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**Working Paper**

## Social Capital, Networks, and Economic Wellbeing

IZA Discussion Papers, No. 13413

**Provided in Cooperation with:**

IZA – Institute of Labor Economics

*Suggested Citation:* Hellerstein, Judith K.; Neumark, David (2020) : Social Capital, Networks, and Economic Wellbeing, IZA Discussion Papers, No. 13413, Institute of Labor Economics (IZA), Bonn

This Version is available at:

<https://hdl.handle.net/10419/223855>

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DISCUSSION PAPER SERIES

IZA DP No. 13413

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Wellbeing**

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JUNE 2020

## DISCUSSION PAPER SERIES

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# Social Capital, Networks, and Economic Wellbeing

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JUNE 2020

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ISSN: 2365-9793

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## ABSTRACT

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# Social Capital, Networks, and Economic Wellbeing\*

One definition of social capital is the “networks of relationships among people who live and work in a particular society, enabling that society to function effectively”. This definition of social capital highlights two key features. First, it refers to connections between people, shifting our focus from characteristics of individuals and families to the ties between them. Second, it emphasizes that social capital is present not simply because individuals are connected, but rather when these network relationships lead to productive social outcomes. In that sense, social capital is productive capital, in the same way that economists think of physical capital or human capital as productive capital. Social capital, under this definition, is still very broad. Networks can be formed along many dimensions of society in which people interact – neighborhoods, workplaces, extended families, schools, etc. We focus on networks whose existence fosters social capital in one specific way: by facilitating the transfer of information that helps improve the economic wellbeing of network members, especially via better labor market outcomes. We review evidence showing that networks play this important role in labor market outcomes, as well as in other outcomes related to economic wellbeing, paying particular attention to evidence of how networks can help less-skilled individuals. We also discuss the measurement of social capital, including new empirical methods in machine learning that might provide new evidence on the underlying connections that do – or might – lead to productive networks. Throughout, we discuss the policy implications of what we know so far about networks and social capital.

**JEL Classification:** J1, J8

**Keywords:** social capital, networks

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\* We gratefully acknowledge past support for our research on labor market networks from NICHD and the Russell Sage Foundation, and very helpful comments from Giorgio Topa, Melissa Kearney, Ron Haskins, and Jon Wallace.

The term *social capital* is used often in casual social discourse, as well as in policy and academic discourse, to refer to something beyond the productive capacity and skills of individuals that can improve economic wellbeing. Everyone seems to recognize social capital as present when it is indeed present, and absent when it is indeed absent. But because social capital has been given many different definitions, we run the risk of naively attributing many economic and social problems to its absence and proposing that simply increasing social capital might help. Unless we precisely identify the problems and the mechanism by which specific forms of social capital can ameliorate them, the result could be vague diagnoses and untested, ill-formed policy proposals.

One definition of social capital is the “networks of relationships among people who live and work in a particular society, enabling that society to function effectively.”<sup>1</sup> This definition encompasses what people mean by social capital in many contexts, but it’s still narrow enough to be useful in identifying and studying social capital. In particular, it highlights two key features. First, it refers to the connections between people, and thus shifts our focus from the characteristics of individuals and families to the ties between them. Second, it emphasizes that social capital is present not simply because individuals are connected to one another—connections that can be described as networks—but rather when the relationships that undergird these networks lead to productive social outcomes. In that sense, social capital is *productive capital*, in the same way that economists think of physical capital or human capital (the accumulated skill that makes an individual productive) as productive capital.

Social capital, under this definition, is still very broad. Networks can be formed along virtually any of the many dimensions of society in which people interact—neighborhoods, workplaces, extended families, schools, etc. In this article, we focus more narrowly on networks whose existence fosters social capital in one specific way: by facilitating the transfer of

information that helps improve the economic wellbeing of network members, especially (but not exclusively) via better labor market outcomes. Much evidence shows that networks play this important role in labor market outcomes, as well as in other outcomes related to economic wellbeing. We review this evidence here, paying particular attention to evidence of how networks can help less-skilled individuals, who typically come from lower socioeconomic backgrounds. We also discuss the measurement of social capital, including new empirical methods in machine learning that might provide new evidence on the underlying connections that do—or might—lead to productive networks.

Throughout, we discuss the policy implications of what we know so far about networks and social capital. We see two key questions: How can public policy encourage the formation of social capital in the form of network connections that transmit information to improve socioeconomic outcomes? And how can policymakers use the potential of existing networks to create social capital that leads to more effective public policies? The burgeoning research on networks hasn't focused sharply on policy; still, we draw what lessons we can, and emphasize what we view as important remaining questions.

## **Networks and Labor Market Outcomes**

Perhaps the key area in which networks are known to affect social outcomes is in the labor market. Broadly speaking, networks in the labor market can play three roles.

First, networks can provide informal insurance or risk sharing to protect against adverse shocks in the labor market from a layoff or other unexpected drop in earnings.<sup>2</sup> Second, when individuals who are networked together participate in the labor market, we may see the impact of *peer effects* among network members. (Peer effects occur when the choices or outcomes of one networked individual directly affect the choices or outcomes of another member of the network.) Third, networks can facilitate the transfer of information in labor markets, where individuals face

barriers to learning about job opportunities and employers face barriers to learning about potential employees.

Here we're concerned primarily with this third role for labor market networks. We don't focus on risk-sharing networks, which have more to do with what happens outside the labor market in response to adverse labor market events, rather than with what improves success within labor markets. That said, it can be hard to separate peer effects from information transmission in networks; as a result, some of the research we discuss doesn't draw a hard and fast distinction.

In this section, we review the evidence on how networks can improve information flows between employees and employers, and improve the employment and wages of network members. We believe this evidence establishes that labor market networks can be an important source of social capital that helps create strong labor force attachment and higher wages, and hence they are critical for the wellbeing of families and children.

### *Evidence on Labor Market Networks*

Early evidence on labor market networks established that many people search for and find jobs through informal connections to others, in contrast to the usual job search models set down by economists. However, this research didn't demonstrate that the relationship between networks and labor market outcomes is causal.

