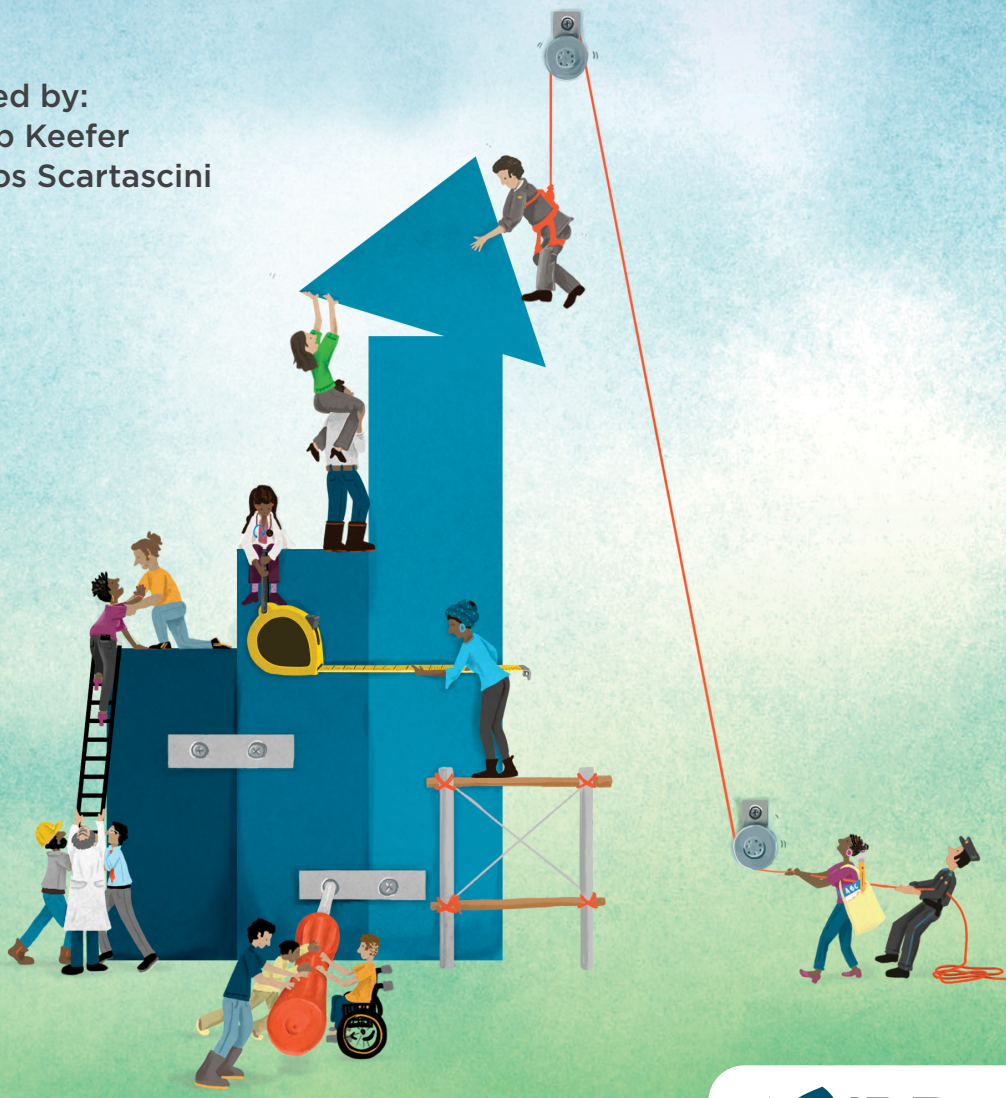
DEVELOPMENT IN THE AMERICAS

# TRUST

## The Key to Social Cohesion and Growth in Latin America and the Caribbean

Edited by:
Philip Keefer
Carlos Scartascini



IDB

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# Preface

The 2020 pandemic shocked a world already shaken by mistrust and social polarization. Lives and jobs were lost despite the best efforts of governments to contain COVID-19 and support families and firms. Confronted with the magnitude of the shock and the suffering it has unleashed in Latin America and the Caribbean, the Inter-American Development Bank's commitment to improving lives in the region has never been greater. That commitment includes doing all it can to build trust in the region.

Latin America and the Caribbean can build on the ingenuity and diversity of its people and the abundant natural resources that line the region from coast to coast. The region can exploit the benefits of its markets from north to south, and its strategic location at the crossroads between the east and the west. The IDB supports this transformation with its *Vision 2025* agenda: tighter regional integration and strengthened value chains; digitalization; more productive and faster growing small and medium-sized businesses; gender equality; and robust action on climate change. Trust is fundamental to the achievement of these goals.

Trust is the belief that others will not act opportunistically. It is faith in others—in their honesty, dependability, and good will. Trustworthy people make promises they can keep and keep them; they respect social norms. Without trust, people live in fear, not freedom; they focus on the opportunities of today rather than innovating to expand the opportunities of tomorrow.

Latin America and the Caribbean has significant opportunities to increase trust. According to data from the Integrated Values Survey, interpersonal trust is lower in the region than in the rest of the world. Today, only one in ten people in the region considers that other people can be trusted—down from one in five a mere four decades ago. Trust in government is also lower than elsewhere. Fewer than one in three people trust their government, and the numbers are even lower for institutions such as Congress and political parties.

Many are aware of the growing lack of trust between citizens and their governments, and the other way around. This 2021 *Development in the*

*Americas* report provides new evidence on the importance of trust in the private sector, for example, on its effects within firms. In a survey conducted on the IDB's *ConnectAmericas* platform of 3,000 firms from 17 Latin American and Caribbean countries, managers told us of the importance of trust to their business operations.

Trust affects not only how firms are organized, but also societies. Low trust weakens social cohesion, contributing to high levels of informality and the reluctance of individuals and firms to obey laws, pay taxes, and comply with regulations. Mistrust drives people apart.

This book describes the great possibilities that await the region as trust grows. Democracy will deepen, as politicians will be more responsive to voters who are able to trust their promises. Economic growth will accelerate, as firms will invest more in innovation because they trust governments to tax and regulate them as they do other firms. Good jobs will multiply, as employment increases when employers and workers trust each other. Public safety will improve, as the police can better protect citizens who trust them. And so will public health, as individuals are more likely to get vaccinated and take medications when they trust their doctors. In short, throughout the world, trust can be a prescription for fighting political and economic malaise.

By raising trust levels to those of the OECD, the region can give a powerful and irresistible boost to its exit from the pandemic. The IDB supports this effort through a broad and sophisticated program of financial and technical assistance. It recognizes that the uninformed and disempowered are more likely to believe that other people, firms, or government will take advantage of them. To convince them otherwise requires a two-pronged approach. One is to inform and empower. The other is to increase trustworthiness—for example, by improving the capacity of the public sector to fulfill its commitments to citizens.

The more people understand the world around them, the greater their trust in others. Hence, education is crucial to inform and empower. The IDB is especially proud of its long dedication to promoting access to higher-quality education in every country of the region. Novel and more targeted initiatives also inform and empower citizens. The IDB has worked with 12 countries to erect digital platforms, such as *MapaInversiones*, to provide citizens with real-time information on where public investment spending is going, allowing them to register allegations of misuse.

Operations to inform and empower also build trust in the private sector and are crucial to the *Vision 2025* agenda. For example, concern that borrowers will abscond with loan proceeds is a significant obstacle to credit access, particularly for small and medium-sized enterprises. To build

trust in credit markets, the IDB has worked with six countries to establish guarantee funds that give banks greater confidence in the loans they extend to these businesses. We are also at the frontier of leveraging digitalization to increase trust and inclusion in credit markets, supporting the use of alternative credit scores based on nontraditional data in El Salvador and Argentina.

It is not enough to support new technologies. The IDB also works with countries to overcome the regulatory barriers that slow their adoption. These barriers are both a product of mistrust, given governments' wariness of new technologies, and a source of it, as firms fear that regulation will be arbitrarily applied. To build trust between governments and fintech entrepreneurs, the IDB has supported more collaborative and experimental regulatory approaches in six countries throughout region. These inform government and industry—about the limits and potential of technology and the oversight concerns of government—and empower them—by allowing a more experimental and small-scale approach that reduces exit costs.

Trust in credit markets is essential to mount a robust response to climate change. Private investors demonstrate increasing willingness to fund green investments, which grows with their confidence that investments really are green. To increase that confidence, the IDB launched the *Green Bond Transparency Platform*, exploiting distributed ledger technology to give investors better, more reliable information about green projects.

Many other areas of private sector activity depend upon trust among governments and firms, including nearshoring and participation in global value chains. Both increase when institutions empower firms to challenge opportunistic behavior by firms or governments. Recognizing this, the IDB has an entire department dedicated to supporting the consolidation of the region's pioneering preferential trade agreements, from Mercosur to the United States-Mexico-Canada Agreement: these accords strengthen precisely the institutions that govern exchange among firms in global value chains.

The IDB also recognizes that the ability of governments to keep their promises is key to building citizen trust and therefore works on many fronts to build their institutional capacity to deliver. This includes giving governments the tools to gather and disseminate information on citizen needs and government performance, improving their ability to direct and coordinate different public sector agencies to meet the cross-cutting needs of citizens, and improving the incentives and capacities of public sector employees to work for the benefit of citizens.

With respect to information, the IDB's infrastructure sector supports data observatories that allow governments to better pinpoint public

investment priorities. In Jamaica and Trinidad and Tobago, the IDB is helping policing organizations build information systems that track whether they are achieving their public safety goals.

The IDB also has operations in a growing number of countries to reform the center of government. Through these reforms, presidents can more effectively communicate their priorities and expected results throughout the public sector and to the public and carry out their priorities with greater efficiency and dispatch.

Trust in government increases with more collaborative decision-making. To support citizen trust in public investment, the IDB has therefore adopted environmental and social management plans that involve citizens and communities in the planning and oversight of projects.

Finally, the IDB assists governments in the key task of building social cohesion and citizenship. One aspect of this is strengthening public safety: nothing undermines cohesion more than insecurity. This endeavor extends from broad efforts to strengthen policing to specific and crucial initiatives like those to increase cybersecurity. Citizens who are concerned that neither firms nor government will protect them from cybercrime are less likely to embrace digital services. To increase the trustworthiness of digital services, the IDB is therefore actively working to strengthen cybersecurity in eight countries.

Another crucial indicator of social cohesion is the willingness to pay taxes. Reluctance to do so grows when citizens do not trust others to pay their taxes or do not trust governments to use tax revenues efficiently to improve citizen welfare. The IDB addresses both dimensions, with lending and advisory operations in 13 countries to make tax enforcement fairer, and a broad effort, inspired by the 2018 *Development in the Americas* report on public spending, to improve spending efficiency across the region.

The 2021 *Development in the Americas* report highlights the challenges the region faces and the critical importance of trust and citizenship. While the COVID-19 pandemic has weakened countries and many continue to suffer, the region is ready to leap forward. We are prepared to embrace this challenge, with the priorities outlined in *Vision 2025* and the recommendations in this book. Greater trust will be an engine of growth, propelling the region towards prosperity as it emerges from the pandemic.

**Mauricio Claver-Carone**
President
Inter-American Development Bank

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Notwithstanding the valuable contributions of the many people who provided inputs to this volume, the editors and authors assume full responsibility for any errors in information or analysis. The opinions expressed in this publication are those of the editors of the project and authors of the corresponding chapters and do not necessarily reflect the views of the IDB, its board of directors, or the countries they represent.

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# 1

# Trust, Social Cohesion, and Growth in Latin America and the Caribbean

***Mistrust in the region is high, increasing, and permeating all corners of society. It undermines productive relationships between and within firms, it erodes citizenship, and limits citizens' ability to undertake collective action in support of the laws and institutions that promote sustainable development.***

Lucy: "The whole trouble with you is you don't trust anyone."

Charlie Brown: "Look... Every year you pull the same trick on me... You say you're going to hold the ball while I kick it, but you never do."[1]

Generations of Peanuts readers around the world know that over and over again, year after year, Lucy holds the ball, Charlie Brown tries to kick it and, every time, he lands flat on his back after she moves it. In the real world, Lucy's behavior is all too common, but Charlie Brown's is not: when their trust is violated, people stop playing, with dire consequences for their well-being and that of society. Mistrustful people are less willing to join others in pursuit of a common cause or enter into business transactions; to hire strangers; to pay their taxes; to ask governments to fund infrastructure projects and construct a better future for themselves and their offspring; and they are more likely to ask the government to provide them with immediate personal benefits in the form of subsidies and transfers instead of demanding more efficient and effective investment in public goods.

Unfortunately, in Latin America and the Caribbean, individuals are more likely than ever to believe that others will act like Lucy. This report

[1] From Peanuts, October 4, 1959. Available at https://peanuts.fandom.com/wiki/October_1959_comic_strips.

describes the consequences of mistrust in the region for both governments and societies, the causes of mistrust, and what the countries of the region can do to increase trust and mitigate the consequences of mistrust.

Trust, in this report, is the belief that others will not act opportunistically.[2] They will not make promises they cannot keep, renege on promises they can keep, or violate norms to take advantage of other people who adhere to them. In short, trust is faith in others—in their honesty, dependability, and good will. Rather, trustworthy people make promises they can keep, follow through on those promises, and do not violate social norms. Opportunistic behavior is a persistent threat everywhere; those who engage in it can earn substantial rewards that the trustworthy forego. Lucy's reward happens to be intangible: the questionable delight she takes in laughing at Charlie Brown. In the real world, tangible temptations to act opportunistically are pervasive, from the borrower who chooses whether to repay a loan, to politicians who elect whether to fulfill a campaign promise or divert public monies to their private interests. The basis of a trusting society is the willingness of its members to resist these temptations—to act not as Lucy acts, but as Charlie Brown hopes she will.

## Why Trust Is Important

Trust underlies countless interactions that are essential for healthy societies. Voters choose candidates they believe will fulfill their electoral promises; firms invest in innovation expecting governments not to impose confiscatory taxes if innovation succeeds; employers pay workers even though they cannot be completely assured of worker effort, and workers exert effort expecting they will be paid; buyers rely on sellers to provide quality goods and services, which sellers deliver today expecting payment in the future; investors entrust their capital to managers of firms; citizens provide information to police, on whom they rely for protection; individuals get vaccinated and take medications recommended by doctors they depend on for healthy living. When trust is absent from these interactions—when individuals are convinced that others will behave like Lucy—society and all its members suffer: politics is unstable; the quality of public policy deteriorates; economic growth slows; social equity wanes; and individual well-being declines.

A key issue in this book is the interaction of interpersonal (or generalized) trust with trust in government, two dimensions of trust that have usually been tackled separately. Government officials, like people in general, are more likely to act opportunistically—in an untrustworthy manner—when they cannot be held accountable for their actions. Large asymmetries in

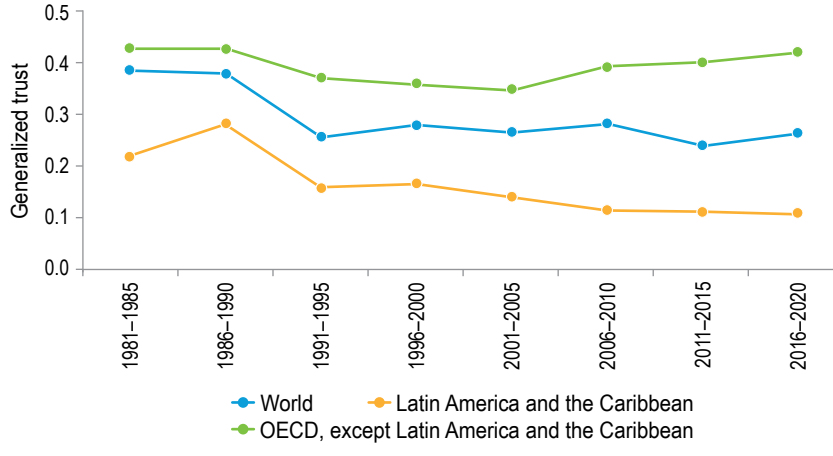
[2] Chapter 2 describes the many ways of measuring trust.

terms of information—citizens have a difficult time independently evaluating the work of government—and coercive power—citizens are obliged to abide by the rules set by the government—make it even simpler for politicians to act opportunistically. Working together, citizens can punish untrustworthy officials, for example by voting them out of office. Faced with such a prospect, officials have stronger incentives to pursue citizen interests rather than their own. However, removing incumbents from office demands a collective act by citizens. Unfortunately, when citizens do not trust each other, they are less likely to work together to hold governments accountable. Citizens in this situation can feel like Charlie Brown: they believe that all governments will act like Lucy, but they have little alternative but to continue to rely on them.

## A Region Full of Lucys?

Given the importance of interpersonal trust for most social, political, and economic interactions, its low level and decline in the region are a source of concern (Figure 1.1). Worldwide, the fraction of people

**Figure 1.1 ▶ Declining Trust in Latin America and the Caribbean**




*Source*: Authors' calculations based on data from the Integrated Values Survey, which compiles the seven waves of the World Values Survey (1981–2020) and the five waves of the European Values Study (1981–2020).

*Note*: Generalized trust is calculated from answers to the question, *"Generally speaking, would you say that most people can be trusted, or that you need to be very careful in dealing with people?"* Trust is equal to 1 if the respondent answers, *"Most people can be trusted"* and 0 otherwise. The trust variable was aggregated at the country level as a weighted average from individual observations, and after that, averaged in five-year brackets. When data from a country is available in both surveys for a given year, the simple average of those values was used. OECD countries per year are included when a country acquired its membership. The OECD group of advanced economies excludes Latin American and Caribbean countries: Colombia, Chile, and Mexico. The total sample is 115 countries. The 16 Latin American and Caribbean countries included in the sample are Argentina, Bolivia, Brazil, Chile, Colombia, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Mexico, Nicaragua, Peru, Trinidad and Tobago, Uruguay, and Venezuela.

believing that most people can be trusted (generalized or "interpersonal" trust) dropped from 38 percent in the 1981–1985 period to 26 percent in 2016–2020, according to World Values Survey data. In Latin America and the Caribbean, the decline is even more dramatic, with trust levels plunging from 22 percent to 11 percent. Only 1 in 10 considers that other people can be trusted. In the advanced economies, by contrast, trust has remained relatively stable at a level well above that in Latin America and the Caribbean.

Viewing the situation through Latin American eyes does not change reality. The Latinobarometer survey compiles information from 18 countries in the region from 1996 to 2020 and includes a larger sample of countries from Latin America than the World Values Survey. In 1996, about one in five respondents believed that most people could be trusted. By 2020, this had dropped to a little more than one in eight (13 percent of respondents) (Figure 1.2A). No country in the region exhibits high levels of trust in 2020 (in Uruguay, one in five agree that others can be trusted); in some, trust is much lower (in Brazil, one in 20 say that others can be trusted) (Figure 1.2B).

Since trust is low and declining slightly around the world, except in advanced economies, why should Latin America and the Caribbean be the focus of a book on trust? The reason is simple: As shaky as trust is in the rest of the world, it is lower in Latin America and the Caribbean than anywhere else, and barely one-fourth the level in the OECD (excluding Chile, Colombia, and Mexico) (see Figure 1.3).

**Figure 1.2 ▶ Trust Levels in Latin American and Caribbean Countries Are Low**

**A. Evolution of trust**

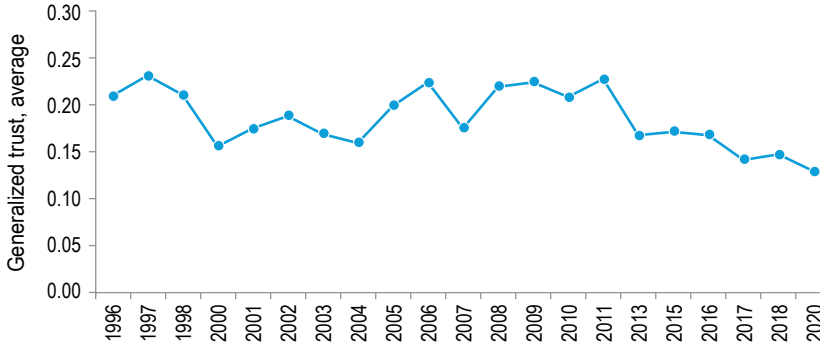



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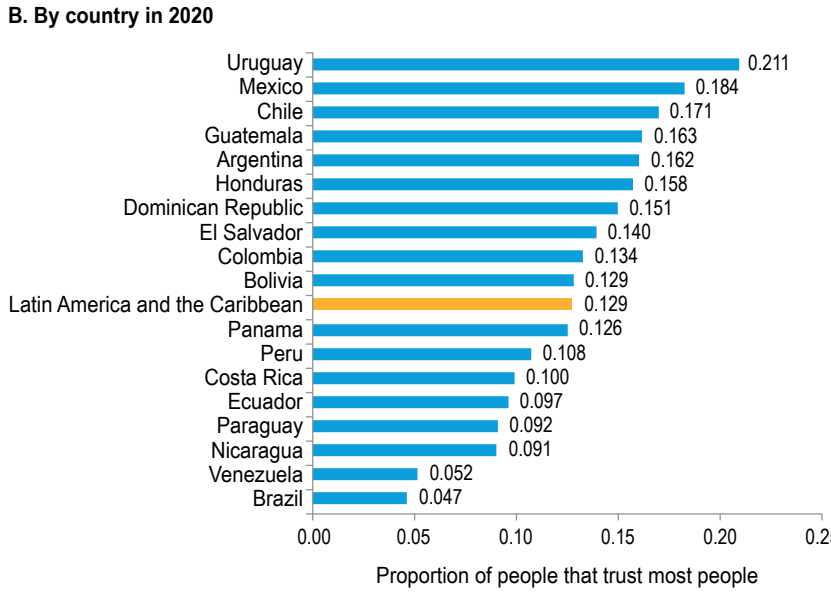
**Figure 1.2 ▶ Trust Levels in Latin American and Caribbean Countries Are Low** *(continued)*



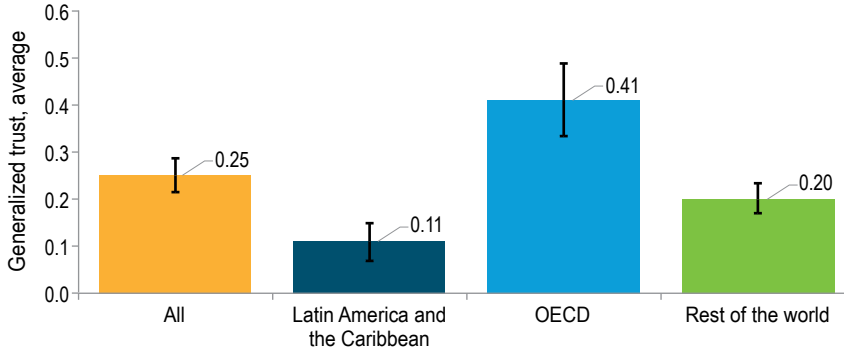

*Source*: Authors' calculations based on data from the Latinobarometer Survey.
*Note*: Generalized trust is calculated from answers to the question, *"Generally speaking, would you say that you can trust most people, or that you can never be too careful in dealing with others?"* Trust is equal to 1 if the respondent answers, "One can trust most people" and 0 otherwise. The trust variable was aggregated at the country level as a weighted average from individual observations. The total sample is 18 countries, as indicated in Panel B.

## The Ripple Effects of Mistrust

This book explores the many ways that interpersonal mistrust ripples through society, with significant implications for trust in government, institutions, and the private sector. For example, not only is interpersonal trust in the region low, but on average, over the period 2010–2020, according to the Latinobarometer survey, fewer than 3 in 10 Latin American and Caribbean citizens trusted their government. Mistrust of government is also a worldwide problem, but it is greatest in Latin America and the Caribbean, even if the differences are not as dramatic as with interpersonal trust (Figure 1.4).

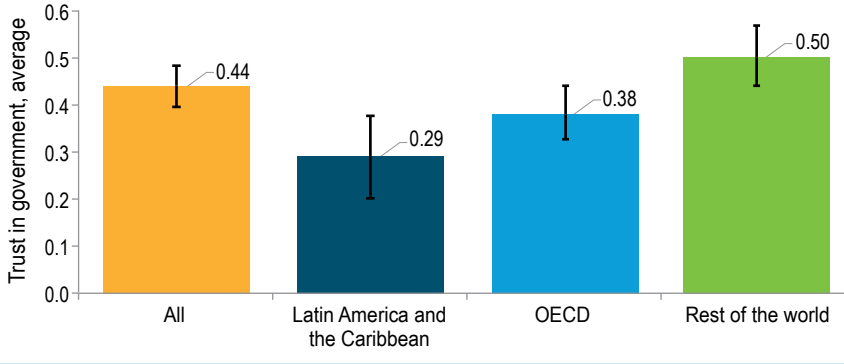
Institutions play a key role in helping citizens hold governments accountable (see Chapter 7). When they do, institutions help build trust in government. Judiciaries and legislatures can place checks on government behavior that limit government capacity to act opportunistically. Political

## Figure 1.3 ▶ Interpersonal Trust across Regions




*Source*: Authors' calculations based on data from the Integrated Values Survey.
*Note*: Generalized trust comes from the Integrated Values Survey (2010–2020), which compiles the sixth and seventh wave of the World Values Survey (1981–2020) as well as the fifth wave of the European Values Study (2017–2020). Generalized trust is calculated from answers to the question, *"Generally speaking, would you say that most people can be trusted, or that you need to be very careful in dealing with people?"* Trust is equal to 1 if the respondent answers, *"Most people can be trusted"* and 0 otherwise. Each bar is a simple average from country-level data. The OECD group of advanced economies excludes Latin American and Caribbean countries: Colombia, Chile, and Mexico. The total sample encompasses 95 countries, and the Latin American and Caribbean countries included are Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Guatemala, Haiti, Mexico, Nicaragua, Peru, Trinidad and Tobago, and Uruguay.

## Figure 1.4 ▶ Trust in Government across Regions

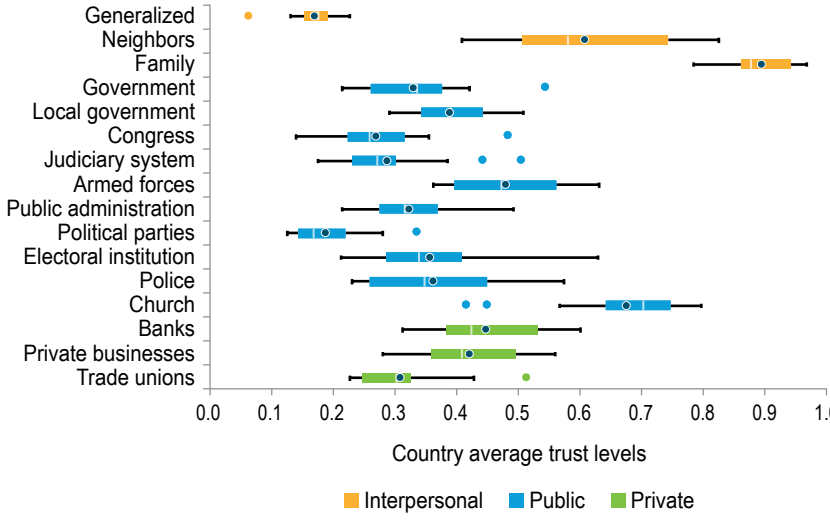



*Source*: Authors' calculations based on data from the Integrated Values Survey.
*Note*: Trust in government comes from the Integrated Values Survey (2010–2020), which compiles the sixth and seventh wave of the World Values Survey (1981–2020) as well as the fifth wave of the European Values Study (2017–2020). Trust in government comes from the question: *"Could you tell me how much confidence you have in [the government]: is it a great deal of confidence, quite a lot of confidence, not very much confidence or none at all?"* Answers were recoded so trust equals to 1 when the response is *"a great of a deal"* or *"quite a lot"* and 0 otherwise. Each bar is a simple average from country-level data. The OECD group of advanced economies excludes Latin American and Caribbean countries: Colombia, Chile, and Mexico. The total sample encompasses 95 countries, and the Latin American and Caribbean countries included are Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Guatemala, Haiti, Mexico, Nicaragua, Peru, Trinidad and Tobago, and Uruguay.

parties can be effective vehicles to promote the collective action of citizens to hold governments accountable. Unfortunately, the opposite is also true; distrust of institutions renders them part of the problem rather than the solution. In Latin America and the Caribbean these institutions often do not perform their intended roles. Rather than increasing trust in government, they become part of the crisis of trust (see Figure 1.5).

Of course, if people do not trust each other, government, courts, or political parties, not surprisingly they do not trust the private sector either. In Latin America and the Caribbean, low trust in the private sector and business mirrors low trust in public institutions (Figure 1.5). If people believe that, in general, others cannot be trusted, they are even more likely to believe that firms will try to take advantage of workers, consumers, and each other. Their suspicion is reinforced when they also distrust the institutions that are supposed to rein in untrustworthy behavior of businesses, such as courts and government regulators.

**Figure 1.5 ▶ Trust Levels by Type of Institution and Business**




*Source*: Authors' calculations based on data from the Latinobarometer Survey (2010–2020).
*Note*: Generalized trust is calculated from the answers to the question, *"Generally speaking, would you say that you can trust most people, or that you can never be too careful in dealing with others?"* Trust is equal to 1 if the respondent answers, *"One can trust most people"* and 0 otherwise. The variables related to trust in other institutions/groups are computed from the question: *"How much trust do you have in each of the following groups/institutions. Would you say you have a lot (1), some (2), a little (3), or no trust (4) ...?"* Answers were recoded so trust is equal to 1 if the respondent answers, *"A lot"* or *"Some,"* and 0 when the answer is *"A little"* or *"No trust."* The weighted average per country is computed from the individual-level data. The lines in the boxplot represent the median (50th percentile) and the dark blue markers show the average value of each category. The sample includes 18 countries from the region: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay, and Venezuela.

In short, mistrust reverberates throughout society and is present in every relationship. This report describes the effects of mistrust on growth, public policy, and the behavior of firms, politicians, and public officials. Boosting trust levels is essential not only because people are happier and more satisfied when they can trust others, but also because the more tangible goals of economic growth and equality are more attainable when trust is high.

## Trust: The Glue for Social Cohesion and Citizenship

Apart from Lucy's repeated abuse of Charlie Brown's trust in her promises to hold the ball, the Peanuts characters do not act opportunistically towards each other: Snoopy can rely on Charlie Brown to feed him and he always does; Lucy charges all her customers 5 cents for the advice that she gives them and, even though they could walk away without paying, they never do; Marcie supports the hare-brained schemes of Peppermint Patty even though she gains little from them; and Peppermint Patty, the best athlete in the Peanuts gang, is always willing to organize games with the enthusiastic, but much less athletic, Charlie Brown. Trust allows for social cohesion and, indeed, the Peanuts characters have peacefully coexisted for generations! Low-trust societies do not exhibit such cohesion. Demonstrations in 2019, 2020, and 2021 in Chile and Colombia are indicative that trust and social cohesion are challenges for Latin America and the Caribbean.

Friedkin (2004) observes that social cohesion is an amorphous concept, involving notions of commitment or attachment to society or country and to its members. Others, such as Easterly, Ritzen, and Woolcock (2006), equate social cohesion with objective differences among individuals with respect to a set of salient characteristics, such as income, race, or religion.[3] This book approaches the issue of cohesion from a different perspective that emphasizes the roles of trust and citizenship.

In 1963, Almond and Verba defined citizenship as the willingness of citizens to make individual sacrifices in pursuit of collective endeavors that are central to a society's success. When interpersonal trust is low, collective endeavors are difficult and the bonds of citizenship fray. Citizens are less willing to make sacrifices, including paying taxes and obeying laws, associated with any public endeavor. They are less able to contribute to the collective effort of holding governments accountable for improving citizen welfare. When trust and citizenship are low, as several chapters in

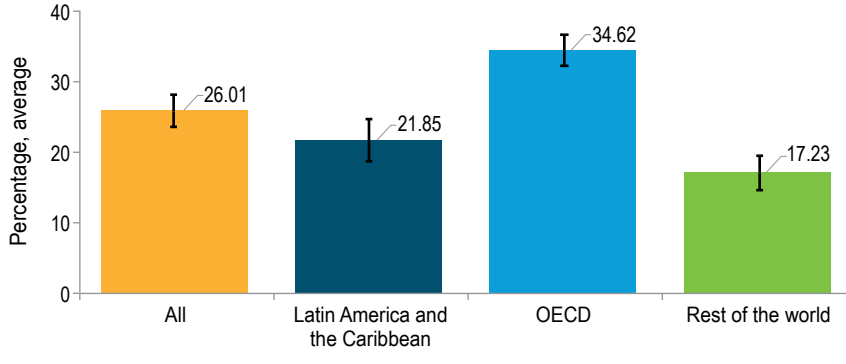
[3] In 2020, ECLAC organized a series of key workshops culminating with an international conference in November: "Social cohesion, welfare guarantees, and social protection: Keys to a postpandemic reconstruction with equality in Latin America."

this book will argue, public policy offers fewer benefits to citizens as a whole and relatively more to narrow groups. By any definition, social cohesion tends to disintegrate in such environments: public policy has more unequal consequences, and disaffection with society increases.

Ample evidence demonstrates that the bonds of citizenship are weak in Latin America and the Caribbean: individuals are more likely to make choices in their own personal interest at the expense of the broader community. One natural metric of citizenship is the willingness to pay taxes, the most routine personal sacrifice that societies request of their members to support community activities. Individuals express their willingness to pay taxes by supporting larger tax payments to further community objectives and by paying, rather than evading, the agreed taxes once society, acting through government, sets tax rates. If the citizens of a country fail to do one or the other, the ratio of taxes paid to GDP is lower. Figure 1.6 shows the tax-to-GDP ratio across various regions for the years 2010–2018. The ratio in Latin America and the Caribbean is 22 percent (13 percentage points) lower than that of OECD countries.

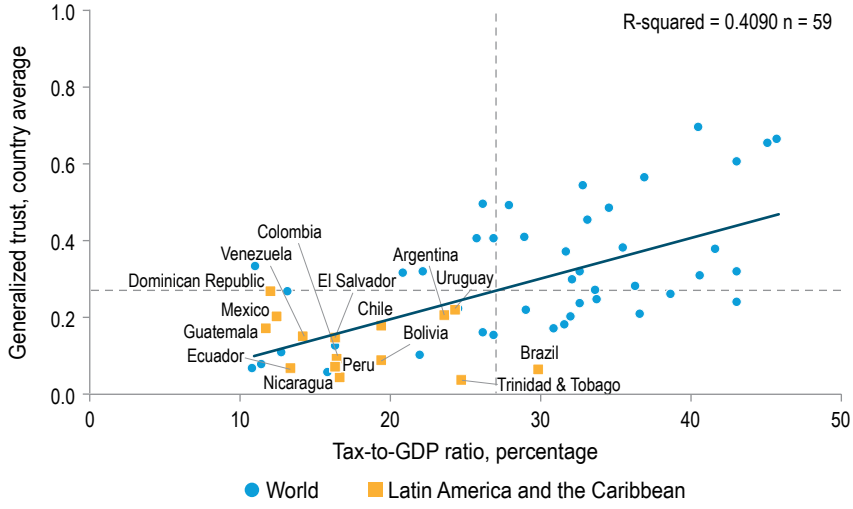
In an environment of generalized mistrust, individuals are more likely to free-ride on others' contributions to the collective action of supporting government works. In fact, Figure 1.7 demonstrates that the willingness to pay taxes is strongly associated with generalized trust. The countries of the region are concentrated in the lower left-hand quadrant of Figure 1.7: they are below average in both generalized trust and tax payments.

**Figure 1.6 ▸ Willingness to Pay Taxes across Regions: Tax to GDP Ratio**




*Source*: Authors' calculations based on data from the Global Revenue Statistics Database, OECD.
*Note*: Tax-to-GDP ratio (2010–2018) comes from the Global Revenue Statistics Database and uses the total tax revenue of a country. Each bar is a simple average from country-level data. The OECD group of advanced economies excludes Latin American and Caribbean countries: Colombia, Costa Rica, Chile, and Mexico. The total sample encompasses 78 countries, and the Latin American and Caribbean countries included are Argentina, The Bahamas, Belize, Bolivia, Brazil, Barbados, Chile, Colombia, Costa Rica, Cuba, Dominican Republic, Ecuador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Panama, Peru, Paraguay, El Salvador, Trinidad and Tobago, Uruguay, and Venezuela.

**Figure 1.7 ▶ Relation between Trust and Tax Revenues**

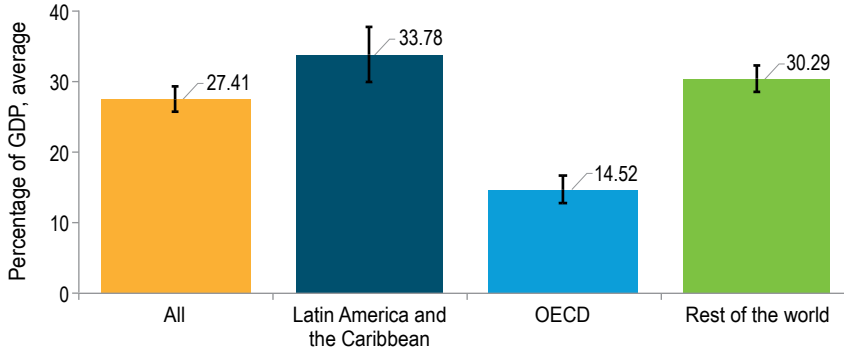



*Source*: Authors' calculations based on data from the Integrated Values Survey and the Global Revenue Statistics Database, OECD.
*Note*: The trust data comes from the Integrated Values Survey, which compiles the seven waves of the World Values Survey (1981–2020) and the five waves of the European Values Study (1981–2020). Tax-to-GDP ratio (1990–2018) comes from the Global Revenue Statistics Database and uses the total tax revenue of a country. Each point is the simple average of the observations of each country for the years 1990–2018 and 1981–2020, x-axis, and y-axis, respectively. The dotted lines represent the average values in the entire sample for each variable. The total sample encompasses 59 countries including Argentina, Bolivia, Brazil, Chile, Colombia, Dominican Republic, Ecuador, Guatemala, Mexico, Nicaragua, Peru, El Salvador, Trinidad and Tobago, Uruguay, and Venezuela.

Another indicator of citizenship is the degree to which individuals adhere to formal and informal community norms. When citizenship is low, individuals cannot easily prevent governments from enacting laws and regulations that reduce their welfare; they are more likely to disregard such laws. At the same time, when citizenship is low, individuals are more likely to disregard them simply to gain private advantage at the expense of others. One example of both effects is the decision of businesses to operate informally, either as a response to onerous and unnecessary regulation or as a signal of their willingness to seek private advantage at the community's expense.

By its very nature, informality is difficult to measure, but experts have found an indirect way to assess its prevalence. Informal firms are likely to prefer cash transactions, both because informal firms have less access to the financial sector and because cash transactions are more difficult for the authorities to track. The excess of cash in circulation relative to GDP can be taken as a proxy for the size of the informal or shadow economy

**Figure 1.8 ▶ Firm Willingness to Obey Laws and Regulations across Regions: Shadow Economy**



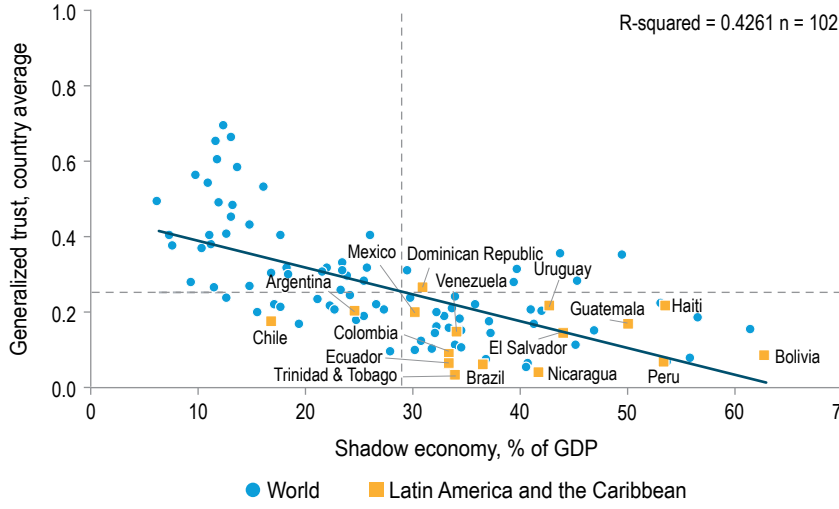

*Source*: Authors' calculations based on data from the Shadow Economy Index.
*Note*: The Shadow Economy Index (2010–2017) comes from Medina and Schneider (2019). The authors define shadow or informal economy as *"economic activities which are hidden from official authorities for monetary, regulatory, and institutional reasons. Monetary reasons include avoiding paying taxes and all social security contributions, regulatory reasons include avoiding governmental bureaucracy or the burden of regulatory framework, while institutional reasons include corruption law, the quality of political institutions and weak rule of law. The shadow economy, in this paper, reflects mostly legal economic and productive activities that, if recorded, would contribute to national GDP, therefore the definition of shadow economy in our study tries to avoid illegal or criminal activities, do-it-yourself, or other household activities."* Each bar is a simple average from country-level data. The OECD group of advanced economies excludes Latin American and Caribbean countries: Colombia, Costa Rica, Chile, and Mexico. The total sample encompasses 157 countries, and the Latin American and Caribbean countries included are Argentina, The Bahamas, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Peru, Paraguay, El Salvador, Suriname, Trinidad and Tobago, Uruguay, and Venezuela.

(Medina and Schneider, 2019). Figure 1.8 displays the size of the shadow economy estimated by Medina and Schneider between 2010 and 2017; it is far larger in Latin America and the Caribbean than the OECD countries or even than the rest of the world.

Once again, where generalized trust is low, confidence that the rules have been made in the public interest, and that others will comply with the rules, is likely to be low. Firms and individuals, therefore, opt for informality rather than regulatory compliance. Consistent with this expectation, among countries for which there are data on both, trust and informality are strongly negatively correlated. Latin American and Caribbean countries appear largely in the lower right-hand quadrant, where those with the least trust and greatest informality are located (Figure 1.9).

Survey-based measures of citizenship deliver a similar message: Latin American and Caribbean citizens are more willing to disregard community norms and to admit that in a survey. Three instances of such disregard are tracked by questions in the World Values Survey: whether respondents would claim government benefits to which they were not entitled, avoid a

**Figure 1.9 ▶ Relation between Trust and Informality**

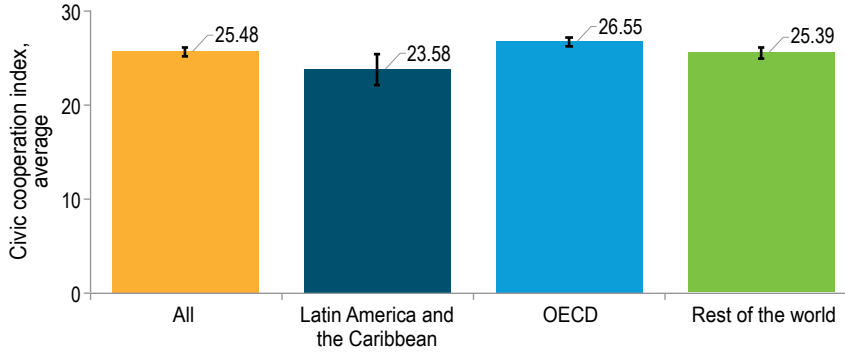



*Source*: Authors' calculations based on data from the Integrated Values Survey and the Shadow Economy Index.
*Note*: The trust data comes from the Integrated Values Survey, which compiles the seven waves of the World Values Survey (1981–2020) and the five waves of the European Values Study (1981–2020). The Shadow Economy Index (1991–2017) comes from Medina and Schneider (2019). The authors define shadow or informal economy as *"economic activities which are hidden from official authorities for monetary, regulatory, and institutional reasons.[. . . ] The shadow economy, in this paper, reflects mostly legal economic and productive activities that, if recorded, would contribute to national GDP, therefore the definition of shadow economy in our study tries to avoid illegal or criminal activities, do-it-yourself, or other household activities."* Each point is the simple average of the observations of each country for the years 2010–2017 and 2010–2020, x-axis, and y-axis, respectively. The dotted lines represent the average values in the entire sample for each variable. The total sample encompasses 102 countries including Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Guatemala, Haiti, Mexico, Nicaragua, Peru, Trinidad and Tobago, and Uruguay.

fare on public transport, or cheat on taxes if they had the choice. Figure 1.10 depicts the responses to these three questions. These norms of civic cooperation are significantly weaker in Latin America and the Caribbean than in the OECD and the rest of the world. Differences are not only statistically significant but economically meaningful (more than 12 percent difference). Among the components, "claiming a government benefit you are not entitled to" presents the highest difference—greater than 20 percent.

Informal norms of respect for other citizens seem to be weaker, as well. A question that was not included in the latest WVS wave, which explains why it has not been included in the index, shows stark differences. When individuals are asked whether it would be justifiable to keep money you have found, the difference with other regions is about 35 percent. That is, respondents in OECD countries are 35 percent less likely than those in Latin American and Caribbean countries to think that it is justifiable to keep somebody else's money. Experimental data offers a similar

**Figure 1.10 ▶ Civic Capital across Regions: Three Elements of Civic Cooperation**

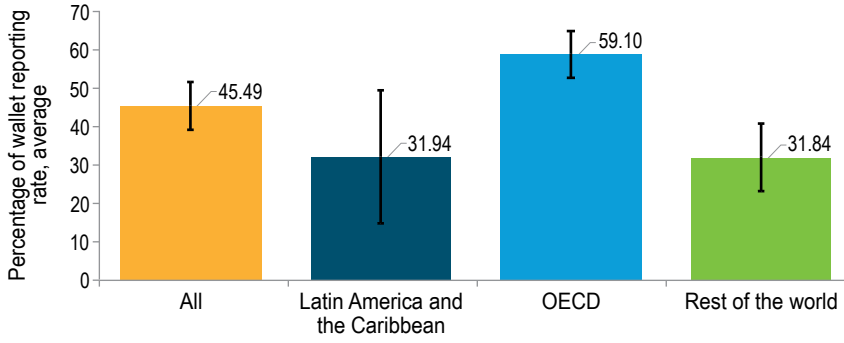



*Source*: Authors' calculations based on data from the Integrated Values Survey.
*Note*: The civic capital data come from the Integrated Values Survey (2010–2020), which compiles the sixth and seventh wave and the partial seventh wave of the World Values Survey (1981–2020) as well as the four waves of the European Values Study (1981–2008). The Civic Cooperation Index is based on the Knack and Keefer (1997) methodology and, because of data availability, uses only 3 out of 5 of the questions originally used in the methodology: a) "claiming government benefits which you are not entitled to," b) "avoiding a fare on public transport," and c) "cheating on taxes if you have the chance." The scale of variables was adjusted; thus, a higher number means higher civic cooperation. Each bar is a simple average from country-level data. The OECD group of advanced economies excludes Latin American and Caribbean countries: Colombia, Chile, and Mexico. The total sample encompasses 94 countries including Argentina, Bolivia, Brazil, Chile, Colombia, Dominican Republic, Ecuador, Guatemala, Haiti, Mexico, Nicaragua, Peru, Trinidad and Tobago, Uruguay, and Venezuela.

picture. Cohn et al. (2019) distributed wallets on the streets of 355 cities in 40 countries and tracked the percentage of wallets in each city that were returned to their owner. Each wallet contained either no money, the local currency equivalent of a modest amount of money (US$13.45), or a substantial sum (US$94.15). All wallets also had identifying information, sufficient to contact the owner of the wallet. On average, approximately half as many wallets were returned in Latin America and the Caribbean as in the OECD (Figure 1.11).

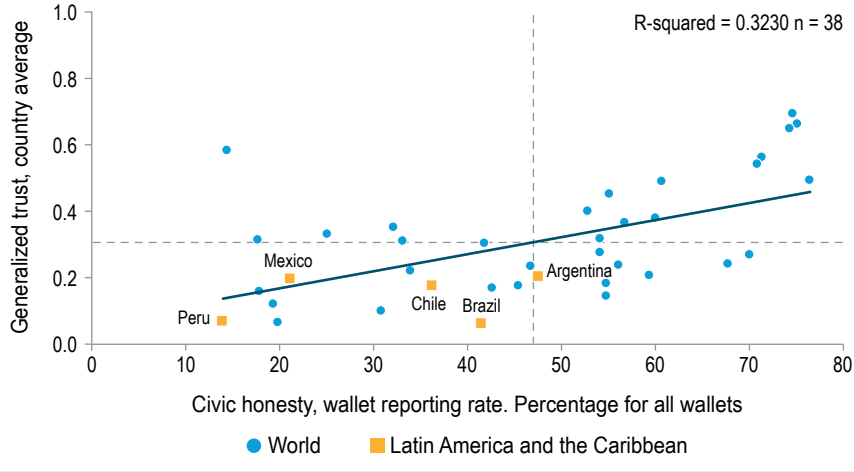
The percent of wallets returned is correlated with responses to the World Values Survey questions above. The data support the conclusion that interpersonal trust plays an important role in the construction of citizenship. Across the entire sample of countries for which there are data, Figure 1.12 shows that in countries where 20 percent of wallets were returned, approximately 15 percent of respondents expressed trust in others; where 60 percent of wallets were returned, approximately 30 percent of respondents expressed trust in others. In four of the five Latin American countries where the wallet experiment was conducted, the fraction of wallets returned was below the median; trust in all five countries was also below the median.

## Figure 1.11 ▶ Civic Capital across Regions: Wallet Experiment and Civic Honesty




*Source*: Authors' calculations based on data from Cohn et al. (2019) wallet experiment data.
*Note*: The computation of the Civic Capital Index used in the figure comes from looking at whether any type of wallet was returned: No money with housekey, money with housekey, big money with housekey, and money but no housekey were dropped in the Cohn et al. (2019) experiment. Each bar is a simple average from country-level data. The OECD group of advanced economies excludes Latin American and Caribbean countries: Colombia, Chile, and Mexico. The experiment was implemented in 355 cities spanning 40 countries. The total sample encompasses 40 countries including Argentina (Buenos Aires, Córdoba, Mar de la Plata, Mendoza, Rosario, Salta, San Miguel de Tucumán, Santa Fé de la Vera Cruz), Brazil (Belo Horizonte, Brasilia, Curitiba, Fortaleza, Manaus, Rio de Janeiro, Salvador, São Paulo), Chile (Antofagasta, Concepción, La Serena, Racagua, Santiago, Talca, Temuco, Valparaíso), Mexico (Chihuahua, Guadalajara, León, Mérida, Mexico City, Monterrey, Puebla, Tijuana), and Peru (Arequipa, Chiclayo, Cusco, Iquitos, Lima, Piura, Trujillo).

## Figure 1.12 ▶ Relation between Trust and Civic Capital: Wallet Experiment and Civic Honesty




*Source*: Authors' calculations based on data from the Integrated Values Survey and Cohn et. al. (2019) wallet experiment data.
*Note*: The trust data comes from the Integrated Values Survey, which compiles the seven waves of the World Values Survey (1981–2020) and the five waves of the European Values Study (1981–2020). Civic honesty comes from the wallet reporting rate for all wallets dropped in the Cohn et. al. (2019) experiment. Each point is the simple average of the observations of each country for the years 2019 and 1981–2020, x-axis, and y-axis, respectively. The dotted lines represent the average values in the entire sample for each variable. The total sample has 38 countries including Argentina, Brazil, Chile, Mexico, and Peru.

## Mistrust and Social Fragmentation: Consequences for Public Policy

Trust and citizenship have significant implications for the public policies that countries adopt. As Chapter 4 explains, they are central to policies that citizens demand—whether they promote the welfare of all or provide individual benefits for a few, whether they build prosperity for the future or simply redistribute rents for today. Education, infrastructure, and citizen safety all suffer when trust and citizenship are weak.

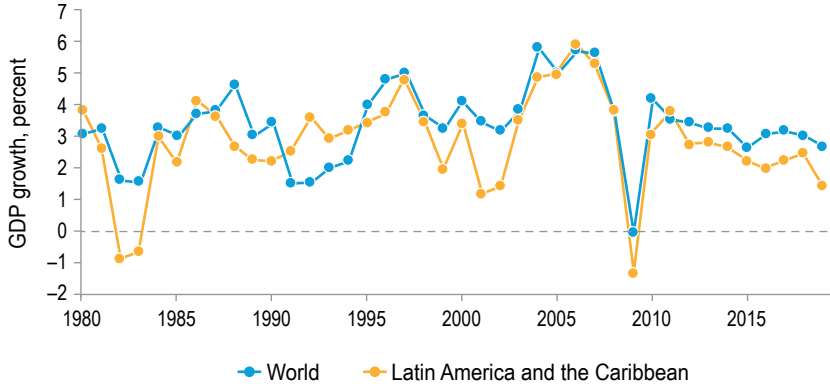
Chapter 5 explains that trust and citizenship are equally key for the implementation of public policies. Citizen cooperation is essential to the success of a wide range of policies, from tax collection and law enforcement to infectious disease control and environmental conservation. Using evidence from a wide body of research in different sectors, Chapter 5 reviews the importance of citizenship, trust, and citizen cooperation across policy areas such as policing, taxation, financial inclusion, health, environmental policy, and dealing with the COVID-19 pandemic.

Government efficiency and the ease of communication between citizens and government also hinge on trust. Digital government offers enormous promise on both dimensions. The internet and its culture, processes, business models and technologies, are changing society and societal demands of government, but also offer revolutionary opportunities to improve government. However, the process of digital transformation in Latin America and the Caribbean is slow, in both the public and private sectors. Chapter 6 analyzes the connection between the region's endemic low interpersonal trust and one key aspect of digital transformation: the adoption of digital services (thus leaving largely untouched important elements of digital transformation such as the change in organizational culture). Specifically, it aims to answer the following questions: Is low trust holding back the adoption of digital services, or boosting it (or both, in different ways)? If low trust is an impediment to the adoption of digital services, how can this be remedied?

## The Link to Inclusive Growth

Mistrust and weak bonds of citizenship heighten the region's chronic, urgent challenges of low growth and high inequality. Between 1980 and 2020, the average per capita growth rate of real GDP in Latin America and the Caribbean was below the world average (Figure 1.13). Other regions have narrowed the gap with the United States: the typical country in emerging Asia substantially narrowed its gap with the income per capita of the United States, from 11 percent of the United States' per capita income

**Figure 1.13 ▶ Economic Growth Rate: The World vs. Latin America and the Caribbean**




*Source*: Authors' calculations based on data from the World Development Indicators, World Bank.
*Note*: Percentage of GDP growth comes from the World Development Indicators (1980–2019). The total sample encompasses 212 countries and territories including the following Latin American and Caribbean countries: Antigua and Barbuda, Argentina, The Bahamas, Barbados, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Cuba, Dominica, Dominican Republic, Ecuador, El Salvador, Granada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, St. Kitts and Nevis, St. Vincent and the Grenadines, St. Lucia, Suriname, Trinidad and Tobago, Uruguay, and Venezuela.

in 1960 to 58 percent in 2017. Latin America and the Caribbean has not: on average, countries in the region closed only 4 percentage points of the per capita income gap with the United States, far less than the 47 percentage points achieved by East Asian countries (Cavallo and Powell, 2018).

In addition to being one of the slowest-growing regions in the world, Latin America and the Caribbean has long been the most unequal. Despite notable recent advances, the region is still about 50 percent more unequal than the average developed country (Izquierdo et al., 2020). Studies from the Economic Commission of Latin America and the Caribbean (ECLAC, 2019) show that the share of people belonging to the high-income strata rose from 2.2 percent to 3 percent between 2002 and 2017, but in 2014, the richest 10 percent of the population still received 40.5 percent of national income in Brazil, and 39.7 percent in Mexico (Roser and Ortiz-Ospina, 2013).

Trust and citizenship significantly impact all the key drivers of growth and inequality. Economic growth depends on public policies and institutions to accommodate and encourage it. Mistrust and weak bonds of citizenship distort these. The most important decisions that drive economic growth—to invest, employ, produce, buy, or sell—all depend on trust. The most productive, skilled, and innovative individuals have greater economic opportunities in high-trust societies; in societies without trust, these opportunities are limited.

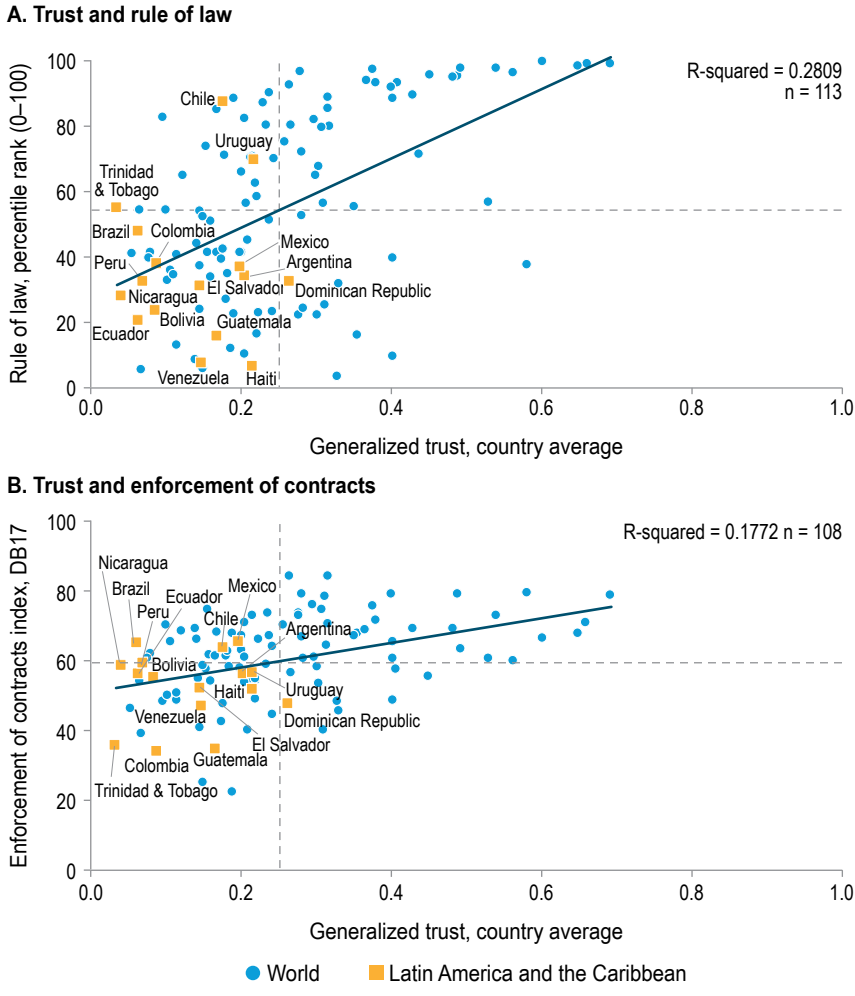
Public policy determines whether barriers to firm entry are high (reducing competition and incentives to innovate), whether education systems lag, and whether essential public infrastructure is missing. Public policy failures, therefore, contribute directly to slower growth. Growth requires capital investment, but distortionary taxes, regulatory costs, and arbitrary enforcement discourage it. It also requires firms to hire workers, but public policies that distort the costs of hiring workers make this difficult. Growth-oriented policies may not be politically attractive, however. Politicians can raise funds to finance their campaigns by creating rents in the form of barriers to entry, or by agreeing to over-priced public investments. Rather than ensure that the best teachers are hired, they can trade votes for jobs in the education system. Such opportunistic behavior is less likely if citizens work together through the political process and state institutions to resist it.

Unfortunately, mistrust and weak bonds of citizenship conspire against citizen collective action. Although all citizens are better off under growth-promoting policies, individually each has an incentive to be exempted from them. They would like to enjoy the benefits of infrastructure, tax and regulatory compliance, and education without paying their share of the costs of these policies. Individual firms prefer tax policies that favor them over other firms, but on average, firm growth and productivity are faster if tax policies apply equally to similar firms. When trust is low and bonds of citizenship frayed, individuals are more likely to believe that others will act opportunistically and seek exemptions even if they themselves do not.

Chapter 7 explores the links among trust, citizenship, and the institutions that undergird inclusive growth—the formal and informal rules and norms that organize social, political, and economic relations (North, 1990). Whether these institutions succeed in enforcing contracts, protecting individuals from expropriation, or preventing the over-harvesting of common resources (fisheries, forests, clean air and water) depends on whether societies can solve the same profound collective action dilemma (Olson, 1965): although citizens are collectively better off if all respect these institutions, they are individually better off if they can renege on their contractual obligations, expropriate the investments of others, enjoy public goods to which they did not contribute, and exploit without restraint society's common resources.

