight in terms of GNP and employment (Barbetta et al. 2003, Salomon and Anheier 1999), but has also diversified its role, its organizational typologies and its relations with the State and the market (Ben-Her and Gui eds 2003, Borzaga and Defourny eds 2001). These innovations are thus idiosyncratic to the projects of welfare reform at national level, which redefine a series of aspects: (1) the institutional structure of public and private actors’ competences; (2) the rules governing their relations; (3) the measures to be taken in order to guarantee an adequate supply of services and public utility goods, considered by policy-makers as “merit goods” for the community (Anheier and Ben-Her eds 2003, Esping-Andersen 2002).

As far as this historical path is concerned, one of the crucial issues for economic theory is to conceptualise the third sector as an institution that governs the performance of a given economy and that can promote its development process. This issue concerns: firstly, the microeconomic foundations of the third sector’s emergence and sustainability; secondly, the relations of complementarity with other economic activities and institutions operating within a given economy. The paper aims at finding an answer to this complex issue.

The wide economic literature on this topic generally seems to reflect the diachronic evolution of the role played by the third sector as outlined above. It can therefore be classified into two groups: a “first generation” group, which includes models giving priority to the macroeconomic aim of pursuing both effectiveness and efficiency of social expenditure; a “second generation” group, which encompasses models mainly centred on the new policy strategy. The latter consists in promoting and supporting the economy’s development process also through the opportunities offered for/by the third sector to increase income, employment and exchange, as

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2 A significant example is represented by the well-known process of industrial conversion of large enterprises in the ‘70s, leading to the creation of industrial districts, which can be interpreted either as a form of intra-industrial dualism or as a new pattern of specialisation. However, the comparison between these two patterns of adaptive solutions does not fall within the scope of this study.

3 It must be underlined that the paper will refer to all the NPOs characterised by “other-regarding” preferences, without considering their different organizational typologies.
well as the chance to distribute its benefits according to principles of equality and social inclusion.

Second generation models highlight two important novelties: a theoretical and a policy-related one.

From the point of view of the theoretical debate, the “residual” approach to the third sector, simply conceived as a temporary solution to the well-known forms of market and State failure in the field of social policy (Sacco 2006), has been radically abandoned. On the other hand, there is a growing research interest in the features characterising the model of economic choices made by non-profit organizations (NPOs). This concerns both the variety of NPOs’ “non selfish” motivations and preferences (e.g. experimental game theory, behavioural economics) and the rules adopted to govern the relations developing inside and outside the NPOs (e.g. incomplete contracts models, transaction costs theory).

As for the political debate, it was ignited by the European Commission in the wake of the European Employment Strategy (e.g. Luxembourg 1997, Lisbon European Council 2000 and Barcelona European Council 2002) and subsequently implemented by individual Member States (e.g. National Plan/Employment from 1999 and National Plan/Inclusion from 2001). From this point of view, there has been a shift from a sectorial approach of social policies to a so-called “integrated approach” (European Commission 2001). Policies involved concern employment and welfare. The integration of these two fields is designed to curb poverty and exclusion by boosting participation in the labour market. From this new perspective, the local dimension becomes extremely significant for both local development and social inclusion (Caroleo and Garofalo 2006). An “integrated approach” of policy objectives is in line with the model of equal-opportunity-choices for the agents (e.g. employment, education, credit, investment). Its pursuit contributes, in practice, to stimulate and support local development. In addition, the “integrated approach” of objectives necessarily implies the creation of an institutional set-up based on coordination between the State, the market and the so-called social community, which is significantly expressed by the third sector (Borzaga and Fazzi 2006, Bowles and Gintis 2000). However, it is worth noting that the effectiveness of this approach is, in practical terms, an historical matter rather than a mere question of institutional design: in other words, it concerns the institutional history of an economy.

The economic theory proposes many lenses to classify the various models of the third sector and its differentiated role with reference to the welfare policy and the integrated approach. One of these lenses concerns the equity-efficiency trade-off deriving from the policy choices and the implementation of a given policy; another lens is related to the design of an institutional mechanism in order to achieve the goals set by that policy. Given the extensive literature already existing on the subject, these two topics do not fall within the scope of this paper and are simply dealt with as background reference.

This paper is based on a widespread criticism in economic theory that, on the one hand, reacts to the explicative and normative power of traditional neoclassical economy (based on a set of complete markets), and, on the other, attempts to understand what generates imperfections in individual choices and in the markets rather than considering them as given\(^4\). Among the numerous scholars supporting this principle, Bowles (1998) radically discards hypotheses of mainstream economics on the possibility to separate means from ends and on the independence

\(^4\) The literature on this subject is evidently quite extensive. In addition, the stances adopted are not (thoroughly) convergent, but rather different in terms of topics, methodologies and failure-related hypotheses.
of the desirable objectives of a welfare policy vis-à-vis the agents’ (or groups’) preferences. Bowles thus focuses on the endogenous nature of preferences, especially the “other-regarding” ones, and on the different channels of their development and learning. In particular, the paper is to be interpreted in line with Bowles’ evolutionary approach (also see Nelson 2001, Rutherford 2001).