A famous book by sociologist Mark Granovetter, *Getting a Job: A Study of Contacts and Careers*, is widely viewed as having launched the scholarship on the importance of networks in labor markets.<sup>3</sup> Granovetter interviewed men in Newton, MA, who were in managerial, professional, and technical jobs and who had switched employers in the previous five years. He documented that networks helped many of these men find their current jobs, and that those whose network contacts, or *ties*, led to their current jobs earned more and had higher job

satisfaction. About half of the workers he interviewed found their jobs through a social contact, and many more through a work contact. (There is similar early evidence for less-skilled jobs).<sup>4</sup>

Survey evidence has since confirmed Granovetter's findings. Economists Yannis Ioannides and Linda Datcher Loury reviewed evidence indicating that job searchers rely heavily on networks of friends, relatives, and acquaintances as part of their job search strategies.<sup>5</sup> One of their findings, to which we return below, is that the use of informal network contacts is more common among some groups, such as less-educated job searchers. But Ioannides and Datcher Loury also conclude that there is little evidence of racial (black-white) differences in the use of network contacts in job search. Thus, the evidence they review only partially supports the view that traditionally disadvantaged populations in the United States are more likely to use networks when searching for jobs.

Survey evidence can help establish how and how often people use labor market networks. But, for many reasons, such evidence may fail to answer the fundamental question of whether these networks have broad-ranging positive causal impacts on labor market outcomes. First, survey respondents who report using network contacts to find jobs may be fundamentally different from those who don't, making it difficult to identify the causal link between use of networks and labor market outcomes such as employment or wages. Second, cross-sectional surveys, which collect information about outcomes at only one point in time, don't offer much information about the importance of networks in securing employment for those who are currently not working, or securing higher wages for those who are. Third, survey evidence on the use of networks doesn't tell us much about how networks operate. Network contacts may be useful because they provide information to job searchers about available jobs generally or about jobs at those contacts' own employers.<sup>6</sup> Alternatively, network contacts can provide information about potential employees to employers who are hiring (that is, *referrals*).<sup>7</sup> To develop a

behavioral understanding of labor market networks, and to think about how policy might be able to improve the productivity of labor market networks in facilitating productive job search, it's important to disentangle these different roles for networks.

### *Experimental and Observational Evidence on Referrals*

Because of the limitations of survey evidence, most recent research on labor market networks instead either turns to observational data on labor market outcomes for individuals who are (or seem to be) connected by networks or uses experimental methods to create or manipulate the functioning of networks in the real world. Some of this work—especially more recently—pays careful attention to identifying causal channels by which networks operate, which can more clearly demonstrate the effects of networks on labor market outcomes. This research establishes direct evidence that network connections can lead to productive hiring of workers, including evidence on this effect for lower-skilled workers in the United States. For employers, productivity of network hiring is measured as higher output and/or profit. When these outcomes aren't measured, the productivity of networks is often inferred when workers who are hired via networks earn higher wages and/or experience less job turnover than other workers.

Experimental studies, by their nature, are narrow in scope. But when they are carefully designed and executed, such studies cleanly isolate mechanisms by which networks affect outcomes.

A recent series of linked experiments by economists Amanda Pallais and Emily Sands tested whether referrals that are made by workers contain information about the quality of referred workers.<sup>8</sup> The setting for their study is an online platform on which the authors hired workers (from the Philippines) to perform short online tasks. In the first stage of the experiment, the researchers hired experienced workers. They then asked these workers to refer others for additional tasks. In the second stage, they hired the referred workers as well as other, unreferred

workers to do these additional tasks. The referred workers were more productive than the non-referred workers. This was true whether or not the tasks involved team production with workers from the first stage, and whether or not the referred workers' productivity became known to the worker who made the referral, suggesting that the productivity effects in this study are not generated by peer effects.

Economists Lori Beaman and Jeremy Magruder provide related evidence from an experiment in Kolkata, India.<sup>9</sup> They note that while networks are common in developing countries as a way for members to insure each other against labor market risk, referrals to network members for job vacancies are also common: 45 percent of employees report having helped a friend or relative find a job with their current employer. Beaman and Magruder first recruited and paid participants to complete some basic tests of cognitive ability and to perform tasks for two hours. The participants were then offered monetary incentives for referring others to perform tasks. Some participants were paid based on the productivity of the workers they referred, whereas other participants were paid a flat fee for a referral. When participants were paid based on the productivity of the workers they referred, they were much more likely to refer a co-worker than to refer a family member.

The evidence from these studies shows that workers can refer other productive workers to employers. But labor market networks need not be productivity-enhancing for employers. Workers who refer family members are using their network connections to help their family members get hired, presumably enhancing the welfare of their family network but at the cost of not referring co-workers who could have been as or more productive. Thus, employers may need to offer incentives for referrals of more-productive workers. This evidence illustrates our earlier point that network connections aren't necessarily social capital. In some cases, network connections could simply affect who among equally productive workers gets jobs. They could

even (as in some of these studies) lead to referrals of less-productive workers.

Two other studies on referrals pertain to lower-skilled workers in the United States. One studies data from a single US financial services company, with information on whether an applicant to the firm was referred by a current employee of the company.<sup>10</sup> The authors tested for differences in outcomes between referred and non-referred workers, examining the probability of being hired, initial wages if hired, and subsequent wage growth and turnover. They found that referrals convey information that employers use in gauging the productivity of new employees. Applicants who were referred to the company were more likely to be hired, were paid higher wages early in their tenure at the firm, and had lower turnover. All of these referral effects were stronger for workers who were applying for and hired into lower-skilled positions at the firm. This suggests that the company finds it harder to screen lower-skilled applicants without the extra information conveyed by a referral. It also implies that networks may be especially important for workers who are more disadvantaged .

However, another finding from this study paints a less optimistic picture of the role networks may play in affecting labor market outcomes for more disadvantaged workers. In particular, the researchers found clear evidence of *homophily* in referrals; that is, current employees were more likely to refer individuals of similar age, gender, race, and ethnicity. It is not surprising that referral networks are segmented at least partially along these dimensions, likely reflecting workers' social contacts. But when companies rely on referrals for hiring (and, at least as in this study, pay referred workers more), these referrals can lead to positive outcomes only for networked workers, perpetuating a cycle of disadvantage for those outside the network.<sup>11</sup>

The second study is a larger-scale examination of how referral networks affect less-skilled sectors in the United States.<sup>12</sup> The authors used administrative data from nine firms in

three industries (call centers, trucking, and high-tech/IT), covering millions of applicants to the firms and hundreds of thousands of hired workers. They found that on many dimensions referred workers' productivity was similar to that of non-referred workers, although they were better on a couple of dimensions. However, in the lower-skilled sectors (call centers and trucking), where workers' contributions to profits are measurable, referred workers often had lower turnover and were cheaper to recruit, and hence added more to firm profits.