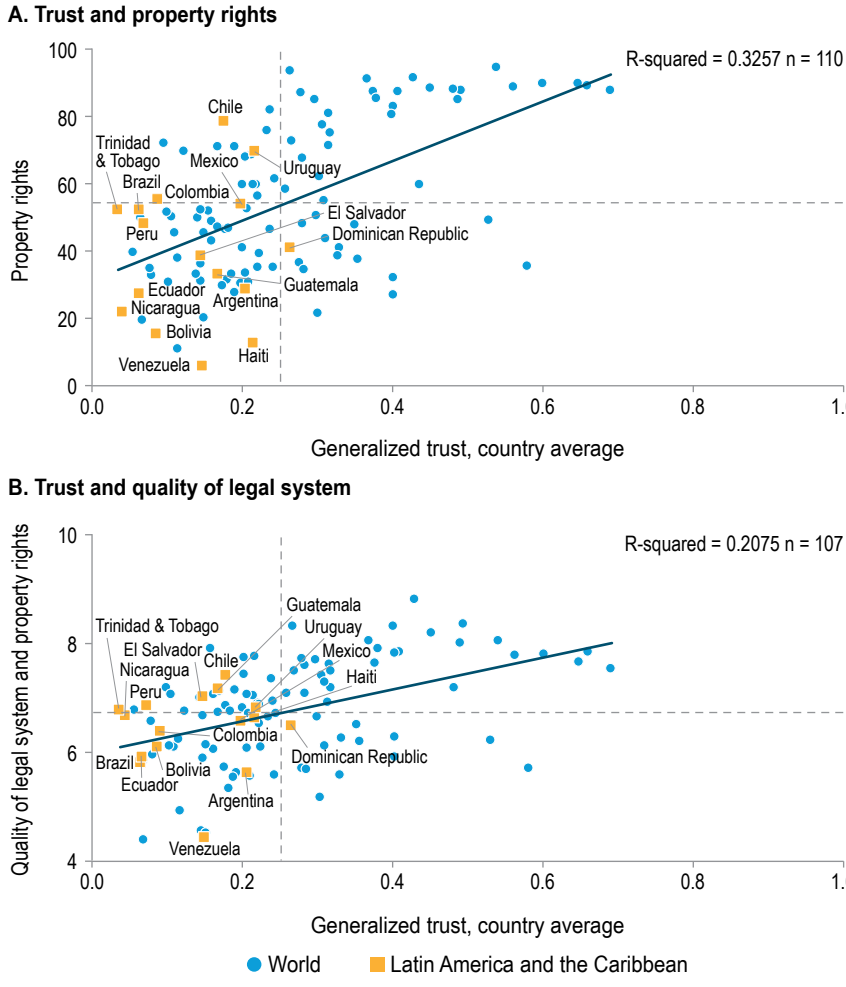
Trusting societies with stronger bonds of citizenship are better able to overcome this collective action dilemma. In countries with higher levels of interpersonal trust, the rule of law and contract enforcement are stronger (Figure 1.14), as are the security of property rights and the quality of the legal system (Figure 1.15). Regionally, as the different figures illustrate, Latin American and Caribbean countries are on average weaker on

## Figure 1.14 ▶ Trust, the Rule of Law, and Contract Enforcement




*Source*: Authors' calculations based on data from the Integrated Values Survey, the Worldwide Governance Indicators, and Doing Business, World Bank.
*Note*: The trust data comes from the Integrated Values Survey, which compiles the seven waves of the World Values Survey (1981–2020) and the five waves of the European Values Study (1981–2020). Rule of law (1996–2017) comes from the Worldwide Governance Indicators and "captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence." The score of enforcing contracts (2016–2020) comes from the Doing Business data and "is the simple average of the scores for each of the component indicators: the time and cost for resolving a commercial dispute through a local first-instance court, as well as the quality of judicial processes that promotes quality and efficiency in the court system." The score is computed based on the methodology in the DB17–20 studies, which include the quality of judicial process index as a new element for the score creation. The country averages only take into account the main largest city sampled. Each point is the simple average of the observations of each country for the years 1981–2020 for x-axis, 1996–2017 for rule of law index, and 2016–2020 for contract enforcement (y-axis), respectively. The dotted lines represent the average values in the entire sample for each variable. The total sample encompasses 113 and 108 countries respectively including Argentina, Bolivia, Brazil, Chile, Colombia, Dominican Republic, Ecuador, Guatemala, Haiti, Mexico, Nicaragua, Peru, El Salvador, Trinidad and Tobago, Uruguay, and Venezuela.

## Figure 1.15 ▶ Relation between Trust, Property Rights, and the Legal System




*Source*: Authors' calculations based on data from the Integrated Values Survey, the Economic Freedom of the World, and the Index of Economic Freedom.
*Note*: The trust data comes from the Integrated Values Survey, which compiles the seven waves of the World Values Survey (1981–2020) and the five waves of the European Values Study (1981–2020). The property rights component is an assessment of the ability of individuals to accumulate private property, secured by clear laws that are fully enforced by the state, where 100 means that private property is guaranteed by the government and 0 is when private property is outlawed, and all the property belongs to the state; the data come from the Index of Economic Freedom (2013–2020). Quality of legal system is an index that goes from 0 to 10 and measures judicial independence, impartial courts, protection of property rights, military interference in the rule of law and politics, integrity of the legal system, legal enforcement of contracts, regulatory costs of the sales of real property, reliability of police and business cost of crime and comes from the Economic Freedom of the World (1970–2018). Each point is the simple average of the observations of each country for the years 1981–2020 for x-axis, 2013–2020 for property rights, and 1970–2018 for quality of legal system (y-axis), respectively. The dotted lines represent the average values in the entire sample for each variable. The total sample encompasses 110 and 107 countries, respectively, including Argentina, Brazil, Chile, Colombia, Dominican Republic, Ecuador, Guatemala, Haiti, Mexico, Nicaragua, Peru, El Salvador, Trinidad and Tobago, Uruguay, and Venezuela.

all dimensions: trust, the rule of law, contract enforcement, the strength of property rights, and the quality of their legal systems.

Trust among private actors also weighs heavily on decisions to invest, employ, produce, buy, or sell. Countries grow when they use more capital and labor more efficiently, but capital accumulation, employment, and productivity all depend on trust (Algan and Cahuc, 2014; Algan et al., 2017). For example, firms invest more in those countries and sectors where they trust that payments will be made in exchange for promised goods and services. They also invest more where they have better access to financing, which expands when savers trust banks and banks trust borrowers. The strong correlation between trust and gross capital formation is consistent with the link between trust and financial intermediation (Scartascini and Valle Luna, 2020a).

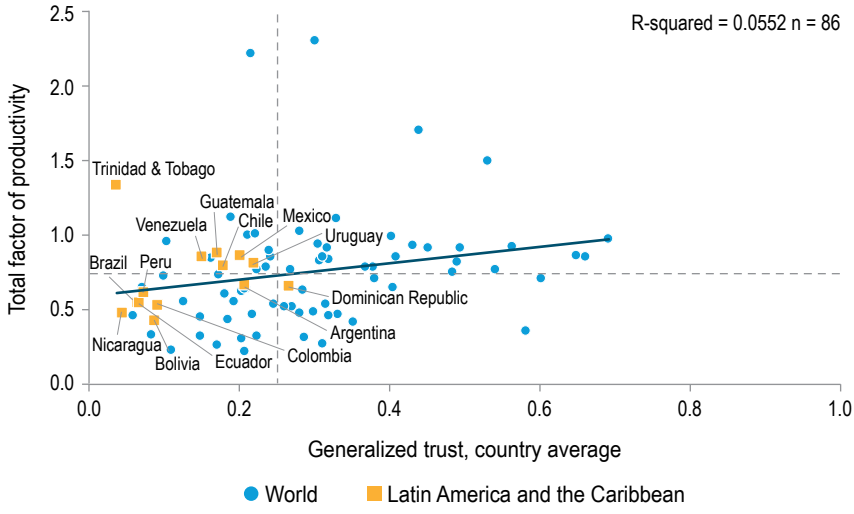
Mistrust can account for the paradox of human capital in the region: although firms in the region frequently describe shortages of skilled workers as a key impediment to growth, the human capital investments of both firms and individuals have not risen significantly to fill the gap. Instead, in low-trust societies, firms hire workers based not only on their productivity but also on characteristics related to trustworthiness—such as kinship ties—which may come at the expense of productivity.

Mistrust also distorts product markets: relationships between firms and customers. Chapter 3 presents new evidence about its detrimental impact on relationships between firms and employees and on how firms organize themselves. Where trust is high, firms are more likely to treat workers generously in the event of an economic (and public health) crisis. When trust is low, owners and managers are less willing to delegate authority to others, sacrificing firm growth, innovation, and productivity to avoid the risks of opportunistic behavior by trusted employees who turn out to be untrustworthy.

Firms that mistrust customers demand payment upfront; customers who distrust firms spend more to verify product quality. When transaction costs are high, economic growth slows. In a low-trust environment, growth also drops because firms are less likely to introduce new and complex products. They expect potential customers to question their claims of improved features and quality and so do not invest in them. Taken together, the effects of mistrust on labor, capital, and product markets significantly suppress productivity and growth. Trust is significantly correlated with total factor productivity (TFP) in country-level data (see Figure 1.16).[4]

[4] Scartascini and Valle Luna (2020a) shows positive correlations between trust and capital, credit, innovation, and productivity.

**Figure 1.16 ▶ Relation between Trust and Productivity**



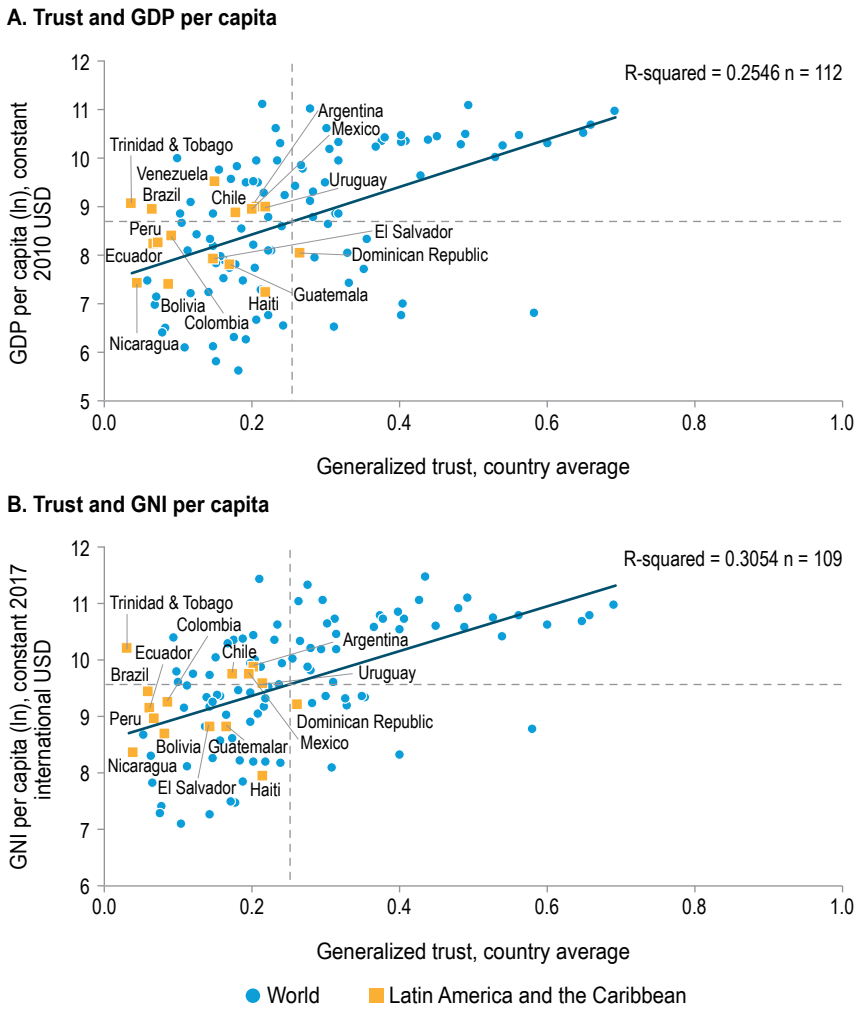

*Source*: Authors' calculations based on data from the Integrated Values Survey and Penn World Table 9.0.
*Note*: The trust data come from the Integrated Values Survey, which compiles the seven waves of the World Values Survey (1981–2020) and the five waves of the European Values Study (1981–2020). Total factor productivity comes from Penn World Table 9.0. Each point is the simple average of the observations of each country for the years 1981–2020 and 1950–2014, x-axis, and y-axis, respectively. The dotted lines represent the average values in the entire sample for each variable. The total sample encompasses 86 countries including Argentina, Bolivia, Brazil, Chile, Colombia, Dominican Republic, Ecuador, Guatemala, Mexico, Nicaragua, Peru, Trinidad and Tobago, Uruguay, and Venezuela.

Knack and Keefer (1997) showed that an increase of one standard deviation in trust leads to an increase of more than one-half of a standard deviation in economic growth. Figure 1.17 updates their findings using data from a total sample of 112 countries and compares it to GDP per capita, a summary measure of long-term economic growth (current GDP per capita is the end result of decades of prior growth). Its correlation with aggregated trust data at the country level confirms that countries from Latin America and the Caribbean have both relatively low incomes and low trust.[5]

Economic activity is full of opportunities for firms and individuals to behave like Lucy and pull the ball away from their workers, bankers, customers, and suppliers. In low-trust settings, there are strong incentives to do business with trusted counterparts. This, however, denies economic opportunity to those who are more productive, but who lack the shared

[5] Regression analysis using WVS data shows that a one standard deviation increase in trust increases (ln) income per capita by about 0.58, or 6.7 percent of the sample mean, which is very similar to the previous literature.

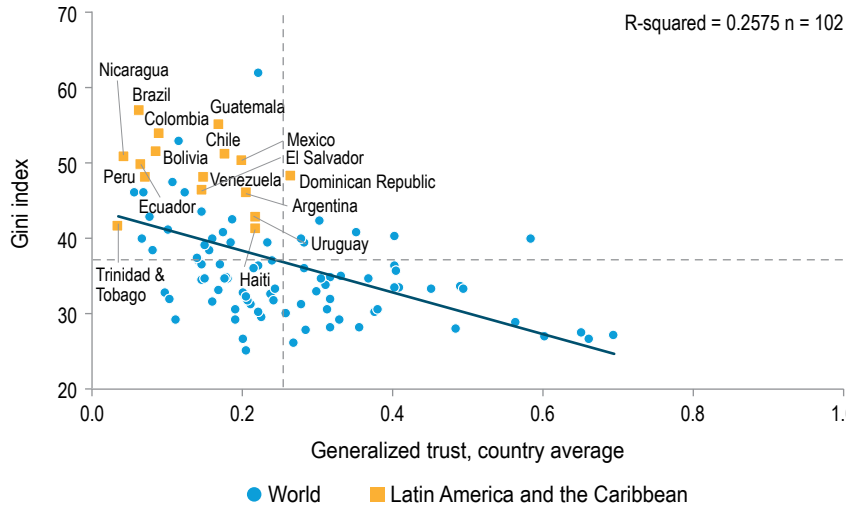
## Figure 1.17 ▶ Relation between Trust and Income




*Source*: Authors' calculations based on data from the Integrated Values Survey and World Development Indicators, World Bank.
*Note*: The trust data come from the Integrated Values Survey, which compiles the seven waves of the World Values Survey (1981–2020) and the five waves of the European Values Study (1981–2020). GDP and GNI per capita come from the World Bank Indicators (1960–2019 and 1990–2019). Each point is the simple average of the observations of each country for the years 1981–2020 for x-axis, 1960–2019 for GDP per capita, and 1990–2019 for GNI per capita (y-axis), respectively. The dotted lines represent the average values in the entire sample for each variable. The total sample encompasses 112 and 109 countries, respectively, including Argentina, Bolivia, Brazil, Chile, Colombia, Dominican Republic, Ecuador, Guatemala, Haiti, Mexico, Nicaragua, Peru, El Salvador, Trinidad and Tobago, Uruguay, and Venezuela.

family, school, neighborhood or other ties that people depend on to avoid opportunistic behavior. Moreover, hobbled by interpersonal mistrust, citizens cannot act collectively to prevent governments from skewing public

**Figure 1.18 ▶ Relation between Trust and Inequality: Country Average**




*Source*: Authors' calculations based on data from the Integrated Values Survey and the World Development Indicators, World Bank.
*Note*: The trust data comes from the Integrated Values Survey, which compiles the seven waves of the World Values Survey (1981–2020) and the five waves of the European Values Study (1981–2020). GINI Index data comes from World Development Indicators, World Bank (1967–2019). Each point is the simple average of the observations of each country for the years 1981–2020 and 1967–2019, x-axis, and y-axis, respectively. The dotted lines represent the average values in the entire sample for each variable. The total sample encompasses 102 countries including Argentina, Brazil, Chile, Colombia, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Mexico, Nicaragua, Peru, Trinidad and Tobago, Uruguay, and Venezuela.

policies to favor the privileged. Mistrust, therefore, has unfortunate implications for inequality. Figure 1.18 shows the strong negative correlation between the Gini coefficient—the most common measurement of inequality at the national level, for which higher values signify greater inequality—and the generalized interpersonal trust measurement from the World Values Survey. Not surprisingly, Latin American and Caribbean countries are concentrated in a quadrant where high levels of inequality meet the lowest levels of interpersonal trust.[6]

Of course, as much as mistrust affects inequality through the distribution of opportunities in society, inequality, and the social, economic and historical circumstances that promote inequality, feed mistrust. For example, economic

[6] Certainly, inequality may reduce trust. However, as Chapter 2 discusses in the case of Latin America and the Caribbean, the same historical circumstances that gave rise to mistrust also promoted inequality: some groups acted opportunistically towards others and established inequitable political, economic, and social arrangements to preserve their privileged position.

inequality often emerges from an unequal distribution of power within a country, as those at the top can better wield the coercive power of the state to benefit themselves at the expense of the rest. Since those with the most power have ample scope to take advantage of the less powerful, the less powerful would be expected to exhibit less trust (Scartascini and Valle Luna, 2020b). Not surprisingly, those in the higher brackets of income or wealth tend to present higher levels of trust than those in the lower ones.

## The Causes of Mistrust… and What to Do about It

Why should some individuals and societies be less trusting than others? A full answer to this question is beyond the scope of this book and even beyond the current capacity of the social sciences. Part of any answer, though, is implicit in the foregoing discussion: in societies where individuals believe that others will not pay a cost for opportunistic behavior, they are more likely to believe that others are untrustworthy. Hence, in societies where the price of opportunistic behavior is low, individuals are less likely to believe that others are trustworthy. Why, though, might the price be lower in some societies than others?

Part of the explanation is of a historical nature, as explained in Chapter 2. Ample research demonstrates that trust falls when individuals in a community are forced to turn on each other. The effects are longlasting. Nunn and Wantchekon (2011) discovered this in West Africa, finding that communities that turned more people over to European slavers in the early 1800s demonstrated significantly lower trust in the late 1900s. Dell (2010) studied the long-run effects of another forced labor regime, the Mita in colonial Peru, in which communities were obliged to select individuals who would then be sent to work in the silver mines of the colony, from which many never returned. Generations later, these same communities exhibit lower local public good provision, symptomatic of weak citizenship. Chapter 2 expands the analysis of this literature to explain some of the determinants of mistrust.

One explanation, explored in Chapter 9, is that in some societies individuals have either systematically less information about the behavior of others, whether politicians, firms, or other citizens, or they are more systematically exposed to biased and untrue information about the behavior of others. Trust in others is intimately linked to beliefs about how others behave, but information shapes those beliefs. When information is scarce, individuals know that trustworthy behavior is not rewarded and untrustworthy behavior not punished. They are more likely to believe that others will take advantage of them. When information is biased, individuals are

more likely to have exaggerated beliefs about the trustworthiness of others, leading them to be either excessively optimistic or pessimistic. Bias is endemic in every country and is growing with the spread of social media; it can be worse in some countries than others.

Behavioral research demonstrates that individuals avoid information that contradicts their beliefs and search out information that confirms them. Populist politicians understand this and tell voters what they wish to hear. Commercial media, aiming to capture the largest possible audience, also has strong incentives to provide information that people wish to receive. Frequently, the information that attracts the most attention—and therefore earns the highest advertising and subscription revenues—is divisive and exacting on trust. Media outlets and politicians concerned about their reputation for probity have incentives to curb these populist and commercial impulses. Reputation has become less of a concern with the emergence of social media and the exponential increase in the number of media providers, from individuals to firms and governments. On the contrary, competitive pressures to provide the information that individuals want to read have increased.

Another key reason that trust is lower in some societies than others is that some societies are less able to punish untrustworthy behavior even when everyone is accurately informed about it. In some societies, individuals and groups enjoy enough power to shield them from punishment for untrustworthy behavior towards others. As Chapter 7 discusses, the institutions that control opportunistic behavior—courts, auditing agencies, police—are more robust in some countries than others. Organizations are also key. This is not only the case in the private sector, where individuals organized together as firms are usually far more productive than they are producing and trading independently. Organizations also solve the collective action dilemmas that prevent individuals from acting together to enforce the social contract: to persuade government to provide higher quality public goods or to expel governments that choose rentseeking over decisions that improve public welfare. Chapter 8 discusses the role of organizations in strengthening citizenship and the social contract, advancing arguments that complement those made by Fukuyama (1996) and North, Wallis, and Weingast (2009) about the role of organizations in development.[7]

[7] Fukuyama (1996) emphasizes the role of organizations in inculcating norms of trustworthiness more than their role as solutions to the collective action dilemmas that mistrust exacerbates. North, Wallis, and Weingast (2009) focus on the role of organizations as facilitating economic and political competition. Chapter 8 extends the logic of organization to trust and the social contract.

Finally, societies may differ in the degree to which their members incur an emotional or moral cost when they act in an untrustworthy manner. Deep historical and cultural explanations can account for such differences. They are, however, evident in the fact that in surveys, individuals always indicate that they believe family members are more trustworthy than people in general. Emotional ties to family members are stronger than to people in general, increasing the emotional cost of intra-family untrustworthy behavior. Counting on the existence of these ties, people express greater trust in individuals inside their family than outside.[8]

This book is primarily concerned with the informational and institutional determinants of trust. It focuses less on the emotional costs of untrustworthy behavior. These two axes mirror broad tendencies of the trust literature. Rothstein (2011) identifies society-centered approaches that focus on social interactions and their role in increasing trust by increasing information that individuals have about others (though also by strengthening emotional ties). These contrast with institution-centered approaches that emphasize the emergence of trust when the political and institutional context promotes collective action to curb opportunistic behavior. Both approaches go back to the same basic principles: trust depends on information, regular interaction, and enforcement, whether moral, social, or grounded in formal accountability institutions.

This book presents recommendations about how countries can increase trust, but recognizes that trust is easily lost and only with great difficulty restored. It reviews evidence from around the world, including Latin America, about the enduring impact of historic episodes of abuse and betrayal. Scarred by often dramatic experiences of untrustworthy behavior, such as the imposition of forced labor by colonial powers on entire communities, parents attempt to protect their children by raising them to be less trusting of others. The intergenerational transmission of mistrust is well-documented. Responding to this, the book also presents recommendations about how countries can optimize the design and implementation of public policies to take mistrust into account.

[8] They also express greater trust in others like them (homophily). Of course, individuals might regard family members as more trustworthy because family members have more information about each others' actions and greater possibilities for imposing costly punishments on opportunistic behavior.

2

# A Primer on Trust: Measures and Determinants

*Advances in the social sciences allow us to measure trust and show that history, culture, families, personal experiences, and individual cognition all shape trust. Still, it is within the grasp of governments to increase trust by changing citizen incentives to be trustworthy: removing power asymmetries that grant impunity to the untrustworthy and removing information asymmetries that allow them to obscure their untrustworthy behavior.*

You approach a busy intersection, look at the traffic lights, and confidently drive through a green light without expecting to be hit by another car. You enter an elevator, unconcerned that it might fall. With a high fever and sore throat, you visit a doctor who orders some tests and diagnoses you with a strep infection. She prescribes antibiotics that you diligently take. You put an ad online to sell an old piece of furniture. An interested buyer picks it up and pays you with a personal check that you deposit in your bank account.

These are just a few of the countless acts of trust that take place daily around the world and make societies better places to live. People take these interactions for granted but, as soon as a fellow driver runs a red light, an elevator malfunctions, a doctor prescribes unnecessary medications, or a check bounces because of lack of funds, people realize how important it is to be able to trust each other. Without trust, people would stop at every intersection, check the maintenance records of every elevator, seek multiple medical opinions for simple ailments, evaluate the approval process for each medication they take, and rely only on cash for market transactions. In the parlance of economists, trust reduces transaction costs.

Mistrust is a significant obstacle to development (see Chapters 3–6). However, unlike other determinants of development, trust is an intangible, psychological phenomenon. Intangible determinants of economic development are inherently more challenging to measure than tangible

determinants, such as infrastructure. Similarly, everyone is familiar with how engineering and construction transform public investment into public infrastructure, but there is less understanding of the processes that give rise to high or low trust. This chapter discusses advances in the measurement of trust and trustworthiness and in understanding the complicated pathways through which individual experience affects trust both contemporaneously and over time, even across generations. Though interpersonal trust is the core concern of this book, its effects radiate through all aspects of society, including trust in institutions and government, which itself significantly impacts development outcomes (see Chapter 4). The dynamics of institutional and interpersonal trust are similar and are explored in the last section of the chapter.

## How to Measure Trust

Measuring trust and trustworthiness is arduous (Bauer and Freitag, 2017). The first challenge is to define it (Uslaner, 2016). In this book, trust refers to the belief that others will not act opportunistically. This is related to, but narrower than, definitions of trust that link it to the concept of social capital. It places more emphasis than others on the importance of *reliance*: trust requires putting oneself in a position in which others can act opportunistically to one's disadvantage. Finally, trust can have emotional dimensions—for example, the warm glow that one feels upon receiving the trust of others or from extending it. The definition in this book does not extend to its emotional causes and consequences.

Another challenge to measurement is that trust depends on context: who is to be trusted, to do what, for how long? When people say they trust others, or when they exhibit trusting behavior, is it because they generally do not encounter individuals who are more powerful or better informed than themselves? Is it because their encounters with others entail only slight risks from opportunistic behavior, or are they trusting even when opportunistic behavior by others can have life-changing consequences? Are they exposed to risks of opportunistic behavior over long periods of time, or are their interactions with others only of short duration? Though many analysts have tried to measure trust in different specific contexts, how can trust be measured and aggregated in all possible contexts?

Regardless of which definition of trust is used, the problem of measurement remains and is perfectly articulated in a quotation attributed to Ernest Hemingway: "The best way to find out if you can trust somebody is to trust them." Unfortunately, people must continually make judgments about the trustworthiness of others *before* choosing to rely on

them. This isolates the biggest challenge of measuring trust: it requires quantifying *two* intangibles—people's *beliefs* about the *expected* behavior of others.

A vast literature in economics, political science, psychology, and sociology uses two main approaches to measure trust. One is the more costly game theoretical approach, which relies on the analysis of individual behavior in games of strategy involving monetary payments. Laboratory games are implemented in a variety of settings including classrooms, computer laboratories, online, or—much more rarely, given its costs—during household surveys. Games can be played between people who know each other or between strangers, in single or in multiple interactions. Laboratory experiments impose uniform, simple contexts that are identical across participants.

The investment or trust game is the main source of measures of trust and trustworthiness in the game theoretical approach (Berg, Dickhaut, and McCabe, 1995). Subjects have two options in this game. One is to earn a guaranteed sum by avoiding interaction with other individuals. The other offers the possibility of earning a significantly larger sum, but contingent on whether other subjects engage or not in opportunistic behavior. Trust matters because, although all are better off under cooperation, every participant has an incentive to act opportunistically.[1] This game "captures the essence of trust: which consists of the investor's willingness to make herself vulnerable to others' actions" (Fehr, 2009, p. 238).

Among their many virtues, laboratory experiments are incentivized; individuals lose money if they trust the untrustworthy or fail to trust the trustworthy. They are also highly controlled to make sure that only people's attitudes towards trusting and trustworthy behavior can account for differences in behavior across individuals. The trust game has been widely used in the literature. Johnson and Mislin's (2011) meta-analysis includes 162 replications of the original Berg, Dickhaut, and McCabe (1995) game. They compare the results of the trust game across different regions and, consistent with the survey results reviewed in Chapter 1, the measure of trust across regions shows that trust is lower in Latin America (based on cases from South America) than in Europe and North America.

[1] In the standard game, two individuals "meet." The first individual, the sender, receives an amount of money $Y. This first individual can choose to send an amount of money $S to the receiver, who gets three times $S. The receiver then has the option of keeping all the money or sending some amount *$R* back to the sender. Therefore, the payoff for the sender is *$(Y-S+R)* and for the receiver is $(3S-R). The amount sent is considered a measure of *trust* while the amount of money the receiver returns is a measure of trustworthiness.

Despite their methodological clarity, laboratory experiments are expensive and logistically complicated, and therefore difficult to use to regularly measure trust in the overall population. It is impractical to conduct laboratory experiments on thousands of subjects on a regular basis in most countries. Even assembling a representative sample of the population is challenging. In most cases, participants are students or other individuals who find it convenient or interesting to sign up for laboratory experiments. Laboratory experiments also do not lend themselves to measuring trust in groups or institutions, like government. They can certainly employ stylized versions of these entities to advance knowledge, but the direct applicability of such experiments to the actual entities may be difficult to infer.[2]

Survey measures, which are the foundation of this book, emerged as a response to these challenges. They exploit attitudinal questions that capture trust. These questions are usually asked of a representative sample of the population using home, phone, and more recently, online interviews. They address the problem of context in two ways. Most often, they elicit people's trust in others in general. This strategy implicitly obliges respondents to aggregate across contexts in the expectation that, on average, all people have a similar understanding of context when they answer the question. Less frequently, surveys also supply context, asking people to express their trust in narrow groups (police, businessmen, politicians) or institutions (government, the church, political parties).

To assess interpersonal trust in general, surveys ask individuals a simple question: how much do they trust others? The most widely used is the Generalized Trust Question: "Generally speaking, would you say that most people can be trusted or that you can't be too careful in dealing with people?" It is also known as the Rosenberg Generalized Trust Question (GTQ) since it was taken from Rosenberg's (1956) "faith in people" scale.[3] Important studies have relied on this survey measure of trust to establish strong correlations across countries with economic growth (Knack and Keefer, 1997), better functioning of organizations (La Porta et al., 1997), financial development (Guiso, Sapienza, and Zingales, 2004), international trade and investment (Guiso, Sapienza, and Zingales, 2009), and increasing village incomes (Narayan and Pritchett, 1999).

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[2] Lately, researchers have tried with a mixed method by applying the traditional trust game to large samples of respondents online (Aruguete, Calvo et al., 2021; Bejarano, Busso, and Scartascini, 2021b). This way, researchers can extract a measure of trust in a more controlled setting, that is incentivized, while reducing the concerns of external validity that some laboratory experiments have.

[3] Scartascini and Valle Luna (2021) discuss the data in detail across the seven waves.

This book relies most on the Generalized Trust Question taken from the source with the broadest country and year coverage: the World Values Survey (WVS). The WVS contains responses from representative samples in more than 100 countries from 1981 until 2020. Region-specific datasets such as Latinobarometer,[4] the most common source of longitudinal data for Latin America and the Caribbean, uses the same structure. Different sections of the book also exploit novel questions with greater context that more explicitly highlight the problem of opportunistic behavior such as, "Do you think politicians (public officials/owners and managers of firms) keep their promises? Do they obey the law?"

Many other efforts have been made to measure trust, for example by capturing slightly different aspects of trusting attitudes or allowing respondents more than two options (other people can be trusted, or not) when characterizing how much they trust others. These are summarized in Table 2.1. One of these alternatives comes from the Global Preferences Survey (GPS). It does not ask respondents about how trustworthy they think others are; instead, it asks whether they believe others have the best of intentions.[5] This is an important shift in perspective. The standard trust question concerns behavior—expectations about whether people behave in a trustworthy manner. Whether others have the best of intentions, in contrast, is an issue of character, independent of behavior. Even individuals with malevolent intentions may nevertheless act in a trustworthy manner if they feel bound by external constraints—the risk of social sanctions, reputational loss, or formal penalties imposed by institutions. The concern of this book is behavior, regardless of whether the source of trustworthy behavior is innate—that people have the best of intentions—or driven by cultural, institutional, and historical conditions. Hence, the analysis in this book, like the bulk of analyses in the large literature on trust, is based on trust data measured using the standard trust question, as in the World Values Survey.

Reliance on the standard trust question, in the literature and in this book, would be misguided if people's responses to survey questions about trust bore no relationship to their actual behavior. Such a mismatch might arise for two reasons. One is inherent to survey-based measures: answers

[4] The wording of the question for Latinobarometer is slightly different than the one used in WVS. However, the binary structure for the answers remains.

[5] The GPS question is "*How well does the following statement describe you as a person? Please indicate your answer on a scale from 0 to 10. A 0 means "does not describe me at all," and a ten means "describes me perfectly." You can use any number between 0 and 10 to indicate where you fall on the scale, using 0, 1, 2, 3, 4, 5, 6, 7, 8, 9, or 10: I assume that people have only the best intentions.*"

## Table 2.1 ▶ Usual Trust Measures in the Literature

| | Source | Question | Construct That Aims to Measure |
|---|---|---|---|
| Survey Approach | World Values Survey (WVS) | Generally speaking, would you say that most people can be trusted or that you can't be too careful in dealing with people? | Interpersonal (generalized) trust |
| | Latinobarometer | Generally speaking, would you say that most people can be trusted or that you can't be too careful in dealing with people? | Interpersonal (generalized) trust |
| | Latin American Public Opinion Project (LAPOP) | Generally speaking, would you say that most people can be trusted, or that you can't be too careful in dealing with people? | Interpersonal (generalized) trust |
| | Latin American Public Opinion Project (LAPOP) | Now, speaking of the people from here, would you say that people in this community are generally very trustworthy, somewhat trustworthy, not very trustworthy, or untrustworthy...? | Interpersonal trust |
| | Global Preference Survey (GPS) | How well does each of the following statements describe you as a person? Please indicate your answer on a scale from 0 to 10. 0 means "does not describe me at all," and 10 means "describes me perfectly." You can use any number between 0 and 10 to indicate where you fall on the scale, using 0, 1, 2, 3, 4, 5, 6, 7, 8, 9, or 10: I assume that people have only the best intentions. | Interpersonal trust |
| | Global Value Survey (GVS) | How much do you agree with the following statement? "I assume that people have only the best intentions." | Interpersonal trust |
| | Bejarano, Busso, and Scartascini, 2021a | How much trust do you have in your family/in immigrants who live in your community/in the teachers of your children's school/in your doctor/in the police that work in your neighborhood? | Interpersonal trust |
| | World Values Survey (WVS) | I am going to name a number of organizations. For each one, could you tell me how much confidence you have in them: is it a great deal of confidence, quite a lot of confidence, not very much confidence, or none at all? | Institutional trust |

*(continued on next page)*

**Table 2.1 ▶ Usual Trust Measures in the Literature** *(continued)*

| | Source | Question | Construct That Aims to Measure |
|---|---|---|---|
| | Latinobarometer | How much trust do you have in each of the following groups/ institutions? Would you say you have a lot, some, a little, or no trust ...? | Institutional trust |
| | Latin American Public Opinion Project (LAPOP) | To what extent do you trust [name of the institution]? Scale from 1-Not at all to 7-A lot. | Institutional trust |
| | Gallup World Poll | Do you have confidence in the national government/judicial system/military/fairness of elections? | Institutional trust |
| | Bejarano, Busso, and Scartascini, 2021a | How much do you think that the following groups (politicians, public officials, the judiciary, and entrepreneurs) deliver on what they have promised? | Institutional trust (effectiveness/competence) |
| | Bejarano, Busso, and Scartascini, 2021a | Thinking about the same groups, how often do you consider that they think of you and the interest of people like you when they make decisions? | Institutional trust (values) |
| Experimental Approach | Trust game (Berg, Dickhaut, and McCabe, 1995) | In the standard game, two individuals "meet." The first individual, the sender, receives an amount of money $Y. This first individual can choose to send an amount of money $S to the receiver, who gets three times $S. The receiver then has the option of keeping all the money or sending some amount $R back to the sender. Therefore, the payoff for the sender is $(Y-S+R) and for the receiver is $(3S-R). The amount sent is considered a measure of trust while the amount of money the receiver returns is a measure of trustworthiness. | Interpersonal trust |

*Source*: Authors' elaboration.

are not incentivized. In contrast to the trust games in laboratory experiments, people lose nothing if they indicate that they are more or less trusting than they really are. The second reason is that the standard trust question predicts behavior, but the behavior it predicts may vary—unobservably—from respondent to respondent and make responses essentially

uninterpretable. As Glaeser et al. (2000) observe, respondents themselves may have difficulty interpreting the standard trust question, finding it vague and abstract (see also Robbins [2016]). This raises the possibility that respondent interpretations may differ from those of other respondents and from those of researchers. Respondents might ask, for example, "Trust others to do what?" and "Does 'generally' mean more than half of all people or almost all of them?"

One obvious approach to building confidence in survey measures is to demonstrate that they correspond to behavior in incentivized (laboratory) settings. Several studies have investigated this issue and, fortunately, found the correspondence to be high. Cárdenas, Chong, and Ñopo (2013) look at a related issue (the measurement of pro-social attitudes) and ask whether people who express these attitudes in surveys behave pro-socially in experimental games that reward cooperation. They collected data from more than 3,100 participants from six cities in Latin America and find a highly significant correlation between the incentivized and unincentivized measures.

Other studies examine the relationship between incentivized and survey measures of trust. Glaeser et al. (2000) shows that the standard survey question from the World Values Survey is correlated with trustworthiness, but not trust. Fehr et al. (2003) find the opposite: the measure is correlated with trust, but not trustworthiness. Sapienza, Toldra-Simats, and Zingales (2013) resolve the contradiction by observing that during the laboratory game, people's behavior is affected not only by their beliefs about whether others are trustworthy, but also by their levels of risk aversion (leading to less trusting behavior); reciprocity (more trustworthy behavior); and altruism (more trusting behavior).[6] In contrast, the survey-based measure, precisely because no money is at stake, is purely a belief-based measure. A modified laboratory experiment focuses on the belief component and discovers that incentivized behavior in the experiment corresponds to responses to survey questions about trust. The validity of the Generalized Trust Question, as demonstrated in these studies, the convenience of administering it, and the large body of data already collected around the

[6] Ashraf, Bohnet, and Piankov (2006) show that "trust is based on beliefs of trustworthiness and on unconditional kindness; trustworthiness is related to unconditional kindness and reciprocity." Karlan (2005) and Schechter (2007) show that the sender's behavior is also affected by risk aversion. There is a long literature that modifies the basic trust game to control for differences in risk aversion, altruism, and other preference parameters that could affect the resulting trust measures. Fehr (2009) analyzes the role of biology in trust.

question, make it an invaluable tool for exploring the consequences and determinants of trust in Latin America and the Caribbean.

## The Determinants of Trust

The difficulty of measuring trust is matched by the challenge of understanding its determinants. Trust is a psychological characteristic of individuals that fundamentally affects how they interact with each other and society. It evolves with people's experiences with others and their exposure to the society in which they live, including its history and cultural characteristics. Individuals can exhibit different levels of trust because diverse life choices—where they live, go to school, work, and socialize—lead them to interact with different people, some more trustworthy than others; moreover, they live in different societies with diverse histories and cultures that promote or undermine trust. Hence, efforts to track the origins of trust proceed on two tracks, looking at the direct effects of personal experience, and the indirect effects of society, its history and culture.

### The Personal Part

Trust is innate—even very young children exhibit variations in trusting behavior—but it responds to new information about the world.[7] In his book on the economics of trust, Ho (2021) crystallizes the evolution from innate to learned in a story about his own family. From any tall platform, his two-year old son would gleefully fall backwards into his parents' waiting arms, making no attempt to catch himself and giggling the entire time. His four-year old son, though equally eager to play the game, no longer had his younger brother's absolute, unquestioning confidence in his parents. Although his parents always caught him, too, he would nevertheless turn his head to make sure, and move his arms to cushion the fall, just in case they dropped him.

[7] Bašić et al. (2021) observe how 929 young children from Austria aged 3 to 6 play a cooperation game. The game consists of giving each child a valuable token. She can choose to keep that token, or can give it to another player. If she gives it to another player, it becomes two tokens. If both players give tokens to another player, they end the game with two tokens each. If they choose to keep their token, they end up with only one. In the first round of the game, the children cooperate (give their token away) approximately 25 percent of the time. However, when children learn about a twist in the game under which there was some probability (around 50 percent) that they would lose their tokens if they did not cooperate, this figure rose to 68 percent.

Experience with the world gives individuals more information on how others behave. As individuals gather more information on the motives or past behavior of others, they adjust their expectations about how these people will behave, as well as how people whom they have never met will behave (see Chapter 9). In other words, the accumulation of information allows individuals to assess the distribution of trustworthy people in society. The absence of information also affects people's beliefs about others. They know that it is in the interest of the untrustworthy to seek out and take advantage of trusting counterparts who are uninformed.

The information people have gathered from diverse sources and experiences affects how they assess whether others have acted in their best interests or have instead taken advantage of them. For example, did the doctor's expensive treatment lead to recovery from an illness, or would a less expensive treatment have achieved the same result? Did government policies accelerate exports, or cause the economic crisis, or were other factors, such as favorable or unfavorable shifts in commodity prices, responsible?

Families are the first source of information about the trustworthiness of others. Parents know that too much or too little trust in others can have severe repercussions on a child's success in life. Hence, they have an interest in passing on societal and familial expectations (or norms) of trustworthiness to their children.[8] Dohmen et al. (2012), using panel data from Germany, find a strong positive correlation between parents' (average age 55 for fathers and 51 for mothers) and children's (average age 25) beliefs when looking at the same measures of trust.[9] Wu (2020) uses data from the United States to ask whether individuals who move from low-trust areas (the American South) to high-trust areas become more trusting, and vice-versa; she finds that regardless of where they move after age 16, Americans' trust changes very little.

As children grow and interact more with the world outside their family, they receive significant additional information about the behavior of others. Their personal experiences in the workplace, relationships, and economic and political marketplaces, all expose them to the potential of untrustworthy behavior by others. So also does their exposure to

[8] In fact, there is suggestive evidence that people start to develop interpersonal trust during childhood. Through a series of trust games, Rosati et al. (2019) test for this development in the lab. They find that young children (aged 4) tend to trust more indiscriminately whereas older children (aged 6) are better at discriminating in favor of trustworthy exchange partners.

[9] There is also a high correlation in the level of trust among spouses.

information about the behavior of others, depending on which and how much mass and social media they consume, among many possible sources of information (see Chapter 9).

Because people are different, the personal experiences and relationships they have, the jobs they take, and the types of information they seek out and consume also differ. Age, gender, intelligence, personality, family, and neighborhood characteristics can all yield different experiences, information, and, therefore, beliefs about the trustworthiness of others. Older individuals have more personal experiences from which to derive conclusions about the trustworthiness of others. Gender bias may expose women to greater risk of opportunistic behavior. Educated people may trust more because they are better able to distinguish whether their bad experiences with others are the result of opportunistic behavior (the doctor proposed a treatment that was expensive but useless) or other factors (the severity of the illness).

Personal characteristics also affect choices people make that subsequently affect their levels of trust. For example, as individuals age, they gain agency over fundamental decisions such as their education, living situation, employment, and family arrangements. Their trust in others affects these decisions, which in turn condition their interactions with people over the course of their lifetimes, ultimately shaping how much trust they have as adults. This dual causal link can, in turn, contribute to the persistence of beliefs—for example, in the presence of assortative mating (e.g., people marry others of similar religion), or to changes in beliefs—for example, when people make these life decisions guided by factors largely unrelated to trust (e.g., beauty or city amenities).

Given the importance of individual choices and history to the formation of beliefs, varied life experiences are systematically correlated with trust. Table 2.2 shows that the within-country correlations are similar whether looking at the entire world, Latin America and the Caribbean, or the OECD, albeit with some interesting variations. Age, gender, marital status, children, college education, and full or part-time employment are significantly correlated with their levels of interpersonal trust. Around the world, older, more educated, and employed individuals are more trusting. Women are more trusting in the OECD, but not elsewhere, particularly not in Latin America and the Caribbean. Married people are more trusting everywhere, but not in the region.

Some rounds of the World Values Survey, though many fewer, also asked respondents how they spend their time. When these variables are added to the estimates in Table 2.2, the sample size falls significantly, but other interesting patterns emerge. People who more frequently play sports, go to church, meet with friends or work colleagues, or visit their parents,

**Table 2.2 ▶ Correlates of Trust at the Individual Level**

| | (1) World | (2) OECD | (3) LAC |
|---|---|---|---|
| Age | 0.001***<br>[0.000] | 0.001***<br>[0.000] | 0.000***<br>[0.000] |
| Female | –0.003**<br>[0.001] | 0.003<br>[0.003] | –0.008**<br>[0.003] |
| Married | 0.013***<br>[0.002] | 0.035***<br>[0.004] | –0.002<br>[0.004] |
| Has kids | –0.018***<br>[0.002] | –0.023***<br>[0.004] | –0.018***<br>[0.004] |
| College | 0.063***<br>[0.002] | 0.140***<br>[0.004] | 0.051***<br>[0.004] |
| Employed | 0.011***<br>[0.002] | 0.032***<br>[0.004] | 0.014***<br>[0.003] |
| Year FE<br>Country FE | YES<br>YES | YES<br>YES | YES<br>YES |
| Observations<br>adj. R-sq | 350,144<br>0.119 | 88,011<br>0.136 | 55,239<br>0.045 |

*Source*: World Values Survey (WVS) 1989–2020.
*Note*: The dependent variable, generalized trust, is calculated from answers to the question, *"Generally speaking, would you say that most people can be trusted, or that you need to be very careful in dealing with people?"* Trust is equal to 1 if the respondent answers, *"Most people can be trusted"* and 0 otherwise. The dependent variables come from questions reflecting respondents' individual characteristics such as: age, in years; the gender of the respondent, female equals to 1; marital status where married or living together as married equals 1 and other status (i.e., single, divorced, widowed, etc.) equals to zero. The variable Has kids is also binary, that equals 1 when the respondent answers having at least one child. The College variable was created equal to 1 when the respondent's education is coded as having "Upper" education, and zero otherwise. The Employed variable equals to 1 when the employment status is recorded as "full time" or "part time." OLS regression estimations from individual-level data with robust standard errors in brackets, and significance levels as follow * p<0.10, ** p<0.05, *** p<0.01. The total number of countries in the sample is 103 including Argentina, Bolivia, Brazil, Chile, Colombia, Dominican Republic, Ecuador, Guatemala, Haiti, Mexico, Nicaragua, Peru, El Salvador, Trinidad and Tobago, Uruguay, and Venezuela.

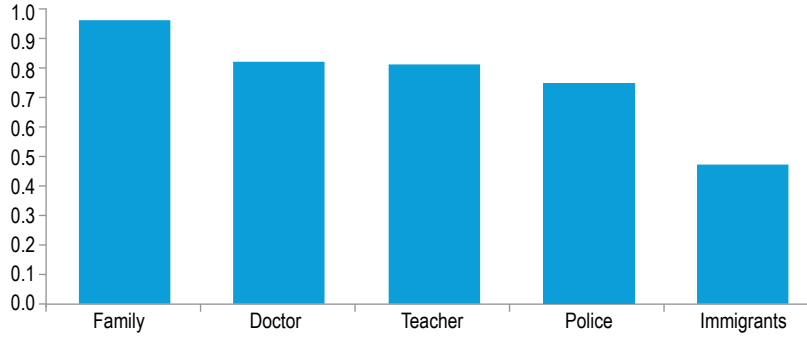
are all more trusting. When these variables are taken into account, gender, marital status, children and employment status are no longer robustly associated with trust. Certainly, these are simply correlations (trusting individuals are more likely to have friends, for example) but they illustrate the point that life experiences and choices are associated with levels of trust.

If experience affects trust, then people should have greater trust in those with whom they interact more. Both the increased knowledge that accumulates from more frequent encounters, and the prospect of future interactions, reduce expectations of opportunistic behavior by others. Cochard, Nguyen Van, and Willinger (2004) compare a seven-period repeated investment game to the one-shot investment game. Results indicate that, on average, both players (the "trustor" and the "trustee") return a larger percentage than in the one-shot game. Bejarano, Busso, and Scartascini (2021b) collected information from a random sample of people in

Argentina, Brazil, Chile, Colombia, Mexico, and Peru in early 2020 and conclude that, in fact, trust rises with the frequency of personal encounters.

This survey asked: "How much trust do you have in your family/ in the teachers at your children's school/in your doctor/in the police that work in your neighborhood/ in immigrants who live in your community?"[10] In Latin America, most people trust their families (Figure 2.1). The level of trust is about 10 percentage points lower when it comes to teachers and doctors they know. Trust in these professionals, whom they know, is in turn much higher than the trust they express in people in general, in their answers to the general trust question.[11]

**Figure 2.1 ▸ Interpersonal Trust (proportion of people who trust other people, regional average)**




| | Family | Doctor | Teacher | Police | Immigrants |
|---|---|---|---|---|---|
| Argentina | 0.98 | 0.93 | 0.85 | 0.82 | 0.56 |
| Brazil | 0.95 | 0.83 | 0.83 | 0.85 | 0.55 |
| Chile | 0.96 | 0.75 | 0.78 | 0.64 | 0.44 |
| Colombia | 0.96 | 0.83 | 0.84 | 0.73 | 0.44 |
| Mexico | 0.96 | 0.87 | 0.85 | 0.69 | 0.58 |
| Peru | 0.97 | 0.72 | 0.73 | 0.76 | 0.26 |

*Source:* Authors' calculations based on Bejarano, Busso, and Scartascini (2021b).
*Note:* Blue bars show the proportion of individuals who responded above the mid-point of the Likert scales to the following questions: "How much trust do you have in your family/in your doctor/in the teachers at your children's school/in the police that work in your neighborhood/in immigrants who live in your community?" Respondents could choose from a 1–10 Likert scale where 1 was "Not at all" and 10 was "Completely." The information was collected online in 2020. At 7,229 people (about 1,200 individuals per country), the sample is representative of the population of each country.

[10] The estimate is a simple factor model imposing one factor (and using Maximum Likelihood). The coefficient of reliability Cronbach's Alpha was 0.68.

[11] Bejarano, Busso, and Scartascini (2021b) report generally higher levels of trust because the authors use a 1 – 5 Likert scale that allows people to say they trust people "somewhat" who, when compelled to respond only yes or no would be inclined to say they do not trust others.

One further, significant factor that determines trust and leads to significant interpersonal variation in trust is the fact that people process information about the world through cognitive processes that are often distorted or noisy, affecting their beliefs about others and often leading them to form opinions that are at odds with reality. These distortions are addressed in depth in Chapter 9, which analyzes the role of information in the formation of trust. The next section, discussing the social determinants of trust, identifies inequality as a significant factor. However, as Chapter 9 reveals, beliefs about the fairness of distribution seem to matter even more than the actual distribution of income and wealth and these beliefs are often incorrect. In Argentina, for example, a significant share of low-income people place themselves in higher ranks of the income distribution than is actually the case, while a considerable proportion of rich people underestimate their income position (Cruces, Pérez-Truglia, and Tetaz, 2013). This distortion is not unique to Argentines. Swedes underestimate on average their position in the national income distribution and the levels of inequality (Karadja, Mollerstrom, and Seim, 2017). Americans do the same regarding wealth inequality (Norton and Ariely, 2011).

## The Weight of Society

Individual trust is a direct product of individual experiences and interactions with others. It is also, indirectly, formed by the society in which people live. A society's history, culture, and institutions shape the costs and benefits of trustworthy behavior. Society influences the values families pass on to children, the behavior of the people whom individuals encounter, and even the menu of choices that individuals have about where to live and work, whom to marry, or where and how much to study. All these factors, in turn, affect trust.

The effects of history on trust can be dramatic, if not always predictable. Experience with war, natural disaster, economic depression, or colonial occupation and slavery may increase trust in societies where such shocks triggered greater cooperation among individuals. On the other hand, these same events, perhaps more commonly, have the opposite effect, increasing incentives to act noncooperatively and opportunistically—that is, to betray others.[12] Many countries in Latin America and the Caribbean suffered through violent and often long-lasting conflicts in the

[12] The chaotic aftermath of a disaster and the need for fast disbursements open up opportunities for corruption (Nikolova and Marinov, 2017; Yamamura, 2014).

twentieth century; many also endured oppressive governments. It is likely that these experiences reduced trust.[13]

Just as members of a society share history, they also share institutions. As Chapter 7 discusses, if institutions curb opportunistic behavior by all members of society, they increase trust and trustworthiness. If, on the other hand, governments do not control opportunistic behavior among citizens, or control it among some citizens but not among others (e.g., among elites), interpersonal trust falls. Governments promote trust and cooperation among citizens when, for example, traffic lights work and road safety violations are penalized.

Inequality—economic or political—is another fundamental social characteristic with significant implications for trust. In relationships where one of the actors has more economic or political power, and therefore more coercive ability, the less powerful actor can do little to prevent opportunistic behavior and is necessarily less trusting. Those with more coercive capacity can insist that others transact with them, even if they are not considered trustworthy, and can act in an untrustworthy manner with impunity.

Most research on trust and inequality focuses on economic inequality. In more economically unequal societies, trustworthy behavior—specifically, cooperative behavior—is harder to sustain (Putnam, 2007). Moreover, inequality, in and of itself, is informative about the behavior of others and, if the distribution of income is regarded as unfair, it reduces popular beliefs about the trustworthiness of others (Gould and Hijzen, 2016). However, the effects of inequality need not be uniform across societies. In societies with institutions or social norms that enforce trustworthy behavior by those with more towards those with less, for example, those with less can be more trusting. Furthermore, economic and political inequality need not go together; those with less on one dimension may be able to compensate on the other, again reducing the negative trust effects of inequality.

On average, economic inequality is linked to lower levels of trust.[14] The relationship is stronger for people at the bottom of the income distribution

[13] Rainer and Siedler (2009) demonstrate that East Germans were significantly less trusting than West Germans at the time of unification and that experience with democracy led to convergence between East and West Germans in their trust in institutions.

[14] Most of the evidence relies on cross-country or cross-locality variation (e.g., Alesina and La Ferrara, 2000). It is, therefore, difficult to isolate exogenous variation on inequality to argue a causal effect on trust. A few laboratory experiments, however, implement some version of the trust game and then randomly assign either endowments (e.g., Bejarano, Busso, and Scartascini, 2021a) or players of different socioeconomic strata (e.g., Bogliacino et al., 2017) with mixed results.

and for those more averse to income differentials. This pattern corroborates the theory: those with the least are most vulnerable to opportunistic behavior by others, and those who view income differentials as a sign of unfairness in society are most likely to infer from inequality that others are not trustworthy (Gustavsson and Jordahl, 2008).

Trust should be further affected if people see multiple distributional indicators that point to unfairness. Tesei (2015) argues that racial income inequality particularly reduces trust: when not only the gap between rich and poor widens, but when the gap between the rich majority race and poor minority races increases. Data from the United States indicate that racial income inequality is associated with lower average trust, and the effects are strongest in more racially fragmented communities and among the minority groups within the community.

Even in the absence of income inequality, ethnic and racial diversity have moderate, negative effects on trust.[15] Historic patterns of ethnic interactions, whether harmonious or violent, have consequences for subsequent generations. In the presence of more ethnic or racial diversity, people may choose to interact with their own co-ethnics, blocking off the channels through which inter-ethnic trust could increase (Putnam, 2007). For example, less social integration reduces the flow of information among ethnic groups, disabling one important mechanism for sanctioning members of other ethnic groups who act opportunistically. Ethnic diversity can be associated with linguistic and cultural differences that inhibit communication, coordination, and trust. Finally, people may be averse to heterogeneity and automatically assume that people who look "different," perhaps by virtue of race, are inherently less trustworthy (Olsson et al. 2005; Dinesen and Sønderskov, 2015).

Dinesen, Schaeffer, and Sønderskov (2020) review the empirical literature to estimate the relation between ethnic/racial diversity and trust. They find an average correlation, across all studies, between ethnic diversity and social trust, that is statistically significant and negative, but relatively small (a partial correlation of −0.026). This modest size implies that, as Dinesen, Schaeffer, and Sønderskov (2020, p. 450) write, "apocalyptic claims regarding the severe threat of ethnic diversity for social trust in contemporary societies are exaggerated."

Migration is another experience that affects trust. New arrivals and receiving populations not only have no information about each other,

[15] As in the relationship between economic inequality and trust, the empirical literature has relied on cross-locality comparisons when studying the effect of racial/ethnic diversity on trust. The experimental evidence in this area seem to support the idea that trust does not travel well across racial lines (Glaeser et al., 2000).

which always undermines trust, but they likely differ in the social determinants of trust, from history and culture to previous experience with country institutions.[16] Its effects are particularly important in Latin America and the Caribbean, where the potential effects of cross-border migration on everything from labor markets to crime has recently become the subject of intense policy debate (Blyde, Busso, and Ibáñez, 2020). Tentative evidence from Mexico indicates that migration may reduce trust in the community of origin of the emigrant (Jo, 2019). The effects of immigration on trust in the community of destination is, as with racial and ethnic diversity, more varied.

A resettlement program in Indonesia resulted in significant variation in trust across communities based on their exposure to immigrants (Bazzi et al., 2019). Immigration-driven diversity reduced trust towards neighbors in polarized communities (those with a few larger and distinct groups) but not in fractionalized communities (those with many smaller groups). In Uruguay, trust towards other Uruguayans or towards international immigrants varies little (Gandelman and Lamé, 2021). Similarly, in Colombia, proximity to the wave of migrants from Venezuela has not had a causal effect on trust (Lebow, Moreno Medina, and Coral, 2020). Moreover, immigration increased trust in foreigners in municipalities that are more urbanized, have better public goods provision, and where immigrants and local populations are more residentially integrated.

Since the lack of interaction among ethnic groups is likely to play a sizeable role in the emergence or persistence of inter-ethnic mistrust, it follows that increased interaction should build trust. The so-called contact theory hypothesizes that contact with ethnic/racial outgroups may reduce negative stereotypes about these groups and build positive intergroup relations. This can, in turn, translate into higher levels of trust in the members of the outgroup (Rudolph and Popp, 2010).

In this vein, the South African experience shows how a noxious policy had unintended beneficial effects on interethnic trust (Abel, 2019). The South African apartheid regime forced people from different ethnicities to relocate to the same areas. An unforeseen effect of this policy was to induce a legacy of trust among resettled ethnicities. More than ten years after the end of the apartheid regime in 1994, those who were relocated to or were born and raised in a resettlement community report greater

[16] Fisman and Miguel (2007) famously show that United Nations diplomats from high-corruption countries accumulated significantly more unpaid parking violations prior to 2002, when all diplomats had immunity from parking enforcement. After 2002, when immunity was lifted, their unpaid violations dropped sharply compared to those of other countries.

levels of generalized, intra-ethnic, and interethnic trust. Abel argues that the need to cooperate with other members of resettlement communities in a context of scarce resources induced norms of cooperation and trust within the communities that have persisted until today.[17]

The effects of society-wide factors echo through history. A growing literature explores the role of formal and informal institutions that, although they themselves disappeared, set in motion a particular evolution of culture, including beliefs about the trustworthiness of others, that reverberates through history. These studies link the development of trust and cooperation to a historical setting many generations ago (Nunn and Wantchekon, 2011; Guiso, Sapienza, and Zingales, 2016; Durante, 2009). Past shocks to institutions triggered changes in trust and cooperative norms that persisted over time, even long after the institutions themselves had faded away. Intergenerational transmission, for example through families, explains this persistence (Bisin and Verdier [2001] provide a theoretical foundation for this process).

Durante (2009) analyzes a compelling example. Subsistence farmers in Europe's historical rural societies developed norms of interpersonal trust to mitigate agricultural production risks associated with the weather. These norms translated into persistent high levels of interpersonal trust. Localities subject to stronger historical variations in weather had greater incentives to adopt these norms. Consequently, farmers in these areas were more likely to share labor and material resources such as storage facilities. They were also more likely to cooperate with other local farmers to build infrastructure, such as irrigation systems, to increase their resilience to weather shocks. Moreover, if nearby localities were known to experience less climate variability, exposed farmers engaged in more trade relationships in order to mitigate the negative impact of adverse weather shocks in their own locality. These arrangements fostered norms of interpersonal cooperation and trust in rural areas which continue today. In places where time-related weather variability was stronger between 1500 and 1900, self-reported measures of interpersonal trust are higher relative to places that experienced less weather variability in the past.

[17] Between 1960 and 1980, the homeland policy of the Apartheid regime created ten supposedly homogenous states called Bantustans to divide the Black majority along ethnic and tribal lines. In these communities within the Black homelands, 3.5 million Black or mixed-race South Africans were forcefully displaced. This both strengthened the supremacy of the minority White population while allowing free labor movements of Blacks to and from Bantustans—the only exception to the homeland policy. While originally designed to be ethnically homogenous, the poor urban areas that were artificially created to host the displaced (i.e., the resettlement communities within the Bantustans) in practice ended up being ethnically mixed.

Furthermore, in areas subject to high weather variability in the past, modern-day family ties—as reported by individuals' answers to survey questions on the importance of family—are weaker. This finding is consistent with the work of Tabellini (2008b) and Ermisch and Gambetta (2010), who conclude that as trust in the community grows, individuals are less reliant on family members for protection and insurance, and trust in family members fades.[18]

Many other examples exist of the intergenerational transmission of dramatic historic episodes of untrustworthy behavior. Doctors are usually highly trusted in society. However, the disclosure of an unethical and deadly experiment, the Tuskegee Study of Untreated Syphilis in the Negro Male, fomented persistent mistrust of medical professionals among African Americans in the United States (Alsan and Wanamaker, 2018). Similarly, repeated exploitative colonial practices in Africa affected trust in medicine and health care policies today (Athias and Macina, 2020; Lowes and Montero, 2020). The pervasive effect of the Spanish Inquisition's religious persecution and totalitarian control also still affects outcomes today. In municipalities of Spain where persecution was higher, trust (particularly of government) is lower (Drelichman, Vidal-Robert, and Voth, 2021).

By the same token, individuals who were exposed to the Chinese Cultural Revolution during their formative years (childhood and teenage) are less trusting of others as adults (Bai and Wu, 2020). The key mechanism linking the revolution and trust is the benefit available to individuals who signaled their political loyalty at the expense of others. This practice obviously made it difficult to sustain interpersonal trust.

An even more compelling and dramatic example of a similar, but longer-lasting phenomenon, can be traced to the slave trade in Africa. Nunn and Wantchekon (2011) explore the legacy of slave trafficking in Sub-Saharan Africa on several measures of trust reported in the Afrobarometer Survey. The slave trade entailed not only the capture of slaves by traders, but also the purchase of slaves from locals. Traders offered rewards to locals who would sell strangers—as well as friends and relatives—to them. The slave trade, in other words, provided large incentives for grievously untrustworthy behavior across large populations and for a significant period of time. Individuals who belong to ethnic groups from which the most slaves were taken generations earlier, currently display higher levels of mistrust

[18] Guiso, Sapienza, and Zingales (2016) provide another example of how a disappearing institution, the free city-state from the Middle Ages in Italy, led to long term persistence in civic capital. The authors speculate that this trait was transmitted through a culture of self-efficacy promoted in the free city-states.

towards neighbors, kin, in-group members and out-group members of the community. They also exhibit lower levels of trust in their local community government, which is relevant to the discussion on institutional trust.

## Trust in Institutions: Asymmetric Power and Information

It is ultimately people who can be trusted or that exhibit trustworthy behavior (see Chapters 7 and 8). Trust in institutions, therefore, fundamentally captures whether the individuals who comprise the institutions in question are trustworthy. Institutional trust is not simply a projection of interpersonal trust, however. Although interpersonal mistrust weakens institutions, the purpose of institutions is to orient and constrain individuals' behavior inside the institutions, regardless of whether they are themselves trustworthy or not. Weak institutions place few constraints on the arbitrary behavior of the people that occupy them; strong institutions demand that they avoid arbitrary and capricious behavior. Hence, trust in institutions is faith in their capacity to persuade the people inside the institution not to act opportunistically.