1.2 What is meant by “institution”?

The paper mainly aims at suggesting, thus far at a simple methodological level, a possible interpretation of the emergence and sustainability of NPOs (as interpreted by second generation models), focusing on two points. (i) The first point examines the nature of social preferences and on their endogenous process of development, learning and change. This requires an investigation on the link between “non-selfish” preferences, which are at the origin of NPOs, and the local framework of reference, i.e. the level of activity and its sectorial composition, the success/failure of markets, the social community, the institutional structure, the objectives and policy measures. This link is, however, “a mere piece of history”. It builds up the hypothesis that it is a locally-rooted economic and institutional context to favour, transmit and “cement” the role of social preferences in a given economy. (ii) The second point examines “other piece of history” and it can be considered as complementing the first one. It refers to a real situation where, despite an unfavourable economic and institutional context (e.g. agglomeration of negative pecuniary externalities, insufficient level of social capital, failures of markets, distorting effects of politics on economic choices), some social preferences can actually emerge, not only by pure coincidence. These positive social preferences can therefore contribute to modify the development path of that specific context. However, such process can take place only if “other-regarding” preferences are not isolated expressions of some agents/organizations of the population and provided that they establish a process of coordination and cooperation within the community. These preferences, which initially represent occasional personal motivations, are transformed into shared institutional rules (Denzau and North 1994) when they turn into rules governing the transactions taking place on different interacting markets (e.g. capital, human capital, knowledge etc.), i.e. rules governing the production process, the distribution of gains generated by that same process and their possible redistribution. The paper specifically aims to hold together the two “pieces of history” mentioned above. To this end, two theoretical strands are taken into consideration. In economic theory, these strands do not exclusively and specifically refer to the third sector and generally follow parallel paths, rarely becoming aware of each other. The first strand refers to non-selfish preferences, the other to the modern development economy. Given the extensive literature on the subject, the paper’s aim is not to provide an exhaustive survey, but rather to select some contributions and relate them to each other in order to discuss if and how social preferences, and their agglomeration, can play in favour of an economy’s local development. Only if these conditions occur can the NPOs (which introduced social preferences in the economy) become an institution like the market and the State.

This view finds its collocation in the well-known tradition established by North (1990) and based on the idea that “institutions matter”. In particular, if the new theory on

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5 Evidently, there are numerous methodological issues concerning these subjects. They mainly focus on the contrast between “methodological individualism” and “methodological collectivism” or “holism” (Garofalo 1998, Lawson 1997).
institutionalism (NIE) (which develops into numerous models on a variety of topics\(^6\)), is connected to the old one (OIE), the resulting “core” corresponds to the claim that “institutions matter” (North) \textit{because} they restrain, mould and enable human interactions, in view of the fact that they constrain or enlarge the set of choices. However, the debate as it is today still lacks a general and shared definition of institution: the different categories of “institution” are instrumental to the specific case-studies and therefore overlook the shape that an institution can take in real life. (Nelson 2001). Therefore, a congruous relation between the case-study and the definition employed is the first requirement to select, among those proposed by literature, the most suitable definition to our aim. A second criterion for the selection of an appropriate definition is the taxonomy separating the determinist vision from the evolutionary one: for the purpose of this study, we will not take into consideration the different definitions that describe an institution as the best result of an engineered design based on standard hypotheses of rationality, given preferences and contextual irrelevance. This type of definitions not only involves solutions of equilibrium, as if the market could not fail, but also ignores the existence of heterogeneous and non-selfish preferences among the population. This consequently invalidates the innovative role of the institutional framework reform, based on spontaneous contributions of citizens to collective action (Bowles 1998, Eggertsson 1998, Ostrom 2005).

Taking into consideration these two selective criteria proposed by literature, institutions are generally defined as “accepted or enforced rules” i.e. as “rules of the game”\(^7\). More specifically, Nelson’s idea is embraced: institutions, that represent rules, are treated as “social technologies”: “Institutions define or shape social technologies which are the way of doing activities which involve human interaction” (Nelson p.43). They include “new models of interactions”, “new models of organisation of work”, “new kind of markets”, “new laws” and “new forms of collective action”. Since institutions are assumed to be a specific form of technology, they can consequently increase the productivity of factors, favour the use of potential resources and promote innovations and their effective implementation. They represent, in brief, a development factor\(^8\). North (1990, North and Denzau 1994) is the second point of reference for the economic theory of the institutions. He defines institutions as rules and classifies them as formal – when they include the whole legal framework of an economy – and informal – which include all the social norms, ethical values, shared mental models, ideologies and habits. The stance taken by North is significant for the role he attributes to the informal level. In particular, it is the \textit{complementarity between the formal and informal level} of an institutional framework that affects its effectiveness: the informal level can, for instance, affect the way private agents perceive and therefore take advantage of the transaction opportunities opened by (new) formal rules\(^9\). The informal level can also

\(^6\) These topics concern property rights, governance structure, law and economics, social and cooperative norms, collective action, contracts, voting rules and have different applications, such as the labour market, financial institutions and development. They also differ in their hypotheses on rationality and information. See Rutherford (2001) for the connection between OIE and NIE and Nelson (2001) for a survey on the topics.

\(^7\) This definition is also shared by neoclassical theorists: see Coase’s theorem for example. An important difference vis-à-vis the evolutionary approach adopted is, as mentioned before, the hypothesis of adaptive rationality and of heterogeneous preferences.

\(^8\) The social nature of these “technologies” is twofold: they are “codifiable” and subject of learning (see the role of culture, of personal perceptions and routines) and have a normative content in relation to the choices made by the agents, who evaluate their benefits and costs.