### *Networked Individuals and Labor Market Outcomes*

The research on referrals described above begins with the identification (or, in experiments, creation) of firms that hire, and then studies outcomes for workers hired via referrals versus other channels. This research can't capture outcomes for workers who aren't hired into these firms (perhaps because they lacked a referral). Thus, although these studies examined how employers and the workers they hire benefit from the information contained in referrals, they don't gauge whether networks provide useful information about available job opportunities to job seekers. Understanding how labor market networks can help job seekers requires a research design that starts by identifying groups of individuals—including the non-employed—who are networked together. Once these groups are identified, it becomes possible to study labor market outcomes for these networked individuals across many dimensions, among which finding a job is particularly important.

Many recent studies that use observational data of this kind have documented similar labor market outcomes for individuals who are plausibly networked together across a host of formal or informal relationships. The results establish that labor market networks often deliver improved labor market outcomes for job seekers, including higher employment and wages, lower turnover, and faster re-employment after layoffs. At the same time, this research establishes that these networks have some limitations, including stratification along ethnic or racial lines,

possibly implying that minorities have less access to the benefits of labor market networks.

These studies don't consider all (or even a large number of) possible network links among potential workers. Rather, they typically take advantage of datasets in which workers are observed to be connected along one potential network dimension. Once networks have been defined and identified in the data, the research usually proceeds by testing for correlated labor market outcomes—employment status, places of work, wages—among network members. Finally, researchers try to isolate the extent to which the network connections actually cause the correlated outcomes, attempting to rule out the possibility that the correlated outcomes of network members are spurious by-products of network members' shared observable and unobservable characteristics. These attempts at establishing a causal impact in improving labor market outcomes are central to testing whether such network connections represent social capital.

Recent research on the impact of online social networks like Facebook and LinkedIn constitutes one example of opportunistic use of potential network connections. For example, economist Laura Gee uses Facebook to test whether Granovetter's *weak ties* or *strong ties* are more valuable for finding jobs.<sup>13</sup> (Weak ties are connections with those more likely to have different contacts rather than the same contacts—say, a casual friend rather than a family member.) The evidence indicates that more jobs come from weak ties than from strong ties simply because individuals have more weak ties, but any individual connection is more helpful to job finding if it is a strong tie.

Research on online social networks and the labor market is in its early stages, but might in the future provide information that policymakers could use fruitfully. That said, the role of online social networks in transmitting information (or misinformation) is, understandably, controversial, so useful policy interventions may be difficult to design and implement. Given the

uncertainty surrounding these issues, we focus on network connections based in the physical world. These networks are arguably well understood, can be influenced by policy, and may be especially relevant for the less skilled.

One example of this type of research is a study of World War I veterans based on an unusual data set of men who served together in a particular infantry division during the war and for whom information was later recorded in the 1930 US Decennial Census.<sup>14</sup> Census data on the residential neighbors of these veterans provided a baseline from which to compute the *excess similarity* of outcomes among those who served together. When an additional peer from this group gained employment, the likelihood of a veteran's employment increased by 0.8 percentage point. Because the veterans didn't choose with whom to serve in the war, we can be more confident that the study identifies the true effect of the network on outcomes, rather than the effect of some underlying correlated factor that underlies both the creation of the network and later outcomes. On the other hand, the study has no direct or indirect evidence on information flows between members of the network, so the evidence could represent peer effects.

Other work on labor market outcomes in observational data where individuals are grouped together in networks includes, for example, studies of workers displaced from the same firm, of people who attended the same educational institution, and of people from similar racial or ethnic groups.<sup>15</sup> A common finding is a networked member's employment is boosted by the employment of others in the network, although, as in the study of World War I veterans, the mechanism isn't clear. Indeed, we would suggest that evidence based simply on membership in the same racial or ethnic group is particularly unlikely to reflect information flows.

Recent work has focused intensively on the geographic or spatial dimension of networks. Understanding how networks defined by residential proximity can affect labor market outcomes is particularly important because residential segregation by race, ethnicity, and socioeconomic

status is so pervasive in the United States. Such evidence is also important because social capital in neighborhoods can be meaningfully affected by the institutions that exist in those neighborhoods (schools, religious institutions, libraries, etc.), and potentially by government intervention as well.

It's reasonable to assume that information about jobs flows between people who live in the same neighborhood, and much of the evidence we and others have assembled is consistent with this. Perhaps most importantly, information flows between neighbors about jobs may be especially relevant to less-skilled workers, for whom job markets are more local and where job search may rely more on informal methods. Our evidence supports this hypothesis as well.

Economists Patrick Bayer, Stephen Ross, and Giorgio Topa found evidence of neighborhood-based networks that affect labor market outcomes.<sup>16</sup> They used confidential US Census data from the Boston area that identifies the census blocks where individuals live and the census blocks where they work. *Census blocks* in urban areas are like regular city blocks (they can be larger in suburban and rural areas), and thus they identify a group of individuals who live in close proximity and are very likely to interact as neighbors, thereby potentially forming a network.

Bayer and his co-authors find that individuals who live in the same census block are more likely to work at establishments in the same census block than are two individuals living in nearby areas (the same *block group*) but not the same block. Assuming that networks are stronger within blocks than within block groups, and that unobserved characteristics of workers are similar within blocks and block groups (assumptions that appear to be justified based on the data), this evidence suggests that residence-based labor market networks affect hiring.

As additional evidence, the authors estimate models that ask whether the relationship between residential and workplace proximity is stronger among pairs of people for whom a

network connection is more plausible, such as people of the same race, people who have school-age children of the same age, etc. Some of the results provide this kind of supporting evidence. For example, living on the same block as a stronger effect on working on the same block among people with young or adolescent children of the same age (but not children aged 18 to 24, which makes sense, since having children of this age probably doesn't lead to social interactions among parents). Having a similar education level (both people are high school grads) also has positive effects, which might make sense if those with only a high school degree have more local labor markets, or rely more on informal networks, than do college grads. On the other hand, there appears to be no evidence of homophily on racial or ethnic lines.

Our own past work also assesses evidence on the importance of labor market networks among neighbors, using data for the entire United States.<sup>17</sup> We used matched employer-employee data, which provides evidence on whether neighbors work at the same business establishment (and not simply on the same block). Because the data identify co-workers in the same establishments, this evidence is more directly linked to information flows about specific jobs among residents than in Bayer, Ross, and Topa's study, although the findings are consistent across the two studies.