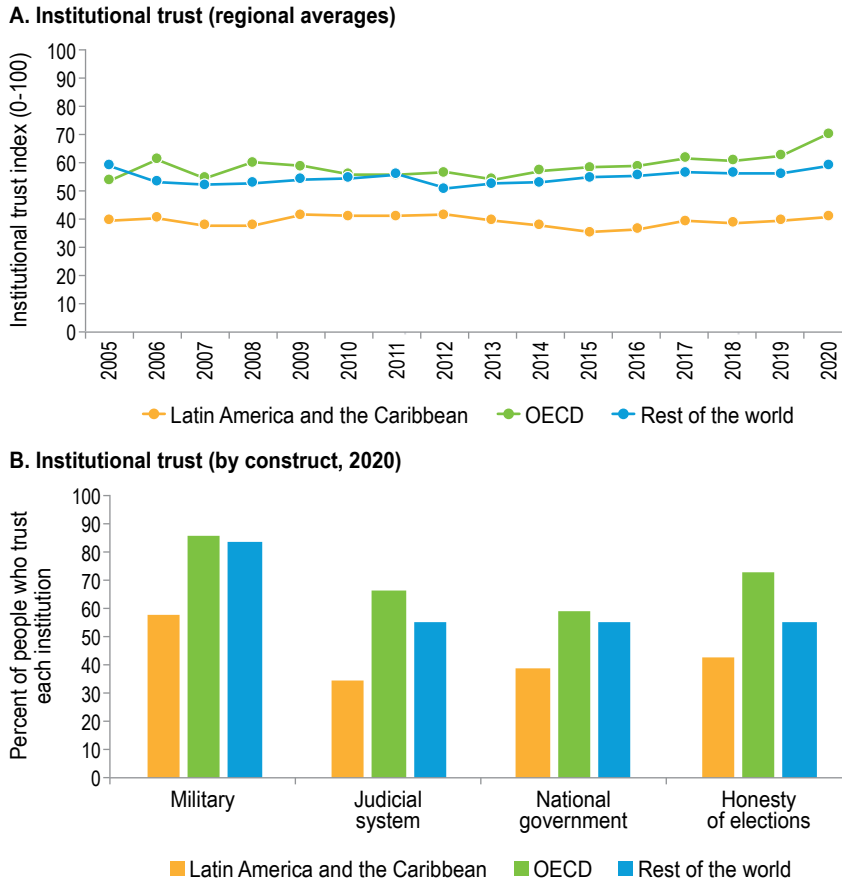
Latin America and the Caribbean exhibit low levels of institutional trust. Figure 2.2 shows data from the Gallup World Poll over 15 years (which covers most of the world including 24 Latin American and Caribbean countries). In 2020, trust in the national government, judicial system, honesty of elections, and the military were all lower in Latin America and the Caribbean than in other regions of the world. An index that aggregates these questions shows that the level of mistrust in institutions has been lower over the past 15 years.

Citizens can mistrust institutions for two reasons: because institutional actors do not have incentives to act in their interests, or because they lack the capacity to do so. Hakhverdian and Mayne (2012) make a similar observation, though without using the term "incentives." They argue that people first assess institutions and government actors according to "the extent to which the democratic promise of political fairness and equality is made real by the rules, procedures, norms, and structures that guide and constrain the functioning of political institutions and the behavior of political actors" (p. 4).

Second, they argue, citizen trust in institutions depends on an *effectiveness* criterion ("government for the people") which captures capacity. Even if they are well-intentioned, individuals may fail to deliver on their promises because they simply cannot. People will, therefore, regard institutions as trustworthy if they believe that institutions and government actors are effective at achieving their goals and if those goals are shared by the society.

Bejarano, Busso, and Scartascini (2021b) apply the Hakhverdian and Mayne criteria in Latin America and ask two sets of questions. First, they

**Figure 2.2 ▶ The State of Trust in Institutions in Latin America and the Caribbean**




*Source*: Authors' calculations based on Gallup World Poll.
*Note*: Each year Gallup World Poll asks a representative sample of 1,000 in each country the following questions: "Do you have confidence in each of the following, or not? How about the military/ the judicial system/ the national government/ the honesty of elections?" People then respond "Yes" (coded as a 1) or "No" (coded as a zero). Gallup then computes a "National Institutional Index" as the average response to each of the four items, then multiplied by 100. The survey is administered in 25 countries of Latin America and the Caribbean, 30 countries of the OECD, and 113 countries elsewhere (Rest of the world). Panel A shows the simple regional average of the "National Institutional Index." Panel B shows the simple regional average of each individual item.

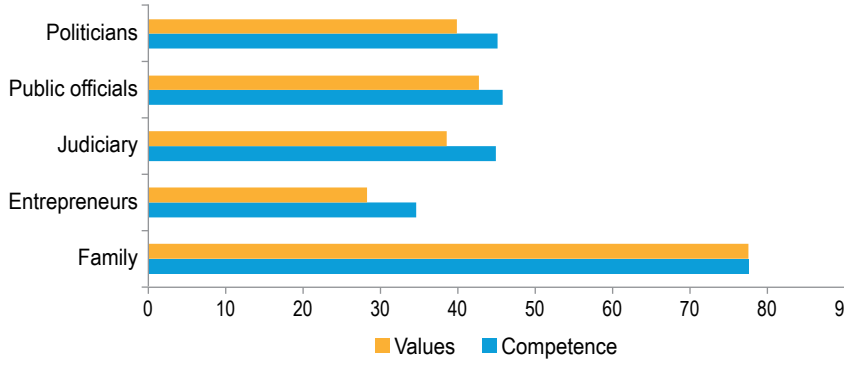
ask: "thinking about the following groups (politicians, public officials, the judiciary, and entrepreneurs), how often do you consider that they think of you and the interests of people like you when they make decisions?" These measures capture whether the different groups and institutions embody values of service towards citizens. Second, "how much do you think that the following groups (politicians, public officials, the judiciary, and

entrepreneurs) can deliver on what they have promised?" These questions capture people's assessments of policy performance; that is, the ability of these groups to provide goods or services. To anchor the answers, similar questions are asked regarding family members.

Figure 2.3 plots the average responses across six different countries: Argentina, Brazil, Chile, Colombia, Mexico, and Peru. Eighty percent of respondents trust their family members' abilities to keep their promises and take their interests into account when making decisions. Trust in institutions is much lower, particularly people's trust in the institution's values.

Several studies look more specifically at the impact of government effectiveness on institutional trust. For example, experience that the government has successfully delivered public safety significantly increases trust in institutions associated with crime prevention and punishment. Corbacho, Philipp, and Ruiz-Vega (2015) conclude that in their large sample of survey respondents, trust in police is 10 percentage points lower among crime victims than among non-victims. Victimization is also negatively correlated with trust in the judiciary. In Colombia, being a victim of a crime or feeling a high level of insecurity is associated with lower trust in the criminal justice system (measured as trust in the police, attorney's office, and the prosecutor's office), lower trust in political institutions (e.g., the national

**Figure 2.3 ▶ Trust as Competence and Trust as Values**




*Source*: Authors' calculations based on Bejarano, Busso, and Scartascini (2021b).
*Note:* The authors administered an online survey in 2020 to a representative sample of individuals in Argentina, Brazil, Chile, Colombia, Mexico, and Peru. The sample size is 7,229 (about 1,200 individuals per country). The survey questionnaire asked (1) "Thinking about the following groups (politicians, public officials, the judiciary, and entrepreneurs), how often do you consider that they think of you and the interests of people like you when they make decisions?" and (2) "How much do you think that the following groups (politicians, public officials, the judiciary, and entrepreneurs) can deliver on what they have promised?" Possible answers were recorded on a 4-point Likert scale which was transformed into an indicator variable. Orange bars show the regional average of the dichotomized answers to question (1). Blue bars show the regional average of the dichotomized answers to question (2).

government and congress) and lower satisfaction with democracy (Blanco and Ruiz, 2013). Exploiting survey data before and after a 7.1 magnitude earthquake in Mexico City, Frost et al. (2021) show that trust in the government fell after the disaster; however, this drop did not take place in those areas in which the government and related institutions installed food and water distribution centers. Again, government effectiveness can increase trust or at least prevent further trust deterioration.

Institutional trust also declines when government seems less competent, for instance because it is unable to maintain economic stability. Similarly, when unemployment is high, trust in the national government and financial institutions is low (Stevenson and Wolfers, 2011). Giuliano and Spilimbergo (2014) also found that when people live through an economic crisis in their formative years, their trust in institutions is damaged. When political appointees to public office are perceived to be competent, trust in government increases. On the other hand, perceptions of favoritism when selecting those appointees are associated with lower levels of institutional trust (Hollibaugh, 2016).

Not surprisingly, people have less institutional trust when governments act in an untrustworthy manner by failing to adhere to the rule of law or engaging in corruption. Citizens in more corrupt countries have less trust in government actors (Anderson and Tverdova, 2003). However, corruption has less effect on institutional trust among supporters of the incumbent political authorities, who presumably are less likely to be subject to opportunistic behavior by government officials than are government opponents. Clausen, Kraay, and Nyiri (2011) find a negative correlation between corruption and institutional trust using the Gallup World Poll.

In sum, the dynamic of institutional trust is similar to that of interpersonal trust: through their experiences and those of others, people gather information about the trustworthiness of institutions and adjust their expectations accordingly. They confront significant problems of inference, since whether they have been a victim of crime or suffered job loss during a recession is usually the result of many factors, above and beyond the actions of government institutions. Difficulties of inference may lead them to under- or over-estimate (though more typically the latter) the responsibility of government. What is essential, though, is that, just as individuals can be perceived as trustworthy by transparently acting in the interests of others, so also can governments and institutions.

## The Future of Trust

Over the past 30 years, research on the impact of trust on economic development and well-being has exploded. Serious attempts have been

made to measure trust and its determinants, including both personal and historical factors. Evidence demonstrates that historical legacies of mistrust are persistent. However, more optimistically, significant interpersonal differences in trust within societies indicate that individuals can adjust their trust attitudes in reaction to new information and experiences. In other words, adverse legacies can be overcome.

The possibility of change is important, especially for the people of Latin America and the Caribbean, who show lower levels of interpersonal and institutional trust than other regions of the world, even controlling for the level of development. After the family, schools are the next most important source of information for individuals as they mature; given their importance, schools may be a promising place to begin to increase trust. But a successful school-based strategy requires a two-pronged approach: on the one hand, students must receive accurate information about the trustworthiness of others in their societies; on the other hand, students must experience trustworthy and cooperative behavior inside schools.[19] In contrast, increasing trust in institutions requires more than better information; it demands more effective institutions. By providing institutions that deliver fair and effective results for all citizens and eliminating opportunistic behavior by officials, both interpersonal and institutional trust will rise.

[19] Activities within schools and elsewhere that help to increase bridging (creating and maintaining social networks composed of heterogeneous groups) and bonding (creating and maintaining social networks with a homogenous group of people) help build communities around common goals. In times when migration is increasing, these are potential venues for increasing collective action and hence, interpersonal, and later on institutional trust (see Jaitman and Scartascini [2017] for examples of these types of programs).

# 3

# Trust and the Economy

***Mistrust stifles growth. It inspires costly regulations, deters firms from expanding and from hiring the most capable individuals, and promotes the adoption of costly contractual arrangements that undermine competition, global value chains, and consumer welfare.***

Trust is at the center of economic prosperity. Any growth strategy, whether rooted in free markets or import substitution, focused on education or tax reform, or driven by digitalization or natural resource exploitation, flounders in an environment of mistrust. Mistrust—between governments and firms, voters and firms, workers and firms, and among firms—blocks the pathways to inclusive growth: entrepreneurship, innovation, and investment. It hinders the rapid flow of workers, capital, and ideas towards the firms and sectors with the greatest potential to grow.

Prior research, for example by Dearmon and Grier (2009), identifies a cross-national relationship between trust and growth. This chapter examines three specific pathways through which mistrust distorts economic activity. One is between government and firms. Governments use a myriad of policies—regulatory and fiscal, macro and micro, in health and infrastructure—to promote economic activity. If firms mistrust government, they are less likely to respond to the favorable conditions that such policies might create. They should similarly be less responsive to good news about government performance that affects firms (for example, during the pandemic). Another pathway starts with interpersonal mistrust among citizens and significantly affects government regulation of firms. Research from scholars such as Aghion et al. (2010) shows that citizens who mistrust both government and firms demand excessive regulation from the government, which saddles firms as they try to innovate, expand, and grow. Updated evidence reinforces this finding and emphasizes its relevance for Latin America and the Caribbean. The third pathway leads from interpersonal mistrust to the way in which firms organize themselves internally and conduct business with each other. Within firms, interpersonal mistrust dissuades firms from hiring and delegating responsibility to the potentially

best workers. For example, restricting decision-making to the family instead of hiring external workers is characteristic of low trust environments. Between firms, mistrust raises the costs of transactions, favoring incumbents that have been in business for a long time and creating barriers to entry to new, more efficient firms. New survey evidence from firms in Latin America and the Caribbean reveals a strong link between trust, delegation within the firm, investment, and innovation.

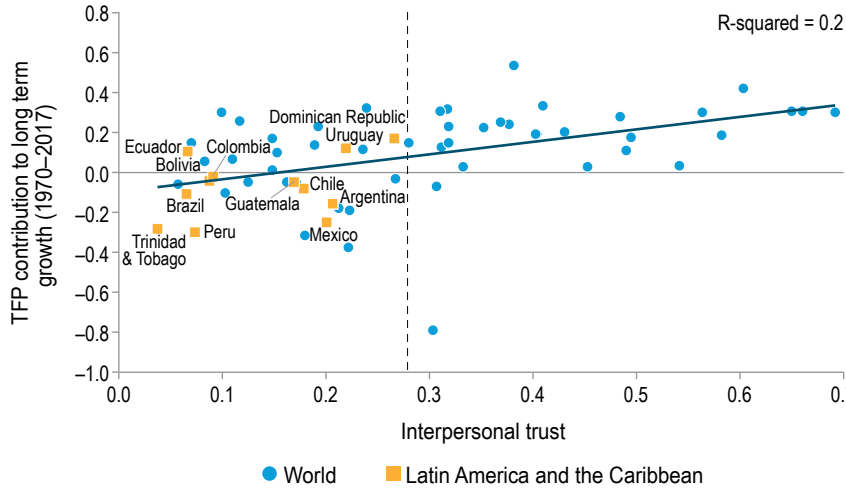
These three pathways are illustrative of the broader ways in which mistrust disrupts growth. Entrepreneurs struggle to start new enterprises when suppliers, customers, and government do not trust them to pay for inputs, produce quality products, or act in the public interest. Firms are reluctant to innovate and invest when they do not trust government to maintain regulatory, legal, and macroeconomic stability and when they struggle to find new and trustworthy suppliers and workers. Mistrust limits the free movement of workers, capital, and ideas to more productive firms. It also reduces firm incentives to deploy the most advanced production methods, expand into new markets, invest in new products and processes, and train workers. Instead, firms make large and unproductive investments to shield themselves from the untrustworthy behavior of others. Just one example of such investments is the 1.4 percent of GDP that firms in Latin America and the Caribbean spend on security to protect themselves from crime.[1]

In sum, trust is essential for economic growth, particularly productivity growth, which in turn is the key to long-run economic growth and prosperity. Other growth strategies do exist, such as using more workers, capital, and land to grow richer. However, in the midst of stagnant productivity, these strategies raise growth at ever diminishing rates. Unfortunately, not only does mistrust suppress productivity, as Chapter 1 illustrates, it also reduces the contribution of productivity growth to overall economic growth. That is, growth in low-trust countries depends more on increasing the use of capital, labor, and land, and less on enhancing productivity. Figure 3.1 illustrates this phenomenon: total factor productivity contributes less to economic growth in low-trust than in high-trust countries.[2] Countries from the region, with low trust and low productivity growth, anchor

[1] Jaitman et al. (2017) reports this as an upper bound estimate of crime prevention costs incurred by firms and households; the lower bound is 0.8 percent.

[2] The growth accounting exercise decomposes the factor and productivity contributions to growth starting from the basic production function $Y_t = A_t K_t^{\alpha} H_t^{1-\alpha}$ where $t$ is a time subscript, $Y$ is output, $A$ is total factor productivity, $K$ is physical capital, $H$ is the number of workers in the economy times their average human capital, and $\alpha$ is the output elasticity of capital. Applying log differences, output growth can be decomposed as $\Delta lnY_t = \Delta lnA_t + \alpha\Delta lnK_t + (1-\alpha)\Delta lnH_t$ and $\Delta lnA_t$ is the contribution of

**Figure 3.1 ▶ Interpersonal Trust and the Contribution of TFP to Growth**




*Source*: Authors' calculations based on data from the Integrated Values Survey, which compiles the seven waves of the World Values Survey (1981–2020) and the five waves of the European Values Study (1981–2020), and Penn World Tables (1950–2017).
*Note*: The figure depicts cross-country comparisons of aggregate total factor productivity (TFP), the contribution of productivity to growth, and long-term growth based on country-level measures of interpersonal (generalized) trust. Data related to productivity and growth come from the Penn World Tables and are calculated by taking country-level averages. Data from interpersonal trust come from the Integrated Values Survey and are computed as a simple average of all the available survey waves for each country. Interpersonal trust is thus measured as the share of citizens responding that, in general, it is possible to trust in people.

the left side of the upward sloping line. In contrast, East Asian countries, such as Vietnam and China, are on the right end. They have grown rapidly over decades, in part thanks to high levels of interpersonal trust.

Given the relationship between trust and productivity, and Latin America and the Caribbean's lagging performance on both counts, the remainder of this chapter investigates in greater detail three questions. To what extent does mistrust in government affect firm responsiveness to government policies? Is citizen mistrust likely to contribute to excessive regulation? And does mistrust have a material, distortionary effect on the organization of firms and between-firm transactions?

## Mistrust in Government: A Problem for Policy

Untrustworthy governments reduce firm incentives to employ, invest, and innovate, and lead firms to choose sectors and production processes

total factor productivity to growth. In relative terms, this contribution corresponds to the $\Delta lnA_t/\Delta lnY_t$ ratio. See Inklaar and Timmer (2013) for more details.

that are less vulnerable to opportunistic behavior, even if they offer fewer economic rewards (see Knack and Keefer, 1997; Algan and Cahuc, 2013). This section presents new evidence that, in addition, untrustworthy governments find it more difficult to use public policy to stimulate growth. Governments often try to accelerate economic growth with firm-friendly regulations, tax provisions, or subsidies. They also attempt to spur investment by spreading good news about the effectiveness of government policy. For example, in 1935 President Franklin D. Roosevelt broadcast "fireside chats" with Americans to announce new policies to deal with the Great Depression. The chats boosted economic activity most among individuals in geographic areas with greater access to radio signals (Pedemonte, 2020).

However, the success of such policy announcements is far from guaranteed, especially if firms lack trust in the government. Skeptical firms question the durability of policies announced by untrustworthy governments. They are, therefore, less inclined to respond to positive announcements. This section presents new evidence that when mistrust in government is high, firms are less willing to respond even to good news about government performance.

During the last quarter of 2020, with the pandemic in full swing, 3,000 firms from 17 Latin American and Caribbean countries responded to a survey about their economic situation, levels of trust in government and other firms, and expectations of the country's future economic performance. All were participants in ConnectAmericas, an online business platform that links firms in Latin America and the Caribbean with potential customers around the world. The survey was directed at the firms' owners or top managers and elicited information on a battery of firm characteristics and opinions about the future economic outlook. It also provided some respondents with good news about the government's handling of the COVID-19 pandemic. Specifically, it told them that their country scored high relative to other middle- and high-income countries in its handling of COVID testing and contact-tracing.[3]

At the end of the survey, all firms—not only those that received information about the handling of testing and contact tracing in the country—responded to questions about their future sales, likely investment, and

[3] The expectations of firms that received information should be different from those that did not receive information only to the extent that the information was a surprise to them. "Bad" news—information that the government's testing and contact tracing were lower than most other middle- and high-income countries—did not come as a surprise to the firms that received it.

**Figure 3.2 ▶ The Effect of Good News about Government Pandemic Management on Firm Pessimism**


*Source*: Authors' calculations based on data from the ConnectAmericas 2021 survey.
*Note*: The figure reports the effects of providing positive information on the government's testing and contact tracing during the pandemic based on the level of mistrust in politicians. Trust in politicians is measured by an indicator that takes the value of 1 if the respondents reported "A lot" or "Somewhat" to the question of whether they trust that, in general, politicians tend to fulfill their promises. Treatment effects correspond to regressions of the dependent variable of interest on an indicator of treatment status and country fixed effects. Confidence intervals are computed using standard errors clustered at the country level.

likely hiring to gauge their pessimism.[4] Were high-trust firms that received good news about the government's pandemic performance less pessimistic than low-trust firms? Figure 3.2 demonstrates that among managers that trust the government, the information significantly or nearly significantly reduced pessimism in all three areas. Among mistrustful managers, the information had little effect on expectations in any of the three cases.[5]

[4] Specifically, firms are asked about approximately how long it will take their sales and workforce levels to recover to pre-pandemic levels (pessimism in sales and employment) and until they make investments in machinery or infrastructure (pessimism in investment). The response options were 1, 2, 3, or 4 quarters, or more than a year.

[5] These results mirror findings on the impact of news of economic shocks on inflation expectations. When households and firms trust central banks to conduct monetary policy in pursuit of stable prices, short-term domestic and global price shocks have a smaller effect on their long-run inflation expectations. Hence, Kose et al. (2019) conclude that inflation expectations in developing countries, where trust in institutions is generally lower, are less robust to short-term shocks.

The results underscore three lessons for policymakers. First, most obviously, firm decisions are sensitive to governments' actions in response to crisis. Second, trust in government is key for policy effectiveness, a lesson that Chapter 5 revisits. Firms that believe government is responding well to the crisis—the pandemic—are more likely to invest and retain employees during the crisis. Firms that mistrust government will ignore good policies and wait until the crisis recedes before investing. Trust can, therefore, accelerate crisis recovery.

Third, communication policies are more likely to boost policy effectiveness when trust in government is high. The information provided to firms came from a reputable international source (the University of Oxford COVID-19 Government Response Tracker), and used a performance benchmark that firms could easily understand.[6] Of course, information itself can increase trust, depending on how it is conveyed and by whom (see Chapter 9).[7] Still, even if a government is not able to increase trust in the short run, it can structure policy communication to take (mis)trust into account. In the case of the experiment with the ConnectAmericas firms, if trust in politicians is not too low, good news regarding the government's pandemic response interacts with trust, and impacts positively on investment and hiring intentions. Thus, while effective implementation is a key necessity for good policymaking, effective communication is also important. Certainly, however, widespread mistrust is an obstacle to effective communication.

## Regulation: A Poor Substitute for Trust

Regulation is a second key pathway through which mistrust distorts economic activity. Chapter 4 presents wide-ranging evidence that citizen mistrust in government distorts fiscal and other public policies. This section gathers evidence consistent with arguments made by Aghion et al. (2010) that when citizens mistrust firms and government, they are more apt to demand excessive, growth-suppressing regulation.

In any country, firms may pollute excessively, renege on their contractual obligations to workers and suppliers, or misrepresent the quality of their products to customers. If trust in firms is high, citizens have greater confidence that firms will not engage in such behavior; they trust that firms will act civically, respecting the rights of others in society. However, where

[6] https://www.bsg.ox.ac.uk/research/research-projects/covid-19-government-response-tracker.

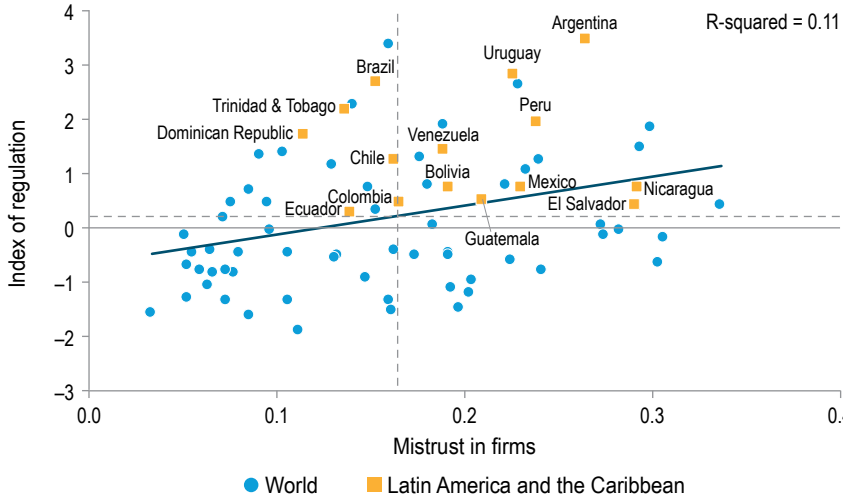
[7] Coibion, Gorodnichenko, and Weber (2019) find that different forms of communication have significant effects on individual inflation expectations.

trust is low, citizens may demand greater regulation. In fact, Figure 3.3 demonstrates that mistrust of firms is associated with more stringent requirements to start and scale up businesses. Trust accounts for around 11 percent of the cross-country variation in regulation. The association is nowhere stronger than in Latin America and the Caribbean, where both mistrust in firms and regulatory stringency are high.

This association may seem unsurprising, but in fact points to an important puzzle. If citizens believe that firms will not act civically, they are also likely to believe that government officials will not act in support of their interests either. For example, they are more likely to believe that officials will accept bribes in exchange for decisions that help firms that do not act civically, thereby reducing citizen welfare. This leads to the stark question posed by Aghion et al. (2010, p. 1018), "[W]hy do people in countries with bad governments want more government intervention?"

Aghion et al. (2010) propose an answer to this question. When governments impose regulations, their regulators are charged with keeping

**Figure 3.3 ▶ Regulation Stringency and Mistrust of Firms**




*Source*: Authors' calculations based on data of the World Enterprise Surveys (2006–2020) and the Integrated Values Survey, which compiles the seven waves of the World Values Survey (1981–2020) and the five waves of the European Values Study (1981–2020).
*Note*: The figure depicts a country-level index of government regulations as a function of average levels of mistrust in firms. The index is computed using the weights corresponding to the first principal component of a battery of variables related to a firm's perceptions on regulations obtained from the World Bank's Enterprise Surveys. The index considers the proportion of business owners reporting that the most important constraints to growth relate to obtaining opening and construction licenses, dealing with courts and customs, as well as the number of days needed to obtain an opening license and a construction permit. Mistrust in firms is computed as the share of households in each country that report absolutely or somewhat trusting firms in each survey wave, which is then averaged across all available survey waves in the Integrated Values Survey dataset for each country.

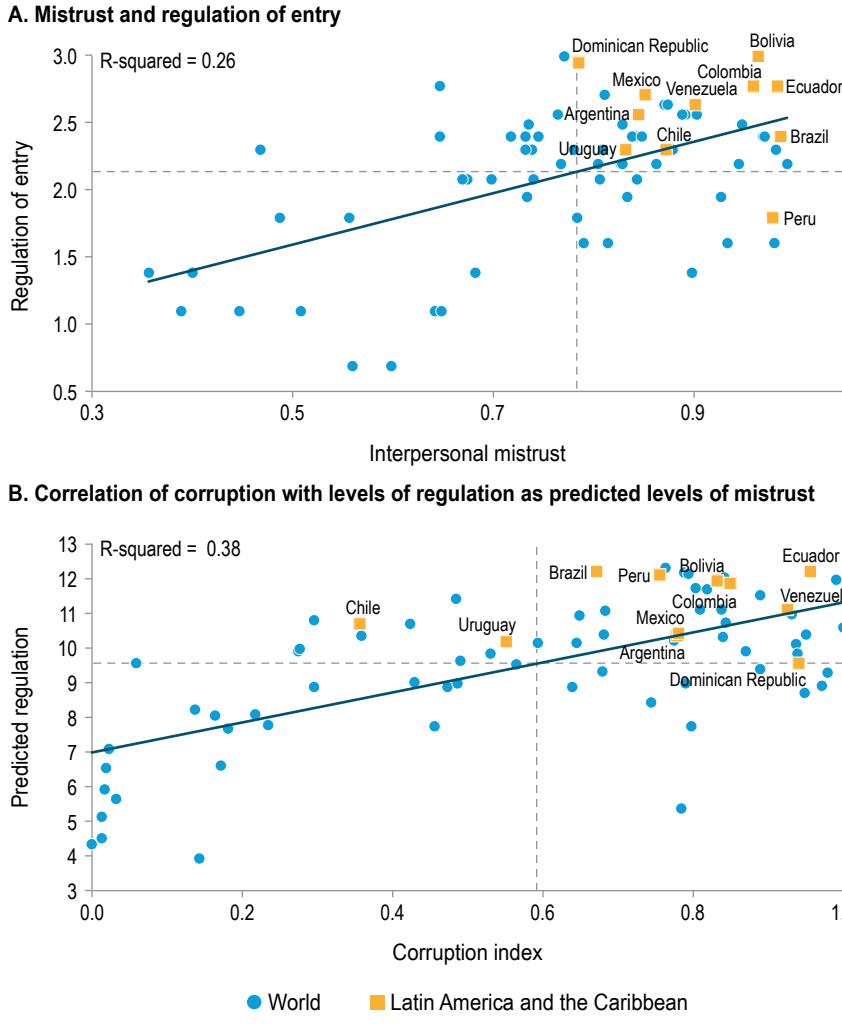
out non-civic firms. However, the greater the mistrust, the more likely it is that regulators themselves are untrustworthy, will not implement the regulation as written, and instead will ask for bribes from all entrants regardless of whether they behave civically. All high-productivity firms, whether civic or not, can afford to pay the bribes and enter. All low-productivity firms, whether civic or not, cannot afford to pay the bribes and stay out. Citizens still prefer even this corrupt implementation of regulation over no regulation at all. Corrupt regulation excludes low-productivity, non-civic firms that cannot afford to pay the bribes; these firms would enter the market in the absence of regulation. Non-civic high-productivity entrepreneurs enter when regulators are corrupt, but they would also have entered if there were no regulation at all.

This subtle argument implies an association between interpersonal mistrust, on the one hand, and stricter regulation and greater corruption, on the other (see Figure 3.4). Figure 3.4A shows that where interpersonal mistrust is high (as opposed to the mistrust in firms depicted in Figure 3.3), entry regulation is more onerous. Figure 3.4B presents a new relationship: the component of entry regulation associated with mistrust is strongly correlated with corruption. That is, mistrust, regulation, and corruption go together, directly suppressing growth.

Interpersonal mistrust can increase regulation for other reasons, however, unrelated to citizens' demand for regulation. In fact, the distrust can run in the opposite direction—government officials' mistrust of citizens—and have the same effect. Government officials have significant discretion over the regulations they promulgate and enforce. New evidence from government officials indicates that their own levels of mistrust influence their decisions to regulate. Results of a survey of 2,200 public servants throughout Latin America and the Caribbean reveal a strong correlation between their mistrust of citizens and their support for stronger enforcement of mobility restrictions and measures to promote social distancing during the COVID-19 pandemic (see Chapter 8).

Interpersonal mistrust can also undermine citizens' collective ability to exert social pressure on firms. Firms are less likely to impose costs on society when citizens are better able to organize on behalf of their communities. Pargal and Wheeler (1996) find that significant plant-level variation in pollution in Indonesia can be explained by differences in local communities' ability and willingness to exert informal pressure on firms. Poorer, less-educated communities are more reticent to mobilize against highly polluting plants as they place a relatively higher value on job opportunities in those industries. Powers et al. (2011) identifies a similar phenomenon in India. Information campaigns exposing the environmental consequences of the country's largest pulp and paper plants improved

## Figure 3.4 ▶ Regulation of Entry, Mistrust, and Corruption




*Source*: Authors' calculations based on data from Aghion et al. (2010) and the Integrated Values Survey, which compiles the seven waves of the World Values Survey (1981–2020) and the five waves of the European Values Study (1981–2020).
*Note*: Regulation of entry is measured as the number of procedures needed to open a business (in logs). Mistrust is measured as the share of survey respondents that responded that one can never be too careful when dealing with people and is then averaged across all available survey waves in the Integrated Values Surveys dataset for each country. The share of regulation of entry explained by mistrust is computed based on a regression of regulation of entry and country-level mistrust.

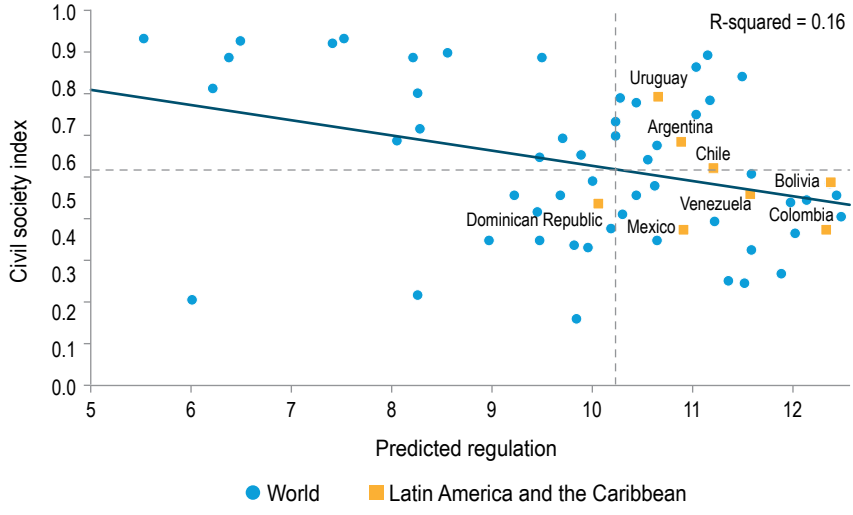
their performance—dirty plants improved the most and did so more in wealthier communities.

Without the discipline imposed by social pressure, firms are less likely to behave civically, which reinforces citizen mistrust in firms and intensifies

their demands for regulation. The Civil Society Index from the V-Dem database (more fully described in Chapters 7 and 8) yields evidence that echoes this argument. The Civil Society Index measures the robustness of civil society in countries and, therefore, citizens' ability to exert social pressure on firms to act civically. Figure 3.5 depicts the correlation between the index and the degree of entry regulation that can be accounted for by citizen mistrust in firms. The correlation is significantly negative: the more robust is civil society, the lower the level of entry regulation associated with mistrust in firms.

Another possible explanation for the link between mistrust and regulation is that firms may simply have more to gain from anti-social behavior in some countries than others. Specifically, when markets are competitive, workers, customers, and suppliers have more options to flee from firms that treat them badly. Customers can more easily find other sellers, just as workers can find other employers. Huck, Lünser, and Tyran (2012) demonstrate just this effect experimentally. They find that the ability to build

**Figure 3.5 ▶ The Strength of Civil Society and Levels of Regulation as Predicted by Mistrust**




*Source*: Authors' calculations based on data of the Varieties of Democracy (V-Dem) dataset (1920–2019) and the Integrated Values Survey, which compiles the seven waves of the World Values Survey (1981–2020) and the five waves of the European Values Study (1981–2020).
*Note*: The Civil Society Index measures the robustness of civil society in a country each year. The figure uses country-level averages across all available data points during the past century (1920 onwards), for each country. Predicted regulation is estimated from a regression of entry regulation on mistrust in firms and is the regulation predicted by levels of mistrust. Mistrust in firms is computed as the share of households in each country that report absolutely or somewhat trusting firms in each survey wave and is then averaged across all available survey waves in the Integrated Values Surveys dataset for each country.

a reputation partially solves the trust problem, but competition resolves it completely. Competition also empowers consumers to boycott firms that impose high externalities on society. When markets are less competitive, though, firms can disregard with impunity their obligations to customers, suppliers, and workers.[8] Low levels of competition might, therefore, increase mistrust in firms and, therefore, demand for regulation.[9]

Results from the ConnectAmericas survey illustrate this logic. The 3,000 managers of the firms in the survey were asked whether their firms faced significant competition. Those who said they confronted more competition professed significantly greater interpersonal trust than those who acknowledged less competition.[10]

The three explanations for the association between mistrust in firms and strict regulation—interpersonal mistrust, the absence of social pressure, or weak competition—point to solutions other than strict regulation to better balance the competing concerns of citizens who want growth and economic prosperity on the one hand and, more socially conscious firms on the other. One would be greater social pressure on firms that impose externalities. Providing citizens with more information on firms' behavior (see Chapter 9) and reducing the legal and institutional barriers to collective action in response to this information (reforms such as those discussed in Chapter 8) might be part of this strategy. Reforms to boost competition might also result in greater market penalties for firms that engage in antisocial practices although, as the next section discusses, greater competition might also raise the costs of contracting between firms.

The ideal policy option—to increase social capital, including interpersonal trust—is also the most difficult. Such an option could be implemented

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8 Francois, Fujiwara, and van Ypersele (2009) examine a somewhat different argument that they trace back to Montesquieu and the sociologist Georg Simmel: competition increases interpersonal trust. Financial deregulation in the United States effectively boosted competition by facilitating the entry of new firms. They show that this increased interpersonal trust. After ruling out numerous alternative explanations for this relationship, they conclude that working in a competitive marketplace increases the costs to individuals who free ride on the efforts of their co-workers. As free riding in the workplace declines, people's trust in others increases.

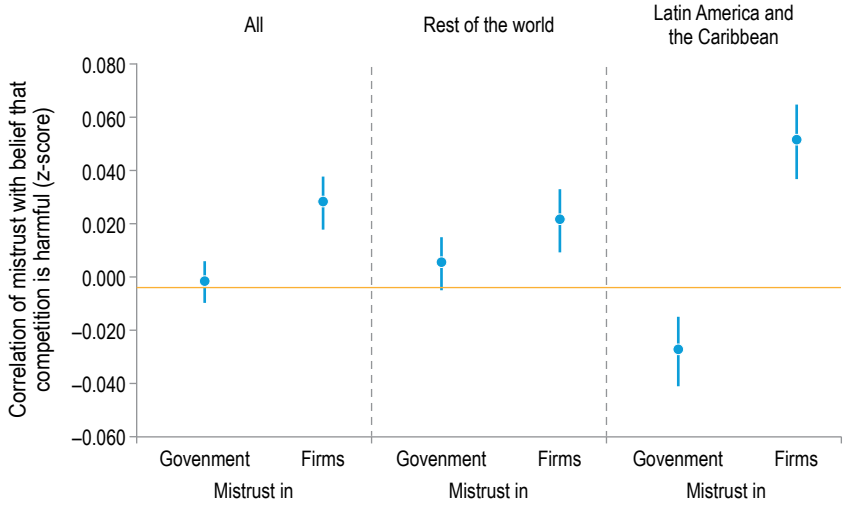
9 The relationship between competition, trust, and regulation is complicated, however, by issues described in the next section: in a low-trust environment with weak institutions, firms depend on self-enforcing contracts that are only sustainable if parties to the contract expect to earn future rents from continuing their relationship—rents that would fall in the presence of fierce competition.

10 Specifically, managers who indicated that their customers receive attractive offers from their firms' competitors also expressed higher levels of interpersonal trust.

through information campaigns like those associated with public health (see Chapter 9). If successful, such interventions would directly increase firm incentives to act civically, reduce obstacles to social pressure on firms that do not, and generally allow countries to replace regulation with trust (Carlin, Dorobantu, and Viswanathan, 2009).

Social pressure and competition are both more difficult in the absence of trust. The mistrust of citizens weakens collective action (see Chapter 8 on citizenship), while mistrust in government and, especially, in firms reduces support for competition. Figure 3.6 reports the relationship between mistrust in government or firms and the belief that "competition is harmful." In all countries, people who mistrust firms are also significantly more likely to say that competition is harmful. This correlation is significantly higher among survey respondents from Latin America and the Caribbean. The fact that higher mistrust of firms weakens support for competition helps explain why mistrust in firms is strongly associated with stricter entry regulations and a more active role for government. Mistrust of government has little bearing on opinions about competition in countries outside of Latin America and the Caribbean. In the region, however,

**Figure 3.6 ▶ Mistrust in Government and Firms and the Belief that Competition Is Harmful**




*Source*: Authors' calculations based on data from the World Values Survey (1981–2020).
*Note*: The figure reports coefficients of a regression of whether the respondent reported agreeing with the statement that competition is harmful for indicators of a respondent's mistrust in governments and firms, and a vector of demographic characteristics and country fixed effects. Standard errors are clustered at the individual level and are presented in parentheses. The first column uses data from all available countries while the second and third columns estimate the same regression by regions.

people's mistrust of government and belief that competition is harmful go hand in hand.

Escaping this vicious cycle of low trust and high regulation may require a coordinated effort to boost trust among both citizens and governments. Extreme shocks such as the COVID-19 pandemic may offer governments, firms, and citizens the opportunity to show each other that they can be trusted. However, these shocks can cut both ways; when mismanaged, extreme shocks can have the opposite effect and reduce trust.

## Trust at the Micro Level

Changes in a society's institutional and regulatory frameworks are not the only pathway to growth. At the micro level, leaders matter and so do the beliefs of managers. This section discusses how interpersonal trust shapes two central sets of relationships in any economic system: those inside a firm and those between firms.

Mistrust distorts many firm decisions. Firm owners prefer to work with employees whom they trust, even if they are not the best suited for the job. They may also choose to work with individuals from their family circle or with employees whose families have spent years with the firm rather than look for the most skilled employees. Interpersonal mistrust also distorts firm interactions with clients and suppliers. This slows firm expansion into new markets and reduces firms' willingness to commit to new suppliers who promise better quality and cheaper inputs. Both relationships, within and between firms, reduce investment, divert the allocation of labor and capital away from their highest valued uses, and ultimately suppress economic output.

### Avoiding the Curse of Micromanagement: Interpersonal Trust and Delegation

A key challenge confronting firm owners and managers is to decide how much they should delegate to employees. An economically strong association exists between trust and delegation: firms that delegate more also tend to invest and innovate more. Trust also affects how firms treat employees in the event of economic shocks.

Managers and owners are pressed for time. Since they cannot directly manage multiple plants or lines of business, their reluctance to delegate directly limits their company's growth. They are also more expert in some aspects of their firms' business than others. If they fail to delegate, they can neither focus on the tasks where they have the greatest expertise nor

take advantage of the superior knowledge that employees might have about innovations to improve firm productivity.

However, delegation poses risks. Owners and managers must rely on employees to represent their experience and knowledge accurately, to exert (unverifiable) effort on the delegated task, and to refrain from seeking personal profit by making sweetheart deals with suppliers or by selling knowledge to competitors.

A business owner, observing favorable business conditions, would be expected to hasten to take advantage of them by investing in machinery and expanding the firm's workforce. The investment expands the size of the firm and reduces its costs of production, gives it the opportunity to access new markets, and potentially allows it to start new product lines. None of these benefits are easily achieved without delegation to train and supervise new employees, change production processes, maintain new equipment, and meet with potential customers in new markets. However, delegation exposes managers to the risk that employees will behave opportunistically. They may supervise badly, change production processes to suit supplier interests, neglect equipment, or offend new customers. Mistrustful managers, all else being equal, perceive higher risks of delegation and are likely to be reluctant to delegate.

In countries where mistrust is high, so too are the risks of delegation. Hence, delegation is likely to be less common, firms smaller, and innovation and growth lower. Consistent with the low levels of trust in Latin America and the Caribbean, Pagés (2010) amply demonstrates that firms in Latin America and the Caribbean tend to be small and unproductive. Hsieh and Olken (2014) document that the distribution of firms in Mexico, skewed towards small and unproductive firms, cannot be explained by a single factor such as regulatory or tax notches that dissuade small firms from growing. Mistrust is a likely alternative explanation. Pellegrino and Zingales (2017) argue that the lack of productivity growth in Italy can be explained by mistrust. The response to mistrust in Italy is loyalty-based management (i.e., familialism and cronyism), which has reduced the ability of Italian firms to take full advantage of the information and communications technology (ICT) revolution. This practice explains between 66 and 73 percent of Italy's total factor productivity (TFP) growth gap.

The survey of ConnectAmericas firms discussed earlier, with novel data from 3,000 firms in 17 Latin American and Caribbean countries, yields more direct evidence of the impact of trust on delegation. Respondents provided firm-level information about delegation, firm innovation, and manager trust in others. The data allow for within-country and even

within-industry comparisons, isolating the influence of industry- and country-specific unobserved factors.[11]

To measure delegation, survey respondents—typically firm managers or owners—revealed whether they delegate any of several tasks to employees. If they said they delegated, they then indicated how many employees with no relationship to the owner's or manager's family were authorized to perform the task.[12] Delegation is then measured as the number of activities delegated to nonmanagerial employees multiplied by the number of nonmanagerial employees to whom these activities are delegated. The measure captures the fact that the risks of delegation (opportunistic behavior by employees) and the benefits (freeing up managers to expand the firm and allowing them to leverage the expertise of the most knowledgeable employees) increase with the number of activities delegated and the number of employees with delegated authority.[13]

These data reveal three important relationships: firms with more trusting managers delegate more; firms that delegate more also invest and innovate more and are more likely to expand into new markets, and among larger firms, manager trust is associated with greater investment and expansion into new markets.

Figure 3.7 correlates interpersonal trust and different types of delegation controlling for firm age, firm size, and country fixed effects. Firm

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[11] Bloom, Sadun, and Van Reenen (2012) used variation in bilateral trust between the home and destination countries of multinationals to identify the effect of trust on different measures of decentralization. This, however, leaves out most firms in Latin America and the Caribbean, which operate in only one country.

[12] The three tasks were making large purchases of production inputs, contracting temporary employees, and signing checks on behalf of the firm. Respondents also indicated whether they delegated access to petty cash, but this is excluded from the set of eligible activities as access to petty cash is not associated with high-impact business transactions.

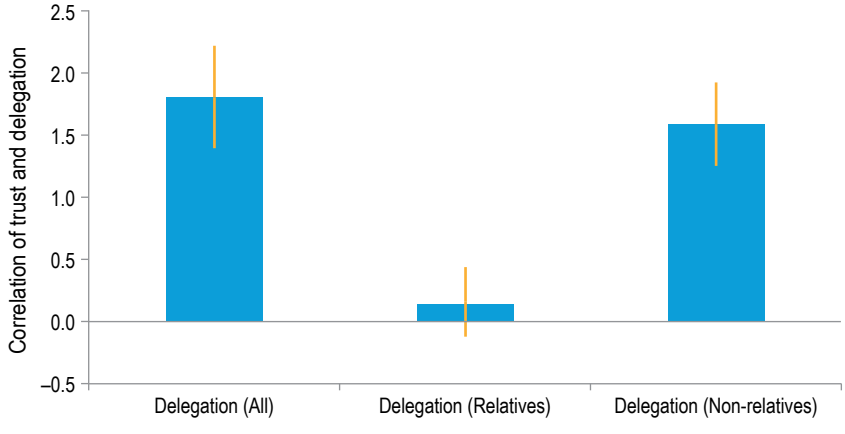
[13] Four activities, each delegated to four individuals, yields a delegation measure of four activities times 16 individuals, or 64. Four activities each delegated to one individual yields a measure of four activities times four individuals, or 16. The risks and benefits in the former case are four times higher because four times as many employees have been delegated authority. Note that the survey does not distinguish whether the employees who are delegated responsibility for one task are the same or different as the employees for another. The same individuals may be delegated authority for each task. If this is uniformly the case, the first firm is still exposed to four times the risks and benefits of delegation (four tasks delegated to four individuals) than the second (four tasks delegated to one individual). Naturally, differences across firms in the extent to which individual employees take responsibility for multiple tasks introduces noise into the measure. This noise creates a bias against finding correlations between delegation and trust.

age matters since managers of older firms have had more time to develop personal relationships with employees to support delegation. Firm size is key since the risks of delegation are lower in enterprises with few employees where personal contact is greater. Country fixed effects account for factors such as institutions that vary from country to country. The calculation also controls for economic sector since the benefits of delegation (the potential for innovation and expansion) as well as the risks are both sector-dependent; it also controls for the manager's position within the firm (whether the respondent is a CFO, CEO, or the owner).

All delegation, whether to relatives or nonrelatives, is significantly greater in firms where respondents voice greater interpersonal trust. However, the novel distinction that the survey makes between delegation to family and nonfamily members turns out to be crucial. Since family members are in general more trustworthy, a manager's decision to delegate to more family members should not be sensitive to the manager's trust in others. Figure 3.7 shows this to be true. In contrast, manager trust should be strongly related to delegation to nonfamily members. In fact, 88 percent of the correlation between trust and delegation reflects delegation to nonrelative employees.

Clearly, manager trust is crucial for firm organization. The evidence from Latin America and the Caribbean makes this point, confirming prior

**Figure 3.7 ▶ Trust and Delegation within Firms**




*Source*: Authors' calculations based on data collected by Hernaiz et al. (2022).
*Note*: This figure shows the correlation between trust, delegation, investment, and innovation inside firms. Points are the estimates of a regression of delegation on interpersonal trust. All regressions control for managers' position in the firm, and firm characteristics such as age, size (bins based on number of workers), and sector. Regressions also control for date-of-interview fixed effects and country fixed effects. Robust standard errors at 95 percent confidence.

research on family firms. Even large firms in Latin America are more likely to be family-controlled, indicative of low trust (Aminadav and Papaioannou, 2020). Trust also plays an implicit role in the theoretical work of Burkart, Panunzi, and Shleifer (2003), who conclude that family firms are more likely to hire professional managers when the legal environment makes it more difficult for managers to extract rents from owners.

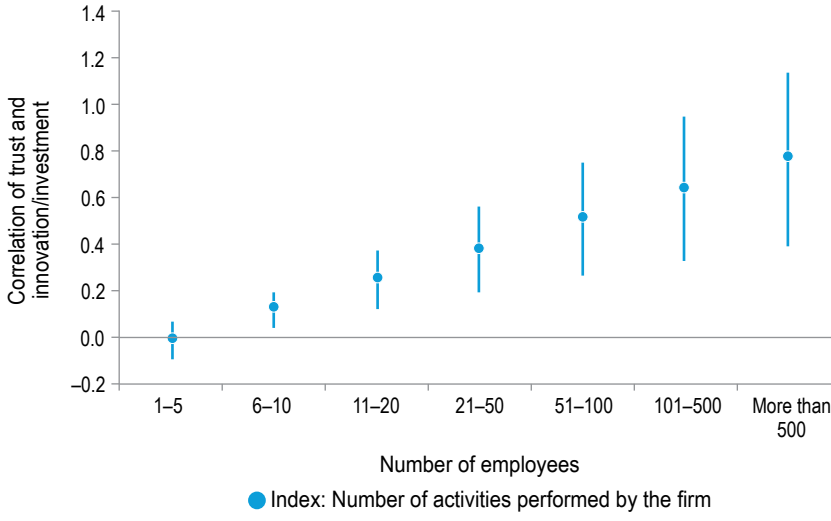
Firms that delegate more should be better able to grow and innovate. Using cross-country data, La Porta et al. (1997) identify a robust correlation between the size of firms and interpersonal trust. Estimates using the ConnectAmericas data provide further support for this conclusion. Respondents to the survey indicated which activities related to growth and innovation the firms undertook in the previous year: whether they invested in machinery, facilities, or software; expanded their product lines; entered new markets; found new customers; or began to export. Delegation is strongly associated with the number of these activities that firms undertook, accounting once again for country- and sector-specific characteristics, firm size and age, and the manager's position in the firm.[14]

The foregoing evidence shows that trusting firms delegate more and firms that delegate more engage in more innovative activity. If trust is really driving these relationships, though, the influence of trust should also be more pronounced in firms with more employees. In smaller firms, managers' reach is wider and personal contact with all workers is more intense. Both delegation and interpersonal (generalized) trust are less relevant. This logic has two implications. First, the relationship between manager's trust and delegation is stronger among larger firms. Second, trust and the interaction of trust and firm size impact innovation, investment, and expansion into new markets (Hernaiz et al., 2022). Figure 3.8 illustrates the results of these estimates. As expected, the larger the firm, the stronger the association of trust with innovative activity.

Manager trust influences not only the decision to delegate but also firms' efforts to retain employees in the event of negative economic shocks. Firms might seem to prefer simply laying off workers to adjust to the new, lower level of production. They could then recall workers once the shock had passed. However, this strategy risks losing good workers permanently.

[14] An increase of one standard deviation in the measure of delegation is associated with a .12 standard deviation increase in the innovation and investment index, which is highly statistically significant (p-value less than .001). Delegation is also significantly associated with each of the activities individually except for entering new markets or finding new clients. Although the magnitude of the association of this activity with delegation is similar to the rest, the relationship is less statistically significant.

**Figure 3.8 ▶ Interpersonal Trust, Firm Size, Investment, and Innovation**

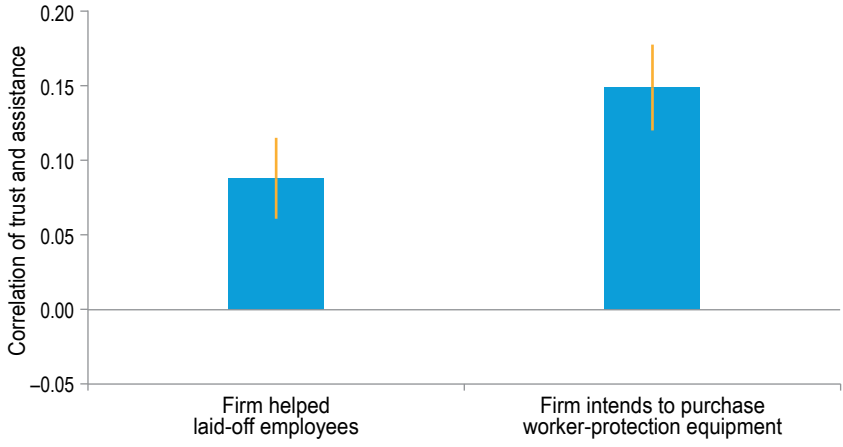



*Source*: Authors' calculations based on data collected by Hernaiz et al. (2022).
*Note*: This figure shows coefficients of a regression of several measures of an index of investment and innovation on manager's interpersonal trust and interactions of interpersonal trust by firm size measured as a range of number of employees. All regressions control for the manager's position in the firm, and firm characteristics such as age, size (bins based on number of workers), and sector. Regressions also control for date-of-interview fixed effects and country fixed effects. Standard errors, clustered at the country level, at 95 percent confidence level in bars.

Ironically, this risk rises with manager trust. Trusting managers are more likely to delegate high-value tasks and therefore to hire workers based on their skills rather than personal relationships. Such workers are better able to find alternative employment if they are laid off. In contrast, low-trust managers delegate less and give greater weight to personal relationships. These deeper personal relationships with current managers have little value to managers of other firms, however, giving these workers no advantage in finding other employment. Trusting managers have stronger incentives to take measures to prevent permanently losing skilled employees if they are forced to furlough them.

The COVID-19 pandemic was just such a shock. It precipitated an economic crisis of uncertain duration that prompted massive layoffs. However, some firms sought to maintain their relationships with the workers they were forced to furlough. One way they did this was to offer them monetary assistance. Such assistance is not only altruistic, but signals to workers an intention to rehire them when the crisis lifts and reflects manager trust that workers who receive such payments will prefer to return to the firm when it rehires rather than move to competitors.

**Figure 3.9 ▶ Interpersonal Trust and Employee Assistance During COVID-19**




*Source*: Authors' calculations based on data from Hernaiz et al. (2022).
*Note*: The figure shows coefficients of a regression of the relevant dependent variable on an indicator on interpersonal trust and a set of controls capturing firm and respondent characteristics. Standard errors, clustered at the country level, at 95 percent confidence level.

Were such payments more common among firms with more-trusting managers? Data from the ConnectAmericas survey support a link between interpersonal trust and a firm's effort to retain workers (see Figure 3.9). More-trusting managers were more likely to provide monetary help to their recently laid-off workers. They were also more likely to invest in safety protocols and equipment to protect their workers from contracting the virus in the future.[15] A survey of a large sample of individuals in Latin America and the Caribbean who responded to a Facebook survey produced a similar result. Among the respondents, more than 40,000 reported losing their jobs at the onset of the pandemic. Those located in countries with relatively higher levels of interpersonal trust were far more likely to report receiving a re-employment promise and monetary aid from their previous employer.[16]

[15] Although these associations are only correlations, they do suggest a causal effect, since they emerge after controlling for potential confounders related to sector- and country-specific factors, as well as firm and manager's characteristics that could also account for these decisions.

[16] A 10-percentage point increase in country-level trust (measured as the proportion of respondents to the World Values Survey who expressed trust in others) is associated with an increase of 7 percentage points in the fraction of laid-off respondents on the Facebook survey who received a promise to be re-hired, and 3 percentage points in the fraction who received financial assistance.

Overall, interpersonal trust seems crucial in shaping the relationships within the firm and in fostering productivity-enhancing managerial decisions. One policy implication is that, given that government investments in state capacity and improving contract enforcement can take time to yield returns, efforts to foster environments of high interpersonal trust can make up for low levels of contract enforcement and spur growth, even in the short run.

## Trust and Transactions: It's Complicated

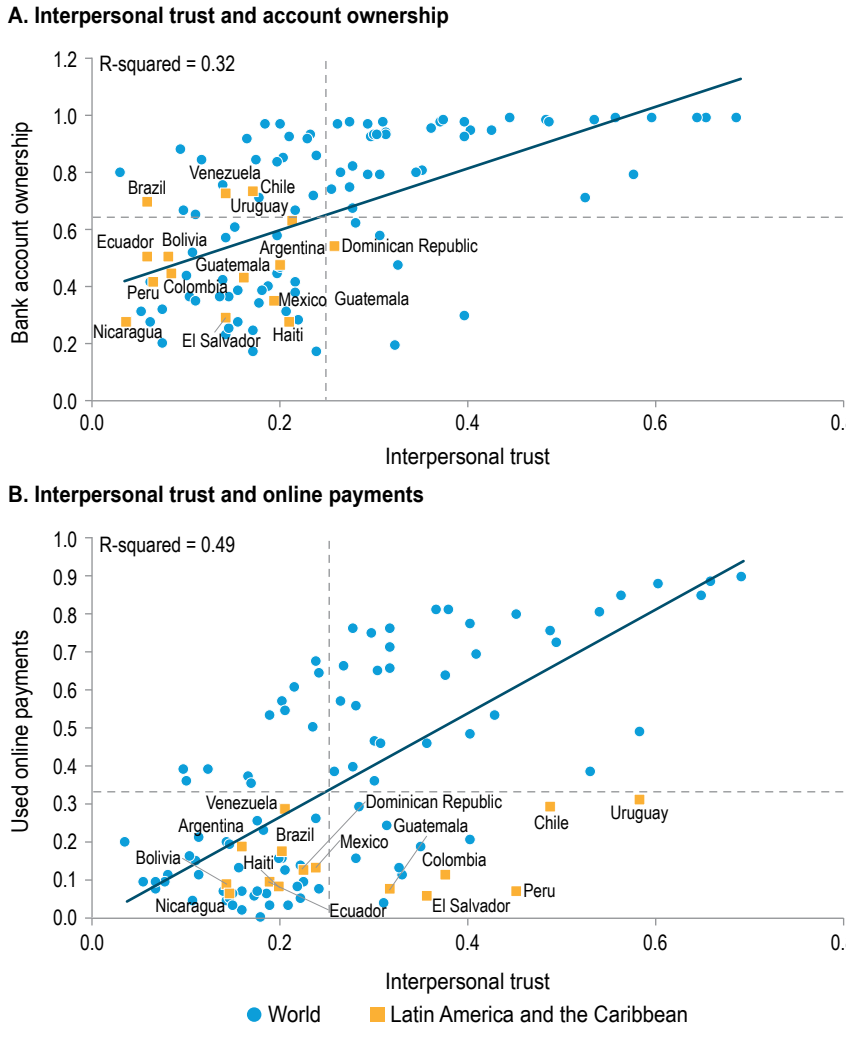
Economic growth and productivity depend upon firm specialization and innovation, which in turn requires exchanges between the most efficient producers of intermediate and final goods. These transactions rest on promises to deliver the right good on the right day, to pay an agreed-upon price on an agreed-upon day for an agreed-upon good, and to share the costs if unexpected shocks cause anything to go awry. Trust is fundamental in this process. Without trust, firms take costly steps to protect themselves from the risks of non-compliance, steps that chip away at the gains from trade, slow growth, and reduce productivity.

The importance of trust for financial transactions is well-understood since they mostly entail giving money to strangers. It is also particularly relevant for Latin America and the Caribbean, where bank credit to the private sector is notoriously low. The cross-country analysis of Nicolas and Tarazi (2019) concludes that bank lending grows faster when generalized trust is greater.[17] Household evidence also illustrates the nature of the problem. Despite dramatic innovations and increases in the supply of financial services, the region's emerging middle class—particularly households with no previous contact with financial institutions—has not significantly increased its savings, gained greater access to credit, or expanded its use of digital methods of payment (Frisancho and Vera Cossío, 2020). Figure 3.10 provides ample reason to believe that interpersonal trust plays an important role in this phenomenon. Trust is strongly associated with the ownership of bank accounts and with making online payments, which are precisely the transactions that require trusting that the goods or services will indeed be delivered.

Trust affects the entire range of exchanges between firms, not only their financial transactions. It has significant implications for the costs of

[17] This association only holds in countries with relatively lower levels of institutional and judicial development. As discussed earlier in this chapter and in Chapter 7, institutions of contract enforcement can offset the effects of mistrust.

## Figure 3.10 ▶ Interpersonal Trust, Bank Accounts, and Online Payments




*Source*: Authors' calculations based on the FinDex 2017 dataset and the Integrated Values Survey, which compiles the seven waves of the World Values Survey (1981–2020) and the five waves of the European Values Study (1981–2020).
*Note*: The figure depicts country-level shares of people reporting that they own a bank account and the share of people that report having used online payment platforms as a function of interpersonal trust. Each data point represents a country-level average.

contracting, the viability of competitive market structures, the decisions of firms to coordinate their decision-making with other firms in tightly connected supply chains, and even international trade. In all these areas, firms take major steps to mitigate the threat of noncompliance in a low-trust environment. They choose from among four possible strategies.

First, they can undertake spot transactions—the simultaneous exchange of goods for payment. These are extraordinarily inefficient in most cases. Second, they can vertically integrate the production of intermediate and final goods into a single firm. Contract risks disappear, but so do the efficiency gains of being able to purchase inputs from the most efficient producer. Third, firms can rely on third-party enforcement of their agreements. Certainly, third-party enforcement institutions such as courts can mitigate the risks of contract noncompliance (see Chapter 7). However, recourse to third-party enforcement is costly and time-consuming. Moreover, in many countries, including those in Latin America and the Caribbean, third-party enforcement institutions are unreliable arbiters of contractual disputes.