\(^9\) Hoff (2000) draws a distinction between: “North I”, according to whom the economy inevitably pursues - in the long term - solutions of equilibrium that are coherent with the ones envisaged by neoclassical economy, and “North II”, who believes that an economy does not necessarily achieve these results in the long term. Reference will obviously be made to the institutional and non-deterministic stance expressed by “North II”, who paved the way for the study of path-dependence induced by institutional
affect the way private agents modify their aspirations, or their interaction with public bodies, as in the case of the reform of the Italian welfare system (Garofalo and Supino 2002).

To conclude, on the basis of the analysis thus far developed, the institutions can be defined as the combination of rules that favour the coordination of decisions and promote complementarity and cooperation between economic agents. NPOs therefore become an institution of that kind of economy because: (i) they transfer, not randomly, social preferences and models of production/allocation/exchange that are coherent with these preferences; (ii) they guarantee the learning and the consolidation of these preferences.

However, this idea of complementarity, derived from an extensive interpretation of North, poses some significant questions: “to what extent do formal rules take into account informal ones?”, and “which informal rules are taken into account?” “to what extent are pre-existing informal rules modified by a new set of formal rules?” “how can informal rules affect the implementation of formal rules?” These questions shift the attention to preferences and to the relation between preferences and institutions.

2. Social preferences and the third sector

Against this theoretical and political background, a significant contribution is offered by the extensive literature illustrating the values and motivations governing individual behaviours in real life, be it within social organizations or, more simply, within working groups. Those behaviours appear more complex when compared to the simple assumptions of the *Homo economicus*. In particular, the pioneering work of Coleman (1984, 1988) emphasised the role of the social capital and understood the need to rethink the extreme individualism of neoclassical approach. Bowles and Gintis (2005, p. 380) underlined that: “the social capital boom reflected a heightened awareness in policy and academic circles of real people’s values (rather than the implausible utility function of *Homo economicus*) and the way people interact in their daily lives”10. Different research works gradually presented new hypotheses on individual behaviours: models based upon altruistic behaviour, reciprocity or inequity aversion. Theoretical research studies were then followed by empirical work. Most of the empirical work was in line with the idea that non self-interested preferences11 are, together with egoistic preferences, at the basis of people’s behaviour. Empirical evidence produced over the recent years is particularly important since, as Fehr and Fischbacher (2005) remark, the presence of individuals having social or non self-interested preferences can affect the functioning of competition, cooperation and the outcome of collective actions. If most of the individuals have social preferences, and if these can influence the vitality of the institutions, it is necessary to consider the process of their creation and transmission (see Bowles, 1998).

INEFFECTIVENESS. The issue concerning the nature of long-term equilibrium – be it single or multiple – is dealt with in § 3.2. The distinction made between the institutions, i.e. rules, organizations and players, will not be taken into account.

10 By referring to “real people’s values”, Bowles e Gintis (2002, 2005) suggested to replace the term “social capital” with “community governance” as the latter refers, more precisely, to what people “do” rather than what they “have”. “By a community, we mean a group of people who interact directly, frequently, an in multi-faceted ways. People who work together are usually communities in this sense, as are neighbourhoods, groups of friends, professional and business networks, gangs, and sport leagues.” (Bowles and Gintis 2005, p. 381)

11 “People exhibit social preferences if they do not only care about the economic resources allocated to them, but also about the economic resources allocated to relevant reference agents”, (Fehr and Fischbacher, 2005).
Section 2.1 thus provides an insight into literature on social preferences, which are considered today as the microeconomic foundations of the third sector (Bowles e Gintis, 2002). Section 2.2 discusses issues related to the process of endogenous formation and transmission of preferences (Bowles, 1998), highlighting the role played by all the institutions that govern the performance of an economy.

2.1 Altruistic preferences, preferences based upon reciprocity or upon inequity aversion.

Social preferences can correspond to altruistic preferences, preferences based upon reciprocity or inequity aversion. Strong reciprocators (Rabin, 1993, Levine, 1998; Falk and Fischbacher 2005) are ready to cooperate if others cooperate, but can also punish (at personal costs, if necessary) those not willing to cooperate or not abiding by the rules. Punishment is mainly driven by a “feeling of anger” towards those performing “unfair” actions. Individuals with preferences of risk aversion pursue a fair distribution of resources (Fehr and Schmidt 1999, Bolton and Ocknfels 2000).

Finally, an unconditional altruist considers as positive the economic resources allocated to a relevant reference agent, under all circumstances (Becker 1974, Zamagni 1998). In many contexts, strong reciprocity and inequity aversion trigger similar behaviours, while they both differ from altruism (Andreoni, 1989; Andreoni and Miller, 2002). This is due to the fact that the behaviour of individuals with altruistic preferences is independent from the behaviour of others.

Theoretical research supported different laboratory experiments aimed at testing the explicative capacity of models based upon non self-interested preferences. Out of this abundant literature, only a few examples concerning the “ultimatum game” and the “public good game” are presented below (for a review on this point, see Fehr and Fischbacher 2005).

In the ultimatum game, a player (“the proposer”) offers to share out a sum of money between him and a second player (“the respondent”); if the latter accepts the portion offered by the proposer, the money is shared out on that basis between the two players; in case the respondent refuses, both players are left empty-handed.