We developed an index of labor market network isolation that captures the extent to which employees of a business establishment come disproportionately from the same sets of residential neighborhoods (*census tracts*). The index is measured relative to the residential locations of other employees working in the same census tract but in different establishments. Thus the index measures the excess concentration of workers from residential neighborhoods in specific business establishments, beyond what would be expected if workers were assigned randomly to any of the businesses in that same census tract.

The evidence indicates that residence-based labor market networks play an important role

in hiring. For white workers, the excess concentration of workers in specific establishments is about 10 percent of the maximum amount of sorting that *could* occur if networks were completely sorting workers across nearby establishments (an unreasonable expectation, but a useful benchmark). This figure is somewhat higher for blacks when we look at comparable tracts, and nearly twice as high when we compare blacks and whites in small establishments (which we do because the way the sample is constructed leads to disproportionate underrepresentation of small establishments for blacks). That is, overall, our evidence indicates that networked hiring is more important for blacks than for whites. Networks are also more important for less-skilled workers, which we would expect for network connections among residential neighbors, given that low-skilled labor markets tend to be local. Finally, residence-based networks are considerably more important for Hispanics, for whom the excess concentration of workers from the same neighborhoods in the same business establishments is about 22 percent of the maximum.

Finally, this excess concentration is twice as high for Hispanic immigrants and those with poor English skills than it is for non-immigrant Hispanics. This suggests that informal labor market networks are particularly important for workers who aren't as well integrated into the labor market and have difficulty learning about job availability, and for whom employers may have less reliable information.

This study offers clear evidence that networks help funnel workers into jobs with specific employers. But data limitations associated with the observational data preclude distinguishing whether networks break down information barriers that workers face or that employers face (or both).

Consistent with our earlier discussion about how hiring via networks may perpetuate disadvantage for some groups, other research finds that labor market networks may be racially or

ethnically based. When they are, reliance on informal referrals in a predominantly white labor market, for example, benefits whites at the expense of other groups.<sup>18</sup> The simple fact that some networks are based on neighborhood of residence implies racial stratification of networks. Beyond that, however, our study finds evidence of racial stratification of networks even within neighborhoods. If networks among co-residents are racially stratified, then the likelihood that a black worker works with a neighbor regardless of race should be smaller than the likelihood that a black worker works with a black neighbor. The evidence points to much weaker network connections between black and white neighbors than between black neighbors; specifically, the empirical importance of networks disregarding the race of neighbors and co-workers falls by more than 40 percent. (There is other evidence of racially or ethnically stratified networks in both the United States and Europe.)<sup>19</sup> Thus it appears that labor market information is less likely to flow between black and white co-residents than between co-residents of the same race.

The studies we've discussed so far examine how residential labor market networks may affect employment. As we've said, though, an important question from the point of view of social capital is whether the jobs that appear to be found through network connections result in more-productive job matches.

More recently, we studied whether individuals who work together in the same establishments and who are networked together via residential proximity (living in the same census tract) have better labor market outcomes.<sup>20</sup> If networks help direct workers to establishments and/or jobs in which they are productively matched, then these networked workers should earn more and leave those firms less often than do non-networked workers, as predicted in theoretical models.<sup>21</sup>

Using a measure of neighborhood network connectedness that is closely related to the index in our first study, we estimated models with controls designed to isolate the impact of a

worker's neighborhood network among his or her co-workers on wages and turnover.<sup>22</sup> The controls included measures of how many networked neighbors work at nearby employers, and a rich set of worker- and employer-specific controls that capture all the unchanging features of both workers and employers (these are known as *fixed effects*).

One of our key findings is that workers who have more neighborhood network connections at work have lower turnover, suggesting that information flows in the network get workers valuable jobs. We observed this network effect both for connectedness to one's neighbors generally and for connectedness to neighbors of the same race or ethnic group.

However, turnover could be low when networks are strong simply because workers enjoy working with their network members, and not because the job is a productive match for the worker. Thus we also examined how earnings vary as a function of network strength among one's co-workers. We found that the overall neighborhood network measure had a positive effect on earnings. But when we measured network connectedness only within race and ethnicity, we saw a negative effect. This suggests that workers value working with neighbors of the same race and ethnicity to the extent that it makes them willing to earn lower wages to do so. But the finding that network connectedness to all workers raises wages (as well as lowering turnover) suggests that networks are more than just workplace amenities, and that they lead to more productive job matches for workers.

Economist Ian Schmutte focuses on the relationship between neighborhood networks and wages.<sup>23</sup> Also using matched employer-employee data from the United States, he defines a worker's network as individuals who live on the same census block; as Bayer and colleagues did, he, uses the slightly broader census block group as a comparison. He found that when an individual is networked to other workers who work for high-wage employers, that individual is more likely to change jobs to move to a higher-wage employer. Only part of this effect occurs

through job changing to a networked neighbor's employer, which suggests that the results may reflect a blend of network and peer effects. He also demonstrates that local referral networks have a stronger effect for immigrants than for natives, which is at least consistent with the idea that immigrant groups face more barriers to information about high-wage employers.

Finally, in our most recent work on this topic, we examined the role that neighborhood networks play in securing re-employment for workers who experience mass layoffs.<sup>24</sup> A tremendous amount of evidence shows that displaced workers suffer long term consequences from mass layoffs, including years of subsequent low (or no) earnings ) and higher mortality, as well as worse long-term outcomes for their children. Thus, the potential role of networks in helping workers recover from mass layoffs can be important for even long-term economic wellbeing , including across generations.

We used matched employer-employee data to examine the likelihood of re-employment for workers who lost jobs in mass layoffs (such as plant closings) in the United States from 2005 to 2012—the period before, during, and right after the Great Recession. We found that neighborhood networks meaningfully increased the likelihood that workers would be re-employed in the calendar quarter following the layoff, often by finding jobs at their neighbors' employers. This was true in models with extensive sets of control variables to control for sorting and worker heterogeneity, making it much more likely that the results reflect causal effects of networks.