Finally, firms can rely on relational contracts, which use the prospect of future profits from an ongoing business relationship to encourage compliance. Relational contracts are both pervasive and costly, and most transactions are conducted between firms that have done business with each other for many years. Trade data identify buyers and sellers in international transactions, for which third party enforcement is particularly difficult. In a wide-ranging review of the literature, Macchiavello (2021) notes that 80 percent of U.S. imports take place between firms with preexisting relationships; for more than half of imports, those relationships are more than three years old (Monarch and Schmidt-Eisenlohr, 2020). The same is true in France (Martin, Mejean, and Parenti, 2020), in Chilean wine exports (Macchiavello, 2010), Kenyan cut flower exports (Macchiavello and Morjaria, 2015), and Bangladeshi garment exports (Cajal-Grossi, Macchivello, and Shleifer, 2020).

Industry-level evidence summarized by Macchiavello (2021) also points to the importance of long-term relationships, particularly in countries with weaker third-party enforcement institutions. In the Peruvian anchovy fishing industry, 60 percent of exchanges between fishing boats and processing plants are within vertically integrated firms, 30 percent are between separate entities with long-term relationships, and only 10 percent are between boats and plants without long-term relationships (Martinez-Carrasco, 2017; Hansman et al., 2020). In the Costa Rican coffee industry, 40 percent of the exchanges between first stage processing mills and exporters are characterized by vertical integration, 40 percent by relationships of three years or more, and only 20 percent by relationships of fewer than three years (Macchiavello and Miquel-Florensa, 2019).

Unfortunately, the deeper is mistrust, the costlier are these contracts. In a relational contract, each party has an interest in fulfilling the terms

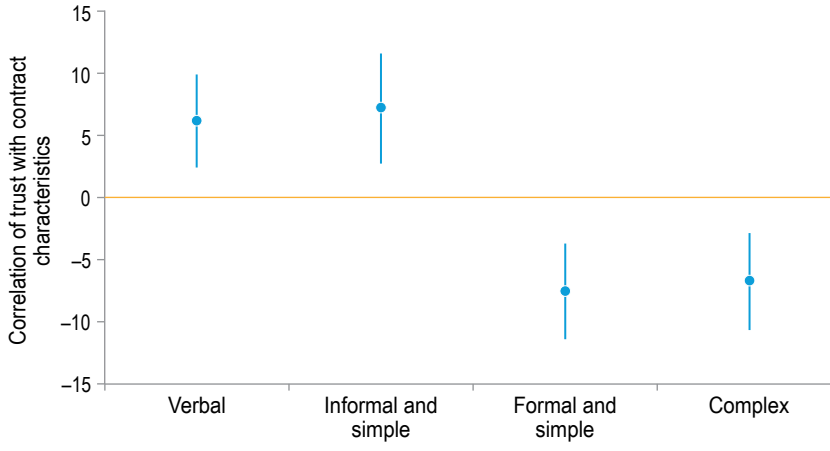
of the contract because noncompliance will destroy the future value of the business relationship. Where interpersonal trust is high, compliance is more likely even if the future value of the business relationship is low. In a low-trust environment, however, the value of the relationship must be correspondingly high to discourage noncompliance.

Rents high enough to ensure contractual compliance in relational contracts cannot be sustained in competitive markets. The expectation that new firms will enter competitive markets and displace incumbents reduces the future rents from current business relationships. In contrast, in monopolistic markets, the value of future rents is large and creates incentives to maintain the relationships and disincentives to act opportunistically. Hence, the contractual problems triggered by low trust can be solved by relational contracts, but only by foregoing the economic gains from competition: greater innovation and efficiency and lower prices for consumers. The tension is empirically important: Machiavello and Morjaria (2015) show that in Rwanda, competition between coffee mills weakened the relational contracts between mills and farmers. With less recourse to relational contracts, mills exhibited lower efficiency and produced output of lower quality.

Relational contracts are themselves a barrier to entry. Consider a final goods producer with a long-standing relationship with a supplier of intermediate inputs. Competing suppliers of intermediate inputs cannot easily displace the incumbent supplier since they cannot offer the same contractual reliability. Even their offers of lower prices and higher quality may not be sufficient to offset the relational advantage of the incumbent. The barrier to entry is effectively large (Macchiavello, 2021). In one low-trust setting, transactions between flower growers in Kenya and buyers in Europe attribute nearly one-third of the profits of producers to the value of their long-term relationships with buyers (Macchiavello and Morjaria, 2015). This implies that new entrants could displace current producers only if they were willing to earn just two-thirds of the profits of the incumbent producers. Although relational contracts between banks and firms increase the availability of loans to small firms in the United States, when small firms try to borrow from other lenders the amount of credit available to them falls and its price rises (Petersen and Rajan, 1994).

Trust affects contracting in other ways as well. In low-trust environments, firms feel pressure to write contracts that specify mutual obligations under every conceivable contingency. When trust is high, firms can write simpler and more flexible contracts. D'Acunto, Xie, and Yao (2020) show that more trusting firms in the United States tend to sign

**Figure 3.11 ▶ Contract Complexity and the Interpersonal Trust of Owners and Managers**




*Source*: Authors' calculations based on survey data on firms in El Salvador collected by Hernaiz et al. (2022).
*Note*: This figure shows coefficients of regressions of the most common type of arrangements between each surveyed firm and its suppliers or costumers on interpersonal trust of its manager, controlling for industry fixed effects as well as firm size and age. For example, focusing on the first coefficient, the probability of a firm with high trust using verbal contracts is 6 percentage points higher relative to firms with low trust. Robust standard errors at the 95 percent confidence level.

less complicated contracts. A novel survey of firms in El Salvador yields similar findings. Figure 3.11 shows that firms in which managers exhibit greater interpersonal trust are more likely to rely on simple contracts: the percentage of "trusting" firms that use verbal agreements is 6.3 percentage points higher than the percentage of non-trusting firms; the difference is 7.3 percent for informal and simple contracts. The percentage differences for more complex contracts are the mirror image of these. Firms with mistrusting managers tend to rely on more complex contracts covering a larger set of contingencies.

Firms make other costly arrangements to ensure contract compliance in low-trust settings. For example, they rely on suppliers to finance working capital, which are arrangements typical of links between firms in a supply chain. These arrangements tend to reduce transaction costs (e.g., a lengthy loan approval process with a bank). However, in low-trust environments suppliers take additional costly steps to reduce risk. To ensure repayment, lending firms may threaten to suspend the supply of inputs, which in turn can depress production (see Wu, Firth, and Rui, 2014). Lending firms may also charge a premium for the inputs sold to the borrowing firm.

## Mistrust: The Weakest Link in Supply Chains

Ideally, by integrating themselves into supply chains, firms boost their productivity by acquiring inputs best suited to their own products and production processes. Tightly knit supply chains allow firms to customize their products more closely to buyer needs, for example with respect to design, frequency of delivery, and scale. Firms in these chains are likely to confront fewer transaction costs in rearranging contractual obligations when unexpected contingencies arise.

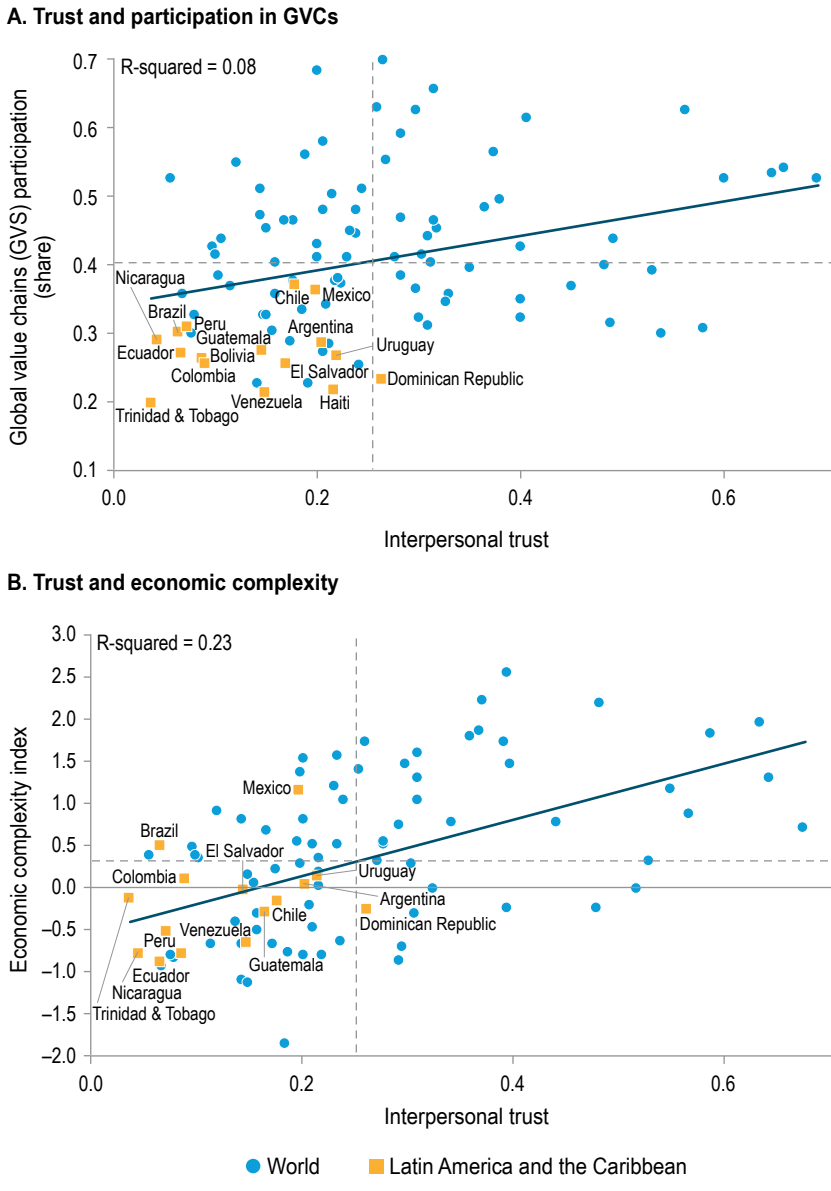
These significant efficiency gains entail risk, however. The more buyers and sellers in the supply chain customize their operations to meet the needs of upstream and downstream firms in the chain, the more difficult it is to replace their counterparts with firms outside of the supply chain. Possible replacement suppliers or customers will not be able to offer the same timely delivery commitments, product characteristics, or insurance arrangements. Nor will firms outside the supply chain share the same understanding of how to respond to contingencies.

There are at least two indications that mistrust hinders the emergence of supply chains. One is that low-trust countries are less engaged in activities that add value to their imports or in exporting high-value-added products. They are less integrated into global value chains (GVCs). This explains why high-trust countries tend to exhibit higher shares of foreign and domestic value added in their total exports (see Figure 3.12, Panel A). Countries in Latin America and the Caribbean, with low levels of interpersonal trust, are also among the countries with the lowest participation in GVCs.

The other indication of the importance of trust for supply chains is that low-trust countries have less complex—and less productive—economies. Hidalgo and Hausmann (2009) argue that as economic complexity rises, country exports become more diverse and fewer countries are able to produce them. In contrast to commodity exports, diverse exports are more likely to require customized inputs tailored to customer specifications. Complexity, therefore, is likely to demand levels of trust between firms that approach those found in tightly knit supply chains. Complexity is also a widely used indicator of a country's economic productivity. Consistent with this, Figure 3.12, Panel B shows that trust is higher in countries that tend to produce a wide variety of goods, including complex products that few other countries can make.[18]

[18] An additional explanation for the association of trust and complexity is described in Figure 3.8. Economic complexity requires firms to organize themselves internally to support innovation and specialization, for example, by delegating discretion to employees.

## Figure 3.12 ▸ Trust, Integration in Global Value Chains, and Economic Complexity




*Source*: Authors' calculations based on data from the Integrated Values Survey, which compiles the seven waves of the World Values Survey (1981–2020), the five waves of the European Values Study (1981–2020), the World Development Report (2020), and Observatory of Economic Complexity (1995–2018).
*Note*: Participation in global value chains is measured as foreign value added in total exports (backward linkages) plus domestic value added in intermediate exports, expressed as a share of total exports. The horizontal axis corresponds to the average interpersonal trust reported by each country in the Integrated Values Survey, constructed as the percentage of respondents in that country that believe most people can be trusted.

What accounts for the positive association between trust and participation in GVCs or complex production processes? One explanation is that less trusting managers perceive a higher risk of transacting with previously unknown firms, particularly those from countries with different cultures or beliefs. This mechanism underlies the idea of cultural bias in international trade and may rationalize the evidence in Guiso, Sapienza, and Zingales (2009), showing an association between trade flows and bilateral trust between origin and destination countries. At the macro level, institutional factors (such as those discussed in the section on interpersonal trust and regulation and more broadly in Chapter 7) may affect the beliefs of foreign firms about domestic firms. The lower the perceived risk of opportunistic behavior—mistrust—the higher the chances of high-value-added transactions in GVCs.

## Trust as a Growth Strategy

Latin America and the Caribbean is one of the least trusting regions in the world, whether measured in terms of trust in government or interpersonal trust. It is also one of the slowest growing and most unequal. This chapter demonstrates that the coexistence of these two phenomena is not a coincidence, that they are intimately related, and that trust plays a pervasive, fundamental role in economic growth.

When voters mistrust firms, they demand more regulation and, when civil servants mistrust the public, they advocate for excessive levels of regulation. When their trust in government is lower, firms are more apprehensive that in the future government will expropriate them or dramatically and adversely change the public policies governing product, capital, or labor markets. Their economic response to even good news about government performance is tepid. This reticence discourages investment in innovation and physical capital, as well as human capital. These decisions hurt growth in general, but also economic integration, a pillar for inclusive growth: opportunities for workers and outsiders fall when trust in government is low.

Low levels of interpersonal trust also suppress inclusive growth, by distorting both the internal decisions of firms and their relationships with other firms. Internally, firms hire trusted insiders to the exclusion of potentially more talented and productive outsiders; they delegate less authority to employees; and they invest less in human capital. This behavior reduces productivity: firms that both delegate and trust less, also innovate less. Again, workers and outsiders suffer more in the absence of interpersonal trust.

Finally, mistrust also forces firms to rely on costly contracting instruments. They either vertically integrate, cutting themselves off from the most efficient suppliers, or they enter costly relational contracts that use the promise of future business to encourage compliance with current obligations. Relational contracts are common, in both high- and low-trust environments, but the way they play out is markedly different. In low-trust environments, the minimum future profits required to secure mutual obligations are a more substantial barrier to entry and a greater drag on productivity and growth. Hence, low-trust countries are less likely to participate in global value chains and more likely to exhibit less-complex economies.

Institutions can sustain economic exchange even when mistrust is high. Unfortunately, these institutions are weaker in poorer countries. In fact, Besley and Ghatak (2010) note that the relationship between trust in the government and growth can be largely explained by the existence of institutions that mitigate mistrust and promote growth, such as secure property rights, contract enforcement, and the rule of law. In countries that lack these institutions, firms have limited recourse when their providers deliver defective products, customers fail to pay, or government officials levy higher taxes than the law allows. Because they cannot count on institutions to protect their property rights or enforce contracts, firms in developing countries base their investment decisions more on their beliefs about whether others are trustworthy. Institutional reforms, together with communication and information strategies, offer a way out of the economic stagnation induced by mistrust.

4

# Trust, Citizenship, and the Making of Good Public Policy

***When trust is low, citizens do not—cannot—demand policies to support inclusive growth; governments cannot supply them; and mutual suspicion plagues the interaction of public officials and citizens. Policy and policy implementation shaped by mistrust and fiduciary concerns cannot meet the region's development goals.***

Even before the COVID-19 pandemic, progress in reducing poverty and inequality had slowed under the weight of inefficiencies in the design and implementation of public policies.[1] Fueled by budgets that grew thanks to the commodity bonanza, poverty and inequality had fallen and secondary education was nearly universal. Nevertheless, public investments in education, health, and infrastructure—all of them public goods with long-term benefits—remained low relative to advanced economies, and the allocation of those investments continued to be packed with inefficiencies (Izquierdo, Pessino, and Vuletin, 2018). Income inequality remains high. And the region's growth has been lackluster and uneven, averaging only 2.5 percent per year between 2000 and 2019. Sadly, while other regions have been able to catch up to the most advanced nations, Latin America and the Caribbean has not.

Mistrust has much to do with this slow, erratic progress. In an ideal democracy, citizens elect their representatives and expect them to implement welfare-enhancing policies. They vote for the politicians who promise and deliver high-quality policies. Politicians, in turn, promise and deliver policies

[1] Prior to the COVID-19 pandemic, the poverty rate in Latin America and the Caribbean had dropped around 70 percent between 2000 and 2019, inequality fell 15 percent, and secondary education coverage became nearly universal, exceeding 97 percent in 2019. Based on aggregate trends, secondary school enrollment and poverty headcount ratio is at $1.90 per day for Latin American and Caribbean countries. Data come from the World Bank.

that benefit most voters. Long-term sustainable and inclusive growth is achieved. This is the virtuous circle that results in good public policy.

Mistrust disrupts this virtuous circle. For reasons explained in this chapter, low trust in government produces systematic biases against broad-based policies with long-term benefits, like improving education, or policies whose returns are more difficult to observe, like bureaucratic reform. Instead, citizens prefer politicians who promise policies with immediate, tangible effects on their welfare, even if they do not promote long-term sustainable and inclusive growth. Mistrust among citizens precludes collective action in pursuit of public policies that make them all better off. Instead, people elect politicians who promise private benefits over those who promise public goods: neighborhood streets over inter-city highways, transfer payments and subsidies over investments in security or education. Interpersonal mistrust and mistrust in politicians increase the probability that citizens will favor a clientelist relationship with politicians who offer them private benefits, rather than public goods, in exchange for electoral support.

A web of mistrust exacerbates these tendencies. The trust of government decisionmakers in each other and in citizens is essential for effective public policy that prioritizes public goods and policies with long-term benefits. Government officials shape the policy agenda and have substantial discretion over policy design and enforcement. However, the elaboration and implementation of effective public policies require collaboration throughout government, sharing both tasks and information. Mistrust short-circuits collaboration and reduces decisionmaker demand for policies that depend on collaboration. Without trust, there is no scope for cooperation, which is key for long-term growth promoting policies (Stein et al., 2006; Scartascini and Tommasi 2010; Scartascini, Stein, and Tommasi, 2013). Legislators who trust their peers support greater spending on public goods; public employees who trust their coworkers are more willing to implement innovations in the public sector, such as online services for citizens. The remainder of this chapter explores the channels through which mistrust distorts public policy, through its effects on the policies that citizens choose to demand and that government officials are able—and willing—to supply.

## Trust and the Demand and Supply of Public Policies

Interpersonal mistrust affects the demand for public policies in three related ways. First, it reduces people's confidence that other citizens will comply with the law. Instead, they believe that others will seek benefits to which they are not entitled, avoid taxes they should pay, or secure exemptions from regulations that are binding on the rest. Hence, people

are less likely to demand public goods (since they are skeptical that others will pay the taxes needed to finance them) and redistributive policies (since they believe ineligible citizens will capture benefits for themselves).

Second, distrust prevents citizens from working together to demand policies that benefit them collectively. Instead, they demand policies that deliver private benefits (e.g., transfers rather than public health investments). Individually, citizens are better off supporting politicians who provide them with private, "clientelist" benefits. Collectively, they benefit from politicians who provide public goods that leave all citizens better off. As this book repeatedly emphasizes, when mistrust is high, citizens cannot rely on others to act collectively—e.g., by abjuring politicians who promise clientelist transfers—and therefore are less inclined to vote for politicians who promise public goods.

Interpersonal trust also affects trust in government: politicians and public officials are citizens, too, so greater interpersonal trust should spill over into higher trust in government. Mistrust in government implies that citizens expect politicians to renege on their promises or shirk their responsibilities once in office. It leads citizens to demand policies with tangible, short-term benefits (e.g., jobs in government rather than education). Such policies are less susceptible to opportunistic behavior by governments but deliver fewer benefits to society than public goods.

Mistrust also affects the policies governments supply. Some policies, especially public goods and policies with long-term benefits, require cooperation among politicians and within the public administration, including sharing information about how best to design and implement them. Mistrust within government limits cooperation. For example, regulatory policies that support inclusive growth are in the interest of all politicians, but are only effective if individual politicians and government officials do not create formal and informal exemptions for favored constituencies. Unable to trust other officials not to undermine effective policies, all officials have less incentive to propose and implement them. Mistrust in citizens also distorts the supply side of policy. Politicians and public officials who do not trust citizens make them jump through needless hoops when seeking government benefits to which they are entitled.

The effect of these distortions on the demand and supply of public policies is far-reaching. Public goods such as roads, air quality, education, and the control of infectious disease, offer more bang for the buck to citizens collectively than do private transfers. Nevertheless, when interpersonal trust and trust in government are low, citizens are less interested in voting for politicians who promise such public goods. Interpersonal mistrust and mistrust in government also reduce citizen demand for redistributive policies: they do not trust ineligible citizens not to apply for benefits, nor

do they trust government to allocate benefits solely to eligible citizens. Mistrust in government reduces demand for public investment; since benefits materialize in the medium-term, the scope for opportunistic behavior, including the diversion of funds that leaves infrastructure projects incomplete and abandoned, is great. Interpersonal mistrust makes it difficult for citizens to combat corruption (Uslaner [2005] argues that corruption and interpersonal mistrust feed off each other). Removing corrupt politicians is in the collective interest of citizens, but is less likely if mistrust prevents citizens from acting collectively.

## The Demand Side: Citizen Trust and Public Policy

The study of trust and public policy is not new. Nannicini et al. (2013) argue that trust limits citizens' ability to cooperate and hold the government accountable for the economic and social policies it pursues. Persson and Tabellini (2002) and Keefer and Vlaicu (2008, 2017) emphasize one key mechanism: mistrust reduces the credibility of electoral promises, which lowers politicians' incentives to implement policies that promote growth. It can thus lead to rent-seeking and vote-buying. Keefer (2007) identifies credibility and trust as reasons why younger democracies perform less well than older ones: fledgling democracies, where politicians have had less opportunity to build up credibility, are more corrupt, adhere less to the rule of law, have less competent bureaucracies, and spend more on pork barrel rather than public investment.

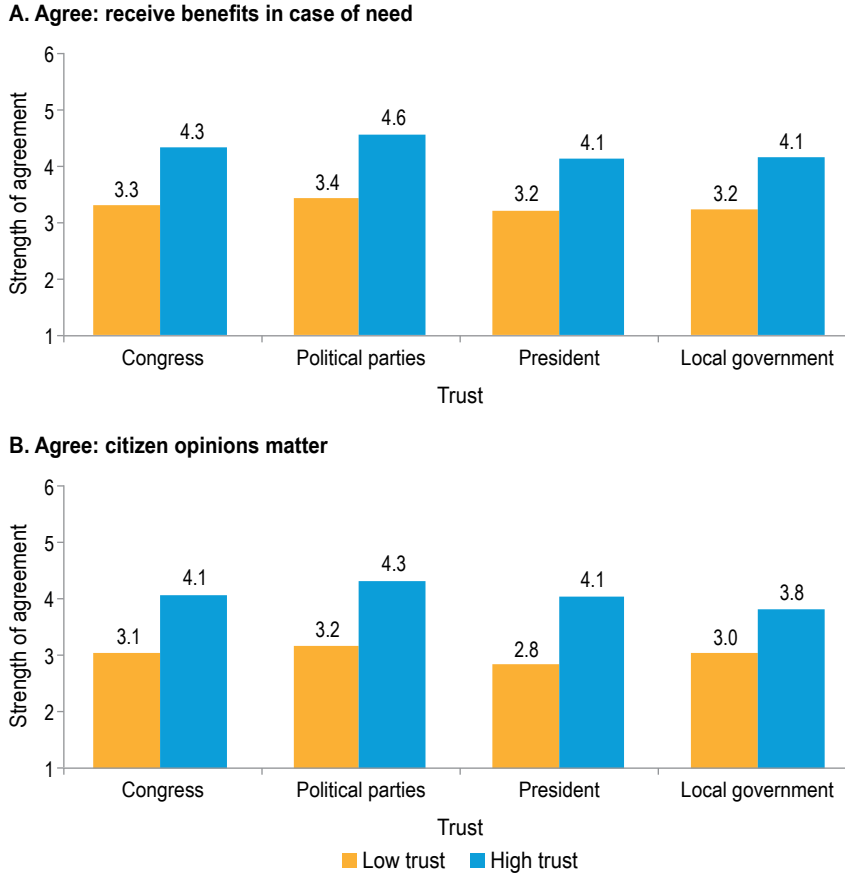
### Show Me the Money: How Citizen Mistrust Leads to Bad Policy

Latin America and the Caribbean display some of the lowest levels of citizen trust of any region in the world, and even from that low level, trust is declining (see Chapter 1). People directly confirm this skepticism when asked whether they trust politicians and public officials to keep their promises and obey the law. Keefer, Scartacini, and Vlaicu (2018) use data from the IDB-LAPOP 2017 survey covering seven Latin American capital cities to ask people whether they believe government officials to be opportunistic or not. Only 22 percent of respondents believe that politicians and public officials keep their promises. Low-trust respondents are similarly skeptical that taxes raised to fund public policies will improve their welfare. On average, only one out of four respondents agrees that higher taxes to finance redistribution or maintain water pipes would actually be used to help the poor or finance infrastructure maintenance. If mistrust in government implies little faith in the promises of government

to provide public goods or redistribute income, citizens who mistrust government do not demand these policies.

Figure 4.1 illustrates that trust in government is related to people's confidence in both how government implements and formulates policy. The message is clear: mistrusting citizens are less likely to say they would receive

**Figure 4.1 ▸ Political Trust and Policy Perceptions**




*Source*: Authors' elaboration based on LAPOP 2018–2019 Database.
*Note*: Opinion outcomes measure respondents' agreement with the statement that the government takes into account the opinions of people like you when designing or reforming public benefits, such as social services and transfers. Benefits outcomes measure respondents' agreement with the statement that you would easily receive public benefits provided by the state in case of need. Opinions and benefits perception values range from 1 to 7, where 1 is strong disagreement and 7 is strong agreement. Trust values range from 1 to 7, where 1 is no trust in the actor and 7 is a lot of trust. Low trust is defined as options 1 to 5, and high trust as the complement. The opinions and benefits perception questions were elicited in Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, and Peru.

the benefits promised by government policies (see Figure 4.1A). Moreover, respondents with low trust are less inclined to believe that governments consider their opinions when they formulate public policies (see Figure 4.1B). Citizens' perception of a disconnect between social problems and public policies could explain voters' policy preferences (Kuziemko et al., 2015).

Interpersonal trust is also strongly associated with policy preferences. People with greater interpersonal and political trust demonstrate greater support for social welfare spending (Algan, Cahuc, and Sangnier, 2016; Camussi, Mancini, and Tommasino, 2018; Gründler and Köllner, 2020). Similarly, interpersonal trust is associated with spending on social services (see Figure 4.2). Data from 130 countries show that public spending on education and health, as a percentage of GDP, is higher in countries with greater interpersonal trust. Latin American and Caribbean countries confirm this relationship; however, it is low interpersonal trust and low public good spending that go hand and hand in the region.[2]

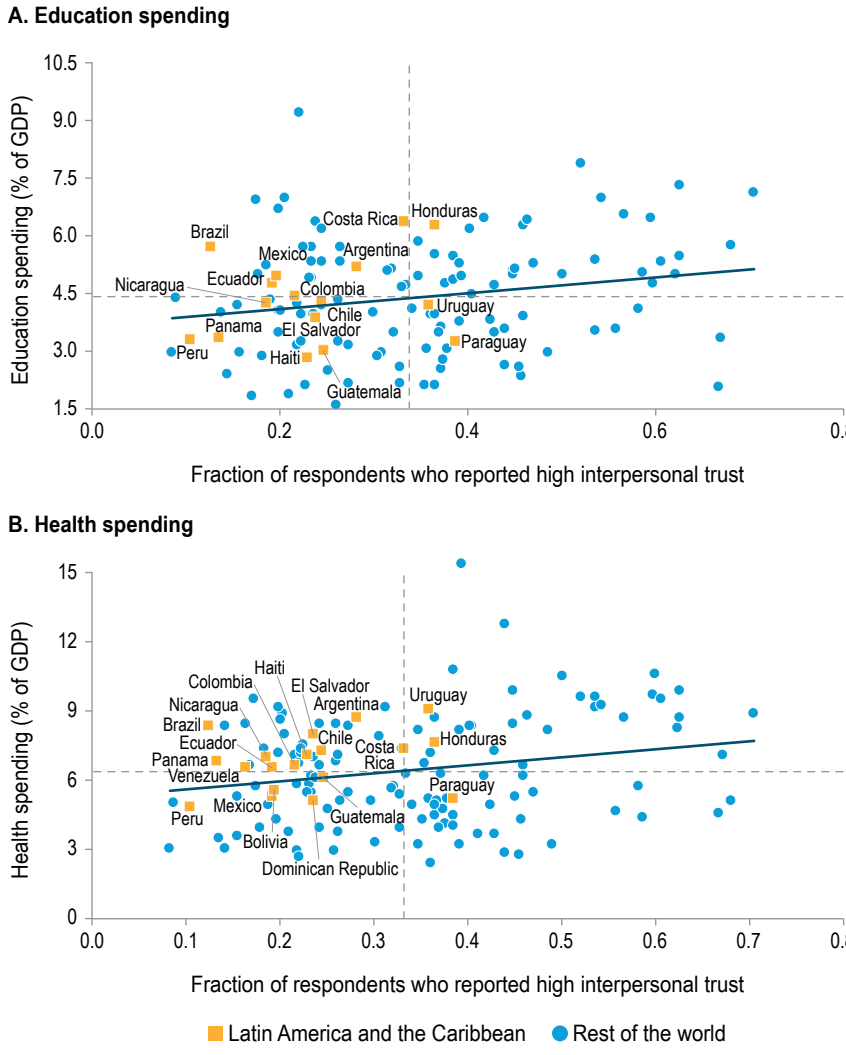
Interpersonal trust is also reflected in two measures of redistibutive policies. Countries with greater interpersonal trust spend more on social protection. Based on country-level data averaged over 2006–2019 for 135 countries, Figure 4.3A shows that interpersonal trust and the fraction of GDP that governments spend on social protection are significantly correlated at 0.25. Figure 4.3B looks at a more comprehensive measure of redistribution available for 40 countries from Latin America and the Caribbean and countries of the OECD. This measure is the difference between pre-tax and post-tax Gini coefficients, including social benefits, for a sample of 40 countries from Latin America and the Caribbean and the OECD. The correlation with interpersonal trust is 0.58. In both figures, Latin American and Caribbean countries tend to appear in the lower left, low-trust quadrant.

A significant debate in Latin America and the Caribbean, and around the world, concerns the impact of inequality on trust in government. The premise for this debate is that inequality reduces trust in government.[3] Directly, low interpersonal trust reduces the confidence of citizens that only

[2] The discussion of trust and the supply of public policies, below, points to the importance of trust for information sharing inside government. Ponzetto and Troiano (2018) make a similar point about trust and information sharing among citizens in the context of education. They argue that trust among voters facilitates the diffusion of information about the high returns of investing in public education. Voters then select candidates who are more likely to support public education spending. They show that countries with higher social capital (related to interpersonal trust) spend a higher share of output on public education and experience higher economic growth.

[3] This is, for example, the argument in Scartascini and Valle Luna (2020a) and reflected in Chapter 9.

## Figure 4.2 ▶ Interpersonal Trust and Public Good Provision

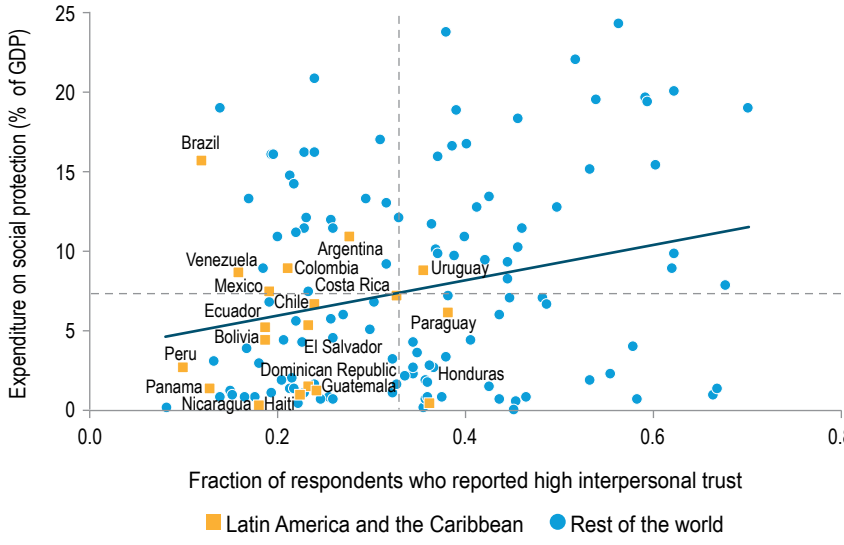



*Sources*: Authors' elaboration based on UIS UNESCO 2006–2019 Database, WHO 2000–2018 Database, and Gallup World Poll 2018 Database.
*Note*: Education spending presents the average for the period 2006–2019; missing values are replaced with interpolated values. Health spending presents the average for the period 2000–2018. Interpersonal trust ranges from 1 to 4, where 1 is no trust in neighbors and 4 is a lot of trust. Low trust in neighbors is defined as options 1 to 3, and high trust as the complement. Sample includes 126 countries in Panel A, and sample includes 139 countries in Panel B.

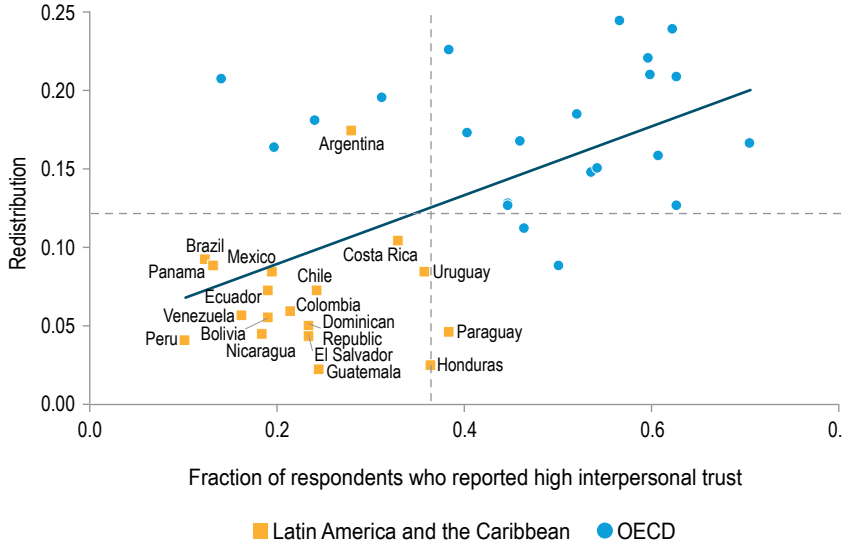
eligible citizens will seek the benefits of redistributive policy. Indirectly, by discouraging citizens from acting collectively, interpersonal mistrust limits citizens' ability to hold governments accountable for the implementation of redistributive policy (Keefer, Scartascini, and Vlaicu, 2020a).

## Figure 4.3 ▶ Interpersonal Trust and Income Redistribution

**A. Social protection**



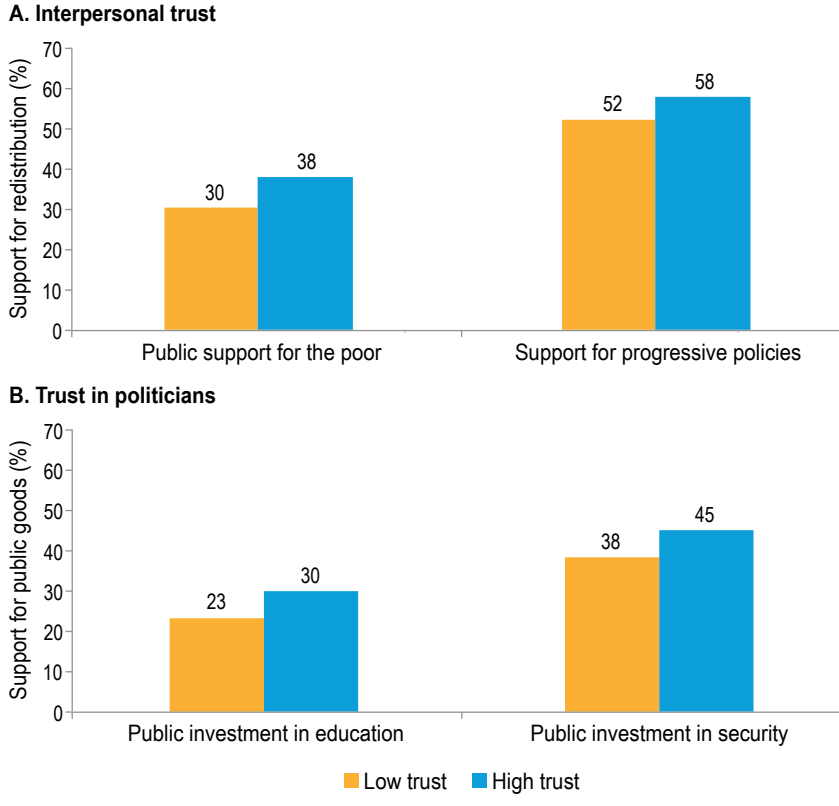

**B. Gini differential**




*Sources*: Authors' elaboration based on ILO Database, Commitment to Equity Institute on Fiscal Redistribution Database, and Gallup World Poll 2018 Database.
*Note*: Social protection spending represents the value for the most recent year. Redistribution is the difference between the gross and net Gini coefficients, calculated with the most recent data. Interpersonal trust ranges from 1 to 4, where 1 is no trust in neighbors and 4 is a lot of trust. Low trust in neighbors is defined as options 1 to 3, and high trust as the complement. The sample for Panel A comprises 135 countries, while the sample for Panel B encompasses 40 countries.

Thus, countries with low and high average levels of interpersonal trust produce systematically different public policies. Individuals display similar tendencies (Keefer, Scartascini, and Vlaicu, 2020a).[4] People who exhibit lower interpersonal trust are about 8 percentage points less supportive of tax-funded government assistance to the poor, and about 6 percentage points less supportive of progressive taxation that redistributes income from the well-off to the needy (see Figure 4.4A).

**Figure 4.4 ▶ Citizen Trust and Policy Preferences**




*Sources*: Authors' elaboration based on IDB-LAPOP 2017 Database.
*Note:* In Panel A, respondents chose between a preference for higher taxes for the poor and progressive tax policies, or lower taxes for the rich to create jobs and lower taxes for economic growth to reduce poverty. In Panel B, respondents chose between a preference for increased taxes to boost spending in education and security, or lower taxes to allow households to spend more on private education and security, respectively. Interpersonal trust ranges from 1 to 4, where 1 is no trust in most of the people and 4 is a lot of trust. Low interpersonal trust is defined as options 1 to 3, and high trust as the complement. Trust in politicians ranges from 1 to 4, where 1 is no trust in politicians promises and 4 is a lot of trust. Low trust in politicians is defined as options 1 or 2, and high trust as the complement.

[4] The IDB-LAPOP survey elicited policy preferences of 6,040 respondents from the capital cities of seven countries: Chile, Colombia, Honduras, Mexico, Panama, Peru, and Uruguay.

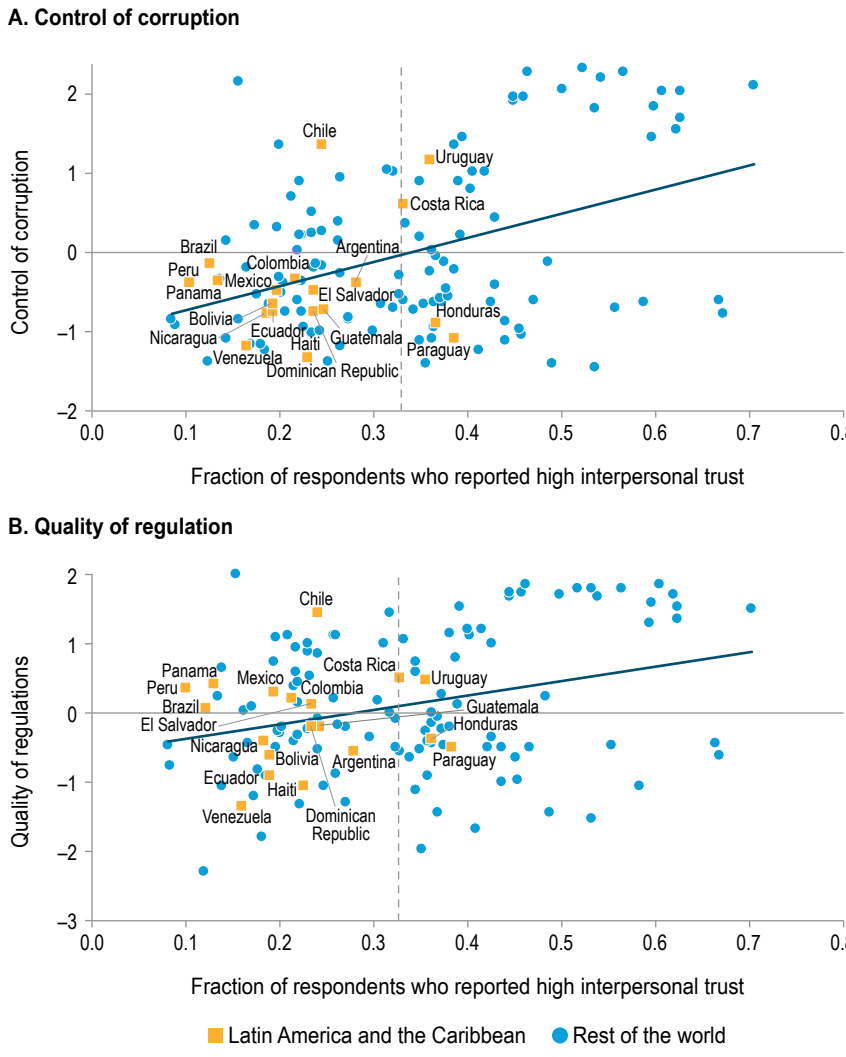
The IDB-LAPOP survey also shed light on the effect of trust on policy preferences for targeted government spending versus public goods. Citizens who doubt that politicians keep their promises were more likely to prefer targeted transfers to public goods. Respondents were asked to weigh the trade-offs between two spending alternatives, one that gave households more resources to procure the service for themselves, and another that raised taxes so that government could provide the service. For example, one of the questions asked whether citizens preferred higher taxes to fund public education spending or lower taxes so that households could pay for their children's education themselves. Another question offered a choice between higher taxes to fund government spending on security and lower taxes so households could procure their own security. Distrustful voters should be less likely to support government spending on the two public goods, education and security, because they more heavily discount politician promises of converting tax revenues into quality education and reliable public security.

Indeed, results confirm this expectation. Figure 4.4A and B show the percentage of respondents who support redistributive policies by level of interpersonal trust, and support for public goods spending by level of trust in politicians. People who express a low level of trust in electoral promises support public goods less than more trusting citizens. Individuals who place little trust in politicians' promises are about 7 percentage points less supportive of public investments in education than individuals who report high trust, and about 7 percentage points less supportive of public investments in security.[5]

Interpersonal trust could also be expected to affect citizen demand for better governance. Citizens who cannot act collectively would likely find it difficult to hold government accountable for corrupt administration or for regulations that limit their economic opportunities with no offsetting benefits for society. Figure 4.5 plots governance indices from the Worldwide Governance Indicators (WGI) project against interpersonal trust, using data from 2018. Greater trust among citizens is associated with greater control of corruption and higher regulation quality. Bjørnskov (2010) goes one step further, arguing that interpersonal trust has a causal effect on government quality: citizens who trust each other cooperate more efficiently to monitor the government and punish low-quality politicians at the polls.

[5] Higher average support for security relative to education may reflect awareness that private markets cannot adequately provide public safety. Helsley and Strange (1999) showed that private markets seeking to address the under-provision of security may increase the overall crime rate.

**Figure 4.5 ▶ Interpersonal Trust and Governance**




*Sources*: Authors' elaboration based on WGI 2006–2020 Database and Gallup World Poll 2018 Database.
*Note*: The control of corruption and quality of regulations index presents the average for the period 2006–2019. Interpersonal trust ranges from 1 to 4, where 1 is no trust in neighbors and 4 is a lot of trust. Low trust in neighbors is defined as options 1 to 3, and high trust as the complement. Sample includes 131 countries in both panels.

## Flying Solo: Citizen Mistrust and Collective Action

One mechanism through which mistrust distorts policies is direct and straightforward: citizens express less support for redistribution if they do not trust other citizens and government officials to respect eligibility. They

prefer policies with material individual benefits that are easily monitored, such as transfer payments, over policies with broad, less tangible benefits, such as education, where opportunistic behavior by government is largely unseen.

The other mechanism through which mistrust affects policies is indirect and less obvious: citizens' capacity to act collectively. Collective action is vital to the process of economic development, since good public policy confronts significant collective action dilemmas that conspire against it . Firms and citizens have incentives to free ride on their obligations to finance public goods ranging from education to public health and policing. They may also seek private exemptions from the rules that govern economic life, from contract enforcement and property rights to firm regulation. This behavior is likely to be pervasive in societies where citizens have little capacity to act collectively and is counterproductive for economic development. Trust among citizens is key to facilitating collective action and paving the way for progress.

Dramatic historical events illustrate the long-run impacts on economic development of trust and collective action (see Chapter 2). Acemoglu, Johnson, and Robinson (2001) show that endemic disease is associated with weak property rights, fragile rule of law, and lower incomes centuries later. What is the link between disease and development? One answer lies in viewing the results through the lens of trust and collective action. Disease and mortality shorten individuals' time horizons and encourage emigration. These population movements reduce the social penalties for untrustworthy behavior and the ability of citizens to mobilize collectively for stronger institutions. Forced labor requirements in colonial Peru suppressed the provision of public goods three centuries later as it destroyed communities, reduced trust, and limited the capacity for cooperation necessary to support public goods (Dell, 2010). A similar phenomenon occurred in East Africa, where slave trader strategies of coercion and cooptation to acquire slaves pit communities against each other, encouraging dramatically untrustworthy behavior. Those East African communities where slave traders were most active still exhibit low levels of trust a century and a half later (Nunn and Wantchekon, 2011).

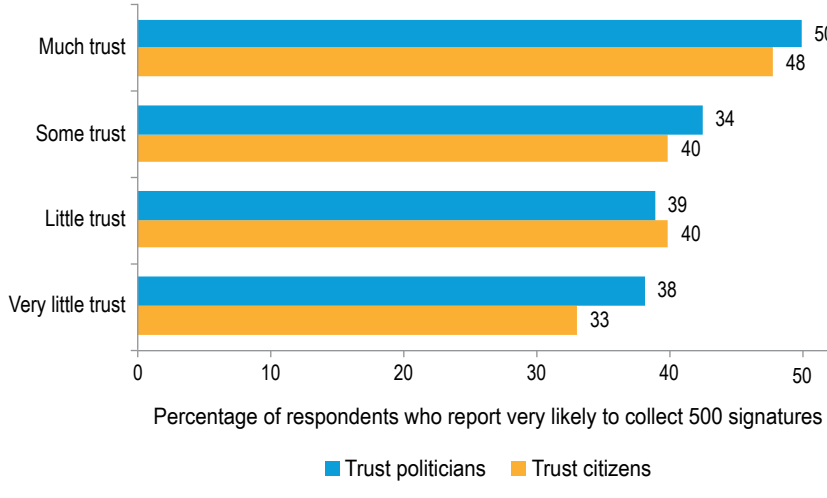
Contemporary evidence supports more explicitly the links from trust to cooperation to greater public good provision. Keefer et al. (2019) study self-government in popular markets in Lima, Peru. They conclude that markets that can enforce the rule of law and punish infractions of market rules are better able to engage in collective activities. In particular, market infrastructure is of better quality where the rule of law is stronger. But trust is key to the rule of law: markets founded by vendors with strong

social ties are significantly more likely to enforce rules. Arias et al. (2019) demonstrate the effects of trust, again embedded in social connections, on citizens' ability to hold governments accountable. When citizens are informed about political malfeasance, social connections help coordinate and remove the poorly performing politicians.

Survey evidence from Latin American countries further links trust in fellow citizens with collective action to demand public goods from government. The IDB-LAPOP survey asked respondents whether their neighborhood could collect 500 signatures on a petition asking the local government to fix neighborhood streets and sidewalks. Respondents who mistrust each other and government are significantly less confident that their neighborhood could collect the requisite signatures. Among respondents who report having "very little" trust in other citizens, or believe that politicians do not obey the law, only one-third state that they could likely collect the signatures in their neighborhood. Among those who report "much" trust in other citizens, or believe that politicians obey the law, about half of respondents are confident of collecting the signatures (see Figure 4.6).

Higher interpersonal trust increases the ability to act collectively. In turn, collective action enhances accountability, which ultimately improves

**Figure 4.6 ▶ Citizen Trust and Collective Action**




*Sources*: Authors' elaboration based on IDB-LAPOP Database.
*Note:* Bars show percentage of respondents answering "very likely" to the question of whether their neighborhood could gather 500 signatures to fix the streets. Trust values range from 1 to 4, where 1 is very little trust in other citizens (the politicians do not follow the rules) and 4 is a lot of trust (politicians obey the law).

the policy process. Higher interpersonal trust is also highly correlated with greater demand for policies that lead to additional and better public investments. Short-sighted policies, that put too much weight on the near term, are characteristic of Latin America and the Caribbean (Stein et al., 2006). Figure 4.7 shows that the governments in the region rank last in their long-term vision, which is blinded by mistrust.

## The Supply Side: Policymaker Trust and Public Policy

Voter mistrust in each other and in politicians distorts the policies that voters demand from politicians. Certainly, because politicians seek to be re-elected, they have incentives to supply the policies demanded by voters. In addition, though, mistrust among legislators and public officials, between legislators and the executive branch, and of government officials in citizens themselves, reduce the supply of policies to support inclusive growth.

Relationships among and between legislators and public officials dictate the policies that governments make and implement. They appear to be highly formal and strictly regulated by constitutions and the law. In fact, however, all of these actors have significant and unregulated discretion and their interactions are more often informal (Bonvecchi and Scartascini, 2020). Discussions of the advantages and disadvantages of a new bill, the decision even to introduce legislation, the speed in authorizing and implementing a bill, or the agreements and promises made to gain the support of others for political initiatives, all depend on trust.

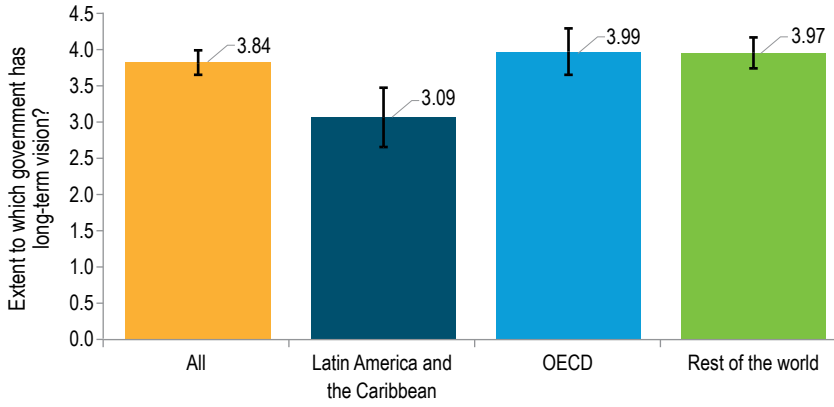
The challenge of trust is not only bilateral between a legislature and executive branch, or between two legislators. It is also one of collective action. When citizens cannot act collectively, they cannot easily demand public goods or hold government accountable for its failure to provide those public goods. Legislators confront the same collective action dilemmas and, as with citizens generally, are less likely to overcome them when trust is absent.[6]

When mistrust among legislators is widespread, individual legislators cannot rely on their peers to join them in voting for public goods, welfare-enhancing regulation, or reform for institutional strengthening. Nor can they count on them to supervise the executive branch as it implements these policies (Stein et al., 2006). In large organizations such as governments, trust facilitates collaboration and coordination among public actors to generate public policies (La Porta et al., 1997). Mistrust

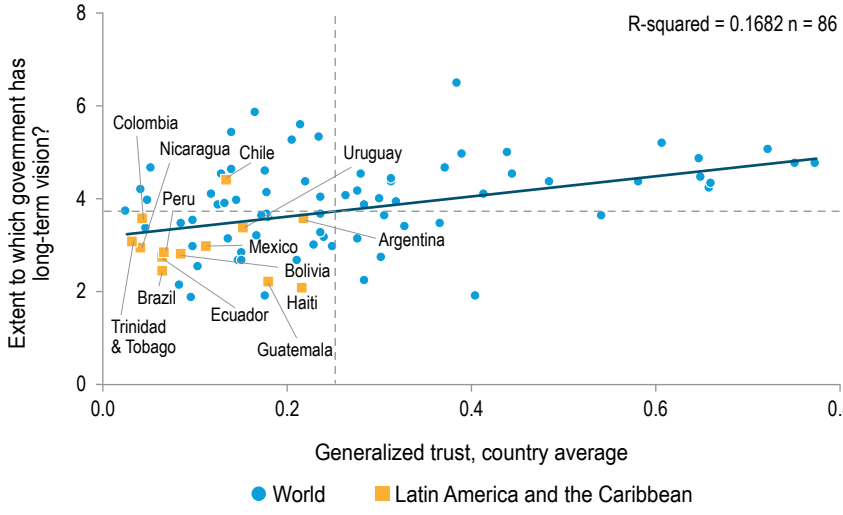
[6] The problem emerges in any group: Bartling et al. (2018) demonstrate that trust significantly increases the efficiency of social interactions inside groups.

## Figure 4.7 ▶ Citizen Trust and Government's Long-Term Vision

**A. Government long-term vision across regions**




**B. Relation between government long-term vision and trust**




*Sources*: Authors' elaboration based on the Integrated Values Survey and the World Economic Forum's Executive Opinion Survey.
*Note*: Government long-term vision comes from the World Economic Forum's 2019 Executive Opinion Survey. It is measured from the answers to the question, "In your country, to what extent does the government have a long-term vision in place?" The answers are based on a scale from 1 to 7 (1 = not at all; 7 = to a great extent). Each bar is a simple average from country-level data. The OECD group of advanced economies excludes Latin American and Caribbean countries: Colombia, Costa Rica, Chile, and Mexico. For Panel A, the total sample encompasses 140 countries including Argentina, Bolivia, Brazil, Barbados, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Haiti, Jamaica, Mexico, Nicaragua, Panama, Peru, Paraguay, Trinidad and Tobago, Uruguay, and Venezuela. The trust data comes from the Integrated Values Survey (2010–2020), which compiles the sixth and seventh wave of the World Values Survey; as well as the fifth wave of the European Values Study. In Panel B, each point is the simple average of the observations of each country for the years 2010–2020 and 2019, x-axis, and y-axis, respectively. The dotted lines represent the average values in the entire sample for each variable. The total sample encompasses 86 countries including Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Guatemala, Haiti, Mexico, Nicaragua, Peru, Trinidad and Tobago, and Uruguay.

reduces legislative incentives to pursue policies with long-run benefits, since these depend on the actions of future policymakers. It leads them to prefer policies targeted at narrow constituencies with whom they have personal connections over public goods, since these depend on cooperation among policymakers for their approval and implementation. It also reduces their incentives to pursue complex or difficult reforms that require them to rely on information from others. Mistrust also reduces the likelihood of investing in institutionalization; legislators do not invest in making Congress the place where decisions take place and they don't invest in their expertise (Scartascini and Tommasi, 2012; Palanza, Scartascini, and Tommasi, 2016). In countries with low levels of institutionalization, formal institutions matter less, which leads to lower quality public policies in the long run (Caruso, Scartascini, and Tommasi, 2015; Palanza, Scartascini, and Tommasi, 2016).

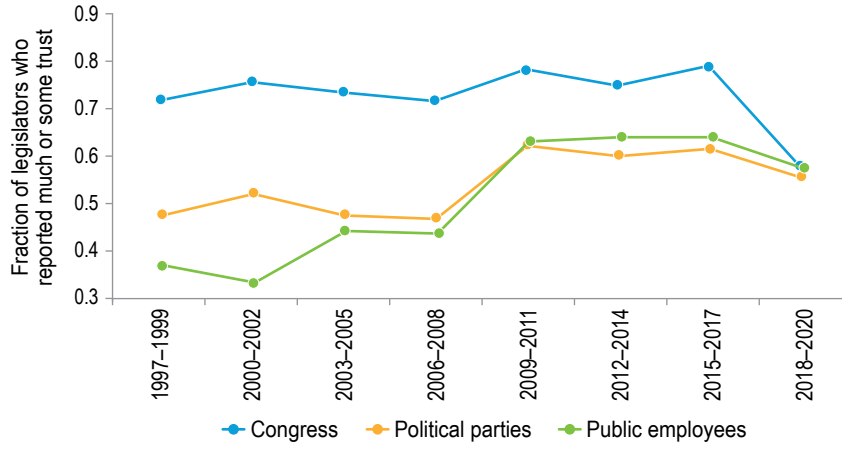
Legislatures are populated by political competitors: legislators are from different parties, often with opposing electoral and policy interests. Cooperation is, therefore, difficult. It depends in the first instance on the political parties through which like-minded legislators organize themselves. Chapters 7 and 8 emphasize the key role of political parties in mobilizing citizens for collective action on behalf of their shared interests. They play the same role inside legislatures. Political parties are the main vehicle for enforcing bargains among legislators to undertake collective action, such as passing legislation related to providing public goods (Aldrich, 1995). If legislators do not trust parties, which is evidently the case in Latin America and the Caribbean, then they are also unlikely to believe that collective decisions will be enforced.[7] Even if legislators build individual bonds of trust with other legislators, as they sometimes do, bilateral bonds fall short of mobilizing group-wise collective action. Moreover, party leaders can always strongarm legislators into breaking their private agreements with other legislators. In sum, where parties are not trustworthy, bargains with other legislators cannot be relied upon, either.

## The Making of Bad Policy

Cooperation among legislators is essential for high-quality public policies. Evidence from a unique survey, the Latin American Elites Project (PELA), sheds light on the role trust plays in determining legislator policy preferences

[7] In Latin America and the Caribbean there is a strong positive correlation: if party institutionalization is low, Congress institutionalization is also low (Palanza, Scartascini, and Tommasi, 2016).

**Figure 4.8 ▶ Legislator Trust in Latin America and the Caribbean**




*Sources*: Authors' elaboration based on PELA 1997–2020 Database.
*Note*: The trust series is the average for each wave for a set of 18 countries: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Peru, Paraguay, El Salvador, Uruguay, and Venezuela. Trust values range from 1 to 4, where 1 is no trust in public actor and 4 is a lot of trust; high and moderate trust is defined as options 3 or 4. Each wave might contain a different set of countries. The latest time period of the PELA survey covers only 7 of the 18 countries.

in the region. PELA is the most extensive survey of parliamentary elites in the region. Scholars at the University of Salamanca collected data from legislators in 18 Latin American and Caribbean countries since 1997, in most cases at least once per legislative period. Legislators answer questions about trust in Congress, political parties, and public employees. Figure 4.8 presents the time trends of legislators' trust in other political actors.

Asking legislators about their trust in Congress is similar to asking members of any organization about their trust in coworkers. Organizations that lack high levels of trust among coworkers are generally regarded as troubled, hence, the importance of the fact that only 41 percent of public employees in the region indicate they trust other public employees. For most of the period covered by the PELA surveys, between 70 and 80 percent of legislators professed their trust in Congress, a number that plummeted to less than 60 percent in the 2018–2020 wave.[8]

Legislators' trust in political parties and public employees has generally been significantly lower than their trust in Congress. In the last ten years, around 60 percent of legislators report high or moderate trust in

[8] However, because of the COVID-19 pandemic, coverage in the latest wave of the PELA fell from 18 to 7 countries.

public employees and political parties. This result is important since the other organization to which legislators belong is their political parties. Nevertheless, around 40 percent of legislators do not trust their parties. Legislator mistrust in their own political parties inhibits their ability to act collectively—parties are the principal vehicle through which politicians coordinate to achieve common objectives. Mistrust in public employees affects their policy choices, leading them to avoid those that vest discretion in the public sector.

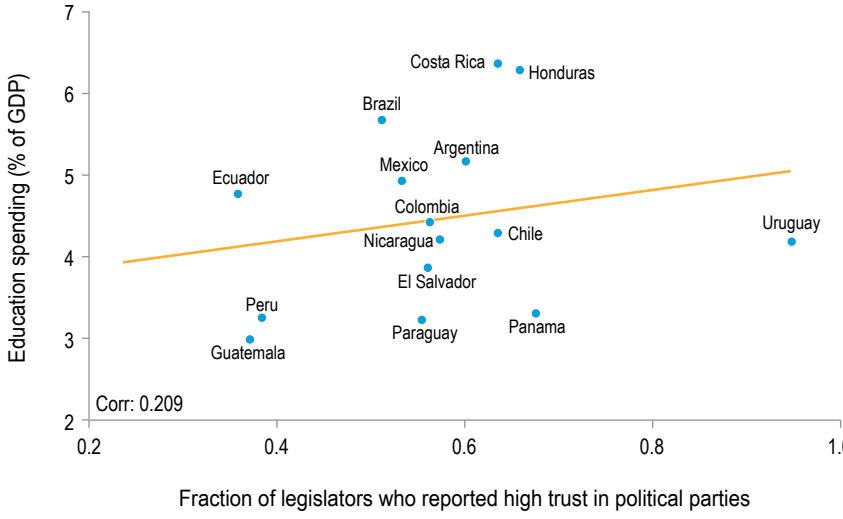
Education spending illustrates the importance of legislator trust in parties. Across Latin American countries, higher legislator trust in parties is associated with higher education spending as a percentage of GDP (see Figure 4.9A). Individually, legislators can do little to improve the quality of education or oversee education spending. They must trust that, collectively, all legislators will take an interest and government officials will allocate the education budget to maximize student learning. When trust in parties is low, legislators have little reassurance that agreements with other legislators or with the executive branch will be enforced. Consequently, they have less interest in allocating resources to education.

Figure 4.9B illustrates more directly the implications of trust in political parties for the credibility of agreements with the public administration. A scatterplot shows the number of days required to obtain electric utility service from the World Bank's World Development Indicators database (averaged for 2010–2019) on the vertical axis against legislators' trust in political parties. Absent reliable parties, legislators have no effective way to collectively compel government to improve the quality of public services. Consistent with this, countries with higher legislator trust in parties tend to have faster service delivery.