If the game is played once, so that the players do not know each other’s identity, a self-regarding respondent will accept any kind of offer, though unfair, while the proposer will offer as little as possible. However, different applications of the ultimatum game displayed a different behaviour on the part of the players (see, Guth and Tiez 1990, Roth et al. 1991, Forsythe et al. 1994, Camerer and Thaler 1995, Roth, 1995): on average, the proposer keeps 60% of the sum to himself, while a 50%-50% sharing is usually the modal division. Respondents often refuse if they are offered less than a third, though the alternative is no money at all. The experiment results can have two plausible explanations: on the one hand, it is likely that the respondent refuses the proposer’s unfair offer as a way to punish him, though he is aware he will get no money by the end of the game; on the other hand, the first player is likely to propose a fair division of the sum either because he fears that his offer is rejected or because his preferences are based upon inequity aversion.

In a typical public good game with several rounds, e.g. 10, the players, under conditions of strict anonymity, establish for each round their level of contribution to the creation of the public good. If the players are moved by egoistic preferences, they do not participate at all to the contribution. However, empiric evidence shows that individuals are ready to cooperate, at least during the first rounds of the game.12

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12 Many experiments (see Ledyard 1995, Fehr and Schmidt, 1999) show that, during the first rounds, players cooperate by offering, on average, half of the portion at their disposal. During the final rounds,
In particular, they are ready to contribute as long as others do so (Andreoni 1988, Fischbacher et al. 2001). In addition, Fehr and Gaechter (2000) propose a variant of the public good game where players are given the possibility, by paying, to punish free riders. If the agents were selfish, no one would decide to punish or contribute. On the contrary, evidence presented by Fehr and Gaechter shows that players often punish free riders, though they personally have to pay for it, and that all players end up by contributing to the creation of public good.

The literature based on laboratory trials is abundant, but many examples are also taken from real life to support hypothesis of non self-interested preferences. With reference to initiatives of voluntary work, Rose-Ackerman (1996) argued the existence of motivations driving individual behaviour that are more complex than simple egoistic preferences. On the wake of Reingen (1982), Kahan underlines that individuals show to reciprocate the disposition of others in giving or not to charity. Fong, Bowles and Gintis (2005) highlight that aversion to policies of income redistribution does not necessarily stem from selfishness, but rather from the belief that poverty is mainly caused by laziness. Moreover, Bowles and Gintis (2005, p. 381) underline that individual motivations supporting peer monitoring and other aspects of community governance are captured by strong reciprocity, which is a “predisposition to cooperate in a collective enterprise, and a predisposition to punish those who violate norms, both of which are individually costly but conductive to strong social capital”. Finally, in highlight the role of “conformist” preferences in the creation and sustainability of social enterprise, Sacconi and Grimalda (2005) suggest a motivational structure similar to the one proposed by the models of reciprocity. Furthermore, evidence derived from a sample of twenty firms in Lombardy shows that the most efficient enterprises are those mainly characterised by “conformist” ideology and preferences (Sacconi and Faillo, 2005).

Empiric evidence produced over the recent years has inspired a common belief: models based on social preferences (namely, those based upon strong reciprocity and iniquity aversion) are generally more appropriate, vis-à-vis the assumptions of the *Homo economicus*, to describe individual behaviour. Some scholars believe that models including reciprocating preferences have a higher explicative capacity than those based upon iniquity aversion, while other studies suggest, on the contrary, that the latter models have the same explicative capacity, though a lower complexity (on this point, see Fehr and Fischbacher 2005).

Leaving academic debate aside, the key challenge remains the need to analyse the social and political repercussions generated by social preferences. In particular, when forecasting the effectiveness of different policies, it is worth recalling that, according to the empirical data, it can be assumed that many people exhibit social preferences, but not all of them. The key problem is thus analysing the results of the interaction between individuals with different preferences (social or egoistic ones), while outlining possible differences with the results based on the neoclassical paradigm of self regarding preferences.

Fehr and Fischbacher (2005) for instance, deal with a sequential Prisoner’s Dilemma game, where a selfish and a strong reciprocator are matched. If the selfish player decides first, and if the subject’s type is of common knowledge, he will decide to...

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13 According to the experiment carried out by Fischbacher et al. 2001, individuals’ willingness to cooperate depends on the average willingness to cooperate shown by all players involved.
cooperate as he knows that the other player will follow his choice and that the output associated with mutual cooperation is preferable to the one of mutual defection. This game is particularly interesting as it reveals the crucial influence that institutions can have on individual behaviours and on the effectiveness of rules: “… if people believe that cheating on taxes, corruption, or abuses of the welfare state are widespread, they themselves are more likely to cheat…it is therefore important that public policy prevents the initial unravelling of civic duties, because once people start to believe that most others engage in unlawful behaviour, the belief-dependency of individuals’ behaviour may render it very difficult to re-establish lawful behaviour” (Fehr and Fischbacher 2005, p. 167).

2.2 Endogeneity and transmission of social preferences: the role of the institutions

If the assumptions of egoistic preferences in the neoclassical paradigm seem to be in many cases unsuitable to describe individual behaviours, the same goes for the assumption concerning exogenous preferences. Bowles (1998) already presents an analysis of the factors affecting the development and transmission of individual preferences. In particular, Bowles (1998) indicates five ways in which society shapes the development of its members.

i) **Framing and situation construal**: individuals behave differently depending on the context in which they are. In the market framework, where buyers and sellers are anonymous and contracts are complete, individuals, although not intrinsically selfish, tend to adopt self-regarding behaviours.

ii) **Intrinsic and extrinsic motivations**: within market processes, rewards for individual actions are explicitly established, which may affect agents’ incentives to the detriment of spontaneous actions.

iii) **Effects on the evolution of norms**: economic institutions affect the structure of social relations, in that they modify the desirability of certain behaviours; behaviours aimed at building a good reputation for oneself, and ethical and moral principles in general, take on a more important role in case of market failures, whereas complete, perfectly functioning markets reduce the desirability of nice traits.

iv) **Task performance effects**: economic institutions affect individual behaviours and, together with technology, determine work types and modes.

v) **Effects on the process of cultural transmission**: the values and behaviours induced by a society’s economic institutions as they have been presented so far are passed on from generation to generation through education patterns imparted on children by their parents; in this process, the action of parents is often integrated (and sometimes replaced) by that of the school system, which contributes to spreading the emerging cultural model in a particular stage of society development.