The evidence that workers found jobs at neighbors' employers, in particular, indicates information flows between residents about jobs where some of them work—whether it was simply information about job availability or actual referrals. Moreover, the jobs found at neighbors' employers lasted longer and paid more than jobs that laid off workers found at other employers, consistent with the theory that network connections lead to more-productive job

matches—which we interpret as a reflection of networks as social capital. Finally, and importantly, we his evidence is driven by lower earners (those who make less than \$50,000 per year), presumably reinforcing the idea that labor markets are more local for lower-skilled workers, and job search for them relies more on informal methods.

### *More on Networks and Immigrants*

Some of the evidence discussed thus far shows that immigrant networks are especially important in the labor market. This conclusion is reinforced by a series of studies that specifically examine immigrant networks.

Sociologists Michael Aguilera and Doug Massey studied a sample of 2,000 Mexican migrants to the United States who were followed as part of the Mexican Migration Project.<sup>25</sup> In their sample, 60 percent of documented immigrants and 71 percent of undocumented immigrants reported using friends or family to find work in the United States. For both types of immigrants, the larger their social network, the better their labor market outcomes, holding fixed a host of the workers' other personal characteristics. Moreover, undocumented immigrants who reported using distant relatives or friends to help them obtain jobs had better labor market outcomes—generally associated with finding a formal-sector job. Aguilera and Massey suggest that these better outcomes result from the social capital of these immigrants' networks, which funnel information to them about employers in the formal sector who were willing to hire workers without documentation.

More recently, economist Kaivan Munshi studied a larger sample of approximately 4,500 Mexican immigrants from the same data set that Aguilera and Massey used.<sup>26</sup> He also found that respondents used friends or family to find work at high rates when they came to the United States, although he sees the networks as providing referrals to employers rather than information to workers about available jobs (based on evidence from surveys of immigrants in the United

States). To isolate whether the network effects were causal, Munshi took advantage of variation in rainfall in Mexico, which creates random differences in the size of migrant cohorts, and hence the size of immigrant networks, because new migrants enter the United States partly in response to rainfall fluctuations that affect agricultural jobs. The study uncovered a large role for local existing migrant networks in the US on labor market outcomes of new arrivals. In particular, migrants were more likely to be employed when there were larger cohorts of previous migrants from their local Mexican community in the place to which they migrated. The new migrants were also more likely to be working in better, nonagricultural jobs when they had more network contacts already established in the labor market in their US locations.

### *Policy Implications*

The research on the effects of networks in labor markets makes the case that labor market network connections can improve labor market outcomes for the less skilled, even during difficult economic times. For example, we found that although high unemployment rates and low vacancy rates during the Great Recession period made it much harder for laid-off workers to find new jobs, neighborhood labor market networks remained productive.<sup>27</sup> So policies that strengthen the information flows or the size of local labor market networks may be especially important during times of economic hardship. In the concluding section, we'll discuss how policy might help accomplish these goals.

### **Networks and Learning**

Networks can also serve to increase information flows that affect outcomes beyond the labor market, and hence the social capital role of networks can extend to other dimensions of economic wellbeing. Although these other roles for networks have been studied much less, there is clear evidence that networks can serve as conduits for information about health access, agricultural production methods, education, crime, and government subsidies. Much of this

evidence is from developing countries, but the kinds of results that have been uncovered may carry over to the United States—as indeed evidenced by a limited amount of research on other kinds of network effects in the United States.

### *Health Interventions*

A recent randomized controlled trial in India examined how social networks can provide information to improve health outcomes.<sup>28</sup> The authors studied whether patients already diagnosed with tuberculosis (TB)—a prevalent but underdiagnosed contagious disease—are more effective than health workers at referring other potentially infected individuals for diagnosis and treatment. They demonstrated that peer referrals for TB screening are much more effective (in terms of numbers of new TB cases identified and of cost-effectiveness), both because current TB patients have better information than health care workers do about who in their networks might have TB, and because current patients are more effective at persuading these potentially infected network members to appear at health clinics for screening and treatment.

### *Agricultural Production*

A good deal of evidence from developing countries shows that information on agricultural production is transmitted through networks, with productivity-enhancing effects that are consistent with a social capital role. One study finds evidence that among pineapple farmers in Ghana, neighbors are an important source of information about using fertilizer to increase productivity.<sup>29</sup> Another study, in Mozambique, shows that that information transmitted within networks is important for the adoption of sunflower as a crop.<sup>30</sup> And a third, in India, finds evidence that information from neighbors about the productivity of high-yield seed varieties increased farmers' adoption of the new technology.<sup>31</sup> The lessons of these studies should apply to other contexts where business owners, especially small business owners, use information from

their network ties in the same industry to guide decisions about changing the nature of production or otherwise increasing their productivity and profitability.

### *Networks and Government Programs*

A small but compelling set of studies shows that networks provide information about government programs to individuals who are eligible to use them but might not otherwise know to (or how to) take them up. Increasing evidence suggests that social assistance and income-support programs that aid families and children can have longer-term intergenerational beneficial effects on poverty reduction, child health, educational attainment, and earnings.<sup>32</sup> These findings imply a public policy interest in encouraging take-up of these programs, making it important to understand whether networks can reduce barriers to the take-up of these programs by eligible recipients.

Economists Marianne Bertrand, Erzo Luttmer, and Sendhil Mullainathan examine how non-English speaking women's participation in social assistance programs is affected by their local network of individuals who speak the same non-English language and live in the same geographic area (Primary Metropolitan Statistical Areas).<sup>33</sup> They show that a woman's probability of receiving social assistance program benefits is higher when her geographic area contains a higher concentration of individuals in who both speak her language and themselves receive social assistance—a relationship that holds even after controlling for overall social welfare receipt in the area and the concentration of individuals who speak the same language. The authors are clear that they can't formally distinguish peer effects from information about social assistance programs transmitted through networks. But they argue that, given the institutional complexity embedded in many of these programs, it seems likely that information transfers plays at least some role in their findings. A related study finds that information flows are responsible for variation in the use of specific social assistance programs across networks of

immigrants.<sup>34</sup>

There is also evidence that information flows within communities affect take-up of the Earned Income Tax Credit Program (EITC), which provides refundable tax credits to low-income households. The EITC is a large program that reaches many families: 20 percent of households filing taxes and 44 percent of households with children, at an annual cost of around \$70 billion.<sup>35</sup> The EITC is credited with increasing the labor supply among single women with children, improving infant and maternal health, improving children's test scores, and increasing educational attainment.