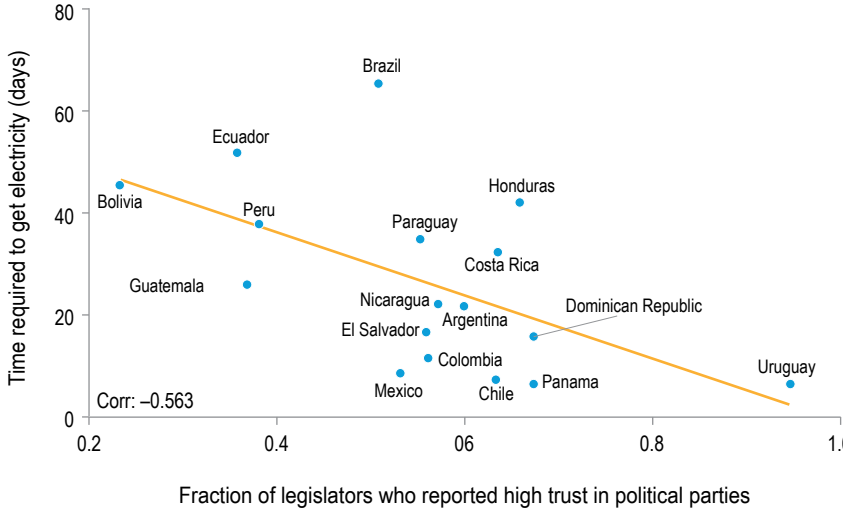
Information sharing is key to the design of broad legislation that affects the collective interests of legislators. Public policies aimed at providing public goods or correcting market failures, ranging from education, health care, and policing to environmental regulation and urban planning, are complex and demand expertise. Effective policymaking requires legislators to share information. However, if parties cannot cooperate enough to develop and enact these policies, information sharing is less likely. The effects of legislator trust in parties on collaboration inside Congress emerges from a PELA-IDB survey in 2019 of Colombian legislators on their experiences with information sharing and their policy preferences. Figure 4.10A reveals a significant association between legislator trust in parties and information sharing.

## Figure 4.9 ▶ Legislator Trust and Policy Outcomes

**A. Education spending**



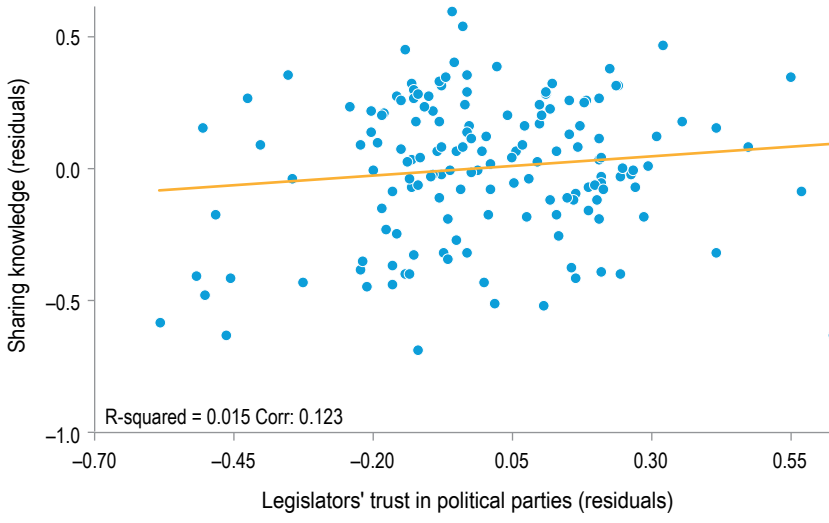

**B. Public service delivery**



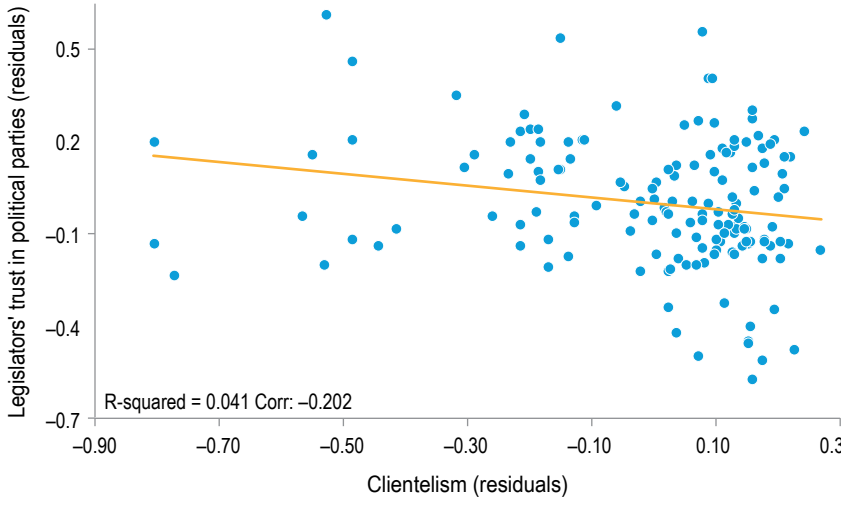

*Sources*: Panel A, authors' elaboration based on UIS-UNESCO 2006–2019 Database and PELA 1997–2020 Database. Panel B, authors' elaboration based on World Development Indicators 2011–2020 Database and PELA 1997–2020 Database.
*Note*: Education spending presents the average for the period 2006–2019; missing values are replaced with interpolated values. The time required to complete an electricity installation procedure presents the average for the period 2011–2020. This variable reflects the number of days to obtain an electricity connection. The measure captures the median duration that the electricity utility and experts indicate is necessary in practice to get the utility rather than that required by law. Legislator trust in political parties ranges from 1 to 4, where 1 is no trust in political parties and 4 is a lot of trust. Low trust in political parties is defined as options 1 or 2, and high trust as the complement.

## Figure 4.10 ▶ Legislator Trust, Information Sharing, and Perceptions of Clientelism

**A. Information sharing**




**B. Perceptions of clientelism**



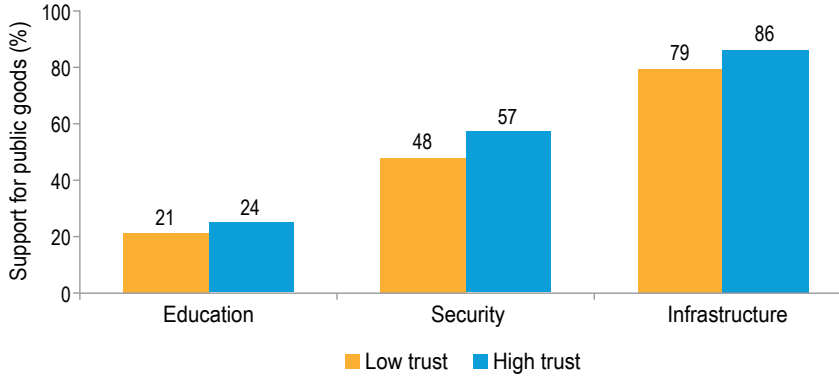

*Sources*: Authors' elaboration based on IDB Colombian Legislators Survey 2019 Database.
*Note*: Sharing knowledge measures respondents' perception of the willingness of other legislators to share their knowledge. Sharing knowledge values range from 1 to 4, where 1 represents not common at all and 4 represents very common. The legislators' trust in political parties is normalized to the unit interval. Clientelism captures the legislator's perception of how often candidates and political parties offer consumer goods in exchange for votes. Clientelism values range from 1 to 4, where 1 represents never and 4 represents very often. Each dot is a legislator observation, and there are a total of 155 observations. The residuals control for first time in congress, age, education, gender, political party indicators, and chamber indicators.

A similar logic links mistrust in parties with the pursuit of clientelist policies. When legislators do not trust their parties to enforce agreements, broad-based policies that affect all legislators are more difficult to construct and enact. Instead, legislators focus on allocating benefits to specific constituencies. The PELA survey asked legislators how often they believed that candidates and political parties offer consumer goods in exchange for votes. Figure 4.10B reveals that legislators who do not trust political parties believe that such exchanges are frequent.

In both panels, the associations account for differences among legislators with respect to their age, education, gender, ideology, opposition status, whether they are a first-term legislator, and their experience more generally. As the level of trust in political parties grows, so too does information sharing, even as the perceptions of political clientelism decline.

Preferences for public goods are also associated with legislator trust in political parties. PELA surveys conducted with the IDB in Colombia and Panama measured legislators' policy preferences on issues such as education, security, and infrastructure. The surveys asked whether legislators preferred higher taxes to fund a public good, or lower taxes so that households could provide themselves the good privately. Figure 4.11 shows the percentage of respondents who support public funding by level of trust in political parties. Legislators with higher levels of trust in political parties also expressed greater support for public goods.

**Figure 4.11 ▸ Legislator Trust and Policy Preferences**




*Sources*: Authors' elaboration based on PELA-IDB Colombian Legislators Survey 2019 Database and PELA Panama Survey 2019 Database.
*Note*: Respondents chose between a preference for increased taxes to boost spending in education, security, and infrastructure, or lower taxes to allow households to spend more on private education, security, and infrastructure, respectively. Trust values range from 1 to 4, where 1 is no trust in political parties and 4 is a lot of trust. Low trust is defined as options 1 or 2, and high trust as the complement.

## Mistrust Among Public Employees: A Handicap for Public Administration

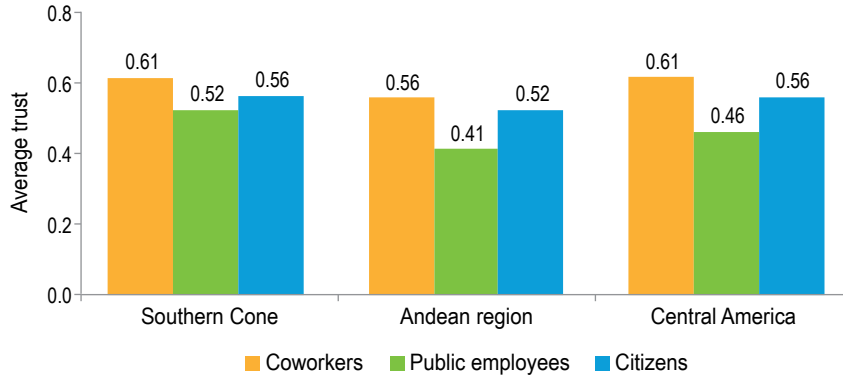
Countries administer and implement public policies through government agencies. The behavior and attitudes of public employees are, therefore, fundamental determinants of the performance of government agencies and, ultimately, the ability of governments to perform their functions (Best, Hjort, and Szakonyi, 2019). Successful policy implementation requires that public employees collaborate, are sensitive and responsive to citizen needs, and apply their discretion over public policy to maximize citizen welfare. Trust—in other public employees and in citizens themselves—influences the performance of these functions in three ways. First, it affects the amount of effort people put into their jobs. Employees try harder if they trust their efforts will be rewarded. Second, trust fosters cooperation and information sharing among colleagues. Third, trust reduces resistance to innovation and organizational change (Keefer, Perilla, and Vlaicu, 2020). Together, the effects of mistrust among public servants constitute a severe handicap for efficient public administration.

Trust enables collaboration on complex tasks among colleagues in government agencies just as it does among legislators. In the public sector, officials must work together with their colleagues, citizens, and public officials in other government agencies to implement government programs. To document the relationship between trust and cooperation in public sector agencies in Latin America and the Caribbean, the IDB Public Sector Survey in 2020 collected information from public employees on their trust and policy preferences. They responded to questions about trust in their coworkers, public employees in general, and citizens. The survey distinguishes between coworkers—those with whom the respondent interacts regularly—and public employees in general. In the three distinct Latin American and Caribbean regions where the survey was conducted, trust in coworkers is around 60 percent and substantially higher than in public employees in general. Also, trust in citizens is higher than trust in public employees. All types of trust tend to be lower in the Andean Region (see Figure 4.12).[9]

The survey also solicited views about cooperation and information sharing. Comparing these responses across high- and low-trust respondents reveals the same pattern of behavior among public employees as among legislators: mistrust in others reduces cooperation and information sharing. Respondents who express greater trust in public employees are

[9] These differences are also statistically significant.

**Figure 4.12 ▶ Public Employees' Trust in Others, by Region**



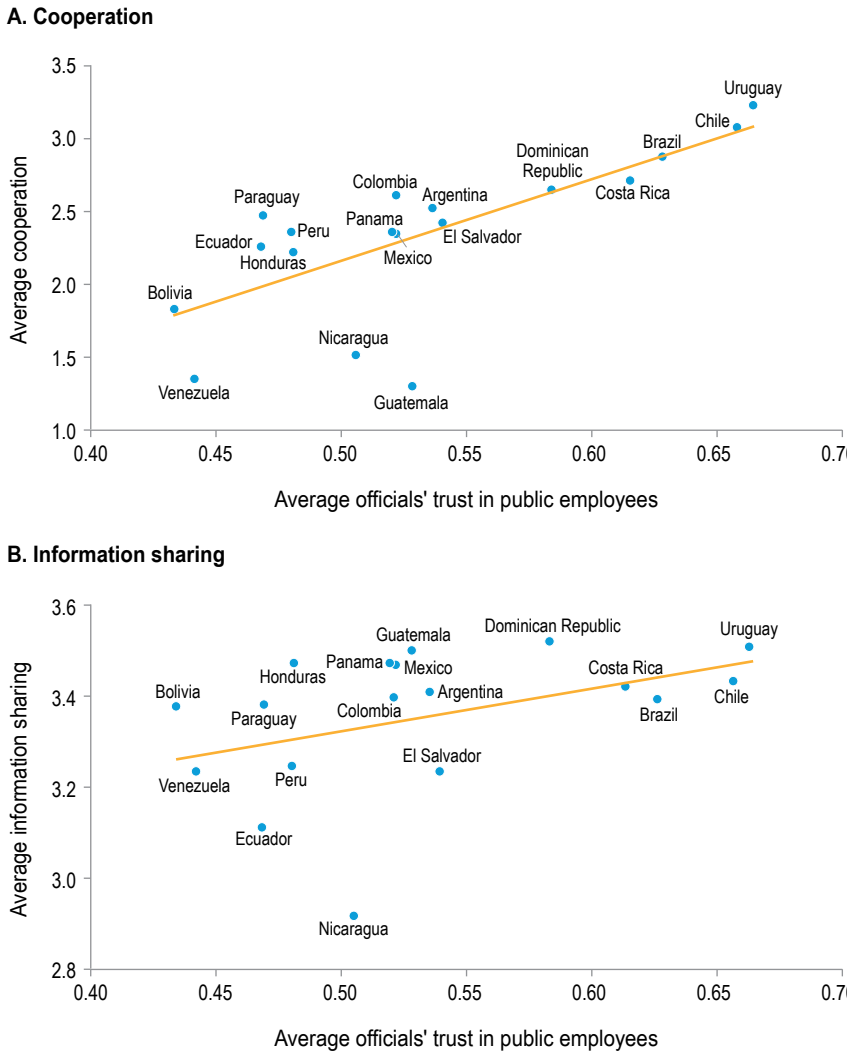

*Sources*: Authors' elaboration based on IDB Public Sector Survey 2020 Database and Keefer, Perilla, and Vlaicu (2020).
*Note*: The Latin American regions are defined for a set of 18 countries as follows: Southern Cone: Argentina, Brazil, Chile, Paraguay, and Uruguay Andean Region: Bolivia, Colombia, Ecuador, Peru, and Venezuela. Central America: Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, and Panama.

significantly more likely to report that cooperation enhances job performance and that they rely on information from colleagues (see Figure 4.13).

In addition to the positive relationship between trust and collaboration, public employees can also increase the effectiveness of government agencies by being open to innovation in the delivery of public services. One such innovation goes hand in hand with the digital revolution. The IDB survey asked public employees about expanding online public services to citizens. Most respondents, (55 percent) strongly favor expanding public services online. However, these improvements can be costly and require changes in the way public agencies operate; therefore, staff may resist these changes. Trust in peers would alleviate these costs; its positive influence on collaborative behavior could help curb resistance to innovation.

Employees with high trust in the public sector are 7 percentage points more likely to support online services (see Figure 4.14). Comparing average country trust from the public employee survey with the E-Government Index, which tracks countries' progress in implementing the digital government agenda, provides further evidence of the link between trust among public employees and digital government. Figure 4.15A demonstrates a strong positive correlation between public employee trust and the index, just as Figure 4.14 shows that individually, trusting public employees are more likely to support online services.

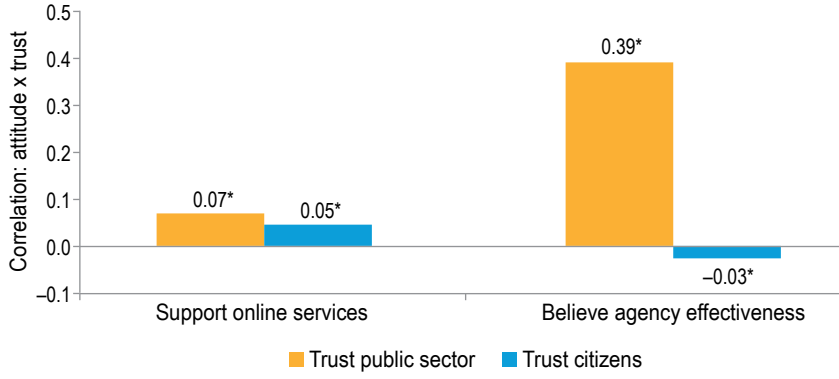
## Figure 4.13 ▶ Public Employee Trust and Collaboration




*Sources*: Authors' elaboration based on IDB Public Sector Survey 2020 Database and Keefer, Perilla, and Vlaicu (2020).
*Note*: Cooperation measures respondents' agreement with the statement that team projects, shared tasks, and meetings affect the ability to do their job well. Cooperation values range from –5 to 5, where –5 represents "reduce a lot" and 5 represents "increase a lot." Information sharing measures how much respondents rely on information obtained from their coworkers. Information sharing values range from 1 to 4, where 1 represents "rely very little" and 4 represents "rely a lot." The officials' trust in public employees presents averages normalized to the unit interval.

Quality regulation, like digital government reforms, demands cooperation and information-sharing among public employees. Trust promotes this cooperative behavior and impacts favorably on the regulatory decisions

**Figure 4.14 ▶ Public Employees' Trust, Attitudes Towards Digitalization, and Views of Agency Effectiveness**



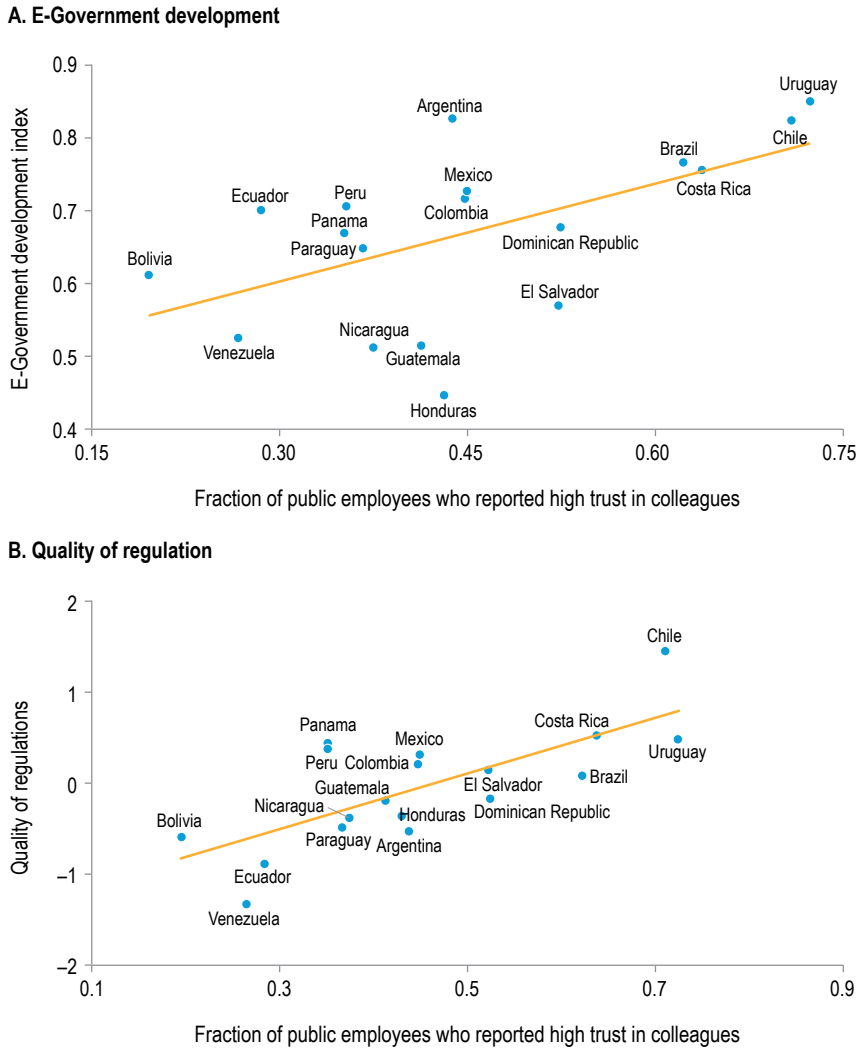

*Sources*: Authors' elaboration based on IDB Public Sector Survey 2020 Database and Keefer, Perilla, and Vlaicu (2020).
*Note*: Each bar indicates the amount by which a unit increase in the variables—trust in public sector, trust in citizens—is associated with attitudes in favor of online services in the public sector and perceived agency effectiveness. The regressions control for age, gender, education level categories, and current public employee. Also, they include country round fixed effects. Online services measure the respondent's view of expanding provision of public services online to citizens. The values from online services range from 1 to 5, where 1 represents aversion to online services and 5 represents strong preferences to provide public services online. Agency effectiveness measures the respondent's perceived agency effectiveness in accomplishing its mission during 2019. The values from agency effectiveness range from 1 to 5, where 1 represents poor agency performance and 5 represents very good performance. The online services, agency effectiveness, and trust measures were normalized to the unit interval.
* indicates statistical significance at the 5 percent level.

that governments make (see Figure 4.15B). In fact, the association between public employee trust and citizen-oriented government is mirrored more broadly in the relationship between trust and faith in the mission of public sector agencies. The survey asked respondents to share their perceptions of their agency's effectiveness in fulfilling its mission in 2019. Only 41 percent of respondents believed that their agency's performance was high or very high. However, the gap between high- and low-trust employees is enormous. Public employees who trust their peers are 39 percentage points more likely to state that their agency was effective (see Figure 4.14).

Trust in other public employees has significant implications for public employee perceptions about how to deal with crises. In the case of the COVID-19 pandemic and the issue of social distancing, public employees who trust their peers are more likely to blame low levels of physical distancing on citizens than government. They are less likely to believe that the appropriate policy response to low distancing involves greater government-imposed restrictions on citizen behavior.

These conclusions result from a randomized experiment with public officials who responded to information about their country's success in

## Figure 4.15 ▶ Public Employee Trust, E-Government, and Regulation




*Sources*: Panel A, authors' elaboration based on UN E-Government Knowledge 2020 Database and IDB Public Sector Survey 2020 Database. Panel B, authors' elaboration based on WGI 2006–2020 Database and IDB Public Sector Survey 2020 Database.
*Note*: The quality of regulations presents the average for the period 1996–2018. This variable reflects perceptions of the ability of the government to formulate and implement policies and regulations that permit and promote private sector development. Public employees trust in colleagues ranges from 1 to 4, where 1 is no trust in colleagues and 4 is a lot of trust. Low public employees trust in colleagues is defined as options 1 or 2, and high trust as the complement.

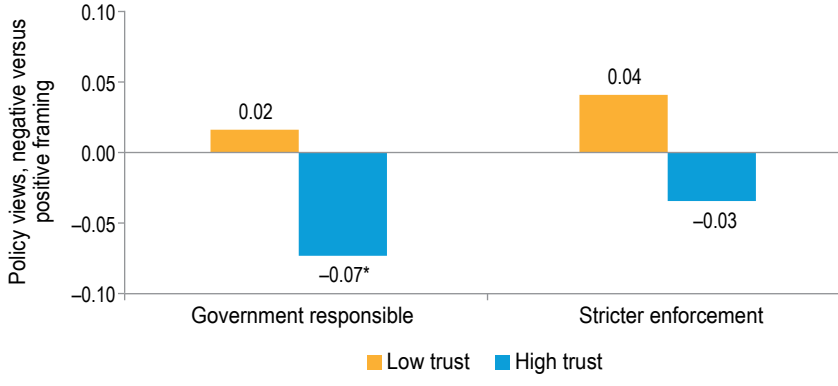
achieving social distancing early in the pandemic and shed light on their preferred policy response to that information. All respondents were shown a bar chart that depicted their country's level of social distancing at the

beginning of the pandemic. Then, respondents were randomly presented with two different statistics: one group saw their country in a positive light when its performance was compared to the average world level of social distancing, which was lower than nearly all Latin American and Caribbean countries;[10] the other group saw their country in a negative light as it was shown social distancing data for Spain, which had greater adherence to social distancing than the region.

After seeing the bar chart, respondents were asked, first, whether they thought government or citizens were more responsible for the levels of social distancing in their country. Second, they were asked whether they thought stricter government enforcement of social distancing was necessary.

Figure 4.16 compares the reaction of low-trust public employees to bad news about their country's social distancing with the reaction of high-trust public employees. Public employees who do not trust their co-workers react to bad news—information that country performance is worse than

**Figure 4.16 ▸ Trust Effects on Perceptions of Responsibility for Good versus Bad Social Distancing Outcomes**




*Sources*: Authors' elaboration based on IDB Public Sector Survey 2020 and Keefer, Perilla, and Vlaicu (2020).
*Note*: Each bar indicates the difference in average policy views between the treated (negative framing) and control (positive framing) respondents by trust level. Trust measures the trust in coworkers; the values range from 1 to 4, where 1 is no trust in coworkers and 4 is a lot of trust. Low trust is defined as options 1 or 2, and high trust as the complement. Measures in the x-axis converted to dummies that indicate response above the median. * indicates that the estimate is statistically different from zero at the 5 percent level.

[10] Nicaragua was the only country whose national statistic for social distancing was lower than the world average. In this case, the national statistic was shown by itself for the positive treatment.

Spain's—by assigning more responsibility to the government and favoring stricter enforcement of social distancing. In both cases—responsibility and enforcement—their mistrust leads them to conclude from bad news that the government response to the pandemic has been inadequate. The results regarding strict enforcement mirror those in Chapter 3 that show stronger preferences for regulation (of firms) in low-trust societies, although mistrust extends to government regulators.

The first two bars in Figure 4.16 consider perceptions of government responsibility for social distancing among respondents who do not trust other public employees (the first bar) and those who do. Those who trust other employees are more likely to hold citizens responsible for negative news about social distancing; those who distrust other employees are slightly more likely to hold government responsible. The second two bars focus on the need for stricter government enforcement of social distancing rules and reveal similarly stark differences. Low-trust employees are significantly more likely than high-trust employees to conclude from bad news that the government should do more to enforce social distancing.[11]

## Enhancing Trust for Better Public Policies

Latin America and the Caribbean is amidst what may be the most challenging time since the Great Depression. Public policies play a key role in meeting the challenge. Policies must be more focused on inclusive growth, better target benefit distribution to those in need, and maintain public integrity and transparency. Citizens' lack of trust in governments and policymakers' low trust in their peers hinder the emergence and implementation of such policies.

This chapter has provided evidence that trust is related to the quality of public policies in two ways: through its effects on the policies voters demand, and the policies politicians and government officials are prepared to supply. Low trust among citizens hinders their ability to act collectively and hold governments accountable, and it reduces their preferences for growth-promoting public goods. Low trust among policymakers handicaps the process of making and implementing policies, leading to less support for public goods among lawmakers and less support for modernized public services in the bureaucracy.

[11] These differences emerge controlling for trust in other public employees, trust in citizens, and country-round fixed effects. Trust in other public employees has no effect, but trust in citizens has a substantial impact, discussed below.

As Chapters 7, 8, and 10 emphasize, a key consequence of mistrust is to drive a wedge between public employees and citizens. Public employees exercise significant discretion when they do their jobs: they can exert little or much effort identifying and meeting the needs of individuals and firms; they can delay or accelerate responses to their requests for assistance; they can undermine or embrace innovative approaches to their work; and they can trust individuals and firms to represent their needs honestly or they can impose burdensome evidentiary requirements before approving their applications for licenses, benefits, or regulatory approvals. Whether they exercise their discretion to improve social welfare depends on their attitudes towards citizens. This includes, broadly, whether they are motivated to serve society, as Banuri and Keefer (2016) and others have pointed out; but also, specifically, whether they trust citizens. Evidence in this chapter illustrates one way in which mistrust has this effect: those who trust citizens are significantly less likely to both hold government responsible for social distancing outcomes and endorse stricter enforcement of social distancing.

Low levels of trust set in motion a vicious cycle that leads to policies with narrow or short-term benefits at the expense of policies to increase incomes broadly and more persistently. Policies that emerge from low-trust environments ultimately disappoint citizens, reinforcing mistrust. This book points to several avenues of reform to build trust and develop policies that improve welfare in the region, such as strengthening the institutional framework, improving the communication of policy outcomes, encouraging citizen participation in elections and community meetings, promoting policies that discourage misbehavior by public employees, and modernizing the system of citizen interaction with the state.

Chapter 6 on digitalization also points to the benefits of e-government for trust, along with the obstacles that mistrust puts in the way of public sector digitalization. Public employees who trust each other are more likely to support the digitalization of services to citizens, as are employees who trust citizens.

The good news is that trust could increase significantly once citizens see their governments striving to be efficient in all areas of public policy. High levels of trust will create the right incentives for citizens to demand policies with deferred and broad-based, rather than immediate and narrow, benefits and for policymakers to push for welfare-enhancing policies. This positive interaction between citizens and their governments would set in motion a virtuous circle in which trust leads to high-quality policies and good policy outcomes build trust in policymakers.

5

# Trust and the Effectiveness of Public Policy

***Mistrust not only distorts the policies that governments adopt but also their implementation. Policies to improve public safety, education, health, environmental protection, and financial inclusion all suffer when trust—in police, teachers, doctors, governments, banks, and, above all, in other people—is low.***

Latin America and the Caribbean faces a number of challenges that hinder its economic and social development. Government policies can address many of these issues, but mistrust undermines their effectiveness. Among the region's greatest development challenges is a growth problem—between 1980 and 2020, the average per capita growth rate of real GDP was below the world average. Governments can accelerate growth with financial policies that make private capital markets more efficient, education policies that build human capital, and innovation and competition policies that spur productivity growth. Governments can also reduce inequality in this most unequal region in the world by using tax revenue to finance public policies that level the playing field and bring opportunities for all. And governments can mitigate the devastating effects of pollution and climate change with environmental policies. Unfortunately, these policies may not have their intended—or any—effect if people trust neither government nor each other.

This chapter illustrates the importance of trust for implementing policies, focusing on primary health care, education, crime, and the environment. Improving health outcomes requires individuals to trust their doctors, follow their recommendations, and comply with the medical community's calls to vaccinate. Improving education outcomes compels teachers to trust public officials when they change the curriculum or introduce standardized tests; it also requires that parents trust the recommendations of teachers to improve students' performance. Reducing crime obliges citizens to trust the police to do their job and to report crime. All public policies depend on taxpayers trusting the government to use public monies well; otherwise, they will

avoid paying taxes at all costs. Adopting preventive measures during a pandemic requires all individuals to comply; therefore, the success of a public health strategy to prevent and abate disease depends heavily on interpersonal trust. This chapter expands on each of these policy areas to show that when trust in institutions and in others is low, the efficiency of public policies is also low, which ultimately prevents countries from developing.

Trust is the belief that others will not act opportunistically. They will not make promises they cannot keep, renege on promises they can keep, or violate norms to take advantage of other people who adhere to their commitments. Opportunistic behavior is more probable when one of the parties (e.g., citizens) has to act based on the promise of future action of the other party (e.g., the government). Such situations are pervasive; just one example is the decision to pay taxes based on the promise of public goods in the future. It is more likely that taxpayers will comply willingly if they trust that the government will not waste money or politicians will steal it. Opportunistic behavior is even more common when the actions of the government or the outcomes are difficult to evaluate, such as those associated with education reform. Opportunistic behavior is more probable when the costs are individually borne but the benefits accrue to society; free riding in recycling, polluting, or pandemic control measures is common and can render the policies useless.

Public policies are key for promoting an inclusive and sustainable society, but they tend to be characterized by tangible short-term costs and difficult-to-measure long-term benefits. Therefore, public policies' effectiveness greatly depends on trust in the government and citizenship, especially in sectors where people's behavior affects others and people are poorly informed—for example, about government efforts to reform and the effectiveness of those efforts. While some of these issues can be addressed with regulation, the rule of law, and public accountability efforts, trust still plays a crucial role in citizens' cooperation with public policies, their support for public programs, and the ability of these programs and policies to achieve their objectives.

This chapter argues that when trust is low, policy outcomes are worse. The COVID-19 pandemic provides a perfect, albeit painful, example of how policy outcomes suffered due to low trust. People in low-trust countries did not comply with national mandates to prevent the spread of the virus, including mobility restrictions, mask-wearing requirements, social distancing, and staying home. These measures impose a personal cost and yield individual benefits that vary according to each person's vulnerability to the virus. But compliance with these mandates also delivers a significant social benefit by reducing contagion in the community. In low-trust societies with

weak bonds of citizenship, individuals do not trust others to act in the interest of social benefits; thus, contagion is greater. Trust in the government also plays a crucial role in successful vaccination campaigns. Vaccinations control disease by limiting contagion. For a vaccination campaign to be successful, citizens must trust that governments will only approve a vaccine that is safe and effective. Interpersonal trust matters too. In low-trust societies, individuals are less likely to believe that others will get vaccinated to achieve this social benefit and the campaigns are less successful or fail altogether. Failure then erodes trust even more, creating a spiraling downward cycle. These processes can accelerate rapidly and grow into a crisis of despair. The rapid erosion of trust and faith in the ability of the public sector to solve problems could be one of the reasons behind social protests and upheavals in several countries in the region (Velasco and Funk, 2020).

## Who to Trust in the Fight against Crime

Latin America and the Caribbean suffers from an endemic crime problem. With 9 percent of the world's population, the region accounts for 33 percent of global homicides (Cafferata and Scartascini, 2021). High crime is a drag on growth and perpetuates inequality. Mistrust, particularly low interpersonal trust, plays an important role in fostering crime, while mistrust in government diminishes the effectiveness of policies to fight it.

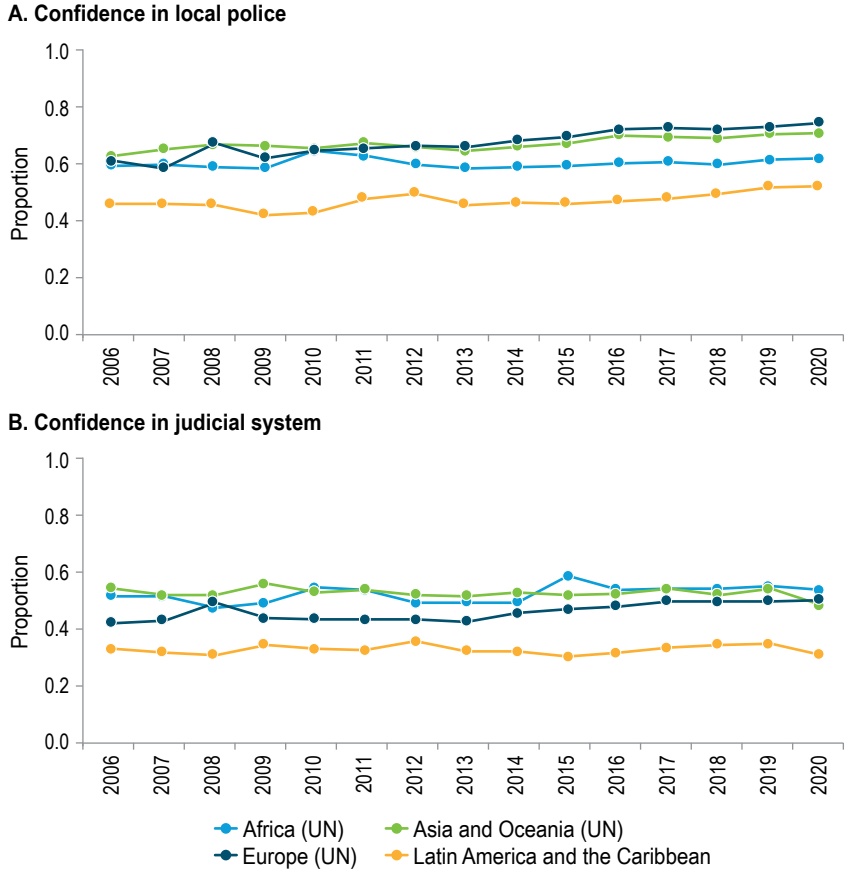
When interpersonal mistrust is high, fear is likely to be greater. In fact, ample evidence demonstrates a relationship between interpersonal trust and crime. Across countries, social capital (a function of interpersonal trust) is negatively correlated with crime while trust among community members significantly helps reduce violent crime across countries (Lederman, Loayza, and Menéndez, 2002). At the subnational level, both civic norms and associational networks negatively impact property crimes across Italian provinces (Buonanno, Montolio, and Vanin, 2009). Akçomak and ter Weel (2012) find a similar result across municipalities in the Netherlands measuring social capital with a composite indicator composed of several factors such as blood donations and voluntary contributions to community well-being. Finally, in Colombia, Cuesta and Alda (2012) find that increasing trust and social capital reduces victimization, albeit modestly.[1]

[1] While social capital and generalized trust are correlated with lower crime, some types of interpersonal trust could actually be more conducive to crime, as is the case with the mafia and similar organizations. Increasing trust among individuals may allow criminals to more easily exchange information, diminishing the costs of crime (Lederman, Loayza, and Menéndez, 2002; Glaeser, Sacerdote, and Scheinkman, 1996; Rubio, 1997).

Criminal justice institutions—police, courts, etc.— are key to reducing crime. However, confidence in the institutions that provide public security and justice is low in Latin America and the Caribbean (see Figure 5.1). Relative to other regions of the world, confidence in local police and the judicial system has been persistently low during the last 15 years.

Mistrust affects the criminal justice system by distorting the organization of policing, undermining its effectiveness, and reducing the demand for publicly provided policing. With regard to the first, it is difficult for citizens to measure crime prevention or deterrence in order to judge police

**Figure 5.1 ▶ Confidence in Institutions by Region and over Time**




*Source*: Authors' elaboration based on Gallup's country dataset extracted from https://ga.gallup.com/Charts.
*Note*: Each panel shows the evolution of key indicators by region for the 2006–2020 period. Panels A and B show the percentage of the population who reports being confident about the local police and the judicial system, respectively. Regional values are calculated using the unweighted average of the country estimates of each year.

performance.[2] If they mistrust police and demand measurable and observable indicators to judge policy performance, they may compel police organizations to invest resources in activities with bigger impacts on measurable outcomes, even when there are other activities with a larger effect on public safety. For example, police are responsible for apprehending perpetrators and, more importantly, for preventing crimes.[3] An effective policy requires a balanced effort to both control and prevent criminal activity (Lum and Nagin, 2017).[4] Apprehension or arrest rates are relatively easy to monitor, but arrests include crimes that could have been prevented in the first place (Nagin, Solow, and Lum, 2015).[5] A focus on the easily-measured arrests skews police activities away from deterrence, yielding both higher crime rates and lower trust in police.[6]

Second, the criminal justice system relies on the cooperation of citizens to reduce crime. Cooperation, though, depends on trust. Trust may be low because citizens fear the criminal justice system will treat them unfairly, or because the system is simply ineffective because of structural deficiencies such as not having enough resources to deal with the problem. Individuals will not cooperate with police and other agents in the judicial system if they believe they are untrustworthy. Evidence of the willingness of individuals to report crimes underlines the importance of trust for criminal justice. If people do not report crimes or are reluctant to provide information for crime investigations, police effectiveness is eroded both in terms of prevention and control of criminal activity. Messing et al. (2015) document that mistrust in police is a greater deterrent than the fear of deportation among

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[2] Deterrence accounts for crimes prevented as well as the costs that could have been saved on investigating, capturing, prosecuting, sentencing, and incarcerating offenders (Chalfin and McCrary, 2017).

[3] This is clearly a simplification of the role of police that, in practice, includes other usual tasks such as traffic safety, medical emergencies, and dealing with community conflicts and disputes, among others.

[4] The importance of citizen reaction reflects the idea that "police in democracies are responsible for preventing crime but also for maintaining their credibility with all segments of citizenry" (Lum and Nagin, 2017, p.341).

[5] A focus on clearance rate is also flawed since it may simply lead police to concentrate efforts on less serious but easy-to-investigate crimes. Moreover, by considering the criminal opportunities and potential offenders' strategic interactions, declines in crime and arrests can reduce clearance rates since offenders may choose to victimize only the crime opportunities with low risk of apprehension. See Nagin, Solow, and Lum (2015) for a theoretical discussion of this issue. A similar point regarding the subtle but important distinction between clearance rate and risk of apprehension was made by Cook (1979).

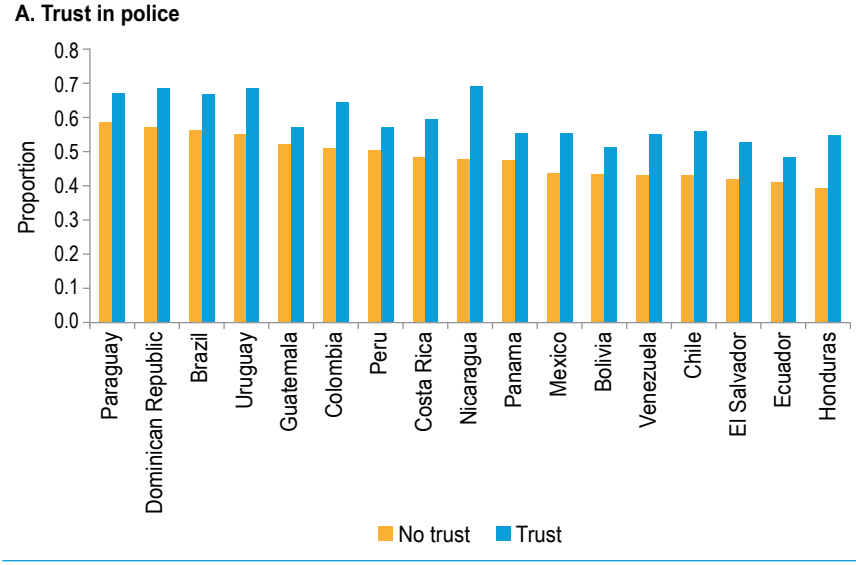
[6] This follows a well-known concept in crime policy that "it is better to prevent crimes than to punish them" (Beccaria, 1995, p.103), an observation that was famously formulated by Becker (1968).

Latinas in the United States when it comes to reporting violent crime victimization. This gives rise to a vicious—or virtuous—circle: the more citizens trust police, the better its performance, which in turn reinforces citizen trust.

Models of procedural justice are meant to break the vicious circle by giving fairness a key role in activating people's connections with authorities (Tyler, 1990). While fairness and trust are not identical concepts, fair police are unlikely to act opportunistically, and trustworthy police are unlikely to be perceived as unfair. Indeed, in the United Kingdom, Jackson et al. (2014) show that "trust in police fairness" predicts cooperation better than alternatives. Concerns with police fairness drove the Black Lives Matter movement in the United States and recent protests in Chile and Colombia. When people observe that police act fairly, they are more likely to trust them and cooperate with them.

Figure 5.2 illustrates the phenomenon of trust and cooperation more systematically across all countries in Latin America included in the Latinobarometer survey with estimates of the likelihood of reporting a crime to police according to people's trust in three areas: the policy, judiciary, and other people. Trust in police clearly correlates with trust in the judiciary, but to a much lesser extent than trust in other people. The probability of reporting a crime among those who do not trust the police is only 0.48 compared to 0.59 among those who do trust the police (Panel A). Similarly, the probability that respondents who do not trust the judiciary will report a crime is 0.49,

**Figure 5.2 ▸ Willingness to Report a Crime by Type of Trust**

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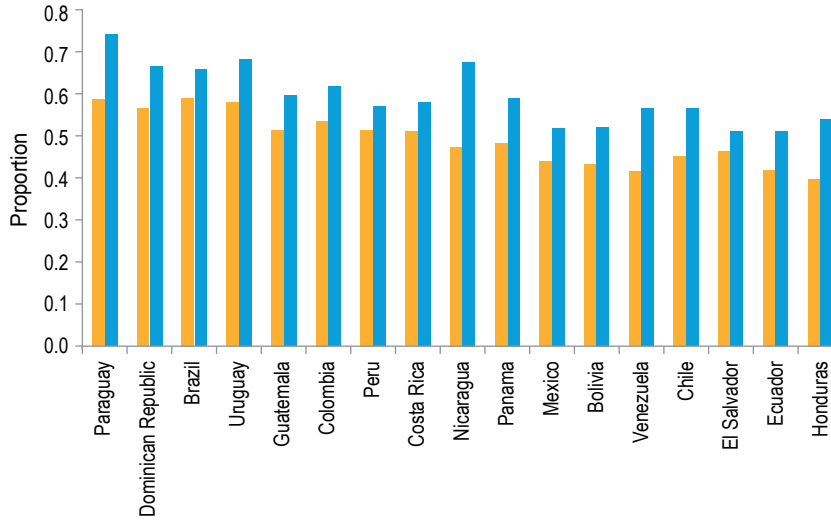
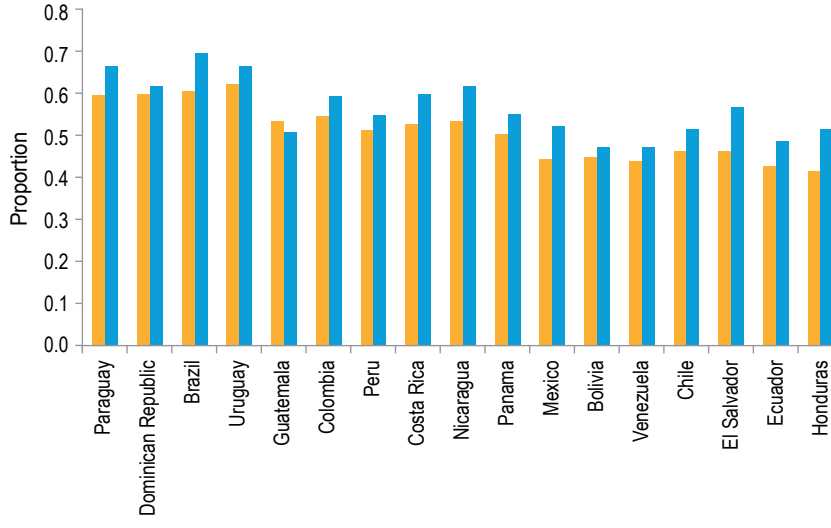
## Figure 5.2 ▶ Willingness to Report a Crime by Type of Trust *(continued)*

**B. Trust in the judiciary**




**C. Trust in people**




No trust Trust

*Source*: Authors' elaboration based on data from the 2020 Latinobarometer.
*Note*: Bars show willingness to report a crime by group category and country. For each trust category, individuals who trust are those who report a lot of trust whereas individuals with no trust are those who report little or no trust. Willingness to report to police is measured as the group average in the question, "If you are victim of a minor crime (theft of a bicycle, cellphone, etc.), how likely are you to complain to the police?" where probabilities were assigned as follows: "very probable" (0.95), "somewhat probable" (0.65), "little probability" (0.35), and "not at all" (0.05).

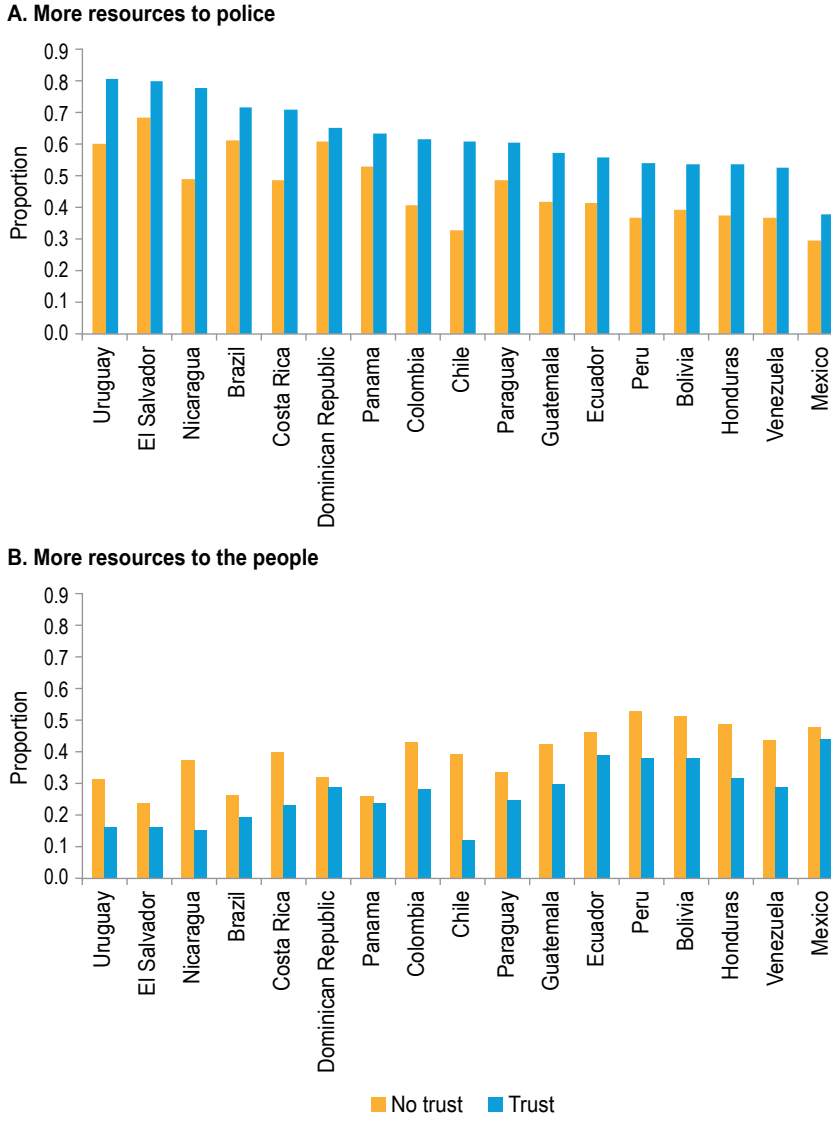
compared to 0.59 for trusting respondents (Panel B). A priori, the expectations regarding the relationship between interpersonal trust and reporting is less clear. On the one hand, those who are mistrustful of others have an incentive to report the incidents more (to get rid of those who do not comply with the rules). On the other, in order to trust the police, people need to trust others, therefore, those who are mistrustful may report less. Additionally, interpersonal mistrust is highly correlated with mistrust in institutions. As argued in this book, trust in the government and its agencies depends on the ability of citizens to hold those institutions accountable. Accountability is not possible if people mistrust each other and cannot act collectively. Panel C shows that differences are less marked for interpersonal trust than for trust in institutions: 51 percent of those who are mistrustful of others indicate that they would report a crime compared to 56 percent among those who trust other people. These correlations do not change significantly if the analysis is done within countries instead of looking at the region as a whole.

The third way in which trust affects public safety is in shaping the public's demand for publicly provided policing. Chapter 4 argues that trust in government and institutions affects individuals' demand for publicly provided services. One of those services is security. A 2020 Latinobarometer survey asked people whether they would prefer the government to devote more resources to the police or instead, direct those resources to households to enable them to privately provide their own security. In all countries, people who trust the government prefer giving more resources to the police than private security (see Figure 5.3). The opposite is also true: individuals with a lower level of trust are more inclined to believe that allocating resources to households is better than providing additional resources to the police (see Figure 5.3B).

The effect of trust on these policy preferences matters because public action against crime is likely to be far more effective in reducing crime rates than the efforts of individual citizens. Households are content to protect their local area from crime, but private security that reduces the likelihood of victimization in one area may simply displace criminal activity to another. Publicly provided security takes crime displacement into account and aims for society-wide reductions in crime; displacing crime is not considered an improvement in public welfare. The strategies differ not only in terms of effectiveness, but with respect to equity as well. Clearly, lower-income households have limited capacity to invest in private security. Replacing police with private security can seriously affect crime exposure across socioeconomic groups (Domínguez, 2020).

Mistrust in institutions that provide public security and justice can spill over into other sectors such as public transportation. Urban transportation

**Figure 5.3 ▶ Trust in Government and Demand for Public Security**



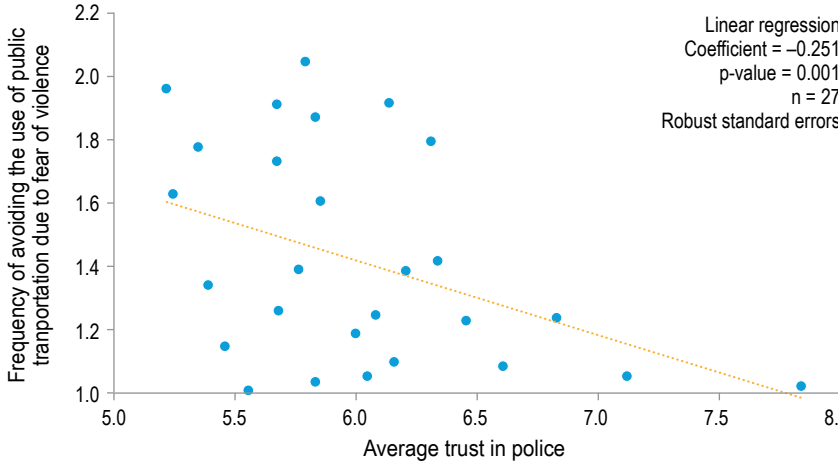

*Source*: Authors' elaboration based on data from the 2020 Latinobarometer.
*Note*: Figures show the proportion of people according to where they prefer to allocate more resources: i. police (more money for police), ii. private security (more money for people to fight crime on their own), iii. keeping the resource distribution as is (in the figures, this is the residual category). For each country, respondents were divided into two groups based on the reported level of trust in government.

projects reduce traffic congestion only to the extent that people who rely on driving to commute and travel decide to switch to public transportation once this option becomes available (Anderson, 2014; Yañez-Pagans et al., 2019).

When interpersonal trust is low, potential users of public transportation may fear that other users may take advantage of sharing crowded spaces to steal from or harass fellow riders. When trust in government is low, users are less likely to believe that the government will provide protection, prevent aggression, and punish offenders. Figure 5.4 illustrates the relationship between trust in government and the use of public transportation using data from 27 municipalities in the state of Minas Gerais,

**Figure 5.4 ▶ Trust in Institutions and Avoidance of Public Transportation for Fear of Violence (Minas Gerais, Brazil)**

**A. Average trust in police**




**B. Average trust in courts**

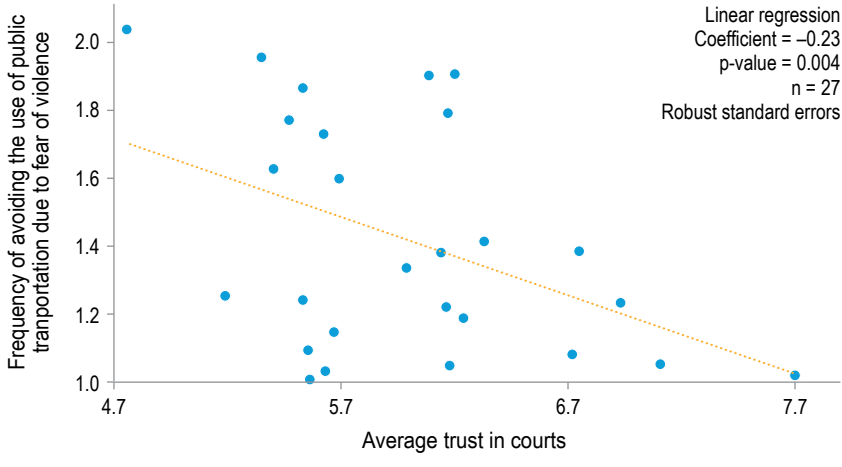



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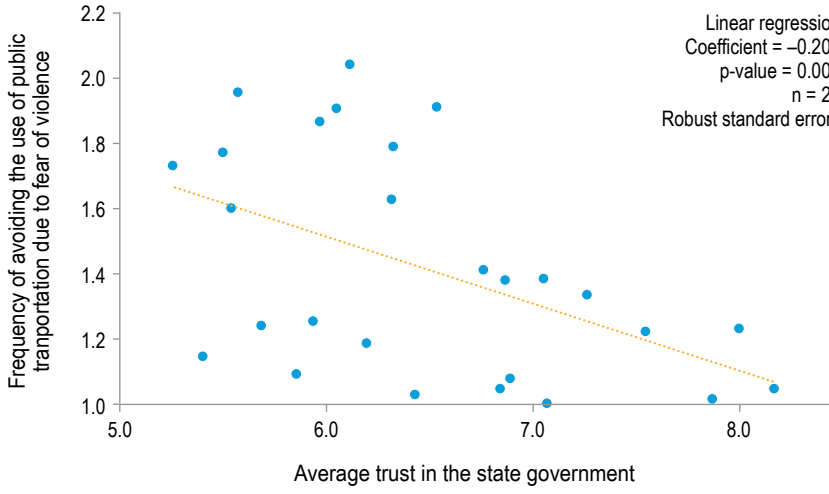
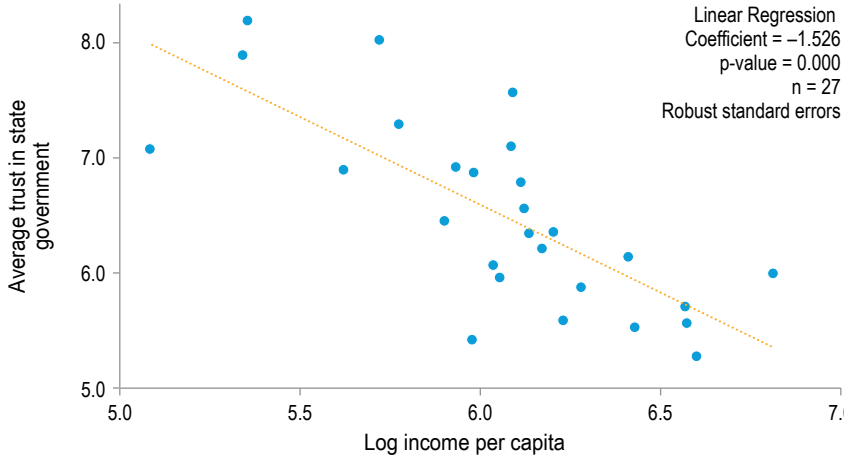
**Figure 5.4 ▶ Trust in Institutions and Avoidance of Public Transportation for Fear of Violence (Minas Gerais, Brazil)** *(continued)*

**C. Average trust in the state government**




**D. Log income per capita**




*Source*: Authors' calculations using data from the 2009 Fear Perception Survey for Minas Gerais by Centro de Estudos de Criminalidade e Segurança Pública (CRISP).
*Note*: All variables are municipal-level averages. The variables related to trust are based on the question, "what is your degree of trust in...?", asked separately for the police, the judiciary, and the state government, respectively. Respondents answer on a scale from zero ("Do not trust in the least") to ten ("Trust a lot"). The variable "Frequency with which you avoid using public transportation for fear of violence" has a minimum value of one ("never") and a maximum of five ("always"). The vertical axis of the first three figures shows the frequency with which survey respondents in each municipality declare that they avoid using public transportation for fear of violence (measured from never [1] to always [5]). The horizontal axis indicates the degree of trust in different public institutions related to public security: the police, courts, and the state government. Municipalities Benito de Minas and Rio Paranaiba are excluded as two data outliers. The average per capita household income is calculated with microdata from the 2010 population census.

Brazil.[7] Municipalities in which people are more reluctant to use public transportation due to safety concerns are municipalities in which trust in these institutions is also lower. Figure 5.4 captures perceptions of insecurity on public transportation. Low-trust individuals are less confident in the ability of institutions to control insecurity; their perception of insecurity is correspondingly higher and they are, as a consequence, less likely to use public transportation.

The goal of using public transportation projects to improve economic opportunities for disadvantaged populations is also more difficult to achieve in low-trust environments. In many Latin American and Caribbean cities, where low-income households disproportionately reside in the periphery (Brueckner, Mation, and Nadalin, 2019), public transportation can play a redistributive role, since most tariff schemes—including flat fares for all users—effectively subsidize long trips (Börjesson, Eliasson, and Rubensson, 2020). But even when overall demand for service among low-income families exceeds supply, fear of harassment and other forms of violence discourages women and members of ethnic minorities and other vulnerable groups from using it (Hsu, 2011; Simićević, Milosavljević, and Djoric, 2016). The costs of this phenomenon can extend well beyond the immediate financial losses. One study in India, for example, shows that female college students may choose to go to a less academically prestigious university close to home in order to avoid commutes that would expose them to sexual harassment. This translates into an estimated 17 percent decline in post-college wages (Borker, 2020).

The interaction of trust, performance, and imperfect information about performance may raise the potential for unintended consequences from innovative and appealing interventions. For example, Mexico City implemented the "Viajemos Seguras" program, which among other things reserved subway cars exclusively for women to improve the perception of security in public transportation. The program did, in fact, reduce sexual harassment towards women by 2.9 percentage points. However, removing women from the other cars on the train appears to have reduced the restraints on opportunistic behavior among men: non-sexual aggression among men increased by 15.3 percentage points (Aguilar, Gutiérrez, and Villagrán, 2021).

## Trust in Education: A Test for Governments, Teachers, and Parents Alike

Human capital accumulation plays a central role in economic growth. Equitable and inclusive quality education is also a Sustainable Development

[7] In Brazil, public security—including courts and police—are centered primarily at the state level (Cano, 2006).

Goal. Since governments fund and regulate most primary and secondary schooling, their actions and policies have a major influence on the results of the educational system. Those results, however, as in many other sectors, are the product of actions of many other actors: local and central governments, unions, principals, teachers, parents, and students (Cerna, 2014). A successful new curriculum requires action from three parties: government, to incorporate into its design the most rigorous understanding of student learning; teachers, to implement it as expected by authorities; and parents, to collaborate with the school and teachers by sending their children to class and making sure they keep up with the material. Teachers and parents must trust government design of the curriculum; government and parents rely on teachers to implement it; and government and teachers count on parental collaboration. Moreover, no single teacher is responsible for the entire curriculum. Teachers rely on each other since learning in one classroom depends on learning in others. Finally, in the event that either teachers or government fail in the education task, parents must rely on each other to act collectively to change the curriculum or other parts of the system; no single parent can improve the learning environment if other parents do not follow suit.