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14 In an experiment carried out by Upton (1974), the introduction of money rewards for blood donations in Kansas City and Denver attracted new donors, but at the same time a decrease in donations among people who had already given blood with no remuneration was recorded (ref. Bowles, 1988).

15 Bowles considers a subset of norms which he calls nice traits; “these are behaviours which in social interactions confer benefits on others” (Bowles, 1998, p. 92).

16 “The simple explanation that accounts for virtually all that is known about the effects of job on personality…is that the processes are direct: learning from job and extending those lessons to off-the-job realities”, Kohn (1969, the reference is in Bowles, 1998 p. 98).

17 In this respect, Bowles writes: “universal schooling may be represented as a particular assignment of cultural models to children, one unprecedented on its divorce from family and degree of centralization.”
The analysis of preferences formation and transmission carried out by Bowles also leads to some policy guidelines: first and above all, the endogenous nature of preferences must be taken into account in assessing the effects of laws and policies; secondly, new, socially desirable behavioural models can be introduced through educational campaigns or through rules stigmatising antisocial behaviours; if markets – and other economic institutions – affect the formation and transmission of preferences, then their functioning cannot but become a topic of public interest, as is the case for the school system.

Bowles and Gintis (2005, p. 390) emphasise the factors which may affect individual behaviours with explicit reference to the logic of reciprocity. The authors highlight how “a heterogeneous population with some civic-minded members (ready to punish those who violate the norms) and some self-interested members may exhibit high or low levels of cooperation depending not on the distribution of types in the population, but rather on the recent history of the group”. In a highly cooperative cultural context, punishing those who do not cooperate is not a costly action. Conversely, if cooperation is not widespread, punishing those who do not cooperate entails high costs, and strong reciprocators end up following the majority and taking on selfish behaviours.

Finally, Bowles and Gintis (2005) stress the relation of complementarity existing between market, State and Community Governance; in particular, they outline that well-working communities enforce norms through mutual monitoring and punishment of antisocial behaviour but, at the same time, require an adequate legal and governmental contest for their good functioning.

The impact of the social and economic context on the formation of preferences, as well as the role of laws and policies, finds evidence in several laboratory experiments and real-life cases (for a more detailed analysis, see Ostrom 2005, Kahan 2005, Bowles and Gintis 2005); some contributions which are particularly significant for the aims of our study are reported below.

The experiments carried out by Henrich et al. 2001 and Henrich et al. 2003 in twenty countries characterised by different political, social and economic contests in America, Asia, Africa and Oceania, reveal little evidence of self-regarding preferences, even if these authors do record remarkable variations in results. A great deal of the differences recorded is attributed to the degree of expansion of the market and the cooperative phenomenon. In particular, individuals living in contexts with greater market development and higher cooperation levels, display greater cooperation in the games. The differences recorded by Henrich et al. in the application of the ultimatum game also reflect differences in customs. For example, among the Au and Gnau populations of Papua Guinea, the proposers’ offer often amounts to more than half the entire sum to be shared out, and these offers are also rejected sometimes. The result is plausible if we consider that in the culture of these populations generous donations are a mark of superiority, whereas rejecting an offer means rejecting a subordinate role.

As far as the impact of laws and policies on individual behaviours is concerned, several authors observed how some provisions may crowd out altruistic motivations. Frey and Felix Oberholzer-Gee, 1997, for instance, underline that the suggestion to offer Swiss citizens money to encourage them to accept a nuclear waste facility actually produced the opposite effect.

As a result the cultural transmission processes became markedly more conformist as cultural models were selected from (or by) dominant groups “(Bowles, p. 101).

18 See the definition of Community Governance, note 9.
19 Ref. Gintis, Bowles, Boyd and Fehr, 2005, p.28-29
20 In order to understand the development level of market integration and cooperation in production, the following questions have been used: “How often do people buy and sell, or work for a wage?”, “Is production collective or individual?”.
21 The reference is in Bowles 1998.
In a review of studies on citizens’ behaviour towards the obligation of paying taxes, Snavely (1990) writes: “compliance policies which emphasize increasing risk for tax evasion will not in themselves be sufficient to curb cheating”. If citizens think that a large part of the population do not pay taxes, they are tempted to do the same. In the light of Bowles’ (1998) arguments, an educational campaign would be preferable to spread the idea that paying taxes is an important duty of citizens.

Similarly, individuals show a greater tendency to adopt dishonest behaviours if they believe corruption is widespread. Also in this case, “a better policy, again, is to make citizens aware that those around are basically honest” (Kahan 2005 p. 363).

Among the examples given to support their arguments on the complementarity of market, state and community governance, Bowles and Gintis (2005) report a study by Sampson et al. (1997) which outlines the importance of cooperation between residents of different Chicago districts to cut delinquency. Bowles and Gintis, however, also stress that in reaching this objective, the efficiency of local police proved essential.