Recent work using detailed tax data offers evidence that local information about the EITC encourages take-up of the program.<sup>36</sup> The study examines EITC claims by self-employed taxpayers, who—in contrast to wage-earning households—have some ability to manipulate their reported income to maximize EITC payments. The authors present two compelling types of evidence that information flows in neighborhoods change individuals' knowledge of the EITC system. First, the self-employed are more likely to maximize their EITC after they move to a zip code where other self-employed individuals also maximize their EITC, while self-employed people who move from those zip codes to zip codes where fewer engage in similar behavior continue to maximize their EITC. This asymmetric response suggests that information is transmitted across taxpayers within the high-EITC locales, in contrast to local variation being driven by local tax preparers, or by local policy to encourage people to claim the EITC (such as San Francisco's Working Families Credit, which pays a one-time credit to families that claim the federal EITC). Second, when self-employed taxpayers first have a child and therefore become eligible for a significant EITC benefit, those who live in places where fewer self-employed taxpayers maximize their EITC also do not maximize, while the opposite is true in high-maximizing locations. Similarly, another study analyzes data on the intensity of Facebook

connections across counties and also finds evidence that information networks operate to change EITC claiming behavior among the self-employed.<sup>37</sup>

### *Networks and Children*

Labor market networks that increase employment and earnings, and informational networks that facilitate productive outcomes outside the labor market, can improve the wellbeing of children in affected families. A small amount of evidence suggests that learning through networks can directly benefit children.

Some qualitative research shows that childcare centers in high-poverty neighborhoods can serve as *resource brokers*, helping families get access to external organizations including businesses, nonprofits, and government agencies.<sup>38</sup> (Other work documents a similar phenomenon for different kinds of institutions in disadvantaged neighborhoods, such as beauty salons in immigrant neighborhoods and churches in black neighborhoods, although in these cases the evidence doesn't pertain to benefits to children.) Sociologist Mario Small and his co-authors argue that “the childcare center is arguably the most important neighborhood institution for low-income mothers.”<sup>39</sup> In some cases, these centers can deliver benefits to children. Some are informational or educational, such as information on how to treat asthma, prevent lead poisoning, reduce domestic abuse, navigate school systems and negotiate enrollment, and instruct children on fire safety. Others are direct services, such as obtaining free health care, speech therapy, or dental work. Small et al. explicitly document both formal informational interventions in these settings—such as parent workshops with government agency workers, bulletin boards with information, or referrals of parents to outside organizations—and informal sharing of information. It also documents informal connections between parents, forged, for example, on field trips or in parent association meetings.

Moving from qualitative to quantitative evidence, a recent study implemented and

examined an intervention that explicitly aimed to increase social capital among parents of children in Head Start.<sup>40</sup> The experiment randomly assigned children to Head Start classrooms based on two different treatments associated with greater potential for parents who live near one another to make connections—one based only on residence in the same neighborhood, and a second that added an explicit attempt to pair parents in the same classroom to support each other and share in solving problems (like assistance in picking up a child). Both quantitative and qualitative evidence point to gains in social networks in the treatment groups (for example, an increase in the size of the self-reported social network, or in willingness to ask a parent in the classroom for help). There is evidence that both treatments increased classroom attendance in the winter when attendance was lowest (with positive but not statistically significant effects on attendance over the whole year).

### *Policy Implications*

In our view, the most concrete evidence on the potential for using networks to spread information comes from the research in developing countries on health interventions and agricultural productivity. We suspect that the same kinds of productivity-enhancing information sharing could work in the United States. The evidence on networks among parents at childcare centers is also intriguing, especially as it relates to disadvantaged neighborhoods; we should search for more information and evidence about neighborhood institutions that can play a similar role.

The evidence on the EITC speaks directly to policy effectiveness rather than wellbeing. But it's important to note that many households that are eligible for the EITC don't claim it: roughly 25 percent of those eligible don't receive EITC benefits.<sup>41</sup> Given that networks can increase information about the EITC, and given that receiving the EITC improves outcomes for families that receive information, it's possible that EITC claims could be increased by

disseminating information about the program through local networks, leading to improved socioeconomic outcomes for eligible low-income households. More generally, using community-based networks to increase information about the availability of and application process for social assistance programs—whether income-based programs like the EITC or in-kind transfer programs like Medicaid or the Supplementary Food Assistance Program (formerly known as Food Stamps)—has the potential to increase the use of these programs by households in need, which could lead to important increases in the wellbeing of both adults and children.

### **Understanding and Measuring Social Capital in Networks**

We’ve seen significant evidence documenting that social capital plays an important role in networks, and evidence that networks play a key role in facilitating information transfers among network members. But how can we measure the extent of this social capital? How can research understand network boundaries and membership]? And can research identify the underlying factors that build strong social capital in networks? In this section, we consider these difficult questions.

In one respect, we’ve already offered a method for measuring social capital in communities—by providing measures of the extent and strength of networks that are productive in producing better job matches, as in some of the studies discussed above.<sup>42</sup> The more standard approach, however, is to study readily available proxy variables that are hypothesized to measure the strength of social capital in communities.

For example, economists Anil Rupasingha, Stephan Goetz, and David Freshwater have created a widely used and regularly updated index of social capital across US counties.<sup>43</sup> The index is based on four variables previously used as proxies for local social capital: voter turnout and response rates to the US Census, both interpreted as measures of trust and civic participation; the number of nonprofit establishments (using data from the National Center for Charitable

Statistics); and the per-capita number of business establishments reported by the US Census Bureau in its County Business Patterns data for 11 industries that are thought to increase cooperation and trust (like bowling alleys, as in Robert Putnam's work).<sup>44</sup> The authors justify the four variables underlying their index as derived from the work of "scholars from various disciplines (who) have reached a degree of consensus on this issue and have put forward a list of factors that contribute to social capital formation in a community."<sup>45</sup>

Rupasingha, Goetz, and Freshwater's index is based on a statistical tool known as *principal components analysis* that weights the four variables in their index so as to best capture the variation in the four variables combined. The authors define their Social Capital Index as the first principal component, which reflects a weighted combination of the four inputted social capital variables that creates high variance across U.S. counties.