Trust is difficult to achieve in the educational arena. First, participants in the education sector confront divergent objectives. All want children to learn, but governments may place a lower value on education relative to other social sectors compared to parents and teachers. Teachers may favor allocating more of education budgets to salaries than governments and parents believe is necessary for quality student learning. And parents may want their child to receive more attention than others. In the face of divergent interests, opportunistic behavior is more likely.

Second, actors have different degrees of power over each other, reducing the costs of opportunistic behavior for some relative to others. Governments may have authority over teachers by virtue of being their employer; teachers may have leverage over parents, through their control of children's grades and daily lives at school. Teachers may also have some power over others if they can routinely threaten work stoppages at no cost. Those who have less recourse against opportunistic behavior are, therefore, more fearful of it—and ultimately less trusting.

Finally, education is also rife with information asymmetries that undermine trust. Ideally, parents could precisely monitor teachers' contribution to their children's education. In fact, in some circumstances parents can observe behavior that has deleterious effects on learning. For example, they can observe high levels of teacher absenteeism or a conflictive school climate. However, neither parents nor government can easily monitor teacher

effort in the classroom, the most important educational input into student learning. Nor can they easily measure either learning outcomes or how much teachers contribute to them. Parents and teachers are not well equipped to judge whether schools are under- or over-funded relative to other sectors. Since teachers can better assess students' needs and performance, parents depend upon them for guidance and advice. These information asymmetries make it easier for actors to shirk their responsibilities towards others. Teachers, for example, can invest little effort in preparing their classes with little risk of detection by parents and governments.

Both interpersonal and institutional trust are, therefore, central to the education enterprise. Coordination among education actors is one area where the importance of trust is evident. Leaders typically assume the coordination role, where trust is essential. An untrustworthy leader resembles a manager who enforces minimum compliance with contract specifications but is unable to lead her staff to higher levels of professionalism and performance (Tschannen-Moran, 2017). This logic applies to all levels within the education hierarchy, including between principals and local educational public agencies. Low interpersonal trust also limits parental coordination: the likelihood that parents will act together to improve the educational experience (as described in Chapter 4).

The effectiveness of the education sector depends on its budget, but limited trust in government reduces citizen support for paying taxes to fund public education, just as it reduces support for police funding. The greater citizens' trust in government, the more likely they are to agree to pay taxes to finance public education. Using data on 34 countries (28 post-transition countries, France, Germany, Great Britain, Italy, Sweden, and Turkey), Gur, Israfil, and Yunus (2015) show that citizens who declare greater trust in government are also willing to give up some of their income or pay higher taxes to improve public education. Keefer, Scartascini, and Vlaicu (2019) found similar results in the region. Based on the 2017 IDB-LAPOP survey conducted in seven Latin American countries, the authors find that people who believe politicians keep their promises are significantly more likely to prefer raising taxes to finance public education over using these resources for private education. Additionally, individuals with lower trust levels prefer government to prioritize direct cash transfers to citizens instead of public education investments (Keefer, Scartascini, and Vlaicu, 2020b). Parents are willing to invest more when the benefits of those investments are higher (Berlinski and Busso, 2016). Mistrust discourages those investments.

The existing literature also points to the importance of interpersonal trust within schools to schools' effectiveness, improvement initiatives,

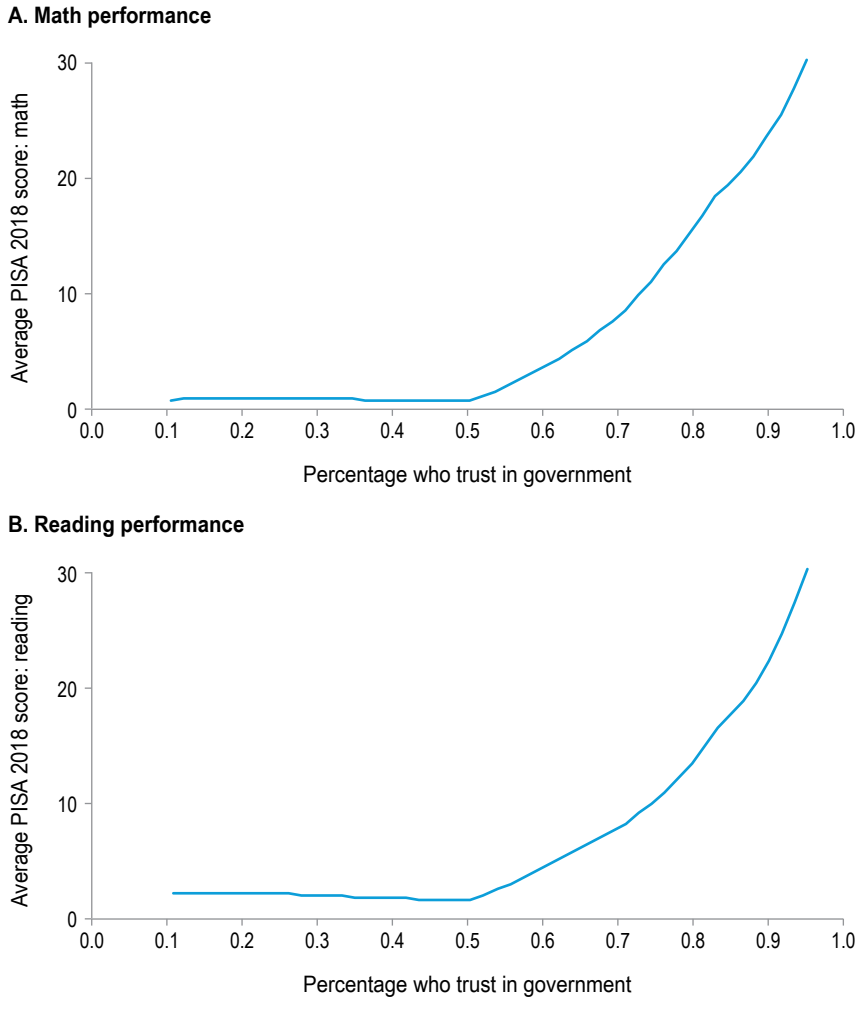
and persistence in reform efforts. Indeed, in the United States, a 25 percentage-point increase in interpersonal trust within schools increases the average years of schooling by approximately 1.5 months (Dincer, 2011). Moreover, trust among parents, teachers, and principals is positively correlated with teachers' beliefs about the collective capability of faculty to influence student learning (Forsyth, Barnes, and Adams, 2006). In addition, in high-trust schools, teachers are more likely to perceive that the structures and school bureaucracy enable rather than hinder their work. Finally, parental trust in the principal and school goes hand in hand with good academic performance.

In a four-year longitudinal study of 400 Chicago elementary schools, higher levels of interpersonal trust between diverse agents in the school ecosystem correlated with successful and sustained school reforms. Higher levels of trust reduced the sense of risk associated with change and, therefore, fostered collective decision-making, greater willingness to resolve conflicts, and broad diffusion of reform initiatives across the school (Bryk and Schneider, 2003). Elementary schools with high levels of interpersonal trust among agents demonstrate greater improvements in student learning.

A broad picture of the relationship between trust in government and student achievement emerges from a comparison of country-level measures of trust in government with student achievement, as measured by countries' average scores in the 2018 round of PISA, the OECD's Programme for International Student Assessment. Relying on data from a cross-country sample of 70 countries around the globe, Figure 5.5 shows that trust is positively and highly correlated with students' math and reading performance. However, this relationship holds only for high levels of trust, when more than 50 percent of citizens say they trust government. At low levels of trust in the government, the relationship flattens out.

Recent experimental evidence from Mexico goes a step further and supports the argument that greater trust is not merely associated with, but causes an increase in education effectiveness. Barrera-Osorio et al. (2020) evaluate a program that advised parents on how to support their children's learning. In five informative sessions led by principals, parents were informed about what teachers were teaching in school, how well they were doing it, and how the learning objectives aligned with their children's development. The intervention improved parental involvement and homework support, which further translated into lower school dropout rates and disciplinary action. The success of the intervention can be traced not only to the information parents received, but also to greater parental trust in teachers. At the end of the intervention, parents in treatment

**Figure 5.5 ▶ The Link between Student Performance and Trust in Government**




*Source*: Authors' calculations based on PISA 2018, World Values Survey (WVS) round 2017–2020, and World Development Indicators database.
*Note*: Estimates were obtained from a kernel-weighted local polynomial smooth in the sample of countries included both in the PISA 2018 and WVS (N=70). The polynomial is estimated with the residuals of a regression of students' performance on GDP per capita in 2017 (PPP, constant 2017 international dollars) and regional fixed effects.

schools were 14.8 percentage points more likely to believe that most teachers can be trusted, compared to a baseline level of 81.2 percent.

Many efforts to improve student learning aim to increase the accountability of different actors for their performance. Trust plays a large role in the success of these initiatives since those being held accountable are less

likely to change their behavior if they believe accountability standards are applied in an arbitrary, untrustworthy manner. Several school reforms in the region have introduced standards to evaluate teachers' performance, especially effectiveness. Evidence from a top-down reform in Wales is cautionary: teachers trusted neither the metrics used to assess performance nor the people administering them (OECD, 2014). Similarly, Dworkin and Tobe (2014) find that standards-based school accountability in the United States has altered teachers' expectations about their job security, increased teacher burnout, and reduced the level of trust teachers have in other school staff. The impact on trust is crucial because all accountability metrics are imperfect and still leave significant room for discretion; lower-trust teachers may exercise that discretion by exerting less effort in the classroom. Finding the right balance in monitoring is, therefore, challenging and requires taking into account how widely accepted teacher evaluations are, and baseline levels of interpersonal and institutional trust in each setting.

Low levels of trust, especially when paired with strict monitoring and accountability mechanisms, can deter innovation in schools. Without trust, teachers try to protect their interests by forming teacher unions or demanding lengthy and complicated contracts that can protect them against the betrayal of other school staff or higher-level authorities (Tschannen-Moran, 2017). Without trust and complicated monitoring mechanisms, agents are willing to risk less and, consequently, innovate less. Teachers who do not trust the system to fairly evaluate their performance and their efforts to help students learn, will aim to excel in the outcome targeted by the monitoring mechanism and have little incentive to go the extra mile, help lower-performing students, or foster critical thinking among students. These results from public sector education echo the results in Chapter 3 regarding the private sector. Firms with less trusting managers are more likely to rely on long and complicated contracts and engage in less innovative activity. Moreover, they exactly mirror the discussion surrounding public safety: police organizations monitored on the basis of arrests will dedicate less effort to prevention even when prevention has a larger impact on public safety.

## Injecting Trust into Health Care

Good health is crucial to people's well-being and quality of life as well as being a key input to economic productivity. For several reasons, medical services and public health recommendations are particularly reliant on trust in institutions and interpersonal trust; when trust is low, these services are likely to be significantly less effective.

Optimal health outcomes can only be achieved when patients trust that providers will not act opportunistically (Gilson, 2003). However, mistrust is rampant in the sector. Patients often cannot judge the efficacy of treatments even after they have received them (that is, health care consists of *credence* goods). Patients are significantly less informed than providers and rely on them to correctly diagnose and treat them (Arrow, 1963). Moreover, health-care providers have an incentive to exploit information asymmetries at patient expense: they often receive payment for services, which could lead them to prescribe unnecessary tests and procedures. In other contexts, kickbacks from pharmaceutical companies may encourage physicians to overprescribe medications. Because medical treatments are credence goods and patients are at an information disadvantage, distrustful patients are less likely to follow the prescribed treatment plan, or even to seek assistance; at the same time, health-care practitioners are less likely to provide quality care to patients who mistrust them. Similarly, public health strategies may ask people to take actions that have spillover effects on others, such as vaccination to combat the spread of COVID-19 and other diseases. Mistrustful individuals are reluctant to make personal sacrifices on behalf of others who may not reciprocate their responsible behavior.

The COVID-19 pandemic has highlighted the role that citizenship and trust in government play in the effectiveness of public health policies. Compliance with non-pharmaceutical interventions to prevent the spread of the virus, such as handwashing, mobility restrictions, mask wearing, and social distancing, involve externalities. These measures protect individuals from becoming infected with COVID-19, but also protect the community by reducing the chances of an infected individual spreading COVID-19 to others. Individuals bear the full cost of their compliance but do not reap the full benefits of it. The disparity is greatest for low-risk individuals, who are no less contagious when they get the disease, but suffer less from it and, therefore, incur fewer private benefits from taking precautions.

Interpersonal trust and civic capital also play an important role in garnering the cooperation needed for widespread community compliance, especially in private spaces where authorities find it difficult to monitor and enforce regulations. Both before and after a mandatory lockdown to slow the spread of COVID-19 in Italy, mobility decreased more in areas with higher civic capital (Durante, Guiso, and Gulino, 2020). If all Italian provinces had levels of civic capital equal to those in the top quartile, COVID-19 deaths would have been an estimated ten times lower. Survey data collected by Martínez, Parilli, Scartascini et al. (2021) provide further evidence that people's willingness to socially distance depends on their

beliefs about what others will do. Those who expect other people to attend a party and/or approve of attending a party are 25 percent more likely to attend than people who do not expect others to attend or do not approve of attending. If mistrust is high, people believe that others will act opportunistically, and social distancing declines.

The importance of trust rises when citizens cannot easily confirm the effectiveness of recommended policies or treatments. In the case of COVID-19, citizens lacked precise information about the effectiveness of the nonpharmaceutical interventions mandated by governments, like masks. Moreover, as the pandemic progressed, new recommendations were emitted, which sometimes contradicted earlier recommendations. Low-trust citizens, viewing these changes in recommendations, might regard government mandates as unfounded and arbitrary. High-trust citizens, in contrast, might believe that at every stage, governments are delivering the best information available and recognize that information is evolving.

Evidence from the IDB-Cornell Coronavirus Survey shows that compliance with nonpharmaceutical interventions varies widely across countries in the region and that compliance is correlated with trust. Some 23,905 respondents completed the second round of the online household survey in 11 countries in Latin America between December 2020 and January 2021. The survey asked respondents to indicate their level of trust in the government's ability to manage the health crisis. It also asked them to self-report whether they always used a mask outdoors and avoided visiting friends and family during the week prior to completing the survey. Comparing mask compliance and avoidance of social gatherings across trust levels within a country, compliance is higher among residents who trust the government's ability to handle the crisis than among residents who do not. Specifically, trust in the government's ability to resolve the health crisis is associated with a 3.5 percentage point increase in wearing a mask outdoors and an 8.3 percentage point increase in avoiding social gatherings.

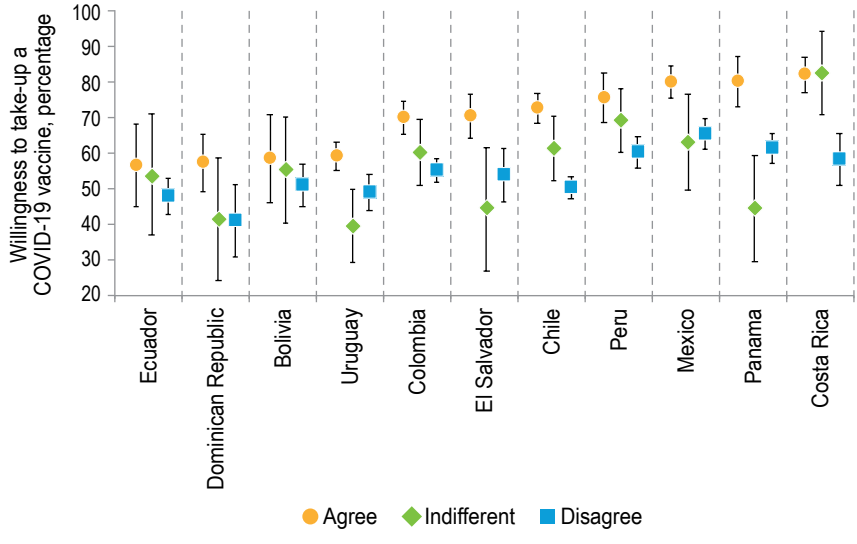
The decision to seek a COVID-19 vaccination further illustrates the role of trust in government. Once again, the decision to vaccinate requires individuals to rely on the judgments of better-informed experts in an environment in which those judgments are in flux. They must trust that medical and scientific experts are providing the government with reliable advice, and that governments prioritize citizens' well-being by only approving a vaccine that is safe and effective.

Using data from the same survey, trust in the government's ability to resolve the health crisis is associated with a 15.7 percentage point increase in the willingness to receive a COVID-19 vaccine in the next three months. Some experts estimate that herd immunity could be achieved when

approximately 70 percent of the population has either been vaccinated or been exposed to the virus (D'Souza and Dowdy, 2021). The 16-percentage-point difference that trust makes in take-up represents over 20 percent of the distance to herd immunity. For each country, Figure 5.6 shows the willingness to be vaccinated against COVID-19 is higher among those who trust in the government's ability to resolve the health crisis. This gap is significant in most countries.

Additional evidence corroborates the importance—and fragility—of trust in the success of vaccination programs. Using a child's ancestors' exposure to the slave trade to isolate exogeneous variation in trust in medicine, Athias and Macina (2020) find that low levels of trust in medicine lead to low child vaccination rates against measles. Moreover, the effect of trust in medicine is larger than the effect of standard determinants of vaccination, such as parental education (Athias and Macina, 2020). In Colombia, the Ministry of Health offered HPV vaccination free of charge

**Figure 5.6 ▶ Correlation between Willingness to Vaccinate Against COVID-19 and Trust in the Government to Resolve the Health Crisis**




*Source*: Authors' elaboration based on the second round of the IDB-Cornell Coronavirus Survey.
*Note*: The vertical axis shows the percentage of respondents selecting either "yes, as soon as possible" or "yes, after 1–3 months" to the survey question, "If the government approved a vaccine against COVID-19 in the next month, would you take it?" The other response options are "yes, after 6–12 months," "yes, after 12 months," and "no." The survey also asked respondents whether they agreed with the following statement: I trust the government's ability to manage the health crisis: "total agreement" and "agreement" are coded as trust; "disagreement" and "total disagreement" are coded as mistrust; and "indifferent" is coded as its own category.

to Colombian girls between the ages of 9 and 13 to prevent cervical cancer and achieved a 95 percent vaccination rate among this cohort within the first two years (Castro, 2018). Unfortunately, after a small group of girls in one school became ill months after receiving the HPV vaccine, some media outlets, several lawyers, and a few local politicians blamed the vaccine, sowing distrust among the public (Castro, 2018). Vaccination rates fell to 14 percent in the target population (Castro, 2018). The analysis in this chapter and book suggest that the decline would have been smaller if trust in government had been higher. It also points to how relevant information is, as discussed at length in Chapter 9.

## The Nature of Trust in Environmental Policy

Recognizing the role that environmental quality plays in health, well-being, and economic productivity, societies have sought to use public policy to improve local and global environmental outcomes. Trust in government and interpersonal trust also play a key role in the effectiveness of environmental public policies.

Trust in government is particularly important for environmental public policies. They often require individuals to incur short-term costs that yield incremental benefits over the long-term. People must believe not only that the policies will, indeed, have those effects if implemented, but also that governments will continuously implement the policies into the future so that the benefits are eventually realized. As with health policies, information asymmetries play a large role: individuals know much less about the efficacy of environmental policies than do experts. They must trust experts to provide good advice to governments, which must then incorporate that advice into public policies that enhance their welfare.

Policies to mitigate climate change exhibit the most extreme intertemporal imbalance of costs and benefits. Societies bear the costs of emissions reductions in the present to limit climate change in the future. Citizens must trust that experts are correct regarding the effects of current reductions on future climate, and that governments will sustain the long-term strategies and commitments required to achieve climate change mitigation. Consistent with the importance of trust to sustain climate change mitigation policies, Fairbrother, Johansson Sevä, and Kulin (2019) find that across 23 countries in Europe, support for taxes on fossil fuels is *not* stronger among countries with greater climate change awareness or concern. Instead, it is most pronounced among those with greater political trust.

As in many other policy areas, those who incur the costs of environmental policy reforms are not necessarily the ones who reap its benefits. To facilitate the implementation of these reforms, governments can offer to compensate the losers; however, such offers of compensation are not highly valued by those who mistrust government. They worry that government will simply not make the agreed-upon compensation, and if it does, the compensation may be insufficient to cover their losses. Citizens cannot easily infer how the costs and benefits of environmental policies are distributed across subgroups of the population. Hence, they have no way of verifying that government compensation is consistent with government promises to target losers.

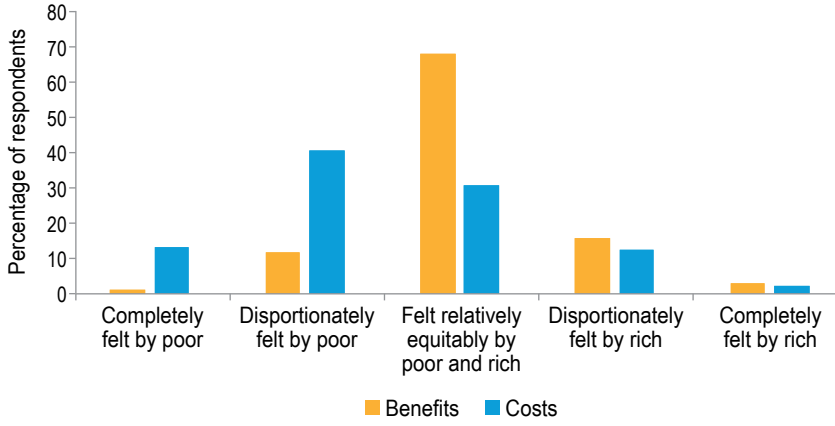
This is not a theoretical concern; evidence demonstrates that citizens are acutely aware of the mismatch between costs and benefits. A recent survey of approximately 650 university students in Bogota, Colombia, asked them whether the rich or the poor disproportionately bear the cost and reap the benefits of environmental improvements and regulation. The median respondent reported that the rich and the poor benefit relatively equally from environmental improvements but the poor bear disproportionately more of the costs of environmental regulation (see Figure 5.7).

Citizens' limited information about the true distribution of the costs and benefits of environmental and climate mitigation policies reflects their lack of information about the government's efforts and effectiveness. Again, lack of information accentuates mistrust: citizens are reluctant to support policies when they feel they cannot verify what government is doing or how well it is doing it. This channel becomes particularly important when the effectiveness of government action is difficult to measure in outcomes. The outcomes of environmental public policies are at least partially determined by events beyond the governments' control. Therefore, citizens' vision of the government's efforts and effectiveness is blurred at best.

The case of local regulations to improve air quality illustrates the information and trust challenge. Citizens have difficulty determining the effectiveness of local regulations based on perceived air quality levels. Local air pollution on any given day is partly determined by emissions but is also driven by weather and thermal inversions. Individuals cannot estimate the relative contributions of each. Distrustful citizens would, therefore, be expected to be less supportive of strict air pollution regulations.

In fact, a household survey in Mexico City provides evidence of the relationship between trust and citizens' support for policies to improve air quality. Nearly 2,000 households participated in an in-person survey

**Figure 5.7 ▶ Perceived Distribution of Costs and Benefits of Environmental Regulation: Rich versus Poor**




*Source*: Authors' calculation based on Blackman and Hoffmann (2021).
*Note*: Figure shows the percentage of respondents selecting each option for two survey questions designed to capture the distribution of the costs and benefits of environmental regulation across the rich and the poor. The two survey questions are "According to the following scale from level 1 to level 5, do you think improvements in environmental quality in Colombia primarily benefit the poor or the rich?" and "According to the following scale from level 1 to level 5, what do you think is the cost of stricter environmental policy on the poor relative to the rich?" The five possible responses are represented by the five categories in the figure.

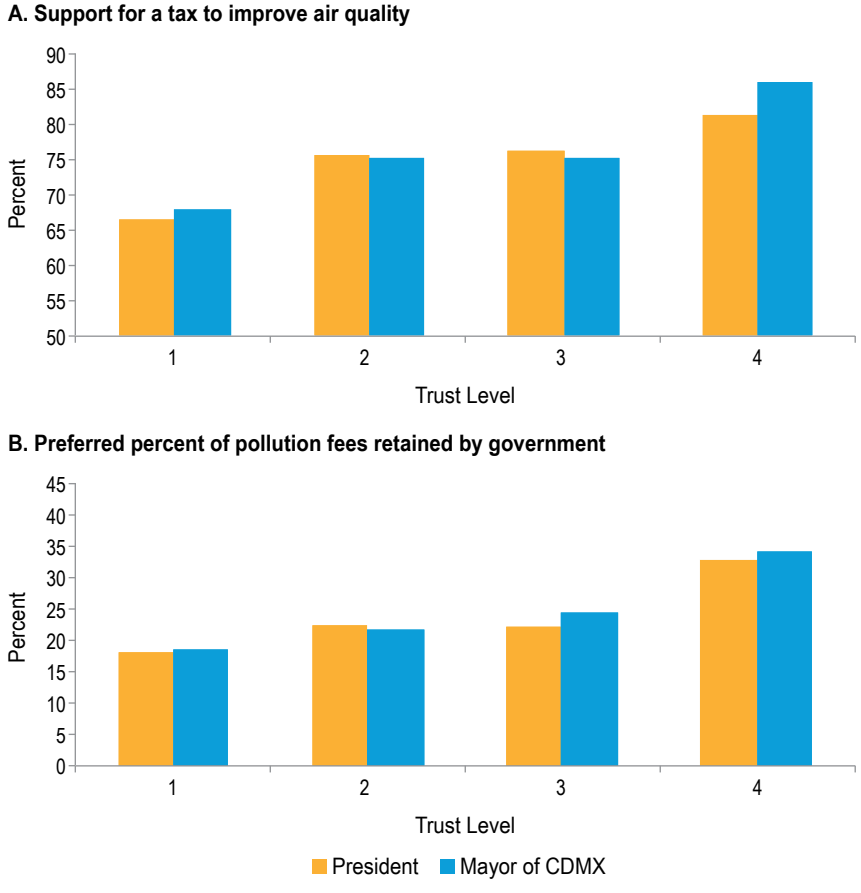
conducted during June-August 2019. Respondents reported their trust in both the president and the mayor using a 4-point trust scale. In addition, respondents were asked whether they would support an additional tax of $100 MXN (approximately one day's minimum wage) per year if the government committed to a plan to improve air quality sufficiently to avoid air pollution contingencies.[8] Higher trust respondents would be expected to be more likely to believe that the government would use the funds effectively to reduce air pollution, despite their inability to observe either the government's effort or its effect on air pollution.

In fact, respondents' trust in the president and mayor is correlated with support for the additional tax to improve air quality (see Figure 5.8A). In

[8] An air pollution contingency in Mexico City is declared by the authorities when, based on the air pollution monitoring system, any pollutant concentration level exceeds the standard levels and represents a risk to the health of the population. During periods of environmental contingency, vehicle circulation is limited, sports, civic, recreational, or other outdoor activities in schools are suspended, and urban maintenance works are interrupted. For further information see: http://www.aire.cdmx.gob.mx/default.php?opc=%27YqBhnmU=%27.

particular, 86 percent of people who reported "a lot of trust" in the mayor support the additional tax, compared to only 68 percent of respondents who report "no trust" in the mayor.

**Figure 5.8 ▶ Trust and Citizen Support for Environmental Policy in Mexico City**




*Source*: Authors' calculation based on Cafferata, Hoffmann, and Scartascini (2021).
*Note*: Trust level 1 corresponds to "no trust," trust level 2 corresponds to "little trust," trust level 3 corresponds to "some trust," and trust level 4 corresponds to "a lot of trust." Panel A shows the percentage of respondents who respond "yes" to the survey question, "If the government were to commit to a plan that would reduce air pollution enough to avoid all contingencies, would you be willing to pay $100 MXN per year in taxes?" by self-reported trust level. Panel B shows the percentage of revenue from a tax on polluting firms that respondents preferred the government to retain based on the survey question, "If there were the possibility that firms pay a tax for polluting, who do you think should receive that money?" The percent shown in Panel B is the sum of the share of the revenue allocated to "the government of the city where the [polluting and taxed] factory is located" and "the national government" by trust level. The other options to which respondents could allocate a share of the tax revenue were "the residents that live near the factory and are impacted by the pollution" and "all the residents of the city where the factory is located."

The same survey asks respondents what share of the proceeds from penalties paid by polluting firms the government should keep and what share should be distributed directly to citizens. More trusting respondents are willing to allow the government to retain a larger share of the proceeds (see Figure 5.8B). In particular, respondents who have "a lot of trust" in the mayor prefer that governments retain 35 percent of the revenue, compared to 19 percent among respondents with "no trust" in the mayor.

The other key challenge of environmental policy is that its success relies on collective action by citizens, and countries. For example, policies to mitigate climate change often involve local or national emissions restrictions. These impose costs on local citizens and industry, but the benefits of limiting climate change are shared globally regardless of where the emissions reductions occur. Individuals, and countries, understand perfectly well that if they ignore emissions restrictions, the impact on climate and even local air pollution is imperceptible; if all ignore the regulations, however, pollution remains high and climate trends unchanged. Trust is crucial to decrease free riding and increase cooperation. Individuals have no reason to incur costs in pursuit of a better environment if they believe others will not. Trust in governments is also important: neither governments nor individuals have incentives to take action if they do not trust others to do the same. The Paris Agreement recognizes the important role trust plays in achieving global goals and specifically seeks to build trust between parties (UNFCCC, 2015).

Collective action dilemmas are pervasive in environmental policy, as is the need for interpersonal trust and citizenship. For example, regulations to keep streets clear of trash and litter can only provide a clean downtown when most citizens follow the regulations every day. However, while all individuals are better off if everyone refrains from littering, for each person the calculus is different: she enjoys a fraction of the benefits of a clean downtown, but all the benefits of littering. As Chapter 8 emphasizes, interpersonal trust is key to solving this collective action dilemma. If individuals do not trust their fellow citizens to comply with environmental regulations, they themselves have no reason to comply; if they do not trust their fellow citizens to behave civically, they themselves are less likely to behave civically. It is not strange then to see completely clean streets in cities where nobody seems to be cleaning them, and very filthy streets in other cities where cleanup crews can be seen at work.

Macias and Williams (2016) provide indirect evidence of the role of interpersonal trust and civic capital. Based on surveys, people who spend time with neighbors are more willing to sacrifice for the environment and

if they spend evenings with friends, they are more likely to have attended an environmental demonstration. Thus, the discovery that others are committed to environmental goals increases trust among citizens and their willingness to contribute to environmental public goods.

Civic capital is also key to the efficient management of common pool natural resources such as forests, fresh water sources, and fishing grounds. Common pool natural resources are subject to the tragedy of the commons: each individual acting in her own interest and ignoring the social costs of her actions will overuse the resource, depleting it for the entire community. High levels of civic capital can offset this tendency. In the same vein, cross-country regressions provide evidence that social capital is negatively correlated with deforestation (Meyer, Van Kooten, and Wang, 2003; Murtazashvili, Murtazashvili, and Salahodjaev, 2019).

Interpersonal trust and civic capital also play a direct role in boosting the efficacy of environmental policies, such as disaster risk management policies. Community-based disaster management has emerged as an effective method to reduce vulnerability and improve resilience to disasters at the community level. Community-based disaster management uses a bottom-up approach to disaster planning by empowering local governments and communities (M. Ali et al., 2019; Lorna, 2003; Liu et al., 2016; Pandey and Okazaki, 2012). Communities have extensive knowledge of local hazardous conditions, vulnerabilities, and capabilities, and compared to centralized authorities, they can leverage their close ties with residents to quickly organize self-help and rescue operations in the hours after disasters strike (Peng et al., 2020).

Community-based disaster management has been shown to reduce the negative impacts of disasters and improve disaster preparedness, response, and recovery (Peng et al., 2020; M. Ali et al., 2019; Lorna, 2003; Shaw and Okazaki, 2004). These community efforts are very effective; by one estimate 85 percent of survivors are rescued by community members, specifically friends, relatives, or neighbors (Shaw and Okazaki, 2004). Community participation and resident engagement are key to the success of community-based disaster management (Gero, Méheux, and Dominey-Howes, 2011; Shaw, 2012; Jahangiri, Izadkhah, and Tabibi, 2011).

As climate change increases the frequency and severity of many types of natural disasters over the next several decades, countries will need to improve their disaster risk management (IPCC, 2018). However, individuals are reluctant to participate in community-based disaster management if they do not trust others to contribute as well. Paton (2007) and Peng et al. (2020) show that interpersonal trust goes hand in hand with participation in community-based disaster management, demonstrating

that interpersonal and other types of trust (Paton, 2007) play an important role in the effectiveness of these programs (Peng et al., 2020).

## Banking on Trust for Effective Financial Inclusion

Financial inclusion is an enabler of long-term, inclusive, sustainable economic growth. Indeed, it is a required intermediate goal to achieve eight of the seventeen 2030 Sustainable Development Goals (SDGs) including eradicating poverty and ending hunger. However, access to quality financial services is still far from universal in Latin America and the Caribbean. Only 47 percent of citizens own an account in a formal financial institution, a fraction that exceeds only the rates in Sub-Saharan Africa—where this share is only a third—and is far from the 92 percent of account owners registered in high-income countries (Demirgüç-Kunt et al., 2018).

Several governments in the region have tried to increase access to financial services to underserved households by linking payments of social-assistance programs to individual bank accounts or by providing basic universal accounts at minimum or no cost. However, take-up rates of formal financial services remain low, especially among the most underprivileged populations. While most people in the region who do not own an account point to the excessive cost of financial services or lack of sufficient income as a reason not to open an account, almost a third of the citizens mention lack of trust in financial institutions (Demirgüç-Kunt et al., 2018).

Financial markets are particularly vulnerable to mistrust because opportunistic behavior is particularly lucrative (e.g., defaulting on loans, absconding with savings). The lure of opportunistic behavior is complemented by the extent of asymmetric information between customers and financial institutions. This information gap can be quite large, particularly with low levels of financial literacy. Transacting parties also face the risks of future uncertainty—about which some are more informed than others—on top of the potential for agents and the government to renege on their commitments.[9] As discussed in Chapter 7, institutions can mitigate these tensions and offset low trust. However, in the presence of weak rule of law, incomplete contracts, weak consumer protection institutions, and obsolete regulations, mistrust is an imposing obstacle to financial inclusion.

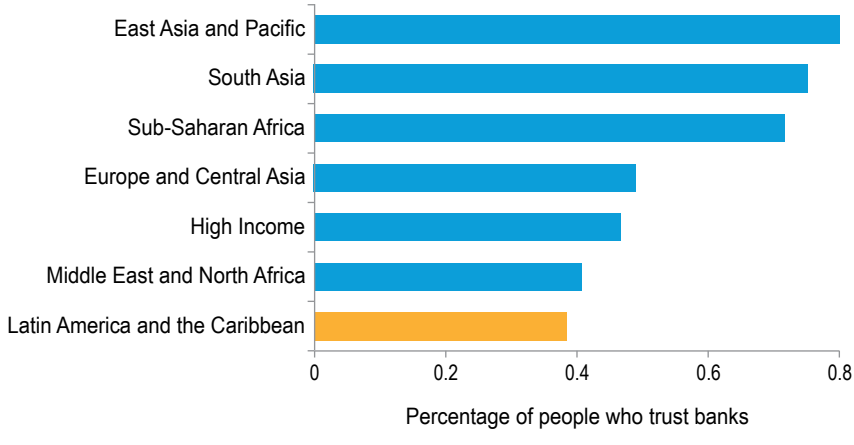
[9] For instance, as many developed economies have introduced bank bail-in, which are regimes that recapitalize banks via forced conversion of deposits into shares of the bank, the risks for depositors increase (Avgouleas and Goodhart, 2015).

Less than 40 percent of citizens trust banks in Latin America and the Caribbean, fewer than in any other region (see Figure 5.9). In fact, in most countries of the region covered in the 2017–2020 round of the World Values Survey, barely a third of the population trust banks, with Colombia and Argentina even under a third. Only Bolivia, Brazil, and Ecuador record levels fluctuating between 48 percent and 55 percent.

A long history of financial and banking crises and government confiscatory practices targeting private deposits both contribute to the erosion of trust in the financial system in Latin America and the Caribbean. For example, Argentina's decision to freeze savers' deposits in dollars to prevent capital flight in 2001 inflicted sharp losses on savers, led to panic behavior in financial markets, and had catastrophic consequences for the economy and financial market (Bortot, 2003; Melvin, 2003). Systemic uncertainty, political instability, and unexpected regulatory changes all exacerbate mistrust in the market, suppressing individuals' willingness to use formal financial systems.

Governments constantly face enormous challenges to handle transparency, stability, and credibility in financial markets, while simultaneously dealing with economic shocks. During crisis, the trade-off between coping with shocks and fostering trust in financial markets intensifies. For instance, the COVID-19-induced economic crisis in the region is leaving several countries overindebted. Governments can try to reduce their primary deficit by cutting down on expenditures (thus, potentially eroding trust in the government in other markets), printing money and thus increasing prices

**Figure 5.9 ▶ Percentage of People Who Trust Banks, by Region**




*Source*: Authors' own estimates and World Values Survey round 2017–2020.

(failing to comply with its commitments on inflation rates), or defaulting and eroding trust among domestic and external investors.

After the financial crisis in 2008, trust in banks plummeted in the United States, which may have been one of the drivers of the recession that followed (Sapienza and Zingales, 2012). Enduring a loss due to a banking crisis seems to lead to greater expectations of a new crisis, even several years after the loss experience (Mudd, Pashev, and Valev, 2010). A recent study combines the latest wave of the World Values Survey with data on banking crises to study the effect of having lived through a banking crisis on an individual's trust in banks in a sample of 52 countries (Fungáčová, Kerola, and Weill, 2019). The authors show that banking crises erode the individual's trust in banks: experiencing a banking crisis reduces the probability of trusting banks by 5.2 percentage points. Interestingly, they show that *all* banking crises, severe or mild, undermine citizens' trust levels in banks.

This book associates the presence of coercive authority with low levels of trust: if it is not possible to impose sanctions on opportunistic behavior, such behavior is more likely, and trust is lower. Banks do not have coercive power, but they do have market power; competition imposes fewer limits on clients victimized by opportunistic behavior in one bank to flee to another. Banking systems tend to be highly concentrated, particularly in developing countries. While the asset share of the five largest banks in developed countries was around 72 percent during the 2000–2010 period, this concentration ratio was as high as 95 percent in developing countries (World Bank, 2013). This higher concentration in the banking sector is usually linked to greater market power. Under poor anti-trust and consumer protection regulation, financial institutions may engage in discriminatory and abusive practices that discourage the use of formal financial services, thereby limiting the effectiveness of financial inclusion strategies promoted by the government and civil society.

The other key factor that exacerbates mistrust is information asymmetries, which plays a key role in the case of the financial sector. The 2018 PISA assessment of financial literacy included three Latin American countries (Brazil, Chile, and Peru); all of them ranked well below the OECD average.[10] For example, the average score in Peru was about 80 percent the score of the mean OECD country. These data make a strong case for financial education. Indeed, authorities throughout the region have recognized this and

[10] The PISA test was applied to 13 OECD countries and economies and 7 partner countries. The report of results can be found at https://read.oecd-ilibrary.org/education/pisa-2018-results-volume-iv_48ebd1ba-en#page54.

placed both financial education and consumer protection policies high on their reform agendas.

The private sector plays a key role in achieving financial inclusion goals in the region. Although public banks are typically the focal point for these efforts, they often lack the operational capacity to implement programs that could increase financial inclusion. One strategy to encourage individuals to enter the formal financial system is to deliver cash transfers through the banking system. Several countries in the region have subcontracted private banks to do this (e.g., Chile, Colombia, Dominican Republic, and Honduras, to name a few). Initially, this strategy largely led to withdrawal operations. Over time, however, adopting and using this new technology fosters trust and higher savings in a formal account (Bachas et al., 2020). Bold, Porteous, and Rotman (2012) also present promising evidence that owning and using an account encourages recipients to use other financial services. Greater trust in private banks could magnify the efficacy of these interventions.

As many as 13 governments in the region have developed or are developing ambitious and comprehensive national financial inclusion strategies (Grifoni et al., 2020). These strategies include policies that establish guidelines for implementing measures in a variety of areas such as promoting greater access to financial services, fostering quality services, increasing financial literacy, and reaching the most vulnerable populations. Due to their multiple goals, financial inclusion strategies usually demand multisectoral efforts and coordination across several ministries, government institutions, and financial institutions. The main actors include public banks, the banking regulator, the ministries in charge of social programs reaching the poor and most vulnerable, ministries of education in charge of delivering financial education, and ministries of infrastructure that foster physical and digital connectivity.

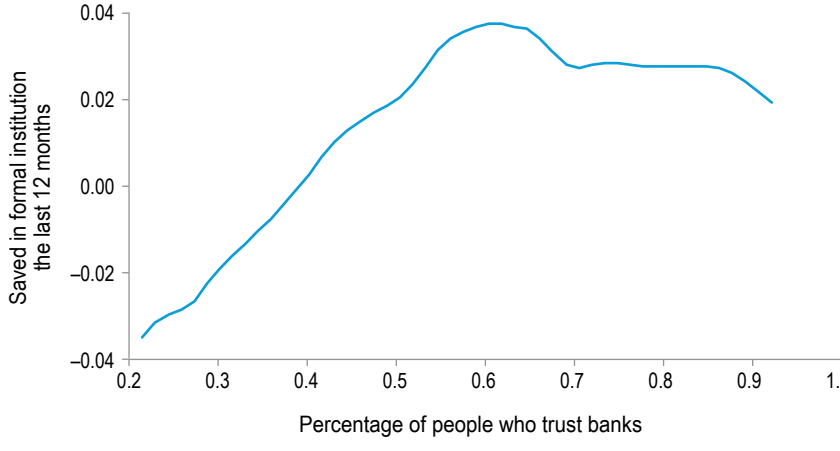
A national financial inclusion strategy can be an effective instrument for an action plan with clear roles defined for each participant. However, mistrust undermines the long-term sustainability and coordination among actors that are essential to success. Since these programs are vulnerable to political cycles, trust in government plays an important role (Grifoni et al., 2020). Necessary coordination between private and public institutions similarly flounders if trust in government and the private sector, respectively, are low. Recognizing this, the OECD's International Network on Financial Education recommends that when developing national strategies for financial education, countries engage with a wider range of trustworthy public stakeholders in the implementation phase and select trusted partners that can support public authorities in the design and implementation of the national strategy (OECD, 2015).

Of course, although trust among implementing agencies is important for successful financial inclusion strategies, the fundamental trust problem is among households, whose low levels of trust in banking institutions limit both borrowing and saving deposits. Beckmann and Mare (2017) provide cross-country evidence from Europe that trust in the safety of deposits has the highest average marginal effect on bank savings, closely followed by the effect of trust in domestic banks.

Trust is positively correlated with take-up of formal savings instruments in a cross-country sample of 44 countries around the globe (see Figure 5.10). After controlling for GDP per capita and world region, the figure presents the relationship between the percentage of people who saved in a formal financial institution in the past 12 months and the level of trust in each country. The results indicate that the share of citizens who keep savings in a formal financial institution increases steeply with the level of trust in banks in an economy.

Experimental interventions aimed at increasing institutional and interpersonal trust, particularly between citizens and banks as well as citizens and credit and savings officers, provide evidence of the causal effect of trust on the take-up of financial services. Mehrotra, Somville, and Vandewalle (2016) ask if repeated interactions, which reduce the level of asymmetric

**Figure 5.10 ▶ Trust and the Take-Up of Formal Financial Services**




*Source*: Authors' own calculations based on Demirgüç-Kunt et al. (2018), World Values Survey round 2017–2020, and World Development Indicators database.
*Note*: Estimates obtained from a kernel-weighted local polynomial smooth in the sample of countries included both in the FINDEX and WVS (N=44). The polynomial is estimated with the residuals of a regression of the percentage of citizens with formal savings in the past 12 months on GDP per capita in 2017 (PPP, constant 2017 international dollars) and region fixed effects.

information, increase trust in India. They engineer an intervention that promotes interactions by randomly opening accounts for the unbanked and making weekly payments into their accounts. The study finds a strong positive correlation between clients' trust in their own banker and savings in the account, but their trust in another banker does not have the same effect. Therefore, a personalized relationship with a banker is relatively more important in driving formal savings than general trust in banks.

Galiani, Gertler, and Ahumada (2020) follow a similar approach and randomly assign beneficiaries of a conditional cash transfer program to a training session designed to build trust in financial institutions. They focus on Peru, a country where only a third of citizens trust banks and 40 percent of the unbanked identify lack of trust as one of the main reasons not to have an account—the highest percentage in Latin America and the Caribbean among the countries covered by Findex in its 2017 round. Training led to large increases in the balance of savings, twice as high as baseline. The authors show that this effect reflects an increased level of trust in the financial system rather than greater knowledge of the banking system or financial literacy.

The transition into private pension funds has been difficult in Latin America and the Caribbean, generating heated controversy that has further reduced trust in pension systems. The intertemporal contract to keep retirement savings in a financial institution imposes higher risks of future instability and uncertainty as well as magnified time inconsistencies. Thus, trust becomes even more fundamental to facilitate these transactions. Koh, Mitchell, and Fong (2021) rely on the Singapore Life Panel to provide evidence of the link between trust and retirement savings. Even in a setting with relatively high levels of trust (only 13 percent of the unbanked report not having an account due to lack of trust in financial institutions; Demirgüç-Kunt et al., 2018), trust in financial institutions is strongly correlated with higher pension balances and pension investing. Greater trust is also linked to an increased likelihood of having a financial advisor.

Other evidence also underlines the importance of personal relationships to overcome the trust barrier in financial transactions, particularly where institutions are weak. Nicolas and Tarazi (2019) link different types of interpersonal trust (in-group and out-group as measured by the WVS) with bank lending using a sample of commercial banks in 34 countries around the world. They find that interpersonal trust significantly boosts bank lending. Consistent with the argument that trust matters more where institutions are weak, this effect only holds in countries with relatively lower levels of institutional and judicial development. However, SMEs in Europe that enjoy a high level of trust from loan managers obtain more

credit and are less credit constrained, even though institutional quality is high (Moro and Fink, 2013).

Mistrust also delays the adoption of new financial products and technological innovations. For example, potential users of digital payments and mobile banking may not understand how these services operate and fear fraud or losses due to connection failures. In these cases, trust has a multiplier effect since these innovations only work when they operate on a large scale.

A recent experimental study from Peru presents causal evidence on the effect of trust on adopting mobile banking. Agurto et al. (2020) randomly provide information and training to promote the use of mobile banking under two scenarios: the trainer is either a trusted local ambassador or an external agent. They find that being invited to attend a workshop led by someone known to the community yields a take-up rate of 70 percent, which is twice as high as the rate in the control group, where training is led by an outsider. This effect also translates into a 3 percentage point increase in the adoption rate of mobile banking relative to the control. Once more, the evidence supports the view that the lack of institutional trust may be circumvented through interventions that foster the interpersonal trust of citizens with private or public officials who constitute the closest point of contact when dealing with the financial system.

## Breaking the Vicious Circle of Mistrust and Poor Policy Performance

Effective public policies and efficient public spending are essential for a region that needs to grow and take care of unfulfilled needs and high inequality. As discussed in Chapter 4, interpersonal trust and trust in government shape public policies and influence whether they can further the goals of inclusive growth. This chapter describes the biases that mistrust creates in the implementation of public policies that are essential for faster growth and greater equality.

Even if governments provide public goods and well-designed, targeted policies, their effectiveness is dependent on the attitudes of the individuals those policies are expected to help. Nonpharmaceutical interventions to contain the spread of a pandemic, such as handwashing, wearing a mask, or social distancing, only work if people abide by those rules. Complying with the rules (e.g., mask mandates) depends on how much people trust those policies to mitigate the spread of the virus as well as how much people trust other people to comply with those rules (Leech et al., 2021). This chapter presented similar examples for crime, education, environmental policy, and financial inclusion in addition to health.

Citizens' trust in government determines their behavior towards public policies, their degree of support for governmental programs, and whether public programs and policies end up achieving their objectives in nearly every sector (OECD, 2014). Similarly, civic capital and citizen cooperation play an important role in the effectiveness of public policies that rely on collective action to achieve their goals. With low levels of interpersonal trust and civic capital, people are less inclined to incur the costs of cooperating, particularly when they believe their net personal benefits are low compared to those of others or when they expect the costs and benefits of policies to be shared unequally.

Governments' ability to implement effective policies and reforms that contribute to the social and economic development of their nations thus strongly relies on citizens' support and trust. Evidence from key sectors highlights how trust in government and institutions as well as interpersonal trust affect the performance of public policies. The role of trust becomes especially salient in the presence of externalities, asymmetric information, difficulty measuring performance, or intertemporal inconsistencies. Effective and efficient public policies require a high level of trust. To the extent that trust depends on the performance of public policies because citizens cannot distinguish whether outcomes depend on the actions of government officials or other factors, a potential vicious circle exists between mistrust, poor public policy performance, and even greater mistrust. Focusing on the determinants of trust that provide insights to make public policies more effective can help break this vicious circle.

# 6

# The Link between Trust and Digital Transformation

***People in Latin America and the Caribbean believe that the digital transformation exacerbates the opportunistic behavior present in the analog world, rather than attenuating it: mistrust has slowed digital transformation of the region. Institutional reforms to increase user confidence, improve the user experience, and enhance cybersecurity can change these beliefs.***

Where can people be simultaneously anonymous and yet exposed, connected and yet worlds apart, free and yet trapped? It is the place where trust can be built as fast as it can be destroyed: the internet. If Peanuts were written today, Charlie and Lucy would probably not be playing with a ball outside, but rather gaming online. Online exchanges, though, present endless possibilities for opportunistic behavior: opportunities to exploit informational asymmetries and to defraud others multiply when anonymity prevails. Because of this, many were skeptical that any meaningful transaction could take place online. Instead, Amazon sells some $400 billion worth of goods each year. This is because the digital environment also provides opportunities for greater access to information, more transparency, broader reach, easier collective action, more accountability, less discrimination, and many other conditions that make opportunistic behavior common in the analog world. In a region plagued by chronic low interpersonal trust and trust in institutions, the digital transformation can provide tools for increasing trust. Unfortunately, the transformation itself depends on trust, which is the focus of this chapter.

Chapter 5 outlines the many ways in which trust facilitates the implementation and success of public policies to address issues ranging from the environment to public safety. This chapter uses the same lens to view one of the most important cross-cutting areas of policy reform that governments confront—the process known as digital transformation—which embraces the internet, its culture, business models, and technologies.

Digital transformation boosts growth by helping create new firms and grow existing firms. In advanced economies, growth in the tech sector has outpaced the economy at large. In Canada, for example, the digital economy grew over 40 percent between 2010–2017, compared to 28 percent for the total economy (Statistics Canada, 2019); in the UK, the digital sector grew nearly six times faster than the economy as a whole in 2018 (Warman, 2020);[1] and in the United States, growth in the digital sector accounted for 30 percent of total GDP growth in 2017 (Boussour, 2019).

Digital transformation also drives growth indirectly by increasing the productivity of the public sector; it reduces the transaction costs for individuals and firms to interact with government, increases the efficiency of public expenditure, improves policy effectiveness, and attracts foreign direct investment. Online procedures for citizens to deal with the government are, on average, 74 percent faster than their in-person equivalents (Roseth, Reyes, and Santiso, 2018). Multiple studies also demonstrate the potential of digital transformation to generate cost savings. In Denmark, for example, the application of data analytics in welfare fraud detection led to savings of over €60 million in 2019 (European Commission, 2020). Digital transformation can also bring greater policy effectiveness. In Uruguay, a text message reminding women to make an appointment for a PAP smear generated three times the number of appointments when it included a link to make the appointment compared to a text message without a link (Cuesta et al., 2021). Additionally, in a regional survey of 2,200 public officials from Latin America and the Caribbean, respondents revealed that the lack of digital tools was a bigger challenge than budget constraints in coping with the pandemic (Keefer, Perilla, and Vlaicu, 2020) Finally, research by the International Monetary Fund shows that the accessibility of government information and services online is directly associated with the amount of foreign direct investment a country receives (Al-Sadiq, 2021).

By automating administrative decisions, digital services reduce both the need for direct interaction between civil servants and citizens and the scope for discretion and abuse of authority. Moreover, since digital services are typically delivered more rapidly than their in-person equivalents, individuals have less incentive to offer bribes for speedier service: a 2016 survey of firms in Mexico found that "speeding up transactions" was the prime motive for bribery (INEGI, 2016). Indeed, multiple studies find that digitalization reduces corruption in service delivery (Banerjee et al.,

[1] As of this writing, there is no consensus on how to measure the digital economy. The OECD (2018) has compiled several leading approaches: https://www.oecd.org/g20/summits/buenos-aires/G20-Toolkit-for-measuring-digital-economy.pdf.

2015; Muralidharan, Niehaus, and Sukhtankar, 2016). This is particularly relevant for the poor and less educated, who may both have less access to digitally delivered services and be more dependent on public services and, therefore, less able to opt out of them.

Latin American and Caribbean countries are largely missing out on the benefits of digital transformation in both the private and public sectors. The region's score on the CAF's Digital Ecosystem Development Index is 49 out of 100, compared to 71 for Western Europe (CAF, 2020). The size of the digital economy in Latin America and the Caribbean is small compared to leading economies: in Chile, a regional leader, it is 3.5 percent of GDP, compared to 11.9, 8.1, and 7.1 percent for Ireland, Japan, and the United States, respectively (Cabrera, 2019). E-commerce as a share of retail in Brazil and Mexico is under 3 percent, compared to nearly 10 percent for the United States and nearly 25 percent for China (ProInvex Panama, 2019). In terms of adopting digital public services, Latin America and the Caribbean is also behind. In the months prior to the COVID-19 pandemic, only 21 percent of survey respondents from 10 Latin American countries had done their last government transaction online. Despite the widespread restrictions to mobility and office and business closures imposed by governments during the pandemic, this proportion rose to only 39 percent (Roseth, Reyes, and Yee Amézaga, 2021).

This chapter analyzes the connection between the region's endemic low interpersonal trust and its slow adoption of digital services. Specifically, it attempts to disentangle the importance of two competing forces. Low trust provides a strong incentive for digital transformation, to the extent that it reduces the scope for opportunistic behavior in exchanges between government and citizens. However, it also slows the transformation, to the extent that mistrust makes people reluctant to adopt new technologies. This chapter concludes that the second force outweighs the first: the uptake of digital services is hindered by the region's low level of interpersonal trust. Uptake of digital services requires two layers of trust: those of the physical world, associated with corruption, non-compliance, fraud or theft, and those of the digital world. The digital medium introduces a new set of trust concerns, associated with the identity of providers and users, privacy, and simply the absence of the personal interaction that human beings have used to cement transactions for millennia—and which are hardest to surrender in low-trust societies. Although the digital medium also offers certain advantages over the physical world in terms of limiting untrustworthy behavior (e.g., limiting the scope for bribery), these advantages are outweighed by the perceived additional risks in their impact on uptake. Thus, strengthening trust-building institutions, both

digital-specific and those predating the digital era, would help unleash the potential of digital transformation for growth.

Chapter 9 looks at the role that digital tools have for the distribution of information and for building reputation, that is, increasing trust. This chapter instead presents evidence that, indeed, low-trust people use digital services less—albeit with several important exceptions. It accounts for these effects through both an analysis of citizen perceptions and a diagnostic of the trust-building institutions relevant to the digital medium. The lesson, which will be echoed in Chapter 7, is that institutions are central to building trust, although they are themselves more difficult to build in low-trust environments.

## A Direct Connection: Trust and Digital Service Use

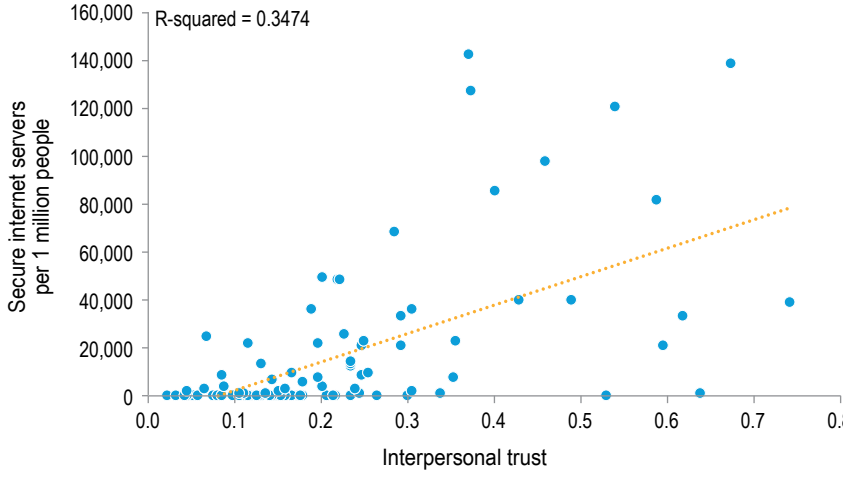
Using digital services requires multiple leaps of faith. Users must believe that the good or service will be delivered as promised, even though in many cases they cannot actually see what they are purchasing. They often must pay up front, requiring them to trust the provider to fulfill her commitment (e.g., to send a product in the mail). They must trust that, if they do not like what they have received, they will have some recourse, even though their only contact with the provider is virtual. Furthermore, they have to trust that the provider will be a responsible steward of the personal data they provide.

Given such high trust requirements, it is perhaps intuitive that low-trust people, who make up the majority of Latin Americans, would be reticent to use digital services (Suh and Han, 2003; Kim, Ferrin, and Rao, 2008; Abyad, 2017). Indeed, cross-country data suggests such a relationship. Figure 6.1 presents correlations between trust and the use of digital services. Panel A shows a positive correlation between generalized trust and the prevalence of overall digital development (using the number of secure internet servers as a proxy), and Panel B shows a strong positive correlation with e-government development.

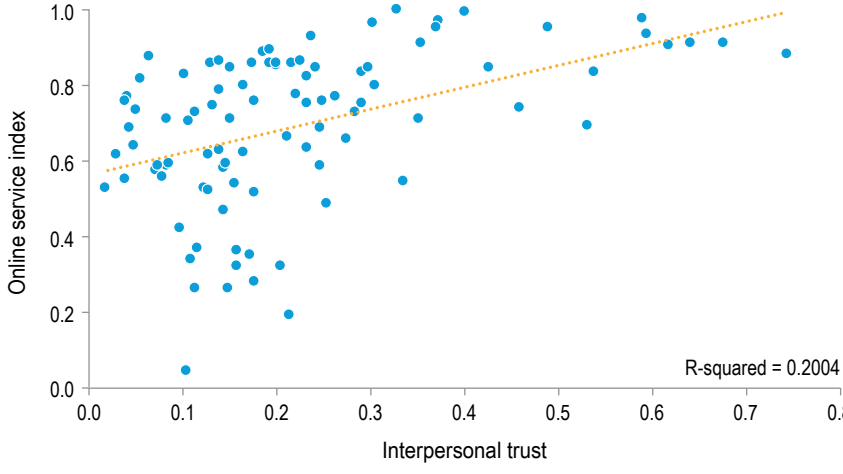
Individual-level data shows the same relationship: low-trust people are systematically less likely to use both private and public digital services than their more trusting counterparts. In an analysis of 2017 Latinobarometer household survey data from 18 Latin American countries, high-trust people—those who agreed with the statement "most people can be trusted"—were 3.5 percentage points more likely to have conducted an e-commerce transaction in the past 12 months than those who believed "you can never be too careful in dealing with other people." This gap is the difference in usage that remains after controlling for a slew of variables that are themselves associated with trust, including age, gender, education level,

## Figure 6.1 ▶ Trust and Digital Development

**A. Digital development and trust**




**B. E-government development and trust**




*Source*: Authors' elaboration based on World Values Survey, World Bank World Development Indicators, and UNDESA.

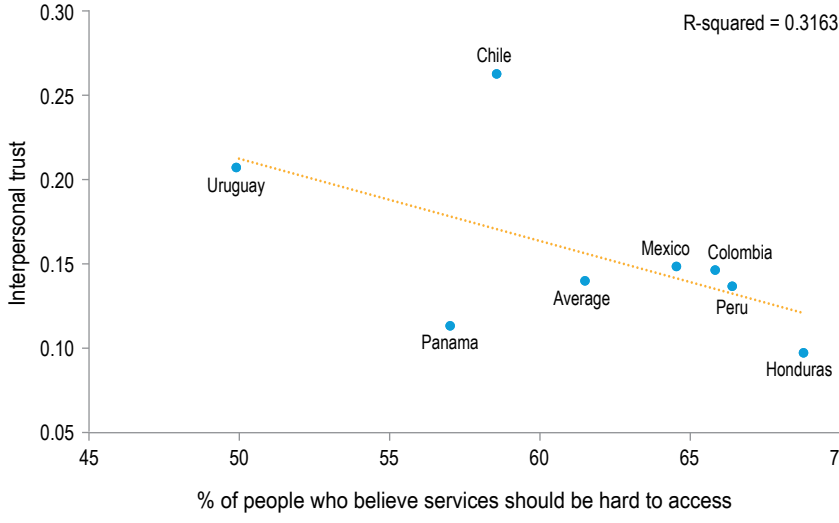
*Note*: Generalized trust comes from the Integrated Values Survey (2010–2020), which compiles the sixth and seventh wave of the World Values Survey (1981–2020) as well as the fifth wave of the European Values Study (2017–2020). Generalized trust is calculated from answers to the question, "Generally speaking, would you say that most people can be trusted, or that you need to be very careful in dealing with people?" Trust is equal to 1 if the respondent answers, "Most people can be trusted" and 0 otherwise. Each bar is a simple average from country-level data. The total sample encompasses 95 countries, and the Latin American and Caribbean countries included are Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Guatemala, Haiti, Mexico, Nicaragua, Peru, Trinidad and Tobago, and Uruguay. The y-axis indicator in Panel A, "secure servers per 1 million people," from the World Bank World Development Indicators, refers to the number of distinct, publicly trusted TLS/SSL certificates found in the Netcraft Secure Server Survey. The y-axis indicator in Panel B, "UN online service index," from the United Nations Department of Economic and Social Affairs (UNDESA), reflects the national online presence of all 193 United Nations Member states as reported in the Online Service Questionnaire conducted by UNDESA.

having a computer at home, and having a smartphone, as well as country fixed effects. The effect of trust on engaging in e-commerce transactions is also 61 percent greater than the effect of education level and nearly four times the effect of income level. Trusting people are 2.16 percentage points more likely to have conducted their last government transaction digitally; this effect is 53 percent higher than the effect of education level and, again, nearly four times the effect of income.