In our view, the argumentations presented by Bowles’ (1998) and Bowles and Gintis’ (2005) are particularly important also to analyse the Italian non-profit sector, where individual and organised volunteer work seems to be particularly active where public services are more efficient and better organised.

3. The microeconomic approach to development

Alongside literature on “non-selfish” nature and on the endogenous formation of preferences, literature on development economics is also taken into account in this paper. As stated above, this literature is taken into account with a selective approach, leaving out growth models which refer to an aggregated production function, based on hypotheses of perfect markets of factors, of increasing returns to the scarce factor and of irrelevance of assets distribution. It is well-known that these models imply a convergence between the economies (or within a single economy) because it is assumed that returns to scarce factors are high, and economies which are lagging behind grow faster than advanced ones, thus producing what has become known as “catching-up”. Therefore, these models do not explain why economies are different and why divergence is a persisting occurrence.

Only the “new theory of growth” is then taken into account, and, in particular, the so-called microeconomic approach to development: as things stand, it does not yet provide a general theoretical framework, but offers a sort of “puzzle” of multiple explanations for the fact that agents (in backward areas) “do not always avail themselves of the best opportunities afforded to them” (Banerjee and Duflo 2005). It follows that the various explanations are idiosyncratic to specific case-studies of market failures or coordination failures observed in real life. This microeconomic approach is relevant in that it stresses the importance of the economic and institutional context on both individual choice models (i.e. preferences, productive and allocative patterns, distributive rules, etc.) and

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22 The reference is in Ostrom, 2005, p. 261.
23 Efficiency and transparency of public institutions also play a major role. If citizens report poor efficiency, corruption, wrong political choices, they will be less inclined to contribute to the production of common good.
24 See note 1
25 Zamaro (2003) identifies a simultaneous increase in the number of non-profit institutions, of their volunteer workers and of the region’s welfare expenses. However, the author does not remark, in the same regions, a significant correspondence between regional funds allocated to non-profit institutions on the one hand and spreading and income of the same non-profit institutions on the other (similar results are found in the purchase of goods and services by non-profit institutions on the part of Regions).
models of interaction between individual agents (i.e. cooperation, coordination, defection, etc.), as well as on the impact that individual choices and their interactions have on the interacting markets of an economy (§ 3.1)26. In particular, among the different explanations given to “poverty traps”, Ray’s (1998) theory seems to be particularly interesting. He believes that the history of a country or the agents’ expectations can explain both the development path of an economy and the differentials observed across countries or within the same country (§3.2).

3.1 Poverty traps and cumulative causation

An important preliminary step in analysing the selective literature survey consists in clarifying what is the definition of development we are adopting among the different theoretical approaches and indicators available. Development is considered as an intertwined process of structural change for an economy, which basically consists in a change in output and employment composition, in the innovation of output production, distribution and redistribution methods. In other words, development can be defined as the ability for an economy to produce, over time, an increasing number of different elements (goods and services). This entails increased opportunities in terms of income, employment and exchange for agents working in that economy. Following this definition, the long-term path of advanced systems shows that the social dimension of development matters (Mira d’Ercole and Salvini 2003), not only because of the emerging social and immaterial needs or because of the ability to turn such needs into demand. The third sector is more and more involved in this phenomenon, in terms of both promotion and production. The set-up of the social market is a good example of the diversification process enhanced by development.

In more radical terms, however, the social dimension of development matters because the widening of choice opportunities requires, to be effective, changing not only the rules of income distribution ex-post, but also the rules for access to the markets, meant as formal institutions. As a matter of fact, this makes it possible to extend ex ante the agents’ active participation to all markets (labour, capital, education, knowledge, etc.), modifying the consequences that the asymmetry of initial distribution of assets have on individual choices. If development is thus defined, then the third sector is an institution of advanced economies because it is an actor of social policies which are “embedded” in development policies at the local level. The widening and diversification of choice opportunities for agents, made possible by the extension of formal rules for access to markets, plays an important role in the development of an economy if it brings to light, mirrors and enhances agents’ varied preferences and if it generates complementarity of choices on different markets.

In the light of the above-mentioned definition, the long-term path of an economy can be explained in several different ways: in particular, following the approach of the new growth economy, the key assumption is that initial conditions matter (Ray 1998). Based on this assumption, among all the microeconomic models explaining why agents are not always using resources at best27, only some “poverty traps” will be referred to in the

26 Of course, the various models which make up the so-called micro-development literature are not considered in detail or compared with each other. See, among others, Banerjee and Duflo (2005), Burgess and Venables (2004), Hoff (2000), Moookherjee and Ray eds (2001)

27 These models differ because they refer to different failure phenomena. The causes for failure that have been identified are: many types of government failures (excessive or high protection of investment, low enforcement of property rights), credit constraints, insurance markets, behavioural issues, demographic factors, low wealth/low investment, local externalities (learning-by-doing, human capital, search, market dimension, social norms). As things stand, there is no explanation which incorporates these various causes in one single model.
present work. These models are particularly relevant for the purpose of this work, as they explain why the long-term path of an economy can be characterised by a persisting low-level of income equilibrium, because of the effects of several forms of externalities (including technological, pecuniary and non-pecuniary ones) (Hoff 2000).