These researchers argue that the county-level variation in their index captures social capital produced by individuals and families who live and work in those counties. As evidence, they show that their index is related to county-level demographic characteristics such as ethnic homogeneity, education levels, and the fraction of households with children, some of which are hypothesized to be factors in the creation of social capital. Other studies, in turn, use this index, as well as other variables, as measures of social capital that are inputs into the production of socioeconomic outcomes. For example, economist Raj Chetty and his co-authors found more intergenerational upward mobility in geographic areas with higher measures of the index, which they interpret as an effect of social capital.<sup>46</sup>

The fact that researchers differ in interpreting social capital measures as inputs or outputs reinforces the challenges of measuring social capital. As an example, consider the variables that underlie Rupasingha, Goetz, and Freshwater's index. High voter turnout and strong response rates to the Census are more plausibly outcomes of what happens in communities that have

strong social capital, rather than direct components of social capital, because it's unclear what these measures produce in terms of socioeconomic outcomes. Thus the index may not capture variations that would be of interest to either policymakers or researchers who hope to create social capital that improves these outcomes.

A second challenge is determining which industries contribute to local social capital—which is somewhat subjective—and how to measure the geographic dispersion of these industries and how to aggregate across them. For example, the National Center for Charitable Statistics data on the number of charitable organizations in a county doesn't distinguish among them in terms of their ability to create local social capital. It also misses some nonprofits, and it places nonprofits with multiple locations at one central site, which for large nonprofits may be far removed from where they are creating social capital.<sup>47</sup> Finally, the county borders that Rupasingha, Goetz, and Freshwater use are driven by geography and the availability of data, and not by fundamentals of how people and organizations interact in communities.

In our own recent work, we also take a data-driven approach to understanding the factors underlying social capital in communities.<sup>48</sup> However, our method of measuring social capital is tied more directly to a measure of productive social capital—specifically, the local labor market networks studied in some of our earlier research.<sup>49</sup> This measure, as discussed earlier, captures the extent to which individuals who live in the same census tract work together in the same establishments, and reflects the way local neighborhood networks can decrease barriers to information flows in the labor market for job searchers or for employers. Thus, we seek to understand which underlying social capital factors work at the neighborhood level to create strong labor market networks that connect neighbors to workplaces and produce better labor market outcomes.

The analysis focuses on which nonprofit industries that might boost social capital are in

fact associated with stronger labor market networks. This analysis is done simultaneous with consideration of the role of measures of social capital based on past research. Given that many possible social capital measures can predict labor market connectedness at the neighborhood level, the study's key innovation is to use a machine learning algorithm called LASSO to identify which potential social capital measures best predict variation in the labor market network measure. Like principal components analysis, the machine learning algorithm is a data-reduction technique. From the many possible social capital measures that could contribute to strong labor market networks, only the most important ones are chosen, and they are chosen by the algorithm and not by the researchers. However, compared to past work, a fundamental difference is that social capital measures are selected based on their ability to predict a measure of productive social capital—the measure of the strength of local labor market networks.

We incorporate four sets of social capital measures as candidates for determining the strength of neighborhood labor market networks. The first set reflects the demographic and socioeconomic characteristics and the homogeneity of neighborhoods, which may capture cooperation and trust within neighborhoods (but could also reflect economic conditions of local labor markets). These measures include tract-level poverty rates, educational attainment, and measures of racial and ethnic composition, educational attainment, commuting to work, and residential stability.

Because parental involvement in schools can raise social capital, the second set of social capital measures captures information on the size and characteristics of local school districts.<sup>50</sup> These variables include the student/teacher ratio, how connected students are across schools in the district, and the fraction of students who receive free or reduced-price lunch.

The third set is closer to the measures discussed above that may reflect outcomes of the production of social capital at the local level, more than inputs. It includes voter turnout,

prevailing political opinion, and ideological homogeneity, as suggested by prior research.<sup>51</sup>

Finally, we chiefly aimed to build on past work suggesting that civic institutions, religious organizations, and other nonprofits contribute importantly to social capital.<sup>52</sup> To this end, we incorporated data from the National Establishment Time Series—a data set that had not been previously used to measure the number and composition of nonprofits by census tract. This data set contains the precise geographic location, employment numbers, and North American Industry Classification System codes for, essentially, all establishments in the United States. The data are recorded at the level of an establishment’s physical location, thus overcoming some of the limitations of the data from the National Center for Charitable Statistics,

We used the National Establishment Time Series data to construct census tract-level counts of the number of establishments in the nonprofit sector (including government institutions)—such as libraries, churches, civic associations, and community centers—that might facilitate the kind of social capital that builds labor market networks. We used a broad definition of the nonprofit sector, partly to account for data limitations, and partly because some for-profit establishments in heavily nonprofit industries may perform similar functions when it comes to creating social capital. Despite restricting our attention to establishments in the nonprofit sector, the data still represented about 90 distinct industries. We used LASSO to identify the most important predictors of the strength of labor market networks from a very large set of potential social capital measures.

LASSO helped us select social capital measures that explain two alternative but related labor market network indexes defined for residential neighbors in the census tract. The first is the census-tract average of the individual labor market network index, used in our earlier work, for each worker in a Census tract.<sup>53</sup> Because this measure captures how connected workers who live together are with one another at work, on average, it is by definition limited to those who are

employed. The second measure includes non-employed workers in the index, who are each assigned an individual network measure of zero because they don't work with any neighbors. Our results turned out to be robust across both indexes.

The analysis proceeded in two stages. In the first, the LASSO algorithm chose the set of social capital measures that were most strongly associated with the census-tract network indexes. In the second, the magnitudes of the effects of the selected social capital measures on the networks indexes are estimated.

We must be interpret the results cautiously, since we didn't explicitly attempt to isolate exogenous (and hence causal) variation in the social capital measures. Nonetheless, our analysis suggests that some of the more traditional measures of social capital (such as residential stability and the share of residents in the census tract with a college education) predict stronger labor market networks at the neighborhood level, while others (such as voter turnout) do not.

The results for nonprofit industries were most interesting. In a number of these industries, a concentration of establishments at the neighborhood level predicted strong local labor market networks. Moreover, the selected industries seem likely to create social capital via either providing public goods or facilitating social contacts. They include churches and other religious institutions, fire and rescue services, schools, police departments, ambulance or rescue services, country clubs, mayors' offices, nursing homes, and amateur or recreational sports teams or clubs.

This study can also be viewed as a preliminary exploration of the role machine learning could play in helping us understand the determinants of social capital in networks. For example, we limited our focus to the nonprofit sector, but it may well be that social capital is created by the for-profit sector too—for example, by neighborhood restaurants and gyms where people gather, or by local businesses that invest in their communities through volunteering or other kinds of outreach. A machine learning approach makes it entirely feasible to take a more

expansive look at which kinds of businesses create social capital.