The interaction of trust and the willingness to use digital tools depends significantly on individuals' trust in the provider of the tool, in digital tools in general, and the risks to which the tool exposes them. E-commerce transactions can be difficult for all three reasons: the seller is unknown, trust in the digital platform may be low, and opportunistic behavior creates tangible risks of losing money. Digital tools recommended or provided by governments range over the entire spectrum: individuals may have high or low trust in government and in the digital tool and the tool may expose them to greater or lower risk. For example, COVID-19 contact tracing apps require users to share an unusually large amount of sensitive personal information with governments. Not surprisingly, those who trust government more are more likely to download a COVID-19 contact tracing app on their phone (Boruchowicz et al., 2020). In other contexts, however, risks of using government-sponsored digital tools are lower and trust in government is less correlated with uptake. An analysis of 2017 Latinobarometer data reveals no significant relationship between trust in government and the likelihood of using a diverse set of digital public services, ranging from digital identification to car registration and digital access to social transfers. Studies on the uptake of digital services for ID renewal in Panama (Vera Cossío, Reyes, and Roseth, 2021) and making medical appointments in Uruguay (Cuesta et al., 2021) find that people with greater trust in government are no more likely than those with low trust in government to choose the digital option over the in-person option.

Mistrust can also hamper the digital transformation of government if people believe digital processes are more vulnerable to fraudulent practices. A majority of Latin Americans believe that transaction costs have to be high in order to prevent fraud in service delivery. They have little trust in fellow citizens, expect those citizens to claim benefits to which they are not entitled, and prefer strong fiduciary controls, even if they cost beneficiaries dearly, in order to prevent fraud. On average, 62 percent of citizens in seven Latin American countries think this way (Roseth, Reyes, and Santiso, 2018). Digital services naturally have lower transaction costs than equivalent in-person services, which low-trust people may perceive makes them more vulnerable to fraud.

**Figure 6.2 ▶ Relation between Interpersonal Trust and Support for High Bureaucratic Hurdles for Public Services**




*Source*: Roseth, Reyes, and Santiso (2018).
*Note*: The variable "interpersonal trust" is drawn from the 2018 edition of Latinobarometer. Generalized trust is calculated from answers to the question, "Generally speaking, would you say that most people can be trusted, or that you need to be very careful in dealing with people?" Trust is equal to 1 if the respondent answers, "Most people can be trusted" and 0 otherwise. The indicator reported is the percentage of people who answered that "most people can be trusted." The variable "people who believe that services should be hard to access" reflects the proportion of survey respondents that answered "yes" to the question, "Do you believe it is necessary for some government procedures to be complicated to ensure that no one receives benefits for which they are not eligible?" The data are drawn from Keefer, Scartascini, and Vlaicu (2017).

Consistent with this intuition, the lower the level of interpersonal trust in a country, the greater the proportion of people who believe that services should be hard to access to prevent fraud (see Figure 6.2). Notably, the country with both one of the highest levels of interpersonal trust and the lowest proportion of people who support high bureaucratic hurdles is Uruguay, the regional leader in digital economy and government.

## Weighing Risks and Benefits in the Digital World

Why does mistrust fuel reluctance to use digital services in Latin America and the Caribbean? The main reason individuals shy away from digital services relates to privacy concerns; they fear their private data may be misused. Citizens in Latin America and the Caribbean feel apprehensive about the benefits of sharing information and are concerned about what both private companies and the government do with their personal data;

they are worried about the risks of digital services. Such concerns are systematically higher among low-trust individuals. People are also concerned about the risk of fraud and, more prosaically, with the quality of the digital experience: websites that crash, transactions that fail to complete. Having a bad experience while transacting online, which is common in the region, feeds their mistrust.[2]

Using digital services, both private and public, almost always entails sharing personal data of some kind. The personal data in question can be varied, ranging from name, address, and marital status, to bank account numbers and land titles, to health status and location, among many others. What is novel about the digital medium is not sharing data as such—accessing services in person also requires sharing data—but rather the ease with which that information can be manipulated, transferred, or commoditized, often without the knowledge or consent of its owner. In many circumstances, sharing and analyzing personal data can offer value to individuals, for instance by leading to personalized recommendations of consumer goods or the proactive delivery of public services. However, abuse of personal data can have serious consequences, including identity theft, unlawful surveillance, or political retribution. Box 6.1 describes this tension, known as the "privacy-personalization paradox."

Latin Americans are particularly apprehensive about data privacy. According to responses from a nationally representative sample from 10 Latin American countries, 77 percent of respondents believe that sharing their personal data entails more risks than benefits, ranging from 89 percent in Ecuador to 69 percent in El Salvador (Figure 6.3). Lafuente et al. (2021) found a similar result: 75 percent of Brazilians do not trust their state government to protect their personal data. Risk perception increases together with educational level, suggesting that the more people know about the internet, the higher their perception of risk (see Figure 6.4).

Interpreting these opinions, however, should be viewed in the context of actual behavioral trends: 63 percent of the population in Latin America

[2] While digital services generally require a smaller investment of time than their in-person counterparts, and that time is the most important element in most citizens' channel selection (Pareja et al., 2016; Roseth, Reyes, and Santiso, 2018; Lafuente et al., 2021), negative perceptions regarding privacy and security are nevertheless important. A broad literature on e-commerce has documented that such concerns can undermine uptake (U. Ali et al., 2019; Bandara, Fernando, and Akter, 2020; Ferrell, 2017; Holtrop et al., 2017; Martin and Murphy, 2017; Petrescu and Krishen, 2018; Rybak, 2018). In the European Union in 2017, 16 percent of internet users who did not make online purchases in the previous year reported not doing so because of payment security and privacy concerns (OECD, 2019).

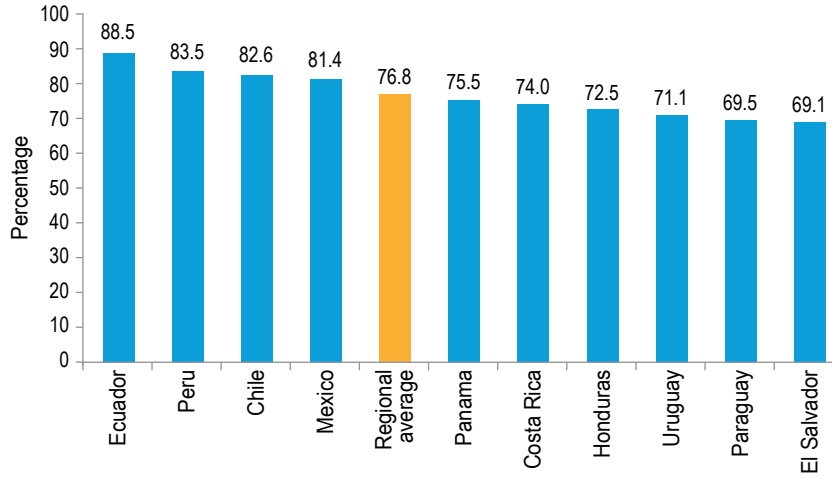
### Box 6.1 ▶ The Privacy-Personalization Paradox

Many users of digital services such as Facebook—widely used in Latin America and the Caribbean—appreciate and have even come to expect personalization. Whether it consists of a product recommendation or a text message reminder that includes the recipient's first name, personalization connects users to relevant products and services quickly. Literature from marketing, sociology and behavioral economics has shown personalization to be a powerful tool to induce desired behaviors (i.e., Respi and Sala, 2017; Karlan, Morten, and Zinman, 2012). However, personalization requires the use of personal data, often potentially sensitive information such as age, health conditions, family composition, consumption patterns, and location, among others. Though as appreciative of personalization as other consumers of digital services, people of the region are also generally apprehensive about how both private companies and their governments store and use such data. In other words, the sword cuts both ways. This tension between the benefits of using personal data for users' benefit and concerns regarding its abuse is known as the "privacy-personalization paradox" (Toch, Wang, and Cranor, 2012; Sheng, Nah, and Siau, 2008; Aguirre et al., 2016).

In the private sector, this tension manifested itself in the business model known as "surveillance capitalism," in which companies offer free digital services to users in exchange for access to their personal information, which is in turn used to sell targeted marketing and other profit-generating activities (Zuboff, 2015). In the public sector, the privacy-personalization paradox manifests itself as a tension between performance (better services) and legitimacy (concerns over invasions of privacy) (Codagnone et al., 2020). The tension is different because the concerns are different across the private and public sectors: a private company can sell personal data, send users false information, and attempt to manipulate them; the government can deny people benefits, take them off voting rolls, and arrest them. Evidence from a study based on a survey of 547 internet users in Rwanda suggests that, indeed, the effect of privacy concerns depresses uptake of public digital services more than private digital services (Mutimukwe, Kolkowska, and Gronlund, 2020).

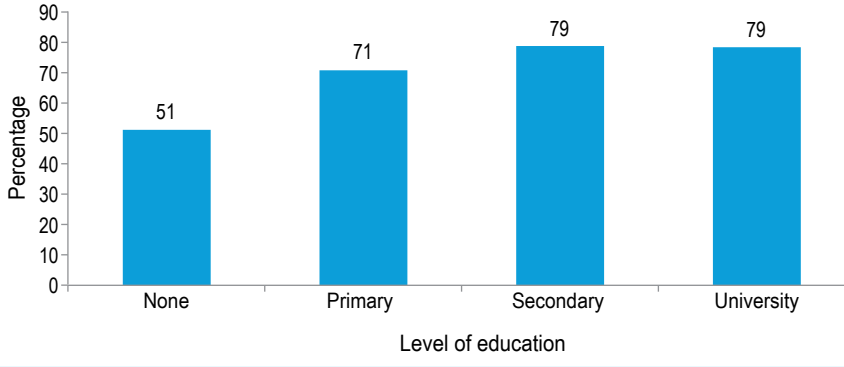
This paradox is acute in Latin America and the Caribbean. Prince and Wallsten (2020) demonstrate that in comparison to citizens from Germany and the United States, citizens of Argentina, Mexico, and Colombia value their privacy much less. Whereas Germans demanded a payment of US$8 per month to be subjected to targeted advertising, Argentineans, Mexicans, and Colombians expressed a willingness to pay for it—Colombians up to US$2.50 per month. This suggests that in a tension between privacy and personalization, Latin Americans prefer personalization. The success of personal data-intensive digital services (such as Facebook) in Latin America supports this conclusion. However, whether this preference extends to the public sector has yet to be shown—a relevant concern in a region with a relatively recent history of dictatorships.

**Figure 6.3 ▶ Population that Feels Sharing Personal Data Entails More Risks than Benefits (percentage, by country)**




*Source*: Authors' analysis of data produced by Boruchowicz et al. (2020).
*Note*: Reports the proportion of respondents that agreed with the statement, "Sharing personal data entails more risks than benefits."

**Figure 6.4 ▶ Population that Feels Sharing Personal Data Entails More Risks than Benefits (percentage, by educational level)**




*Source*: Authors' analysis of data produced by Boruchowicz et al. (2020).
*Note*: Reports the proportion of respondents that agreed with the statement, "Sharing personal data entails more risks than benefits."

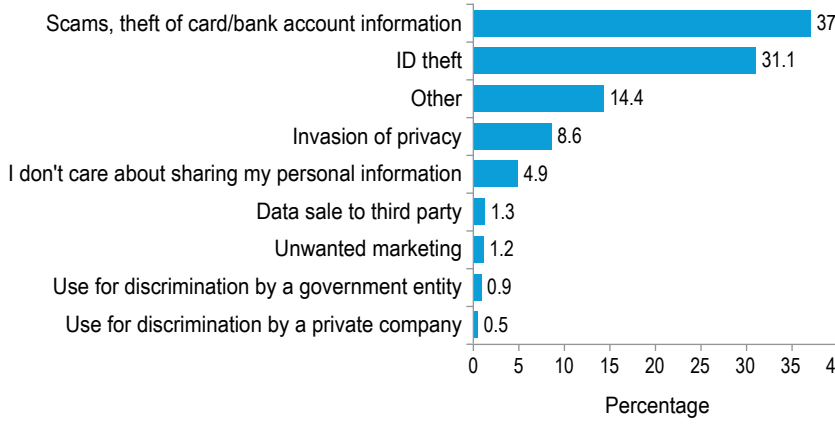
and the Caribbean had a Facebook account as of January 2020, just below North America (69 percent) and significantly above Europe (47 percent) (Statista, 2021a). Clearly, a considerable gap exists between stated privacy concerns and revealed preferences. Thus, opinion data related to privacy should be taken with a grain of salt and its utility may be more

comparative than absolute. Moreover, what people say to survey enumerators may better reflect their attitudes towards public policy governing the digital transformation than their decision to use Facebook.

The specific concerns of the region that inhibit the uptake of digital services fall into two categories. One is particularly relevant to private sector digital services: people in the region are worried about financial scams, theft of card or bank account information, and identity theft (Figure 6.5). Scams or theft of card or bank account information were the main concern of 37 percent of respondents while identity theft topped the list of concerns for 31 percent. Together, these two risks were the first or second concern in each country. Other risks, such as the invasion of privacy, sale of data to a third party, unwanted marketing, and discrimination, were much less prevalent.

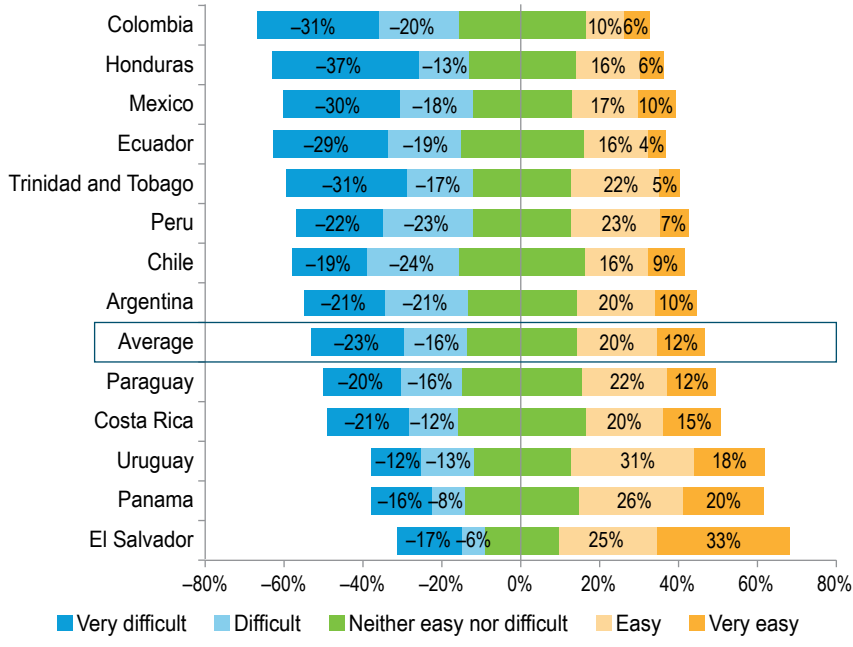
Most government digital services do not entail financial risks, although identity theft is relevant to all digital transactions in any sector. Of particular relevance to government services, though, is the impact of bad experiences on the security of digital services. The quality of public sector digital services is frequently low in the region, and lower than that offered by the private sector. The repercussions of this disparity are problematic since bad online experiences fuel the overall perception of insecurity of digital public services. Given that individuals do not have information to evaluate the cyber capacity of the government, their personal experiences serve as proxies to judge the capacity of the delivering institution.

**Figure 6.5 ▶ Main Risk Associated with Personal Data**




*Source*: Authors' analysis of data produced by Boruchowicz et al. (2020).
*Note*: The figure reports the proportion of respondents that identified each one of the items as the main risk associated with sharing personal data.

**Figure 6.6 ▶ Ease of Use of Last Digital Public Service**

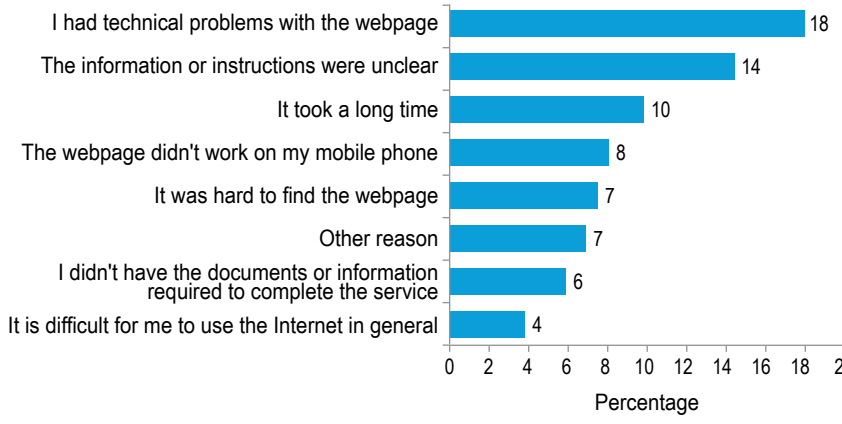



*Source*: Roseth, Reyes, and Yee Amézaga (2021).
*Note*: Respondents who had previously reported having conducted their last government transaction online were prompted to answer the question, "How easy was it for you to conduct the transaction online?" The answer options were: very difficult, difficult, neither easy nor difficult, easy, and very easy.

Roseth, Reyes, and Santiso (2018) find that 40 percent of advanced internet users were unsuccessful in their last attempt to access an online service. The overall user experience did not appear to have improved by 2020: in nine of 13 countries, more users said their last online public service was difficult than users who said it was easy (Roseth, Reyes, and Yee Amézaga, 2021) (see Figure 6.6). The leading causes of difficulty with digital services involved design failures, including technical problems with the webpage, unclear instructions, and the lengthy time required to complete the process (see Figure 6.7). For 27 percent of users, the experience with their last online service was so bad that they said they would never use the internet to access public services again. Vera Cossío, Reyes, and Roseth (2021) find that a difficult user experience for a digital service has a significant deleterious effect on service uptake.

The public sector trails the private sector in user perceptions of digital services, likely creating a gap in user trust towards the different providers. In Brazil, 35 percent of internet users interviewed in a nationally

**Figure 6.7 ▶ Reasons for Difficulty Using Digital Public Service**



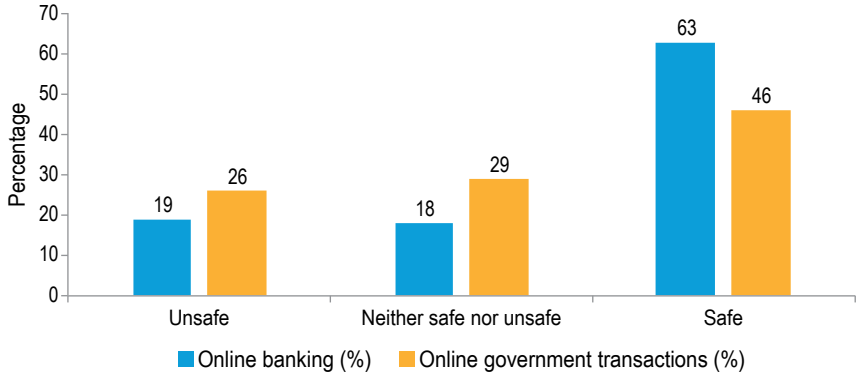

*Source*: Roseth, Reyes, and Yee Amézaga (2021).
*Note*: Respondents who previously reported having conducted their last government transaction online, and who reported that the online transaction was "very difficult" or "difficult" were prompted to answer the question, "Why was the transaction difficult? Select all that apply."

representative survey in 2020 regard the quality of their experience with their last online purchase from a private company to be "very good;" only 4 percent said the same of their most recent experience with a digital public service (Lafuente et al., 2021). Additionally, users perceive public digital services to be riskier than private ones. As shown in Figure 6.8, of approximately 1,000 college-educated daily internet users, 37 percent did not regard online banking as "safe," and a much larger fraction, 54 percent, similarly perceived online government transactions as not completely safe (Roseth, Reyes, and Santiso, 2018). This is particularly striking since banking belongs to a particularly sensitive class of transactions.

The frequency of adverse online events further undermines trust in the digital space. Some of these events relate to cybersecurity, others to data protection.[3] In Chile, one of the region's leaders in cybersecurity capacity (IDB and OAS, 2020), a survey of 1,120 internet users revealed that exposure to cybersecurity-related risks is extremely common: 60 percent reported

[3] An additional circumstance in which an adverse experience with a digital service can undermine trust in the digital medium is the automation of unfairness through biased algorithms (Peña Gangadharan, 2017). An example of such automated injustice arose in 2014 regarding E-Verify, an online employment verification system run by the United States federal government. The system was found to routinely misidentify people with non-Caucasian sounding names as ineligible to work in the United States (Leadership Conference on Civil and Human Rights, 2014).

**Figure 6.8 ▶ Security of Digital Private and Public Services: Perception of Advanced Internet Users**




*Source*: Roseth, Reyes, and Santiso (2018).
*Note*: Respondents who reported having conducted online transactions with the government were prompted to answer the question, "How safe do you believe it is to use the internet to conduct transactions with government institutions?" Respondents who reported having used online banking were prompted to answer the question, "How safe do you believe it is to use online banking to conduct transactions?" In both cases, answer options were: very unsafe, unsafe, neither safe nor unsafe, safe, and very safe. The responses "very unsafe" and "unsafe" were grouped together, as were "very safe" and "safe."

having a computer or phone infected with a virus; 34 percent reported suffering unauthorized access to an email or social media account; 25 percent reported finding fraudulent charges on their debit or credit card; and 16 percent reported being a victim of identity theft (MediaInteractive, Pontificia Universidad Católica de Chile, and TrenDigital, 2018). In Mexico, 40 percent of internet users suffered some online security incident in 2015 (OECD, 2019); 40 percent of a group of 150 Latin American companies interviewed by Deloitte suffered a cyberattack in the 2017–2018 period (Deloitte, 2019). Privacy violations are also problematic. A study from the OECD indicates that Latin American countries fare worse than their OECD comparators: in 2018, 8 percent of Chilean internet users had experienced an online privacy violation in the three preceding months—the highest of all OECD countries (OECD, 2019). This statistic is likely to underestimate the true magnitude of privacy violations, as unauthorized data are frequently commercialized without the knowledge of owners.

## A Well-Grounded Mistrust of Digital Services

If everyone knew that the risks posed by digital transactions were low, even low-trust individuals would engage in them. However, perceptions of risk in Latin America and the Caribbean are high; low-trust individuals are thus less

likely to use either private or public digital services. These perceptions are, in fact, well-founded: the risks associated with online transactions are higher since the institutions charged with safeguarding online transactions are weak. As Chapter 7 argues, institutions that increase trust are generally weak in the region, as are those specifically charged with securing digital transactions.

The risks of untrustworthy behavior in digital transactions are counteracted both by institutions specifically created for the digital world and by those pre-dating it. Digital services entail some uniquely digital risks, such as cyberattacks. They also carry risks shared with in-person transactions, such as false advertising or limited capacity to deliver. Even if digital services merely replaced traditional exchanges on a one-for-one basis, they would make greater demands on pre-digital institutions to resolve disputes and assign ownership rights. However, the introduction of digital platforms did much more than simply replace physical transactions with digital; they vastly expanded markets and created exchanges of products and services between buyers and sellers that had never before existed. They placed new and different demands on the pre-digital trust-building institutions, such as the judiciary and civil service. Thus, the successful introduction and use of digital platforms not only depends on the pre-existing quality of institutions but also their ability to adapt to the changes brought on by the digital transformation.

The next chapter considers the difficulties confronting the region with respect to these pre-digital institutions. However, Latin American and Caribbean countries also lag in developing the trust-building institutions of the digital world: cybersecurity and data protection. Both are critical for building user trust in the digital medium by protecting against unauthorized use of user data. Among other objectives, cybersecurity seeks to prevent theft of user information, which is typically used for financial gain via sale or extorsion. Data protection seeks to prevent inappropriate use of personal data, typically for commercial purposes, such as marketing. A broad body of evidence shows that people's experiences and perceptions of cybersecurity and data protection shape their trust in, and uptake of, digital services (Nguyen, 2020; Boerman, Kruikemeier, and Zuiderveen Borgesius, 2018; Mohajeran, Shahrekordi, and Azarlo, 2015; Gupta and Dubey, 2016; Neama, Alaskar, and Alkandari, 2016; Oliveira et al., 2017; Al-Sharafi et al., 2016; Alzahrani, Al-Karaghouli, and Weerakkody, 2017; Liu and Carter, 2018).

Cybersecurity is perhaps the cornerstone of trust in the digital world. Among its many objectives, cybersecurity seeks to guarantee that critical infrastructure, such as electric grids, can operate continuously, protect sensitive information from falling into the wrong hands, educate users on safe behavior in cyberspace, and provide a legal framework for prosecuting

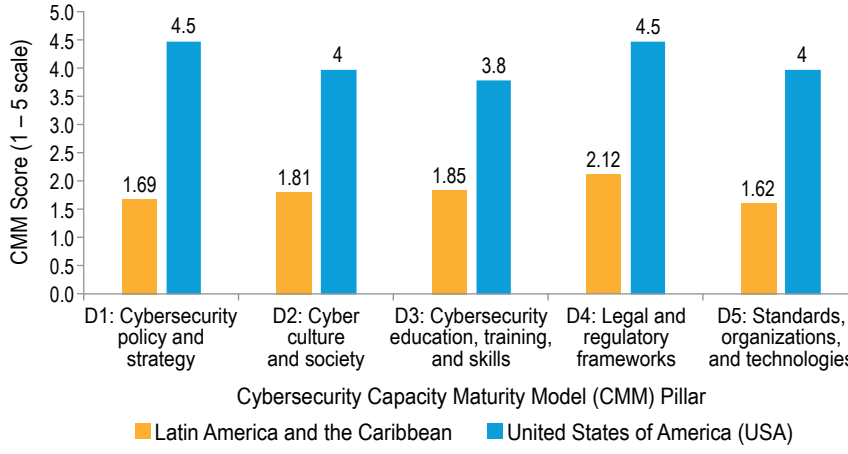
cybercrime. Without adequate cybersecurity, the risk of untrustworthy online behaviors rises, increasing reluctance to use digital services. The threat level is increasing rapidly: in the first half of 2018, data breaches soared 133 percent over the same period in 2017 (World Economic Forum, 2019); and from June 2019 to June 2020, ransomware attacks increased 108 percent, while attacks on Internet of Things networks, the billions of physical devices around the world that are connected to the internet, such as internet-enabled sensors, jumped 833 percent (ECLAC, 2020).

Most countries in the region are seriously behind in their cybersecurity capacity. An analysis conducted by the Inter-American Development Bank and the Organization of American States (2020) revealed that 25 of 32 countries do not have a critical infrastructure protection plan, 12 lack cybersecurity incident response teams (limiting their ability to identify and respond to attacks), 20 have no national cybersecurity strategy, and 22 do not have a government entity in charge of national cybersecurity management. On average, on a scale of one to five, in which one is considered "start-up" and five is considered "advanced," the region has a score of under two (the United States had a score of 4.14 in 2016) (IDB and OAS, 2020).

According to the IDB-OAS study, which applied Oxford University's Cybersecurity Capacity Maturity Model, while all areas have major gaps, the weakest pillars are "Standards, Organizations, and Technologies" (which include items such as ICT security standards, internet infrastructure resilience, and cybersecurity technologies) and "Cybersecurity Policy and Strategy" (Figure 6.9). Notably, these institutional shortfalls, which focus on the public sector, also afflict the security of private companies in cyberspace: in many countries, the government plays a key role in identifying cyber threats facing private companies, remediating damage caused by cyberattacks, investigating cybercrimes, and prosecuting cyber criminals, among other activities crucial to the integrity of private sector digital activities.

A second key trust-building institution for the digital era is data protection, including legislation and the organizations charged with enforcing it. The volume of personal data collected, sold, and reutilized is increasing exponentially due to growing digital transactions and analytics capabilities. The risk of abuse of such data has increased along with it. Abuse ranges from the relatively innocuous, including the unauthorized use of certain data for personalized marketing, to discriminatory, such as undue exclusion from certain public services, to abusive, such as political persecution. An adequate legal and institutional framework for data protection guards against abuses and provides remedies for them. But in the absence of strong data protection measures, citizens are left exposed, thereby reducing the attractiveness of both private and public digital services.

**Figure 6.9 ▶ Cybersecurity Capacity Maturity Model Scores by Dimension (Latin America and the Caribbean average vs. United States)**




*Source*: Authors' elaboration based on data from IDB and OAS (2020).
*Note*: The Cybersecurity Capacity Maturity Model includes results on 57 discrete items, all of which are graded on a scale of 1–5, grouped into the five dimensions reported above. The dimension-level scores reflect a normalization on a five-point scale, such that each dimension has the same maximum and minimum values.

Latin American and Caribbean countries are, in general, underprepared to confront the data protection challenges of digital transformation. As of late 2020, a total of 13 of 26 countries in the region had no data protection laws in effect. Bolivia has no data protection laws whatsoever; Honduras has a draft law; Paraguay and the Dominican Republic have laws concerning only credit data, and El Salvador regulates credit data and has the beginnings of a personal data protection framework. Even in the 12 of 26 countries that do have a legal framework for data protection, the laws are often outdated or insufficient to grapple with the complex situations of the digital economy. Few countries in the region have yet to update their laws to mirror the European Union's General Data Protection Regulation (GDPR), generally regarded as the state-of-the-art policy approach to personal data protection. One important facet of GDPR, yet to be implemented in most Latin American countries, is citizen control. It lets citizens know who has their data, who exchanges it and for what purpose, how to correct inaccurate information, and how to lodge a complaint against perceived abuses.

Implementation is a key weak point of data protection laws in Latin American and Caribbean countries. Only 9 of 26 countries have designated enforcement agencies charged with issuing regulations, conducting audits, and imposing sanctions.

While stronger data protection may provide an incentive to use digital services, lessons from the implementation of strong data protection regulations in the European Union (GDPR) suggest a tradeoff between user trust and provider efficiency. This regulation increased the costs for firms of obtaining user data, and thereby raised the costs of personalizing services. Goldberg, Johnson, and Shriver (2019) analyzed data from 1,508 firms and found that GDPR caused revenue to decline approximately 10 percent. Given that less than a year passed between when GDPR was first enforced and data were collected for the study, it is impossible to know to what extent GDPR eventually boosted user trust, and if that potential boost and concomitant increase in demand compensated for the higher costs faced by firms. In a meta-analysis of literature on privacy and economic growth, Acquisti, Taylor, and Wagman (2016) find that privacy controls can both boost and hinder economic activity.

Informing users of increased data protection measures in an attempt to boost digital service uptake may actually backfire. It can also make them aware of a risk that, prior to the message, was not a concern. This effect was documented by Martínez, Parilli, Rojas et al. (2021) in a survey experiment involving 23,000 Mexican adults. They estimated willingness to adopt COVID-19 diagnostic and contact tracing apps. The respondents who were given a prompt emphasizing the government's commitment to data protection were systematically less likely to adopt the apps than those who did not receive a similar prompt (4 percentage points for diagnostic apps, and 3 percentage points for contact tracing apps).

Trust in digital processes is also a function of the traditional institutions of society that help citizens resolve disputes with others and curb the behavior of people who disrupt the lives of others. Those traditional institutions are the judicial system, which resolves disputes, and the civil service, which produces services and regulates behavior.

The justice system is a key trust-building institution affecting both public and private sector transactions, digital and analog alike. A functional justice system helps strengthen the beliefs of both service providers and users that the other will not commit fraud and will follow through, in part due to the credible prospect of prosecution. On this front, most Latin American and Caribbean countries face significant challenges. Chapter 7 reviews wide-ranging evidence of these challenges; two pieces of evidence are particularly relevant for this discussion.

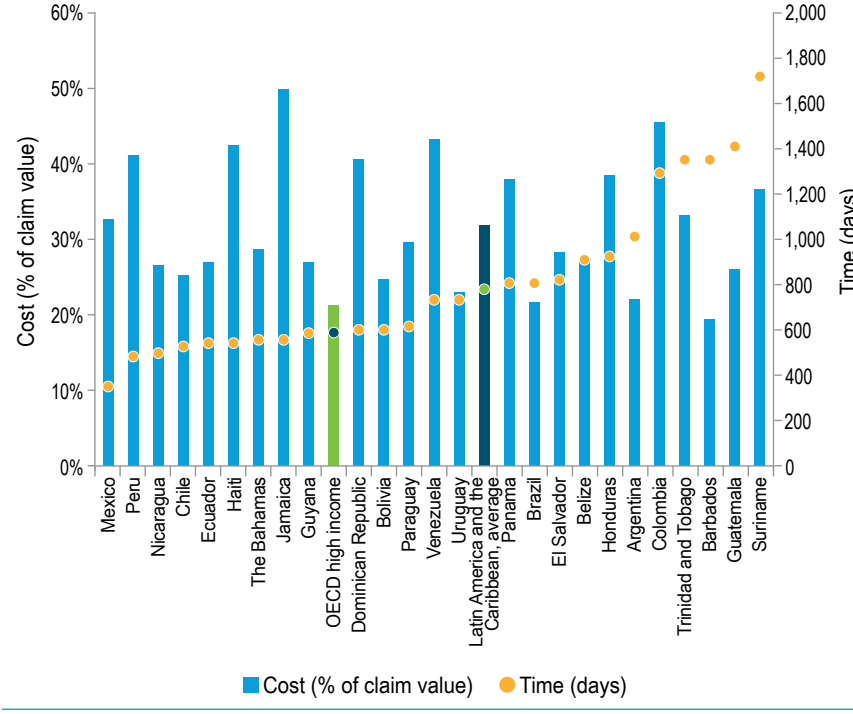
First, the process for enforcing contracts—relevant in the case of disputes over transactions, particular in the private sector—is often costly and lengthy. According to the World Bank's Doing Business database, in most Latin American and Caribbean countries, the average cost of resolving a

contract dispute is higher than the OECD average, and the average resolution time is much longer, in some cases exceeding 1,000 days (Figure 6.10). Such inefficiencies of the justice system discourage digital transactions, which often pair faceless and unknown providers with faceless and unknown users.

Second, most people in the region doubt the judiciary can help them resolve disputes. A review of national surveys on access to justice conducted by the Justice Studies Center of the Americas detected largely negative perceptions of citizens (Bocardo, Martínez, and Valenzuela, 2019). In 2016 in Argentina, 65 percent of respondents said the justice system was not designed to resolve the issues of people like them. In an older survey conducted in Colombia in 2013 and which may not reflect current beliefs, nearly 50% of respondents believed the public servants of the judicial system were corrupt.

The weakness of judicial institutions is an obstacle to the use of digital services, but it is also an opportunity for digital transformation. Offering

**Figure 6.10 ▶ Time and Cost of Enforcing Contracts, Latin America and the Caribbean vs. OECD**

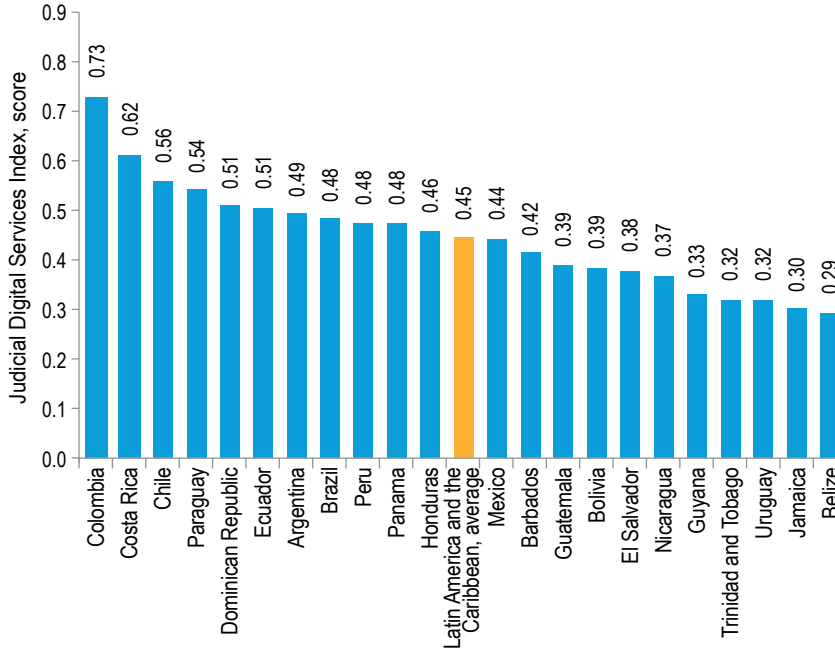



*Source*: Authors' elaboration based on the World Bank's Doing Business database.
*Note*: Both the cost of resolving a claim in terms of the percentage of the claim value and the average time for resolving claims are Doing Business indicators. The OECD group of high-income countries excludes Latin American and Caribbean countries.

judicial services online can improve accessibility and efficiency, but judicial systems are often deeply rooted in paper-based procedures. In Latin America and the Caribbean, few governments offer judicial services online and they are often of low quality. In the 2015 edition, the Judicial Digital Services Index elaborated by the International Development Research Center and the Justice Studies Center of the Americas, the average score for countries in the region was 0.442, on a scale of 0 to 1 (Figure 6.11).[4]

Digital or not, the production of public services depends on the civil service, as does the regulation of private services by government agencies.

**Figure 6.11 ▶ Judicial Digital Services Index, 2015**



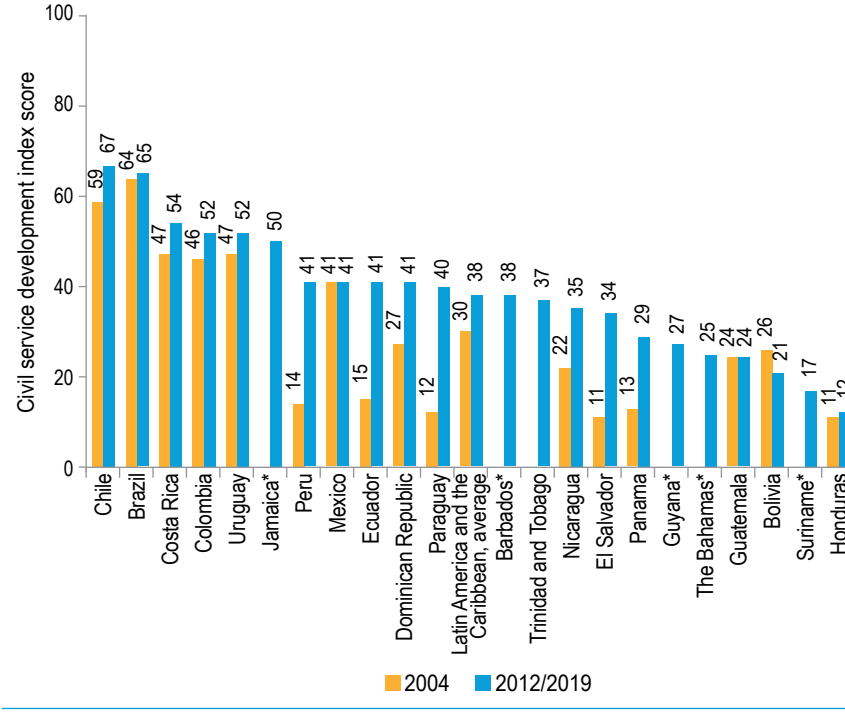

*Source*: Authors' elaboration based on data from the International Development Research Centre and the Justice Studies Center of the Americas (2015).
*Note*: The Judicial Digital Services Index compiles four indicators: how long it takes a judicial institution to respond to a contact from a citizen made online (15 percent of the index value); transactional capabilities of the webpage (30 percent of the index value); usefulness of the information available online and customer support (30 percent); and usability and accessibility of the webpage (25 percent).

[4] The index combines evaluations of how long it takes institutions to contact citizens who reach out through their website (15 percent), the level of sophistication of the web pages (30 percent), the utility of the information and assistance provided (30 percent), and accessibility and usability (25 percent), across four equally-weighted legal issues (claim regarding a defective product, lack of payment of child support, collection of a small debt, and wage collection).

For completely automated services, civil servants are likely responsible for designing and maintaining the digital systems that process them. Equally important, civil servants are also responsible for designing and overseeing the algorithms that determine who gets what. If there is any "analog" piece of a service—whether a review, an approval, an in-person consultation—civil servants must again ensure that the services are delivered to the appropriate people, in a legal and ethical way, and in a timely manner. Achieving this requires civil servants who are adequately qualified, motivated, and managed.

Even in this basic sense, Latin American and Caribbean civil services face severe challenges: on a scale of 0–100 that measures progress towards the principles established in the Ibero-American Charter for the Public Service (signed by all Latin American governments in 2003), the average score is 38 (Porrúa et al., 2021). Figure 6.12 shows the region's

**Figure 6.12 ▸ Index of Civil Service Development in Latin America and the Caribbean, 2004–2012/19**

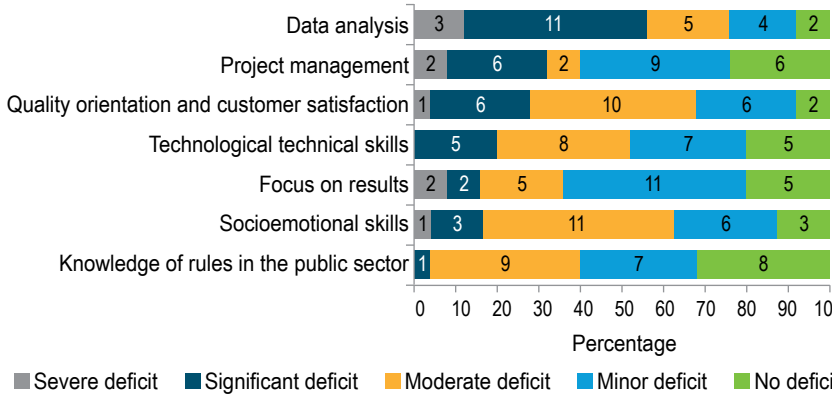



*Source*: Porrúa et al. (2021).
*Note*: For countries marked with an asterisk, there is no available measurement for 2004. The Civil Service Development Index reflects scores on five human resource management subsystems: work organization, employment management, performance management, and compensation management. The bar on the right corresponds to the most recent measurement available for each country, which was undertaken between 2012 and 2019.

evolution on this index over the past 15 years. Key weaknesses include workforce planning, work organization (types of job descriptions and staff composition), employment management (recruitment, selection, promotion, staff development, etc.), and the management of staff compensation, performance, and development (the space to grow professionally and training) (Cortázar Velarde et al., 2014). Many of these shortcomings relate to trust: bureaucratic decisions are more likely to be opportunistic—not meritocratic—when planning, management, and organization are haphazard. Such weaknesses dampen overall economic growth (Evans and Rauch, 1999).

Producing digital services and implementing the two digital-specific trust-building institutions—cybersecurity and data protection—inescapably depend on digitally capable civil servants. Latin American and Caribbean governments face severe challenges in both recruiting in-demand technologists and training current civil servants in digital skills. All central digital institutions in the region have important skills gaps, based on a survey of the institutions' directors (Roseth, Reyes, and Lafuente, 2021) (Figure 6.13). Such gaps are due to a lack of digital professionals in the overall labor market, budget shortfalls, and civil service management problems, including the lack of a salary scale specifically for digital roles (Roseth, Reyes, and Lafuente, 2021). Latin American and Caribbean countries are equally challenged when it comes to adapting existing civil

**Figure 6.13 ▶ Skills Gaps in Central Digital Government Institutions**




*Source*: Roseth, Reyes, and Lafuente (2021).
*Note*: The question asked of the digital government authorities was, "How large are the skills/knowledge gaps on your team in the following topics?" Answer options were: severe gap, serious gap, moderate gap, minor gap, and no gap. One survey response was provided by each participating digital government authority.

servants to the new demands of digital government. In Chile, for example, a 2020 survey of 9,600 public servants in 65 government institutions revealed that, although 64 percent of respondents received training in the past year, only 46 percent stated that training was sufficient when their institution implemented technological changes, and only 25 percent received training specifically in technological topics (Roseth et al., 2021). In Colombia in 2016, only 24 percent of central government institutions provided staff training on the ethical use of data, and 20 percent on data analysis (OECD, 2018). Given such skills gaps, it is understandable that the citizen experience with digital services is suboptimal and cybersecurity and data protection capacities are limited.

Low trust within the civil service also contributes to problems on the supply side of digital services. Undertaking digital transformation—which eventually produces digital services—often requires significant interdepartmental or interinstitutional collaboration (Estevez, Janowski and Roseth, 2021). Given that such cross-unit collaboration often begins explicitly for the digital transformation initiative, it is not commonly enshrined in established rules or procedures. Therefore, the ease of collaboration and, ultimately, the production and quality of the digital services, depends on the nature of the interpersonal relationships of the individuals involved. And, as digital transformation projects often shift power equilibria (e.g., by changing who controls the flow of information and who manages contacts with clients), thereby potentially threatening bureaucratic interests, the extent to which the individuals involved trust one another can have an outsized impact on the success of the project. Thus, as low interpersonal trust translates into low trust among civil servants, Latin American and Caribbean countries may face greater difficulty overcoming the hurdles of collaboration than civil servants in higher-trust environments. Indeed, evidence from Keefer, Perilla, and Vlaicu (2020), based on a survey of 2,449 public servants from 18 Latin American countries, demonstrates a strong connection between individual-level trust in coworkers and other public employees and willingness to cooperate and share information.

## Building Trust for a Digital Future

The digital transformation can create a new relationship between citizens and governments. Digital tools can help disseminate information, provide tools for citizens to monitor governments; reduce the cost of collective action; and hence, increase accountability. Moving procedures online reduces discretion and abuse of authority and curtails opportunities for bribery and corruption. Unfortunately, low trust impedes the uptake of

digital services, both public and private, and thus limits the growth potential that digital transformation offers. Less trusting individuals, who make up a majority in Latin America and the Caribbean, are less likely to use digital services than their high-trust counterparts. This is in part because they perceive digital services to be riddled with risks, and, in the case of public digital services, difficult to use. These perceptions reflect the overall weakness of trust-building institutions, including those that are digital-specific (such as cybersecurity and data protection) as well as those that are pre-digital (such as the justice system and the civil service).

Under certain conditions, citizens may be more willing to move online. For example, during the pandemic, office closures and movement restrictions reduced the gap in the use of digital services by low- and high-trust individuals (Roseth, Reyes, and Yee Amézaga, 2021).[5] Telemedicine is one important area in which this occurred. Historically, demand for telemedicine has been low, even though it can expand access to health care at relatively low cost. However, after the onset of the COVID-19 epidemic and subsequent mobility restrictions, the use of telemedicine grew exponentially. In Argentina, telemedicine calls increased 235 percent and calls resulting in a medicine being prescribed soared 332 percent (Busso, González, and Scartascini, 2021). The effects were mostly driven by older individuals with pre-existing conditions who used the service for internal medicine consultations. The demand for telemedicine remains high even after mobility restrictions were relaxed, which is consistent with telemedicine being an experience good. Once individuals experience the service, they are more likely to continue using it.[6]

Enjoying good services online, as in the case of telemedicine, could increase its long-term use. It can also increase the adoption of other tools, even if not experienced directly. For example, Martínez, Parilli, Rojas et al. (2021) provided an informational treatment to a large sample of Mexican nationals to evaluate the likelihood of adopting contact tracing and

[5] The pandemic also reduced people's concerns about data privacy. When the cost is sufficiently high, beliefs change. During the pandemic, 61 percent of respondents agreed that the benefits their government can provide by gathering personal data outweighed the risks during the pandemic. Agreement with the statement is statistically significantly higher for high-trust people than for low-trust people, by a magnitude equivalent to the difference by educational level (Boruchowicz et al., 2020).

[6] Similarly, those who have been victims of corruption in the physical world have found a solution in the digital world in spite of the traditional barriers of income and education (Roseth, Reyes, and Santiso, 2018; Roseth and Reyes, 2019; Roseth, Reyes, and Yee Amézaga, 2021).

diagnostic apps. The treatment highlights the convenience of online services and government efforts to move bureaucratic procedures online.[7] Those who received the treatment were more likely than a control group to download the diagnostic app and much more likely to download either app than those who were primed by the data privacy vignettes described earlier.

Online private platforms (e.g., Amazon, Uber, Airbnb) are also paving the way for greater adoption of digital services, even in sectors where trust problems might appear crippling—such as allowing strangers to share a person's vehicle or home. The platforms give providers and users information about each other: on the quality of the service, comparisons with other providers, likelihood of payment, etc. This information, in essence, indicates the likelihood of trustworthy behavior on both parts. Furthermore, all platforms impose terms of service that reserve the right to block access, of both providers and users, if a violation occurs (e.g., nonpayment, nondelivery, false advertising), thus creating nontrivial costs for untrustworthy behavior.

For some users, such trust-building mechanisms by platforms are sufficient to persuade them to put aside concerns they may have with individual sellers. The OECD (2019) found that 44 percent of purchasers on mediated platforms in Mexico proceeded with a purchase despite being unsure of the seller. They did so because they trusted the platform; 26 percent did so thanks to the existence of a post-transaction rating mechanism. These proportions are 32 percent and 27 percent in Chile, respectively.

Globally, such platforms appear to be especially successful in low-trust societies: Bergh and Funcke (2020) find that countries with lower trust (as measured by the World Values Survey) have more Airbnb listings per capita than high-trust countries, after controlling for GDP per capita, ICT infrastructure, broadband access, education level, economic openness, and travel housing demand. The negative effect of trust is approximately 46 percent as large as the positive effect of broadband access. Furthermore, the authors find that corruption is positively associated with the use of house-sharing applications. Both findings indicate that the trust-building tools—user and provider information and terms of service—are relatively more valuable in lower-trust societies. The authors posit that this

[7] The actual treatment read: "The government of Mexico has shifted many in-person bureaucratic procedures to online platforms. In addition, thanks to mobile apps, some of those 8 procedures can be performed from any location. For example, Mexicans can now pay fines online at any time and from any location. Do you agree that online services increase the welfare of Mexicans? [Yes/No]".

may be because "companies in the sharing economy transform the need for generalized trust to a need for particularized trust: Users do not need to trust people in general, they need to trust the specific and named users of the sharing economy services and the owners of these services" (Bergh and Funcke, 2020, p. 9).

Notably, private online platforms are succeeding in overcoming mistrust by providing institutional arrangements that allow buyers and sellers to avoid and resolve disputes. These are the very types of third-party institutions that the region has struggled to build in the public sector (see Chapter 7). Future research could shed more light on related issues. A detailed assessment of the tradeoff around privacy controls—between user trust and the ease of doing business—could help resolve tensions between these potentially competing objectives. An analysis of the tradeoffs between personalization and privacy in the public sector (complementing the private sector-focused analysis of Prince and Wallsten [2020]) could contribute to designing public policies that maximize efficiency in service delivery while minimizing the violation of data protection expectations. Further exploration of how interpersonal trust affects digital transformation within organizations could lead to recommendations on how to strengthen the supply side of digital services.

In order to unleash the growth potential of digital transformation, governments and the private sector must build trust. This chapter offers a roadmap for doing this. First, it demands strengthening both digital-specific and pre-digital trust-building institutions, including adapting the latter to the digital age. Modernizing the judiciary would discourage unlawful behavior in the digital space and create a more potent disincentive for bad actors. Adapting the civil service to the digital age would help public institutions deliver higher-quality digital services and provide important oversight of digital economic activity. Second, the trust-building agenda includes providing higher-quality digital services that offer greater protection to users and providers. Stronger data protection and cybersecurity would help safeguard users online. Third, digital transformation must be used to build trust. Digitizing services particularly prone to corruption would likely attract users that fear abuse—a significant proportion of the Latin American populace. Broadening the use of mediated platforms that provide transparent information on providers and users with regulated terms of service can help overcome the concerns over anonymity and noncompliance. These actions, in turn, should improve the user experience with digital services and lower perceived risks, thereby boosting demand and maximizing the promise of digital transformation.

7

# Institutions: Mitigating Mistrust

*Institutions are the bedrock of social organization, minimizing the consequences of mistrust even in high-trust societies. They permit economic exchange when trust is low and allow citizens to act collectively when otherwise they could not. They are essential to inclusive growth.*

Mistrust is part of human nature. Even in high-trust countries, people worry that employers, employees, or suppliers might take advantage of them; that government will make decisions that harm them; that government benefits will flow to individuals who are not entitled to them; or that others will not pay their taxes. When left unchecked, mistrust reduces trade, investment, and innovation; it distorts political incentives to pursue welfare-enhancing public policies; and it hinders the effective delivery of public services.

To minimize this disruption, societies have historically turned to institutions. Law codes written in Sumerian on tablets date from the XXII century BCE; the Codex Hammurabi, from XVIII century BCE, can still be seen. In the Americas, the Aztecs, Incas, and Mayans all had strong legal institutions. In all these cases, societies supported legal institutions that reduced opportunistic behavior that would prevent them from flourishing. Specifically, they introduced third parties to rule over disputes that arise when one party attempts to take advantage of another. King Solomon's judgment is a good example of this. Other institutions flourished in Ancient Rome and Greece to ensure that those in power were accountable for their actions—limiting opportunistic behavior not just by citizens against each other, but by governments against citizens. This chapter explores how institutions can compensate for mistrust in both the private and public spheres and their capacity to fulfill this role in Latin America and the Caribbean.[1]

[1] The previous chapter showed that without strong institutions it is very difficult for digitalization to flourish.

Broad evidence supports the general claim that institutions can sustain cooperative behavior. Cooperation for public goods is highest in countries that exhibit good governance and transparent institutions (Herrmann, Thöni, and Gächter, 2008). Weak institutions, on the other hand, allow corruption to flourish and reduce social trust and trust in public employees (Rothstein, 2011; Uslaner, 2005). Recent evidence from observations of the behavior of young children reinforces the importance of third-party enforcement institutions for cooperative behavior. Even at the young age of 3 to 6 years old, children are almost three times more likely to cooperate when they learn there is third-party enforcement and that the failure to cooperate is costly (Bašić et al., 2021).

Institutions that mitigate the consequences of mistrust among governments, firms, and citizens range from competitive elections and independent judiciaries to building inspectors and bank regulators. When they function well, they encourage investment, restrain opportunistic political decisions, improve the quality of public spending, and promote the selection of trustworthy and competent politicians, yielding higher-quality public policies and less rent-seeking. Modern societies have created hundreds of specialized organizations to deal with the different sectors of the economy and daily life. They all have a common purpose: reducing information—and power—asymmetries between parties and providing access to third-party enforcement.

Many of these organizations attempt to pre-empt opportunistic behavior before it occurs. Though they are not the focus of this chapter, modern states have a vast array of such agencies, charged with reducing information asymmetries that limit trust and economic exchange. Drug regulators give patients third-party information about the quality of medicines that they themselves could not easily infer. Patients can therefore follow medical recommendations without second-guessing intentions. In finance, depositors have limited information about the risk profile of bank assets and whether bank representations about the safety of their deposits are accurate. In such a situation, at the first sign of trouble, depositors rush to withdraw their funds, triggering banking crises. Bank regulators mitigate the problem of asymmetric information between bankers and depositors, increasing trust in banks. They supervise bank balance sheets to ensure that their risk corresponds to the promises they have made to depositors regarding the safety of their deposits. Mistrust between customers and restaurants regarding food safety suppresses demand for restaurant meals. Food inspectors close the information gap by regulating how food is stored and prepared. Real estate markets function more smoothly when customers have greater confidence in building quality; however, quality

is difficult to verify, particularly post-construction. City governments offset this information asymmetry by enforcing building codes and regularly inspecting elevators and other systems.

Regulatory agencies such as those associated with banking or building supervision prevent disputes before they arise; by constantly monitoring the behavior of firms, they limit the scope for opportunistic behavior. This chapter focuses on institutions that resolve disputes after they arise. It reviews substantial evidence that third-party enforcement institutions stimulate investment and employment and foster significantly greater trust in government. However, institutional development is lagging in the countries of Latin America and the Caribbean. The distance between the region's institutional indicators and those of the OECD suggests that institutional reform can yield large economic and political benefits to the region.

## Institutions as Economic Referees

Referees preside over nearly all sports around the world. If competitors trusted each other to self-report rules violations, referees would not be necessary. Players' faith in self-enforcement is evidently limited, however. The absence of referees exacerbates the trust conundrum that Charlie Brown faces when trying to kick the ball that Lucy says she will hold for him—only to take it away at the last minute. The consequences of low-quality refereeing are significant: spectators and players—other than Charlie Brown—lose interest in sporting events where rule enforcement is unreliable.[2] The consequences of fragile third-party enforcement institutions in the private sector are as dire as they are for sporting competitions.

### Contract Enforcement and Property Rights

When they lack trust in each other, and no referee is available to enforce the rules, individuals and firms have less confidence that their contractual and property rights will be respected. They stop playing the economic game. Investment grinds to a halt because investors believe that others will lay claim to their ownership of the assets they purchase. Access to credit evaporates because potential lenders believe that financial contracts are not binding. Economic exchange falls because trading partners cannot rely on promises regarding the quality of the product or the timing

[2] The introduction over the years of additional electronic tools to improve refereeing and reduce mistakes and discretion strengthens this point.

of payment and delivery. More efficient and innovative firms refrain from entering new markets: the very fact that they are new means the market has little confidence in them.

An enormous body of evidence demonstrates that weak contract enforcement and fragile property rights suppress growth and productivity (Knack and Keefer, 1995; Keefer and Knack, 1997; and Acemoglu, Johnson, and Robinson, 2001). These analyses rely on subjective evaluations to gauge the quality of institutions. Objective measures, based on citizens' decisions as to how to hold their financial assets, demonstrate similarly large effects on growth and investment (Clague et al., 1999).[3] This is true for Uruguay going back to 1870 (Fleitas et al., 2013). Weak contract enforcement accounts for a significant share of Argentine economic decline since World War I (Prados de la Escosura and Sanz-Villarroya, 2009). On the other hand, strong contract and property rights support innovation and higher investment (Acemoglu, Antràs, and Helpman, 2007).

Chapter 3 explains that mistrust obstructs specialization and the emergence of efficient supply chains. So too does weak third-party enforcement. Countries with better contract enforcement specialize in producing goods for which relationship-specific investments are most important (investments that are most subject to hold-up problems, that is, investments with returns that could be expropriated ex-post). In fact, contract enforcement may be a more important determinant of the pattern of trade between countries than physical capital and skilled labor combined (Nunn, 2007).

## The Economic Importance of Judicial Institutions

Confidence in third-party institutions, just like confidence in referees at sporting events, is greater when they are independent and do not favor one party or the other; when they are efficient and adjudicate disputes rapidly; and when they are transparent and predictable—when the criteria they use to adjudicate disputes are well-known and applied to every case. The impact of judicial institutions on economic activity highlights the damaging consequences when third-party institutions do not meet these criteria.

Firms operating in jurisdictions with ineffective judiciaries are significantly less productive. Work from Mexico exploits an index that captures key determinants of confidence in the judicial resolution of private sector

[3] Clague et al. (1999) investigate contract-intensive money. When contract enforcement is weak, economic actors prefer to use currency. The use of currency relative to non-currency instruments is, therefore, an indicator of how participants perceive the quality of contract enforcement.

disputes.[4] Firms are larger and more productive in Mexican states with more efficient judiciaries (Laeven and Woodruff, 2007). A one standard deviation improvement in judicial efficiency increases average firm size by 10–15 percent.[5] These third-party enforcement institutions should matter more for firms that face the greatest risk from insecure contract or property rights (Dougherty, 2014). In fact, highly capital-intensive industries in Mexico benefit most from better quality courts.

In other countries, fine-grained data on court quality are usually not available. Researchers have instead focused on how efficiently courts adjudicate disputes, based on the maxim "justice delayed is justice denied." After all, sports referees who are knowledgeable, consistent, and unbiased are still useless if they call penalties minutes or hours after the penalties occur.

Using administrative records of judicial delays in Italy, Giacomelli and Menon (2017) show that factories located in the least efficient judicial districts in Italy employ 23 percent fewer workers than plants in districts with the most efficient courts.[6] In India, lower tariffs to increase firm productivity are better exploited in those Indian states where judicial efficiency is high (Ahsan, 2013). In states where judicial efficiency ranks in the top 25 percent, a 10 percentage point reduction in tariffs increases the productivity of firms by 3.6 percentage points more than it does in states at the median level of judicial efficiency. Overall, countries with independent judiciaries grow more than 1.5 percentage points per year faster than countries without them (Feld and Voigt, 2003; Voigt, Gutmann, and Feld, 2015).

Chapter 3 demonstrates that when trust is low, firms must rely more on relational contracts to enforce mutual obligations. These, in turn, make it more difficult for new firms to emerge. Ineffective judiciaries have the same effect. New firms with better products and production processes are essential to economic growth; however, they are less likely to enter when courts do not reassure potential customers and suppliers that they will adequately resolve any disputes with new partners. Firm managers who believe courts are effective also express greater trust in their customers or

[4] The index is based on the responses of 519 lawyers who work on the collection of bank debt in Mexico. The index comprises responses to questions about the quality of judges, their impartiality, the adequacy of judicial resources, the efficiency of enforcement of rulings, the efficiency of the judicial administration more generally, the usefulness of property registries, and the adequacy of state legislation governing contract enforcement.

[5] Their results are robust to using two instrumental variables: the state's indigenous population in 1900 and the active presence of the drug trade in the state.

[6] To support their causal interpretation, Giacomelli and Menon (2017) observe that because of historical circumstances, the assignment of firms to judicial regions in Italy is quasi-random; they compare firms on either side of the borders of these regions.

suppliers in a survey of 1,700 private manufacturing firms in five post-communist countries (Johnson, McMillan, and Woodruff, 1999, 2002). Crucially, this effect was due to their trust in new partners, not long-standing ones. Firms that rely on the courts were also more likely to abandon their existing supplier if a new, previously unknown supplier offered them a 10 percent lower price (Johnson, McMillan, and Woodruff, 1999). In Spain, rates of firm entry are higher in provinces with greater judicial efficacy (García-Posada and Mora-Sanguinetti, 2014).

Low-quality judiciaries also suppress innovation among incumbent firms (Seitz and Watzinger, 2017). Private sector investment in research and development is significantly higher in countries where contract enforcement is more robust. Again, the effect is strongest in industries in which disputes are more likely to arise: industries in which firms rely more on single suppliers for their inputs and cannot easily shift to other suppliers in the event of contractual nonperformance.