By crossing these classes of models, it is possible to identify the following theoretical, methodological and policy “core”. (i) From a theoretical perspective, the so-called “achievement model of income determination” is rejected (Bowles et al. 2006) and, in general, the starting point is the assumption that the “trap” is not ascribable to agents’ insufficient efforts, as if they were “institution-free” or “context-free”. On the contrary, it is this very insufficient effort, which in turns entails inefficient resource allocation, that needs to be explained. (ii) From a methodological point of view, these models use the cumulative causation mechanism following Hirschmann and Myrdal, which can trigger a virtuous or vicious circle, depending on the relevant economic and institutional context. It is well-known that this mechanism actually includes a “driving force” identifying the necessary conditions for new activities to be launched in any economy, and “mechanisms of propagation” identifying the sufficient conditions for these new activities to generate a self-reinforcing development path. (iii) In terms of policy approach, poverty trap phenomena are considered cases which legitimate policy interventionism, although this does not necessarily or exclusively imply government interventionism, but rather requires the coordination of policy makers with private agents, as well as that of policy makers with private agents working at different levels or in different sectors of an economy (Matsuyama 1996). This may be defined as a coordinated institutional system, which is one of the novelties of welfare reform in EU (Caroleo and Garofalo 2006).

In brief, one of the distinctive elements of poverty trap models is that they are studies carried out at the micro-level, under the key assumption that the economic and institutional context is important both upstream for individual choices and downstream for the development path.

In particular, the taxonomy of poverty trap models recently designed by Bowles et al. identifies three classes of models. The first class is based on the “critical threshold” hypothesis (Azariadis and Drazen 1990) in capital stock (physical, human or social), which enables an economy to start its development path or not. A significant case study is the one related to the consequences that a low human capital stock (the driving force) has on the agents’ education choices (the mechanism of propagation), which in turn affect long-run equilibrium. If an economy or a sector is characterised by an excessive supply of unskilled labour, this depresses salaries and keeps investments in education low. The economy or sector remains entrapped, because the quota for educated population is small, which entails low productivity: in turn, opportunities for businesses to shift from traditional to innovative sectors are scarce, meaning that businesses are not encouraged to innovate if the human capital is scarce. If these assumptions are correct, the levels of skilled labour demand and supply remain low, because of the growing returns on investments in education. This model offers an interesting explanation of the propensity (weaker or stronger, depending on the context) towards investments in human capital as a development factor in the third sector. Another trap case study, similar to the previous case in some respects, is the so-called “search externality”. To conclude, these trap cases are based on hypotheses of negative local externalities.

A second class of models deals with the role played by institutions within an economy (Banerjee and Duflo 2005, Bowles 2006). There are several case studies reporting on various types of government failure. These types of failure have the effect of “distorting” private investment decisions because of the protection levels of private productive activities being too high (which causes the economy to depend on politics) or too low; they also produce an insufficient and rather undiversified supply of
infrastructures and public goods; they do not foster coordination and cooperation between businesses, with the obvious consequence that they are not willing to introduce innovations whose benefits are not completely internalised (Ciccone and Matsuyama 1996). One interpretation of this particular trap, which considers institutions as a set of formal rules, has interesting implications for the third sector. A government failure would occur (i) in the case of unfair rules which do not favour access to the market or (2) in the case of income support measures which are not integrated by precise indicators, needed to select target subjects in the context, as in the Italian case (L.328/2000). If the rules for access are unfair, they exert a weak contrast action on the initial asymmetrical distribution of assets among the agents. In brief, institutions fail because they prove to be inadequate in supporting the implementation of policy objectives aimed at favouring inclusion by means of active participation in the markets (Atkinson 1998, Engermann and Sokoloff 2000).

The last class of models explains poverty traps on the basis of agents’ membership, in contexts where exchanges are assumed not to be regulated by market conditions alone, but by the whole set of social norms (ethical values, habitual behaviour, shared mental models). The idea is that agents adopt behaviours which are widespread within an economy, and if these behaviours are “bad” they discourage “good” behaviours. A significant case study is the one regarding two market segments with different rules, which work simultaneously and put in place, respectively, legal and illegal transactions: an individual’s adoption of illegal behaviours in a context where these are particularly widespread reduces the benefits deriving from isolated legal behaviours as compared to illegal ones as a consequence of membership (Durlauf 2006). This class of models on poverty traps seems to offer some suggestions on the role played by the third sector in the development of an economy: interesting examples are provided by the role of agents and organisations characterised by social preferences encouraging cooperation (e.g. knowledge transfer from the for-profit to the non-profit sectors; donations), or by the motivating role that a policy-maker’s leadership can play in the local economy by promoting innovative rather than bureaucratic behaviours within the community, cooperation rather than defection or collusion.

### 3.2 Path-dependence vs. expectations (Ray 1998)

With respect to the new growth theory outlined in §3.1, Ray (1998 and 2000) offers a “methodological frontier” to explain the long-term path of an economy and the differences between countries and regions, based on the assumption that initial conditions matter. Why is Ray’s contribution to the topic of poverty trap models so significant for the purpose of this paper? Ray’s key idea is to consider underdevelopment “not as a failure of some fundamental economic parameters …or socio-economic values, but as an interacting “equilibrium” that hangs together, precipitated by expectational inertia or by historical conditions” (Ray 2000 p.8), italics added. It is an approach that implies, on the one hand, that convergence is not an automatic result and, on the other, that there are no such “fundamental” differences between an economy’s agents that can make them more or less willing to save, invest, innovate, cooperate, etc. On the contrary, Ray claims it is the origin of agents’ different behaviours that needs to be explained.