Moreover, a key limitation of nearly all of the studies we review in this article is that each one examines only a limited set of networks, and the boundaries of these networks are typically driven by the connections that can be measured in the data, rather than the connections reflected in the outcomes the researchers are interested in. In reality, network boundaries are fluid and can be shaped intentionally or unintentionally by the choices people make, and individuals can have ties to many different networks, many of which overlap and most of which shift over time and across people. Moreover, individuals may have ties to only some of the people we identify as potential network members in the data; for example, they may have ties to only a subset of neighbors in their census tract. With enough information on the different networks links that individuals could have across many dimensions of their daily lives, and information on most of the individuals in the potential network, machine learning techniques could be used to determine the make-up and the boundaries of networks, and to pinpoint which networks and which network connections are better than others at fostering the social capital that improves economic wellbeing. And, to be sure, this evidence could be complemented by the kind of qualitative evidence that sociologists Eric Klinenberg and Mario Small marshal regarding the roles of neighborhood businesses and institutions.<sup>54</sup>

### *Policy Implications*

Our inquiry into what constitutes productive social capital raises more policy questions than it answers. For example, our study measuring social capital and predicting network strength, if interpreted as causal evidence (rather than simply predictive), might point to certain types of civic institutions that merit public support. As a recent example, Klinenberg argues for increased support for what he calls *social infrastructure*—such as libraries, parks, and community gardens—to strengthen community interactions.<sup>55</sup> Though he relies largely on qualitative

evidence, more sophisticated empirical methods could in principle guide the choice of priorities for public investments to increase social capital.

## **Public Policy and Networks**

We've already discussed some broad policy implications stemming from existing research. In this final section, we turn to specific evidence on public policy and networks, most of which pertains to labor market networks.

A key question is what kinds of institutions and policies can help less-skilled workers find jobs (or better jobs,) especially when they are members of disadvantaged communities who may have limited access to job and employer contacts because of their social and residential isolation.

We begin first by asking the opposite question: What might weaken these connections? For example, informal evidence suggests that one reason the Moving to Opportunity program failed to improve labor market outcomes was the loss of informal labor market connections among movers.<sup>56</sup> One consequence of the Moving to Opportunity program was that it encouraged participants to move to areas where there were more jobs. But the program could have been rendered ineffective or even counterproductive if it severed ties to labor market networks among those who moved, perhaps in part because it moved many black participants to areas with smaller minority populations.<sup>57</sup> The flip side is that similar programs might be more effective if they helped to develop labor market networks in the areas to which people move.

Similar issues arise regarding place-based policies that focus on creating jobs where disadvantaged people live. Economist Helen Ladd describes “the social isolation of many residents in distressed areas” that “results in incomplete knowledge of the labor market and limited exposure to people in the labor market who may serve as the informal contacts needed for successful job searches.”<sup>58</sup> Depending on how they are designed, place-based policies (such

as enterprise zones) that offer incentives for job creation in disadvantaged neighborhoods may or may not strengthen labor market networks in those areas. In particular, these policies may be ineffective at improving local labor markets because businesses in these neighborhoods may not hire locals. In a case study, sociologists Philip Kasinitz and Jan Rosenberg found that employers relied on hiring networks that excluded local, poor residents, and hired from networks of workers who lived further away. (In part, they suggest that employers may have preferred to hire those who lived farther away out of fear that local residents would have trouble avoiding family problems at work, and could be pressured by other local residents to help burglarize their businesses.) Thus, policymakers need to think about the geographic targeting of efforts to build networks and social capital, and how to design policies to build social capital where it is needed. For example, if enterprise zones are to help the disadvantaged neighborhoods that are the intended beneficiaries, it may be essential to offer incentives only for local hiring.

The Jobs-Plus program aimed to increase labor supply incentives for public housing residents by reducing the rent increases that accompany increases in earnings. Reflecting the problem Ladd identifies, Jobs-Plus tried to encourage the formation of labor market networks or to provide functions similar to those supplied by networks. Most sites had job developers on staff whose responsibilities included cultivating relationships with local employers in an effort to place Jobs-Plus participants.<sup>59</sup> The program also employed residents as *court captains* or *building captains* who maintained contact with other participants, including sharing information about employment opportunities. More generally, Jobs-Plus attempted to transform the community through a saturation strategy that targeted all non-disabled working-age residents of public housing projects, rather than just trying to change individual behavior. This was based on the network-related (and peer effect-related) theory that saturation can lead to tipping points, creating a critical mass of employed residents who succeed in the workforce. The theory was that

employed residents would “signal to others the feasibility and benefits of working, elevate and strengthen social norms that encourage work, foster the growth of work-supporting social networks, and ... contribute to still more residents getting and keeping jobs.”<sup>60</sup> Trying to link residents to employment opportunities via job developers and captains was also meant to provide the labor market contacts that many of the participants lacked.

Some evidence suggests that the program delivered higher earnings and employment for its participants.<sup>61</sup> But two key problems make it difficult to draw firm conclusions about the value added by the efforts to build labor market network connections. First, implementation of the network component of Jobs-Plus was spotty and encountered unanticipated difficulties. Second, it’s hard to tell which components of the Jobs-Plus program delivered economic gains to its participants.

More sobering is the qualitative evidence from reports on Jobs-Plus of problems encountered in trying to build and strengthen labor market networks, often related to fears of referring an employee who would be unsuccessful or worse.<sup>62</sup> Despite these difficulties, however, the description of implementation reveals numerous cases of job developers and sometimes captains finding ways to link residents to employment opportunities.

Finally, our discussion of learning about social assistance and income-support programs may point to the lowest-hanging fruit policymakers can exploit to improve economic wellbeing. In particular, if we already have policies like the EITC, SNAP, etc., which deliver important improvements in economic wellbeing, then looking to network connections among potentially eligible recipients (as well as other ways of increasing information about how to apply for these programs) seems like an especially efficient direction for policy. Should we view such policy encouragements as spurring social capital? We would argue that the answer is yes, because these programs were deliberately created to serve those who are eligible, with, presumably, some

calculation of positive benefits relative to the costs underlying the creation of the policy. Still, we imagine that a less controversial and more widely embraced goal is to enhance the ability of networks to build social capital that leads to more productive workers and jobs, thereby reducing reliance on public support—although that challenge is more formidable.

### Endnotes

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