The idea is that these behaviours are related to the history of a country or to individual expectations and beliefs. Therefore, the long-term path is a “self-reinforcing equilibrium” which in reality can be either a “historical self-reinforcing outcome” or an “inertial self-reinforcing outcome”, because expectations display high levels of inertia. In the first case, the historic starting conditions imply the persistence of the current
outcome, and the economy is entrapped in a sub-optimal equilibrium because of a “threshold effect”. It follows that the long-term equilibrium is a deterministic one. In the second case, the long-term equilibrium depends on the complementarities existing between agents’ expectations – which may be optimistic or pessimistic: “beliefs that a bad outcome will occur do come true in the sense that such beliefs precipitate bad outcome” (p. 16) and therefore different degrees of “optimism” or “pessimism” drive an economy from one status of equilibrium to the other. Hence the long-term equilibrium is of the “multiple equilibriums” type. The complementarities of the agents’ expectations are of crucial importance since, if agents share the belief that all agents will shift from the traditional to the emerging sector, then they will all be encouraged to take action and invest immediately in order to obtain greater benefits from innovation. Once again, this provides a few suggestions for our case. Depending on whether the expectations are optimistic or pessimistic, non-profit organisations may or may not innovate production methods, diversify service quality and supply, open up new markets, encourage investments in human capital and knowledge transfer, start exchanges with the non-profit sector (e.g. as producers of intermediate input). Furthermore, depending on expectations – optimistic or pessimistic – partnerships between public bodies and non-profit organisations may be either cooperative or collusive. Nevertheless, a crucial and still open question for this theory is “where do optimistic and pessimistic expectations come from?” (Ray 2000 p.5). And, once again, this seems an issue of great interest for the aim of this paper.

In synthesis, even though a large part of the reference literature does not investigate the specific case of the third sector, it can provide some interesting instruments to interpret its role in the development process. In particular, reference literature can help identify the factors which, within a given economy, favour the emergence of non-selfish preferences in a given population; then, if this happens, it can also help explain the agglomeration and consolidation processes of market transactions induced by these preferences. When this happens, it can help explain the activation of strategic complementarities between agents working in different markets and sectors – which obviously impact the development path of an economy. Needless to say, in real life situations there are also factors impeding the emergence of such preferences and preventing agglomeration and complementarity processes from being activated. All this leads to differentials in development paths.

4. Concluding remarks: social preferences, local development and the role of the third sector

The aim of the paper has been to offer a methodological instrument to rethink the role of the third sector in advanced economies: (i) the third sector is one of the institutions of economy if the social preferences which are peculiar to non-profit organisations become recognisable, cemented and agglomerated rules governing and promoting “human interactions”; (ii) the third sector is an important institution for development because, on the one hand, it contributes to modify individual expectations, thus becoming one of an economy’s “social technologies” and increasing opportunities in terms of agents’ income, employment and exchange and, on the other hand, it can activate strategic

28 The different policy implications in the two cases are remarkable: in the first case, the policy concerns the redistribution of initial assets, in the second case it is a temporary policy removing the causes of a low level of complementarities.
complementarity links between agents (externalities). This way, social preferences constitute a driving force, and the new “human interactions” they activate become mechanisms of propagation.

Following a selected literature overview of different theoretical approaches, the paper has identified the key ideas which in our opinion constitute the elements of a general theoretical framework which may be used to explain, in the future, whether and how the third sector impacts the development of different territorial contexts, and whether and how it can contribute to overcome poverty trap phenomena.

First and foremost, the literature on social preferences has highlighted that individual behaviours in society are very often motivated by other-regarding considerations. When individuals cooperate in their neighbourhood, on the workplace, in social organisations, etc., they contribute to the building of socially desirable equilibriums, whose aims are not assumed to be independent of the agents’ preferences. Neglecting individuals’ deepest motivations means dropping an important chance for democracies to solve problems connected to State and market failures (Ostrom, 2005; Fitoussi, 2004).

Secondly, the literature on modern growth give as two suggestions to interpret the role of third sector as an institution of an economy: i) the effectiveness of the third sector depends on its “local embeddedness” both in terms of the whole of economic activities and of the other actors making up the institutional framework; ii) in turn, this local embeddedness may be “positive” or “negative”, meaning that it can trigger either a “virtuous” or a “vicious” circle, depending on the starting conditions captured by various types of market failures and coordination failures (poverty traps).

As things stand, the theoretical challenge is to explain “what is the origin” of agents’ optimistic or pessimistic expectations (Ray 2000) which may act as a driving force in the long-term equilibrium path (multiple equilibria). This explanation is the first stage in developing a model about the agents’ mechanism of “migration” from a “bad” behaviour to a “good” one (Adserà and Ray 1998). In methodological terms, this means shifting the role of the third sector in the development process to the microeconomic level. And this means trying to “reconstruct” a particular territorial economic context based on the linkages the third sector activates with other private agents, i.e. the contractual arrangements on different markets and non-market transactions, as well as with public bodies and policy makers.

Preferences and territorial contexts evolve together, generating self-reinforcing equilibria which may be either path-dependent or driven by optimistic expectations. The third sector can be the institution activating and supporting this co-evolution process: insofar as social preferences materialise into rules governing both transactions which are not mediated by the market and transactions on the various interacting markets (which means that they govern the production process, the distribution of the gains it generates and their possible redistribution), they are transformed from occasional subjective motivations into shared institutional rules.

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