Weak judiciaries undermine supply chains (Boehm and Oberfield, 2020). In India, firms make flawed production and sourcing decisions in states with less efficient courts. They are more likely to vertically integrate production (undertake different stages of the production process themselves) and not participate in supply chains. Consequently, their aggregate productivity is lower. Driven by concerns about the reliability of contracts with outside suppliers, firms bring production in house, sacrificing opportunities to do business with new, more efficient suppliers. The problem is not unique to India. Boehm (2018) gathers evidence from many countries focusing on the economic sectors with the greatest potential for dispute. These sectors are smaller in countries with weaker contract enforcement; firms in those sectors spend less on intermediate inputs. The negative impact on citizen welfare is large.[7]

## Third-party Enforcement Institutions and Firm Financing

Trust shapes credit access: individuals who mistrust banks are less likely to make deposits, thereby reducing the funds available for borrowing,

[7] Boehm calculates which sectors are more vulnerable to dispute by making clever use of data from the United States. These data record the frequency of judicial litigation by firms across different sectors. Provided that two assumptions hold, these data describe the vulnerability to dispute of firms in those same sectors in other countries. The first assumption is that firms in the United States that have more disputes in general should also take more cases to court. Since courts in the United States are relatively efficient, this is reasonably likely. Second, any sector-specific biases in whether firms are prone to disputes or use the courts must be systematically different between firms in the United States and firms in those same sectors in other countries.

and banks that mistrust borrowers are less likely to lend (as discussed at length in Chapters 3 and 5). Third-party institutions can offset mistrust and encourage financial sector transactions: where creditor rights, contract enforcement, and accounting practices are strong, financial intermediation and growth are significantly higher (Levine, Loayza, and Beck, 2000). Firms are also larger (Beck, Demirgüç-Kunt, and Maksimovic, 2006).

In contrast, weak contract enforcement raises the risk of loan default and acts essentially as a tax on borrowing (Bae and Goyal, 2009). Banks pass the costs of this tax on to borrowers in the form of higher interest rates. In countries with stronger contract enforcement, the tax is lower. Banks charge less for their services: spreads (the difference between lending and borrowing rates of interest) are smaller.[8] Bank loans are correspondingly larger and have longer maturities. In Italy, firms in provinces with longer trials and larger backlogs of pending trials have significantly lower credit access (Jappelli, Pagano, and Bianco, 2005). Firms access to credit and their size are larger in regions of Spain with more efficient courts (Fabbri, 2010).

Thus, weak third-party enforcement institutions impede the entry of new and more productive firms. Credit conditions are particularly important for new firms, as Derrien, Mésonnier, and Vuillemey (2020) demonstrate in France. New firms incur significant set-up costs and, therefore, demand more longer-maturity debt. Consequently, when banks in France reduced the supply of long-term loans, new firm creation fell most in industries with high set-up costs. Their analysis, though not explicitly concerned with contract enforcement, accounts for the findings of Johnson, McMillan, and Woodruff (1999): new firms in formerly communist countries were less likely to be offered trade credit by other firms. Firms that said courts were effective gave 6 percent more trade credit; firms extended 13 percent more trade credit to firms they had dealt with for at least three years than they did to new firms.

Comparing Ecuador and the United Kingdom produces a similar conclusion (Arellano, Bai, and Zhang, 2007). Ecuador has weaker contract enforcement. Since the risk-adjusted price of bank loans is higher, firms rely less on it than do similar firms in the United Kingdom. More importantly, consistent with the findings in Derrien, Mésonnier, and Vuillemey (2020), these effects fall disproportionately on smaller firms. In Ecuador, smaller firms rely less on bank financing than large firms. In the United Kingdom, smaller firms rely more on bank financing.

[8] Savers also confront contractual risks and should also demand higher interest rates to compensate. However, if savers consider banks less risky than banks view borrowers, the net effect of contract risk is to widen interest rate spreads.

Weak contract enforcement also reduces access to nonbanking finance, such as private equity. Private equity investments can range from credit-like instruments with no direct influence on firm governance to equity investments with seats on the board. The first is usually cheaper for firms. However, in weak contracting environments private equity investors seek greater scrutiny and control over their investments to better protect their interests. In fact, private equity investors are more likely to take equity shares with board membership in countries with weak contract enforcement (Lerner and Schoar, 2005). In countries with stronger enforcement, in contrast, they are willing to rely on credit (in the form of preferred stock).

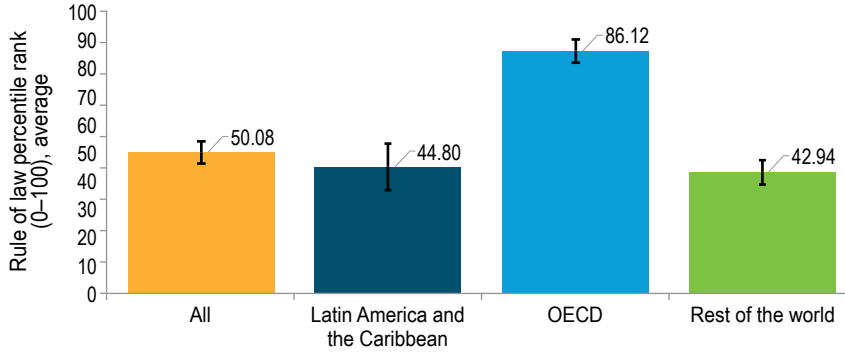
## Latin American and Caribbean Institutions: Lagging in the World

Although institutions of third-party contract enforcement are crucial for economic and firm growth, they are significantly less robust in Latin America and the Caribbean than in the OECD. The most widely used measure of institutional quality, with the greatest coverage of countries around the world, is the rule of law indicator from the World Bank's Worldwide Governance Indicators project. It assesses whether disputes in a country are settled according to predictable legal standards or are based on extra-legal considerations.[9] Figure 7.1 shows that the rule of law is far more securely embedded in the OECD than in the rest of the world. More surprisingly, and despite its middle-income status, the rule of law in Latin America and the Caribbean is not only significantly weaker than in OECD countries, it varies little from the average of all countries outside of the OECD and Latin American and Caribbean regions, most of which are poorer.

The Worldwide Governance Indicators (WGI) are based on the assessments of expert observers. The World Bank Enterprise Surveys (WBES) collect data directly from firms, but irregularly and with more limited year and country coverage than the WGI. These surveys allow average firm experiences with bribery, regulation, and tax enforcement to be compared across countries. Even more importantly, using the WBES data, the variation across firms of their experiences within a country can be calculated. Hallward-Driemeier, Khun-Jush, and Pritchett (2016) argue that an increase in variability has a larger negative effect on firm performance than worsening

[9] Individuals and firms have less confidence in their contract and property rights if extra-legal considerations prevail. The WGI compiles evaluations by many organizations, most of which are efforts by experts to judge country risk. The quality of these evaluations passes a market test, since they are purchased by multinational corporations and other foreign investors.

**Figure 7.1 ▶ Rule of Law (Worldwide Governance Indicators), 2010–2017**




*Source*: Authors' calculations based on data from Worldwide Governance Indicators.
*Note*: Rule of law (2010–2017) comes from the Worldwide Governance Indicators and "captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence." Each bar is a simple average from country-level data. The OECD group of advanced economies excludes Latin American and Caribbean countries: Colombia, Costa Rica, Chile, and Mexico. The total sample encompasses 214 countries, and the Latin American and Caribbean countries included are: Argentina, Antigua and Barbuda, The Bahamas, Belize, Bolivia, Brazil, Barbados, Chile, Colombia, Costa Rica, Cuba, Dominica, Dominican Republic, Ecuador, Grenada, Guatemala, Guyana, Honduras, Haiti, Jamaica, Saint Kitts and Nevis, Saint Lucia, Mexico, Nicaragua, Panama, Peru, Paraguay, El Salvador, Suriname, Trinidad and Tobago, Uruguay, Saint Vincent and the Grenadines, and Venezuela.

levels of bribery, regulation, or tax enforcement. It also reflects weak rule of law, since it reveals the arbitrary application of government policies that yield decisions that are untethered from legal requirements.

For example, the WBES asks firms how much time it took them to obtain an operating license. In East Asia they report on average 21 days and in Latin America and the Caribbean, 44 days. In and of themselves, longer delays in the region are likely to pose an unnecessary impediment to growth, but they are not evidence that the rule of law is weak. The dispersion of waiting times is, however. The variability in the number of days that Latin American and Caribbean firms report it takes them to obtain an operating license is three times the variability reported by East Asian firms.[10]

The WGI and WBES indicators describe the de facto institutional constraints on firm activities—the constraints they confront in practice. The World Bank Doing Business project collects de jure measures of the institutional environment: if countries followed the letter of the law as described by legal practitioners in the country, how strong would property

[10] The average number of days the East Asian firm waits is 21, and the standard deviation is 19.8 days. The average in Latin America and the Caribbean is 44, but the standard deviation is 62 days.

and contract rights be? De jure indicators are not reliable measures of the degree to which institutions protect rights in practice. As Hallward-Driemeier and Pritchett (2015) observe, de facto practices necessarily diverge from de jure prescriptions when the rule of law is weak.[11] Nevertheless, de jure measures of institutional protections of contractual and legal rights are also low in Latin America and the Caribbean.

The Doing Business Contract Enforcement Index is based on the time and monetary costs required to enforce a standard contract through the courts if formal legal procedures were followed exactly, and the quality of judicial processes (e.g., the extent to which they are automated and the efficiency of case management). The index runs from zero to 100. As Figure 7.2 illustrates, the OECD scores significantly higher than the rest of the world, including Latin America and the Caribbean.

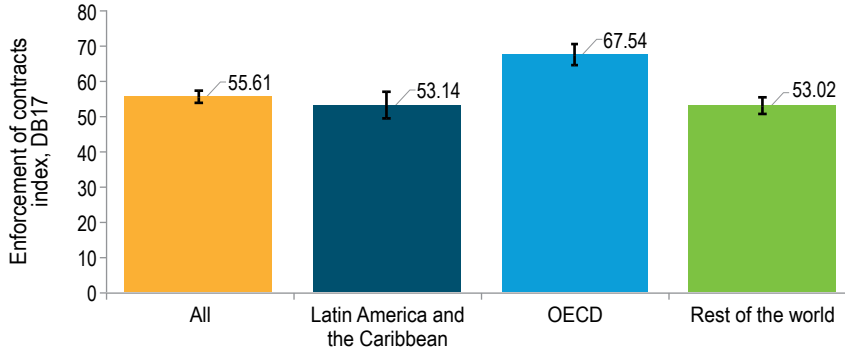
The rule of law, the variability of firm experiences with regulation and the laws governing contract enforcement are products of institutions but not direct measures of the quality of institutions themselves. Of course, many different institutions contribute to these outcomes, from legislatures to courts to the public administration. In the context of the rule of law, however, it is reasonable to focus first on the quality of courts, which has already been identified as important for firm growth.

Systematic cross-country data on the quality of country judiciaries focus on their independence, a central element for ensuring the rule of law. Judicial independence implies that the adjudication of disputes among firms, individuals, and government is based on a transparent application of established law to the facts of the case. Individuals and firms can reasonably expect disputes not to be settled in favor of the more powerful. In contrast, lack of independence implies that judges may make decisions based on other, not necessarily observable factors, unrelated to legal statutes. These—for example, the pressure exerted by outside parties—are likely to vary across judges and over time.

Just as with the rule of law and the security of contractual rights, one can measure either de facto or de jure judicial independence. De facto independence is whether, in practice, judiciaries operate free of outside influence. It is a product of both the formal rules governing the judiciary and the informal norms of the individuals who interact with it. Informal norms matter: in societies with low trust and weak norms of civic behavior, individuals and firms are more likely to circumvent the formal rules and

[11] Theoretically, firms in countries with few *de jure* protections of contract and legal rights could have strong *de facto* rights. The evidence in Hallward-Driemeier and Pritchett (2015) suggests that the bias is more likely to go the other way.

**Figure 7.2 ▶ Contract Enforcement (Doing Business Indicators), 2016–2020**



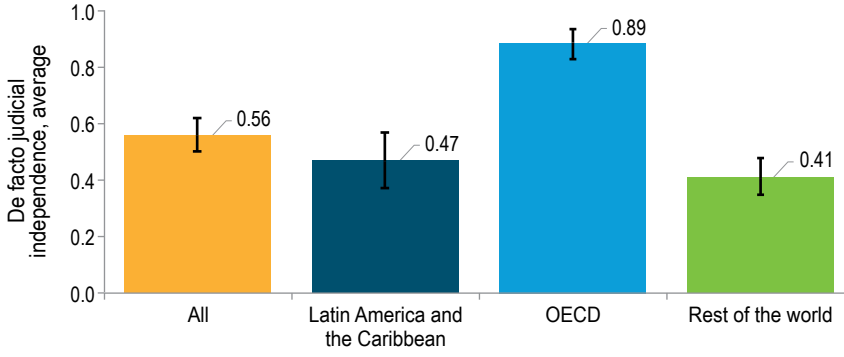

*Source*: Authors' calculations based on data from World Bank's Doing Business Indicators.
*Note*: The score of enforcing contracts (2016–2020) comes from the Doing Business data and "is the simple average of the scores for each of the component indicators: the time and cost for resolving a commercial dispute through a local first-instance court, as well as the quality of judicial processes that promotes quality and efficiency in the court system." The score is computed based on the methodology in the DB17–20 studies, which includes the quality of the judicial process index as a new element for the score creation. Each bar is a simple average from country-level data. The OECD group of advanced economies excludes Latin American and Caribbean countries: Colombia, Costa Rica, Chile, and Mexico. The sample includes data only from the capital city of each country. The total sample encompasses 192 countries, and the Latin American and Caribbean countries included are: Argentina, Antigua and Barbuda, The Bahamas, Belize, Bolivia, Brazil, Barbados, Chile, Colombia, Costa Rica, Dominica, Dominican Republic, Ecuador, Grenada, Guatemala, Guyana, Honduras, Haiti, Jamaica, Saint Kitts and Nevis, Saint Lucia, Mexico, Nicaragua, Panama, Peru, Paraguay, El Salvador, Suriname, Trinidad and Tobago, Uruguay, Saint Vincent and the Grenadines, and Venezuela.

seek support for their positions through extra-institutional means. They are more likely to ask for political interference or to bribe judges, confident that politicians will be willing to exert influence and judges to accept the bribes. In contrast, de jure independence captures only whether formal legal and constitutional provisions insulate judiciaries from outside interference.

Latin American and Caribbean judiciaries enjoy a high level of de jure independence, exceeding the average de jure independence of the countries of the OECD (excluding, as always, the Latin American members of the OECD).[12] Consistent with the critique of de jure measures offered by Hallward-Driemeier and Pritchett (2015), however, measures of de facto

[12] Based on author calculations of data from Hayo and Voigt (2018, 2019) and Feld and Voigt (2003), where the index of de jure independence is composed of the following variables laid out in Hayo and Voigt (2005, p. 15): "modus of nominating or appointing highest court level judges, their term lengths, the possibility of re-appointment, the procedure of removing them from office, their pay and possible measures against reduction of their income, the accessibility of the court, the question of whether there is a general rule allocating cases to specific judges, and publication requirements concerning the decisions of the court."

**Figure 7.3 ▶ De Facto Judicial Independence, Latin America and the Caribbean versus Other Regions, 2010–2015**



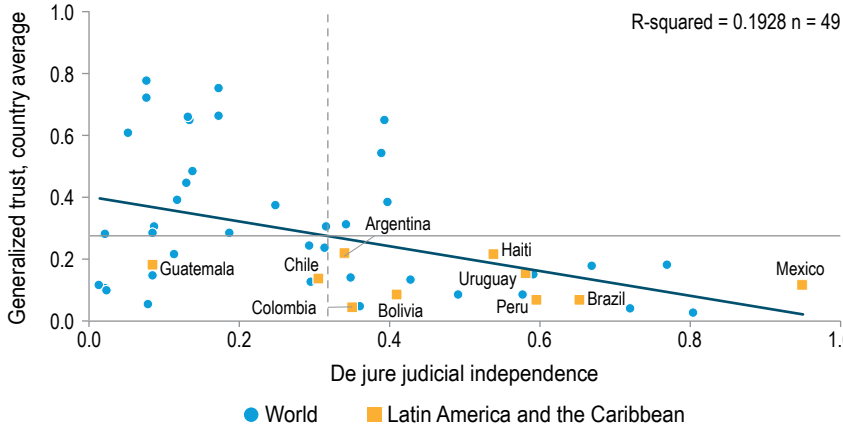

*Source*: Authors' calculations based on data from Hayo and Voigt (2018, 2019) and Feld and Voigt (2003).
*Note*: The de facto judicial independence variable can take on values between 0 and 1, and uses eight components, such as, "effective average term length of the members of the highest court, number of other judges who are members of the same court, income level of their judges, whether a decision of the highest court (in order to be implemented) depends on some action of one, or both, of the other government branches." Each bar is a simple average from country-level data. The OECD group of advanced economies excludes Latin American and Caribbean countries: Colombia, Costa Rica, Chile, and Mexico. The total sample encompasses 87 countries, including the following Latin American and Caribbean countries: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Cuba, Dominican Republic, Guatemala, Guyana, Honduras, Haiti, Jamaica, Mexico, Panama, Peru, Paraguay, Uruguay, and Venezuela.

independence tell an entirely different story (see Figure 7.3). Demonstrating the difficulties of building institutions in low-trust environments, the judiciaries of Latin America and the Caribbean exhibit far less de facto independence than those in the OECD.

The differences between de jure and de facto judicial independence offer insights into the relationship between institutions and trust. Low-trust countries may attempt to offset mistrust by introducing formal guarantees of judicial independence. However, in low-trust societies, individuals and firms are more likely to try to circumvent formal guarantees to secure extra-judicial relief for their grievances. In high-trust societies, in contrast, firms and individuals expect others to play by the established rules, which include respect for the decisions of courts even when judicial independence is not supported by strong formal constitutional provisions. Greater de jure independence is associated with lower generalized trust, while greater de facto independence is associated with higher generalized trust (see Figures 7.4 and 7.5).[13]

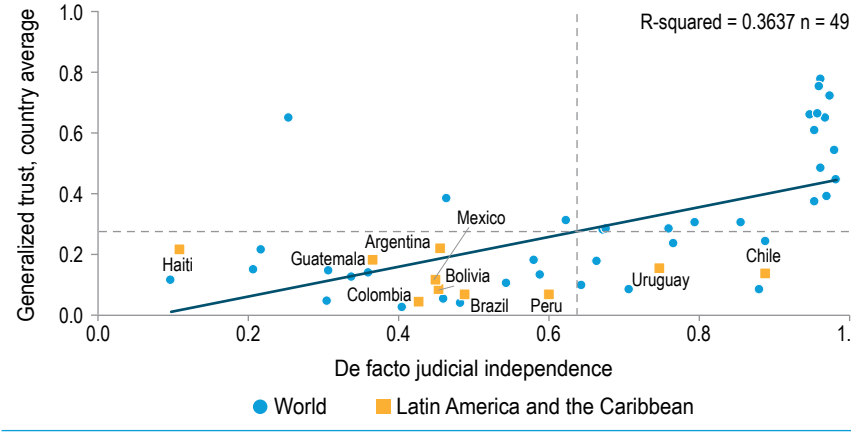
[13] The *de jure* and *de facto* measures are highly related to another concept repeated in this chapter: institutionalization. Formal rules matter in institutionalized settings (Caruso, Scartascini, and Tommasi, 2015) and institutionalization is possible only when actors trust the results of the formal process (Scartascini and Tommasi, 2012).

**Figure 7.4 ▶ Generalized Trust and De Jure Judicial Independence, Latin America and the Caribbean versus Other Regions**




*Source*: Authors' calculations based on data from the World Values Survey, Hayo and Voigt (2018, 2019), and Feld and Voigt (2003).
*Note*: The trust data comes from the Integrated Values Survey (2010–2020), which compiles the sixth and seventh wave of the World Values Survey; as well as the fifth wave of the European Values Study. *De jure* judicial independence data comes from the updated database of the Feld and Voigt (2003) analysis. Each point is the simple average of the observations of each country for the years 2010–2015 and 2010–2020, x-axis, and y-axis, respectively. The dotted lines represent the average values in the entire sample for each variable. The total sample encompasses 49 countries including Argentina, Bolivia, Brazil, Chile, Colombia, Guatemala, Haiti, Mexico, Peru, and Uruguay.

**Figure 7.5 ▶ Generalized Trust and De Facto Judicial Independence, Latin America and the Caribbean versus Other Regions**




*Source*: Authors' calculations based on data from the World Values Survey, Hayo and Voigt (2018, 2019), and Feld and Voigt (2003).
*Note*: The trust data comes from the Integrated Values Survey (2010–2020), which compiles the sixth and seventh wave of the World Values Survey; as well as the fifth wave of the European Values Study. *De facto* judicial independence data comes from the updated database of the Feld and Voigt (2003) analysis. Each point is the simple average of the observations of each country for the years 2010–2015 and 2010–2020, x-axis, and y-axis, respectively. The dotted lines represent the average values in the entire sample for each variable. The total sample encompasses 49 countries including Argentina, Bolivia, Brazil, Chile, Colombia, Guatemala, Haiti, Mexico, Peru, and Uruguay.

## Institutions to Boost Trust in Government

In the private sector, mistrust interferes with economic exchange when, as often happens, buyers and sellers have incentives to take advantage of each other. Institutions compensate for mistrust and support exchange by requiring counterparts to adhere to their obligations. These same institutions can, in principle, also perform this function when one of those counterparts is the government itself. For example, courts can and should offer effective recourse to citizens hurt by arbitrary government decisions. Independent judiciaries are precisely those that are willing to rule against government in such disputes. However, trust in government depends on a much broader array of institutional arrangements. These other institutional arrangements increase the de facto independence of judiciaries, but also protect citizens and firms from entirely legal decisions by governments that are, nevertheless, contrary to citizen interests and to the prior promises of governments. This section examines the relationship to trust of a few of these institutions.

The starting point is that trust in government is low when citizens cannot hold governments accountable for acting contrary to their interests. As noted in previous chapters, one barrier to accountability is the inability of citizens to act collectively. The other is lack of citizen information about government behavior. Institutions that increase citizen trust in government remove these barriers.

Recalling the discussion in Chapter 4, any group of citizens is better off supporting the candidate who will pursue their collective interests: a policy environment more conducive to job and income growth, a more progressive tax system with fewer loopholes, or higher quality education, for example. Individually, however, group members can make themselves better off by voting for candidates who offer them the greatest personal rewards—money for their vote, a job in government, or assistance with the bureaucracy—even when those candidates are inferior. If citizens cannot overcome this collective action dilemma, they cannot punish governments that ignore promises they have made and pursue policies that harm citizen interests.

When citizens are uninformed about government actions, governments can ignore promises knowing that citizens have insufficient information to monitor their behavior. Also, the more ignorant citizens are of politician characteristics, the greater are the incentives of low-quality candidates—and the weaker the incentives of high-quality candidates—to compete for office (Caselli and Morelli, 2004; Markussen and Tyran, 2017).

Even in contexts in which collective action is difficult, elections should help citizens get rid of bad politicians. Voting has lower costs than other forms of participation and the competitive nature of elections

should generate information on which citizens can base their decisions. Competitive, clean, and recurrent elections are associated with greater trust in government.

Elections do not eliminate collective action barriers entirely, however: it is still difficult for citizens to coordinate their votes or to identify candidates whose promises are closest to their own preferences. Institutionalized political parties are the main organizational arrangement through which citizens can overcome these significant remaining barriers. Parties help large groups of voters overcome the collective action problem of coordinating their support for their preferred candidates (Kitschelt, 2007). They also solve the collective action challenge of holding multiple politicians jointly accountable for their actions (Aldrich, 1995) as well as the collective action problem of legislators (Cox and McCubbins, 1994). Political parties can achieve these goals if they are institutionalized—for example, if their internal organization curbs the incentives of opportunistic politicians. They might do this by providing incentives for politicians to build a career, which in turn solves legislators' collective action problems and furthers the institutionalization of legislatures (Palanza, Scartascini, and Tommasi, 2016). Because they limit what rogue politicians can do, they are strongly associated with trust in government.

## The Promise and Limits of Competitive Elections

Competitive elections are a key institution to facilitate citizens' collective action and to increase citizen information. With respect to collective action, they provide the opportunity, time, and place for all voters to make simultaneous judgments about their governments. With respect to information, elections oblige candidates to seek support from citizens and the resulting interactions increase citizen knowledge of candidate qualities (Scartascini and Vlaicu, 2018). If elections have these effects, they should increase citizen trust in government.

Ample evidence supports the argument that democracy affects trust, in general and in government. Dal Bó, Foster, and Putterman (2010) show that democratic institutions in the laboratory positively affect individuals' attitudes and behavior. Rural communities are less likely to violate irrigation rules when they have set those rules at the community level (Bardhan and Mookherjee, 2000).

Aragón (2013) examines national-level elections, comparing citizens' trust in government in Latin American countries in which presidents were selected as candidates by their parties in a primary election and those where party leaders selected candidates. Party leaders are likely to place

more weight on loyalty to the party and candidate ability to represent the party's policy message.[14] In contrast, primaries oblige candidates to demonstrate their responsiveness to citizens and weigh the candidate qualities that party members value more than those valued by party leaders. One of these qualities is trustworthiness.[15] In fact, when the president's candidacy is determined through a primary, government performance is better and trust in government is greater (Aragón, 2013).

Of course, nearly all the countries of the Latin America and Caribbean region have competitively elected governments. However, competitive elections alone—where multiple parties contest the election and no single party is dominant—are insufficient to solve the collective action and information challenges that citizens confront. They are also insufficient to persuade governments to make decisions that are more closely aligned with citizen interests (Bueno de Mesquita et al., 2003). Nevertheless, more expansive measures of democracy do exhibit significant effects on the alignment of public policy with citizen interests. These measures go beyond competitive elections to capture such characteristics as whether elections are conducted fairly or whether challengers can easily enter the contest. Democracy, measured broadly, sufficiently reduces the barriers to government accountability to yield improved health policy and life expectancy (Baum and Lake, 2003; Besley and Kudamatsu, 2006); greater household access to electricity in poor countries (Brown and Mobarak, 2009); and more sustainable environmental policies (de Soysa, Bailey, and

[14] Party leaders in Italy assign loyal party members to safe seats, where they have a greater probability of taking office (Galasso and Nannicini, 2014). They are also more likely to select high-quality candidates (e.g., those with more years of schooling, higher incomes, and local government experience) for more contested districts (Galasso and Nannicini, 2011). Selection matters: politicians in contested districts have fewer absences in parliament. Indeed, high-quality politicians in contested seats that subsequently become safe nevertheless have fewer absences than low-quality politicians in safe seats that subsequently become contested.

[15] Brazilians, for example, exhibit strong aversion to corrupt politicians: 62 percent of survey respondents said they would support a mayor who was non-corrupt but failed to deliver projects; only 28 percent reported that they would support the competent but dishonest incumbent (Winters and Weitz-Shapiro, 2013). In surveys of voters in Britain, France, and Germany, respondents agreed that they would much rather have honest politicians, even if they did not "deliver the goods," to dishonest politicians, even if they did deliver (Allen, Birch, and Sarmiento-Mirwaldt, 2018). Incentivized laboratory experiments with French university students yield the same results: subjects expressed support for the incompetent but honest rather than the competent, dishonest politician, even though they incurred a financial cost in doing so (Galeotti and Zizzo, 2018).

Neumayer, 2009; Roeland and de Soysa, 2021). In the long run, these countries are 20 percent richer (Acemoglu et al., 2018).[16]

If elections must be both clean and competitive to promote greater accountability, then measures of clean elections should be associated with trust in government. The Clean Elections Index of the V-Dem project incorporates assessments of whether vote-buying and voter intimidation are high and whether voting itself is meaningful and not distorted by the manipulation of voter registrations and ballots.

These practices directly undermine voter collective action, substituting the preferences of the election "manipulator" for those of citizens. In addition, they change the composition of candidates. They give an advantage to candidates who excel at ballot stuffing and voter intimidation, but are unlikely to be as trustworthy or motivated by the public interest as those who succeed in fair elections. Compelling evidence from Ghana illustrates the importance of electoral fairness: Ofosu (2019) finds that Ghanaian legislators whose elections are monitored by third parties do significantly more for their constituents than legislators elected in the absence of such monitors.

Elections in Latin America and the Caribbean are moderately clean, but significantly less so than those in OECD countries (see Figure 7.6). The difference between the OECD average, 0.93, and the Latin American and Caribbean average, 0.71, is about the same as the difference between a top-scoring Latin American and Caribbean country and a middle-ranking country in the region.[17]

If clean elections mitigate the collective action problems of voters and improve the quality of candidates who run for office, they should also increase trust in government. Considering only countries in the region, there is, in fact, a strong positive correlation between trust in government and clean elections (Figure 7.7).[18]

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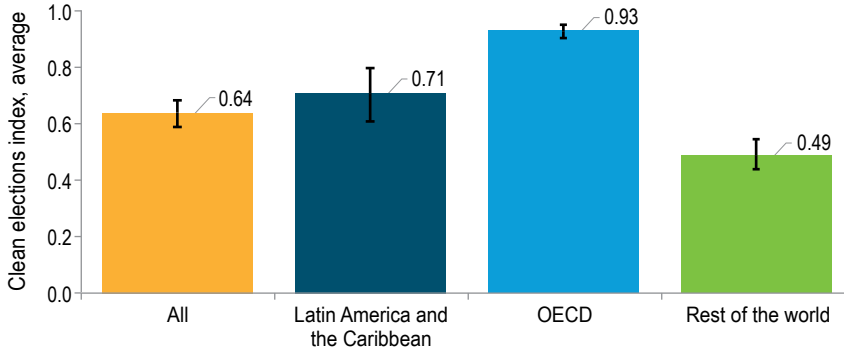
[16] In addition to competitive elections, the Polity measure of democracy in these papers incorporates the regularity of transfer of executive power, the opportunities for non-elites to gain executive power, de facto constraints on the executive, freedom of political expression, and the extent to which non-elites have access to institutional structure for political expression.

[17] The comparison only includes country-years in which a country's leaders were competitively elected since the objective is to see what complementary factors, beyond competitive elections, are needed to improve trust in government.

[18] Across all countries and years with competitively elected governments, the relationship between clean elections and trust in government is weak. This is almost entirely because countries in the Latin American and Caribbean region exhibit higher than average scores on clean elections and lower than average scores on trust in government.

**Figure 7.6 ▶ Clean Elections Index, Latin America and the Caribbean versus Other Regions, 2010–2020**



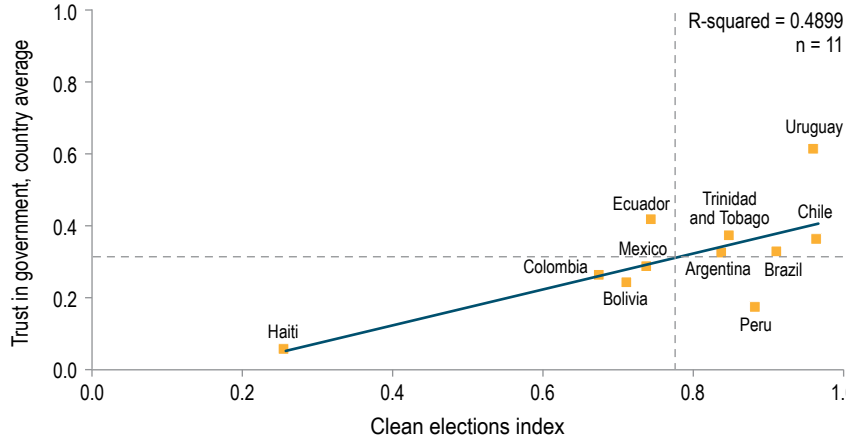

*Source*: Authors' calculations based on data from the Varieties of Democracy (V-Dem).
*Note*: The clean elections index (2010–2020) comes from the University of Gothenburg V-Dem dataset. The index ranges from 0 to 1 and "free and fair connotes an absence of registration fraud, systematic irregularities, government intimidation of the opposition, vote buying, and election violence." Each bar is a simple average from country-level data. The OECD group of advanced economies excludes Latin American and Caribbean countries: Colombia, Costa Rica, Chile, and Mexico. The sample is restricted to observations with competitive elections according to the Database of Political Institutions (2010–2020). The total sample encompasses 137 countries including the following Latin American and Caribbean countries: Argentina, Bolivia, Brazil, Barbados, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Guatemala, Guyana, Honduras, Haiti, Jamaica, Mexico, Nicaragua, Panama, Peru, Paraguay, El Salvador, Suriname, Trinidad and Tobago, Uruguay, and Venezuela.

Trust in government should also rise when citizens have more experience with competitive elections. It takes time for citizens to learn about the quality of individuals seeking to govern them and build the institutionalized political parties that facilitate coordinated voting. Hence, governments elected in democracies with more continuous years of competitive elections should face greater pressure from citizens to align public policy with citizen interests. Countries with more continuous years of competitive elections exhibit lower rent-seeking and favor public policies that extend benefits to all citizens, such as ensuring the rule of law, high bureaucratic quality, and access to education and information, over policies that send benefits to targeted groups of citizens, such as jobs in government and public works contracts (Keefer, 2007). Countries with greater accumulated experience with democracy since 1900 grew faster over the period 1950–2000 (Gerring et al., 2005).

Over the period 2010–2020, the countries of the region exhibited significantly fewer years of continuous competitive elections than countries of the OECD (see Figure 7.8).[19] Importantly, countries of the region with

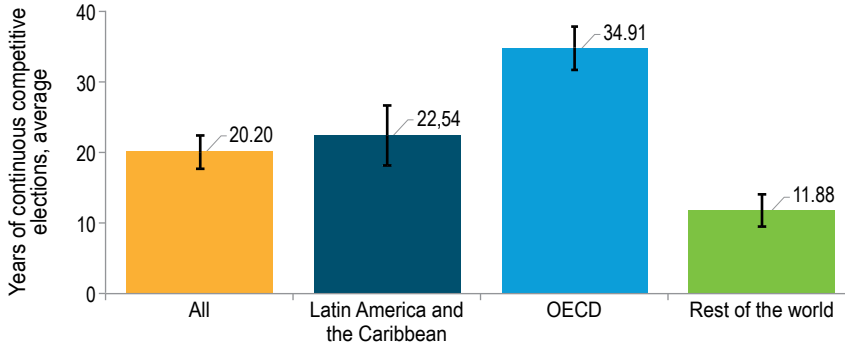
[19] In several countries, candidates or parties were elected with more than 75 percent of the vote. These elections do not count as competitive; the value of the variable continuous competitive elections in those years is set to zero.

## Figure 7.7 ▶ Clean Elections and Trust in Government: Latin America and the Caribbean



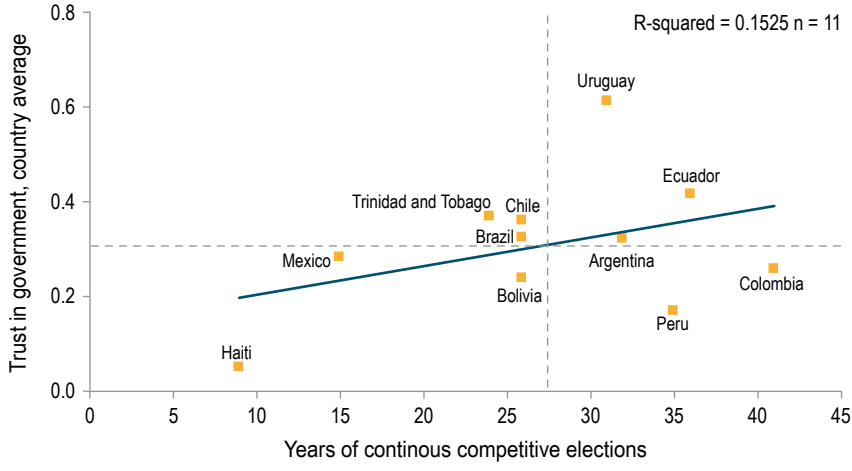

*Source*: Authors' calculations based on data from the Varieties of Democracy (V-Dem) and the World Values Survey.
*Note*: The clean elections index (2010–2020) comes from the University of Gothenburg V-Dem dataset. The index goes from 0 to 1 and "free and fair connotes an absence of registration fraud, systematic irregularities, government intimidation of the opposition, vote buying, and election violence." The trust data come from the sixth (2010–2014) and the seventh wave (2017–2020) of the World Values Survey. The sample is restricted to observations with competitive elections according to the Database of Political Institutions (2010–2020). Each point is the simple average of the observations of each country for the years 2010–2020 and 2010–2020, x-axis, and y-axis, respectively. The dotted lines represent the average values in the entire sample for each variable. The total sample includes 11 Latin American and Caribbean countries.

## Figure 7.8 ▶ Years of Continuous Competitive Elections in Latin America and the Caribbean versus Other Regions, 2010–2020




*Source*: Authors' calculations based on the Database of Political Institutions (DPI2020).
*Note*: A year is considered to have competitive elections when both executive and legislative elections were allocated the highest score (7). Each bar is a simple average from country-level data for the period 2010–2022. Note that in 2010, for most countries, this variable was greater than zero. The OECD group of advanced economies excludes Latin American and Caribbean countries: Colombia, Costa Rica, Chile, and Mexico. Only country-years with competitively elected leaders are included. The total sample encompasses 130 countries including the following Latin American and Caribbean countries: Argentina, The Bahamas, Belize, Bolivia, Brazil, Barbados, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Grenada, Guatemala, Guyana, Honduras, Haiti, Jamaica, Saint Lucia, Mexico, Nicaragua Panama, Peru, Paraguay, El Salvador, Suriname, Trinidad and Tobago, Uruguay, and Venezuela.

**Figure 7.9 ▶ Trust in Government and Continuous Competitive Elections: Latin America and the Caribbean**




*Source*: Authors' calculations based on the Database of Political Institutions (DPI2020) and the World Values Survey.
*Note*: The trust data come from the sixth (2010–2014) and the seventh wave (2017–2020) of the World Values Survey. The competitive elections data (2010–2020) come from the Database of Political Institutions. A year is considered to have competitive elections when both executive and legislative elections were allocated the highest score (7). The sample is restricted to observations with competitive elections according to the Database of Political Institutions (2010–2020). Each point is the simple average of the observations of each country for the years 2010–2020. For example, if a country has a value of 10 the first year and increases by one each year, the variable in the graph would take the value 15. A country with a recent break in competitive elections could still have a high value because of the way the variable is constructed. The dotted lines represent the average values in the entire sample for each variable. The sample includes 11 Latin American and Caribbean countries: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Haiti, Mexico, Nicaragua, Peru, Trinidad and Tobago, and Uruguay.

more years of continuous competitive elections also exhibit greater trust in government (see Figure 7.9).

## Institutionalized Political Parties: Raising Citizen Trust in Government

Strictly speaking, political parties are simply organizations like any other: they mobilize like-minded citizens in pursuit of the collective interests of their members, whether music, sports, or religion. Hence, political parties play a significant role in the next chapter, which discusses the importance of organizations for citizenship and social cohesion. However, political parties straddle the boundary between "institutions" and "organizations" since they are thoroughly integrated into the electoral and legislative institutions through which societies govern themselves. Hence, they are also essential to the discussion in this chapter of institutions and trust in government.

Political parties can mobilize voters for collective action to further their collective interests only if they are organized for this purpose. Many,

in the region and the world, are not. Do they present voters with a platform of fiscal, social, environmental, and regulatory policies that describes how they intend to improve the collective welfare of voters? To make this platform credible, do they recruit and promote candidates who adhere to these preferences? Do they actively work to increase membership among like-minded citizens? Do they advertise their stances on these policies? A party with these characteristics gives like-minded voters an incentive to coalesce in support of the party.

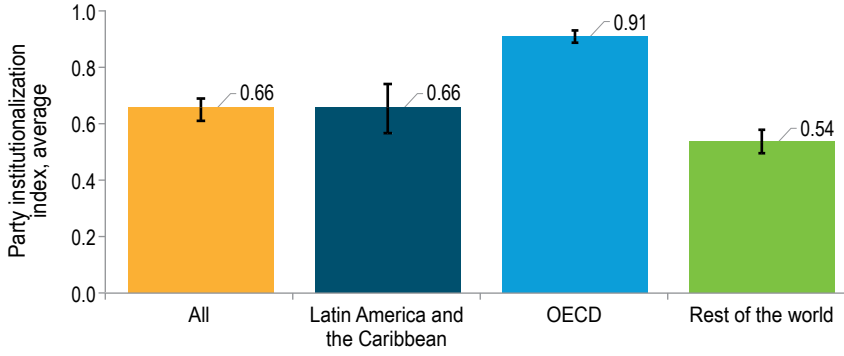
However, many parties in countries with competitive elections mobilize voters with clientelist, individualist appeals. Far from reducing voters' collective action dilemmas, clientelist parties exacerbate them. They provide an individualized incentive to voters—such as the purchase of their vote—to abandon parties that best serve the collective interests of voters like them.

Substantial evidence suggests that in the presence of institutionalized parties, the interests of public officials are more closely aligned with those of citizens. For example, countries that score higher on an index of political party strength also grow significantly faster: a one-point increase in the index, where nearly all countries receive scores between –3 and 3, yields an average increase in growth in income per capita of 1.4 percentage points (Bizarro et al., 2018). Institutionalized political parties are more likely to improve the quality of public administration and pursue more pro-development policies and less likely to distort public spending prior to elections (Cruz and Keefer, 2015; Hanusch and Keefer, 2014; Keefer, 2011).

The V-Dem Index of Party Institutionalization captures the differences between the two types of parties. To succeed in organizing like-minded citizens around the collective pursuit of their public goals, parties require the specific organizational features that Allen Hicken identifies in the party institutionalization index created for the Varieties of Democracy project described in Coppedge et al. (2021). The index encompasses indicators of whether parties appeal to voters based on clientelist exchanges, promises of local collective goods, or broadly programmatic policy positions; whether parties have distinct policy platforms and exhibit legislative cohesion; and whether they have permanent staffing between elections and branches in different parts of the country.[20]

[20] Parties that make appeals to the private interests of members do not, by definition, ask them to contribute to the collective pursuit of broad public policy goals. Parties that exhibit no legislative cohesion evidently do not exhibit a single vision of public policy that would serve to bring together like-minded citizens. If they have no staffing or presence across the country, they cannot easily counteract the incentives of citizens to free ride rather than make individual contributions to the collective goals of the party.

**Figure 7.10 ▶ Party Institutionalization Index: Latin America and the Caribbean versus the Rest of the World, 2010–2020**



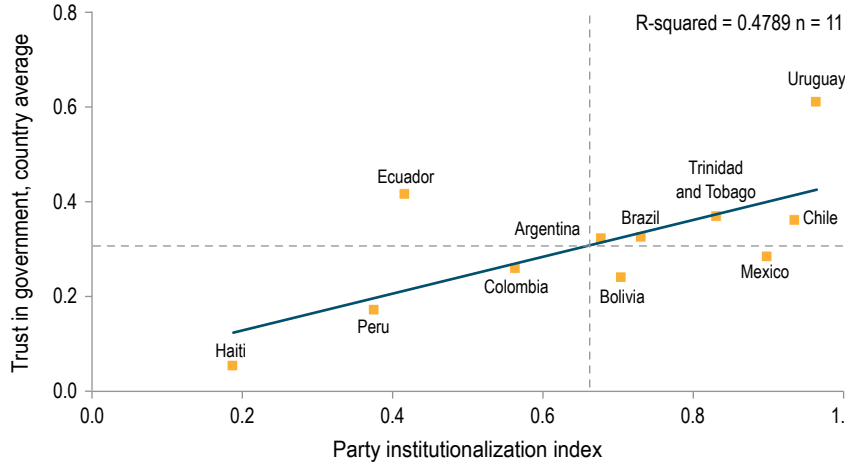

*Source*: Authors' calculations based on data from the Varieties of Democracy (V-Dem).
*Note*: The party institutionalization data (2010–2020) come from the University of Gothenburg V-Dem dataset. According to the V-Dem definition, "party institutionalization refers to various attributes of the political parties in a country, e.g., level and depth of organization, links to civil society, cadres of party activists, party supporters within the electorate, coherence of party platforms and ideologies, party-line voting among representatives within the legislature. A high score on these attributes generally indicates a more institutionalized party system." The sample is restricted to observations with competitive elections according to the Database of Political Institutions (2010–2020). Each bar is a simple average from country-level data. The OECD group of advanced economies excludes Latin American and Caribbean countries: Colombia, Costa Rica, Chile, and Mexico. The total sample encompasses 135 countries including the following Latin American and Caribbean countries: Argentina, Bolivia, Brazil, Barbados, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Guatemala, Guyana, Honduras, Haiti, Jamaica, Mexico, Nicaragua, Panama, Peru, Paraguay, El Salvador, Suriname, Trinidad and Tobago, Uruguay, and Venezuela.

The institutionalization index captures differences between programmatic and clientelist parties. Hence, it should be correlated with party age. Clientelist parties are less stable, since any political entrepreneur can set up a party designed to provide private benefits to members; successful candidates in a clientelist party can easily leave the party and set up their own. In fact, older parties (as measured by the age of political parties from the Database of Political Institutions) tend also to be more institutionalized both around the world and in Latin America and the Caribbean.

Parties in Latin America and the Caribbean are significantly less institutionalized than those in the OECD, a difference of approximately one standard deviation (see Figure 7.10).[21] As with the Clean Elections Index,

[21] This section describes institutional characteristics of countries above and beyond competitive elections that build trust in government. Hence, the comparisons focus only on countries with competitive elections. These are defined in the Database of Political Institutions as countries in which multiple parties compete and none receives more than 75 percent of the votes. Stein et al. (2006) provides a thorough description of the measures and components of political party institutionalization.

**Figure 7.11 ▶ Trust and Political Party Institutionalization in Latin America and the Caribbean**




*Source*: Authors' calculations based on data from the Varieties of Democracy (V-Dem) and the World Values Survey.
*Note*: The party institutionalization data (2010–2020) come from the University of Gothenburg V-Dem dataset. According to the V-Dem definition, "party institutionalization refers to various attributes of the political parties in a country, e.g., level and depth of organization, links to civil society, cadres of party activists, party supporters within the electorate, coherence of party platforms and ideologies, party-line voting among representatives within the legislature. A high score on these attributes generally indicates a more institutionalized party system." The trust data come from the sixth (2010–2014) and the seventh wave (2017–2020) of the World Values Survey. The sample is restricted to observations with competitive elections according to the Database of Political Institutions (2010–2020). Each point is the simple average of the observations of each country for the years 2010–2020 and 2010–2020, x-axis, and y-axis, respectively. The dotted lines represent the average values in the entire sample for each variable. The total sample encompasses 11 countries including Argentina, Bolivia, Brazil, Barbados, Chile, Colombia, Ecuador, Haiti, Mexico, Trinidad and Tobago, and Uruguay.

the difference between the countries in the region with the highest score on the Party Institutionalization Index and those with an average score is similar to the difference between the average OECD score and that of the region.

More institutionalized political parties allow citizens to act collectively to hold government accountable. Hence, they should increase trust in government. In all country-years with competitively elected leaders, there is a significant correlation (0.17) between party institutionalization and trust in government. In fact, the correlation for countries in the region is several times larger (0.48) (see Figure 7.11). The importance of this correlation cannot be understated: even among countries with competitive elections, the presence of institutionalized parties, capable of representing citizens' collective interests, is strongly associated with greater trust in government.

## Institutions and Trust: Towards Symbiosis

Institutions can mitigate the significant distortionary effects of mistrust in both the private and public spheres, among economic agents, and between citizens and government; this chapter examines some of them. They range from third-party enforcement institutions such as courts, to elections and political parties. In all cases, Latin American and Caribbean countries lag significantly behind OECD countries. This institutional weakness matters for trust and development. Stronger institutions are systematically associated with both greater trust and superior development outcomes: faster long-term growth, lower rent-seeking, greater provision of public goods.

Numerous other institutional arrangements, not considered in the chapter, can also build trust or offset mistrust. In the private sector, firms can resolve disputes using private arbitration or professional associations. They can increase trust in their products with third parties that specialize in verifying product quality. However, there is no evidence that these can fully substitute for the third-party enforcement institutions discussed herein.

This is only a partial survey of state institutions that can compensate for mistrust. It touches on but does not delve into the role of regulatory agencies in building trust between firms and citizens. This is an important subject in and of itself since such agencies can reduce trust if they are abusive, extracting rents rather than enforcing regulations that make citizens collectively better off. Regulatory malfeasance is more likely to occur when citizens are ill-equipped to hold government accountable for serving their collective interests.

The chapter further ignores institutional checks and balances that constrain political decision making—including opportunistic decision-making—and thereby also increase trust.[22] Again, however, the efficacy of institutional checks and balances is likely to depend on the incentives of the actors within them. Legislators who are not competitively elected in clean elections and not organized into institutionalized political parties are unlikely to act individually to oversee and attempt to block the executive when it takes actions contrary to citizen interests. Similarly, the chapter does not examine the ease with which new entrants to the political arena can challenge incumbents, although the threat of entry can constrain opportunistic behavior by politicians, thereby increasing trust.[23]

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[22] Keefer and Stasavage (2003) show that political checks and balances reinforce the independence of central banks, allowing them to pursue policies that reduce inflation.

[23] Sattler (2013) observes that investor mistrust in government policies towards firms should manifest itself in lower share prices. Using evidence from 205 elections in

Prosecutors and audit agencies are other entities that create checks and balances inside government. These reassure citizens that some acts of government malfeasance will be sanctioned even if citizens themselves are not able to mobilize to protest them. They also provide information to citizens that they would not otherwise have, further building confidence in the system. However, these institutions are again no substitute for the institutions discussed herein: clean elections and institutionalized parties. Where citizens have limited ability to mobilize collectively on their own behalf, politicians can place stronger limitations on the activities of prosecutors and auditors, as they can with regulatory agencies.

The analysis points to priorities for institution-building. The evidence convincingly shows that efficient, fast, and predictable dispute resolution by the judiciary has a significant catalytic effect on economic activity. In the public sector, it is tempting to focus reform on strengthening the public administration and audit agencies: the more responsive is the first and the more vigorous the second, the more citizens can trust government. The Trustlab Experiment sponsored by the OECD in six OECD countries discovered that perceived government integrity is the strongest determinant of trust in government (Murtin et al., 2018). However, trust in government is constructed on an institutional foundation that consists of electoral processes and parties. When generalized trust is low and citizen capacity to act collectively is weak, public officials are less likely to respect the independence of prosecutors and auditors. Strengthening electoral processes and political parties is thus a paramount concern, particularly in low-trust settings.

Finally, though, a cautionary lesson is in order. Trust and institutions are complementary (Bartling et al., 2021). Although institutions such as independent judiciaries and institutionalized political parties build trust in government and individuals, they are also more difficult to sustain when interpersonal trust and trust in government are weak. Generalized morality (a broad concept consistent with interpersonal trust and norms of civic behavior) lays the groundwork for well-functioning institutions (Tabellini, 2008a). More optimistically, leaders can change norms for better or worse (Acemoglu and Jackson, 2015). High-quality leaders encourage institutions to punish opportunistic behavior, which improves generalized trust. Low-quality leaders, though, do the opposite. The next chapter explains

different countries, he shows that the election of less business-friendly governments leads to short-term declines in the stock market, but only in the case of countries with low constraints to entrants. In those countries, the threat of entry constrains large policy swings.

that where trust is low and obstacles to citizen organization are high, collective action is weaker and institutions more fragile. A focus on institutional reform cannot neglect the need to reinforce citizen trust through other means, as well.

8

# Organization, Citizenship, and the Social Contract

*The region struggles to define and defend its social contracts and expand the benefits and obligations of citizenship. These inherently collective tasks challenge atomized societies. Organizations—the public administration, political parties, civil society—overcome the obstacles of atomization but are weak in the region: strengthening the social contract in Latin America and the Caribbean demands more robust organizations.*

In 2019, hundreds of thousands of demonstrators thronged streets across Latin America demanding a new social contract—a new arrangement of the rights and responsibilities of citizens. But what good is a new contract if it is not enforced? Enforcement, though, confronts an intimidating collective action dilemma. Citizens everywhere prefer the benefits of the social contract to the work required to defend it or to fulfill their responsibilities under that contract. Enforcement is less of a problem when the bonds of citizenship are strong and citizens subscribe to the sentiment expressed by Muhammad Ali: "Service to others is the rent you pay for your room here on earth."[1] Unfortunately, and especially in countries where mistrust is high and the bonds of citizenship frayed, the challenge of enforcement looms large. This chapter argues that when citizens are empowered to act collectively, they are more likely to support and defend a robust social contract. However, collective action is rarely spontaneous and typically requires organizations to help citizens solve the collective action dilemmas that undermine social contracts. Unfortunately, organizations in Latin America and the Caribbean, from civil society groups and political parties to the public administration itself, are weak.

[1] https://www.usatoday.com/story/sports/boxing/2016/06/03/muhammad-ali-best-quotes-boxing/85370850/

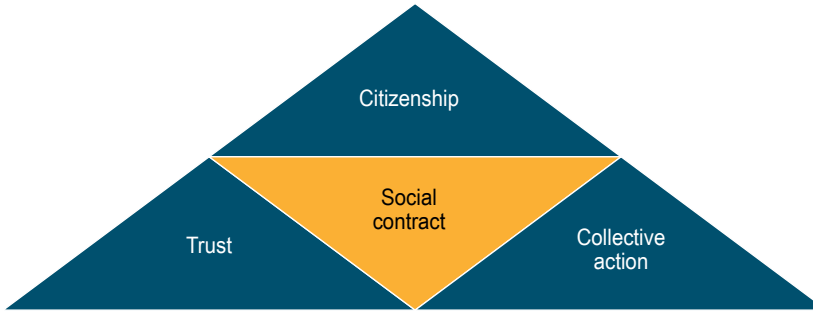
Concerns about citizenship, collective action, and institutions are neither new nor unique to Latin America and the Caribbean. The French philosopher and political economist of the early nineteenth century, Alexis de Tocqueville, feared that atomized individuals would ignore politics and the governance of their societies, undermining the consensus upon which any state must be based (Lipset, 1960). He worried that "each citizen… [would] isolate himself from the mass of his fellows and withdraw into the circle of family and friends; with this little society formed to his taste, he gladly leaves the greater society to look after itself" (de Tocqueville, 1969, p. 506). He expressed the same sentiment that Muhammad Ali would echo many generations later, that an essential element of citizenship was "enlightened self-interest," the willingness to sacrifice personal interests to the common good (Goldstein, 1964, p. 43).

De Tocqueville describes how free riding undermines the collective task of elaborating and maintaining the social contract, which is embodied in laws, regulations, and informal social norms. It serves broad citizen interests by providing a framework for citizens to act collectively to ensure that its construction and enforcement improve their general welfare. If they do not act collectively, these activities can be captured by narrow groups that tilt the social contract towards their own interests. Unfortunately, as Olson (1965) pointed out, individual citizens have no incentive to engage in such collective efforts. They are better off free riding: relying on others to undertake the collective task while they themselves search for loopholes, ignore social norms, or turn a blind eye when social norms are violated.

When the bonds of citizenship are weak and confidence in other citizens to comply with the social contract is low, citizens exhibit precisely the behavior that concerned de Tocqueville: they settle for limited social contracts that offer sparse rights and create few obligations. Consistent with their lack of confidence in each other and in institutions—in short, their apprehension regarding enforcement of the social contract—citizens across the region do not support broad rights for others (e.g., redistributive policies) and frequently shirk their civic responsibilities, as evidenced by the high rates of corruption and informality in the region.

This and preceding chapters describe the interrelated elements of the ecosystem that sustain social contracts (Figure 8.1). They rest on a triangular relationship among trust, collective action, and citizenship. Low trust makes collective action more difficult and frays the bonds of citizenship; the absence of organizations to solve collective action dilemmas reduces citizen trust in others and the civic behavior characteristic of high levels of citizenship; and weak bonds of citizenship discourage civic behavior, undermining trust and weakening collective action. Without all

**Figure 8.1 ▶ The Ecosystem of the Social Contract**




*Source:* Authors' elaboration.

three components, the ecosystem fails. As these elements improve, social contracts become more comprehensive and robust.

## Building Blocks of the Social Contract: Trust, Citizenship, and Collective Action

Public goods and transfers from some citizens to others are central to the social contract, which describes the rights and obligations of each citizen. Enforcing the contract is key since every citizen has an incentive to extract the benefits and ignore their obligations. Trust and citizenship can overcome this incentive. If citizens are both trusting and trustworthy, they will expect others to contribute to public goods and commit themselves. If levels of citizenship are high, citizens have a greater sense of mutual obligation and, therefore, a greater willingness to support the provision of public goods.

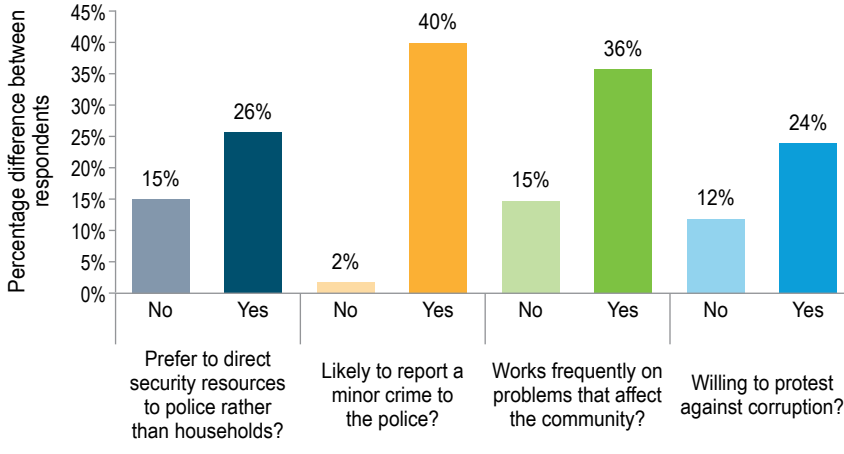
Ample evidence supports the logic linking citizenship, trust, and collective action. Keefer et al. (2019) identify the effect of social ties on collective action to provide public goods within Peruvian popular markets. In markets where the founders enjoyed stronger social ties, the subsequent enforcement of market norms was stronger and markets were more likely to have undertaken the collective actions necessary to build key market infrastructure (lighting, roofing, etc.). In China, clan membership increased the likelihood of entrepreneurship. Individually, entrepreneurs are exposed to predation by corrupt local government officials. However, when backed by a clan that can collectively mobilize its members to resist such predation, individuals face fewer obstacles to entrepreneurship (Zhang, 2019).

Governments are more likely to provide public goods when citizens can act collectively to remove incumbents who follow poor policies and

reward those who implement better policies (see Chapters 4 and 7) (Keefer, Scartascini, and Vlaicu, 2018, 2020a). As usual, though, every citizen has an incentive to free ride on the efforts of others to oversee government performance. Once again, social ties and social capital reduce free riding. Social connections help citizens coordinate to remove poorly performing politicians (Arias et al., 2019). In countries where social capital is high, the electorate is more likely to judge politicians on whether they improve social welfare and not only whether they improve their individual welfare (Nannicini et al., 2013).[2] The evidence indicates that social capital indeed improves economic well-being and political institution performance.

The 2020 Latinobarometer survey offers ample evidence that people who feel more confident about their neighborhood's ability to act collectively are also more trusting, more willing to support public

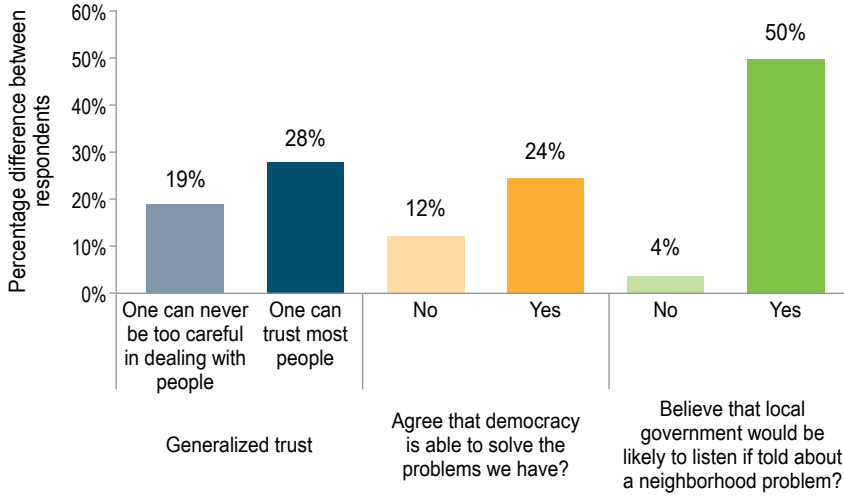
**Figure 8.2 ▶ Collective Action, Trust, and Support for Public Goods**




*Source:* Authors' elaboration based on data from the 2020 Latinobarometer.
*Note:* The bars represent the percentage difference for each subsample in a given public goods question, between the group of respondents that answered "yes" to the collective action question regarding the probability of collecting 500 signatures, and the group that answered it was not likely to collect them. The collective action variable of the probability of collecting 500 signatures comes from the question: *"Many sidewalks and streets in the city are in bad shape. Imagine the government would give the neighborhoods resources for maintenance to those neighbors who can present a petition with 500 signatures. How probable do you think it would be for your neighborhood to collect 500 signatures for that petition?"* The answers were aggregated in the "Yes" category when the answer is "Very probable" or "Somewhat probable"; and the "No" category when the respondent answered, "Little probability" or "Not at all." Each subsample coming from the public goods variables (i.e., resources to the police, willing to protest corruption, etc.), is set at 100 percent.

[2] Other literature that has linked culture with the performance of political institutions includes Martinez-Bravo et al. (2017); Bisin and Verdier (2017), Boranbay and Guerriero (2019).

**Figure 8.3 ▶ Collective Action and Trust**




*Source:* Authors' elaboration based on data from the 2020 Latinobarometer.
*Note:* The bars represent the percentage difference for each subsample in a given public goods question, between the group of respondents that answered "yes" to the collective action question regarding the probability of collecting 500 signatures, and the group that answered it was not likely to collect them. The collective action variable of the probability of collecting 500 signatures comes from the question: "Many sidewalks and streets in the city are in bad shape. Imagine the government would give the neighborhoods resources for maintenance to those neighbors who can present a petition with 500 signatures. How probable do you think it would be for your neighborhood to collect 500 signatures for that petition?" The answers were aggregated in the "Yes" category when the answer is "Very probable" or "Somewhat probable"; and the "No" category when the respondent answered, "Little probability" or "Not at all." Each subsample coming from the public goods variables (i.e., resources to the police, willing to protest corruption, etc.), are set equal to 100 percent.

goods and to contribute to public goods and, ultimately have greater faith in government and democracy. The survey asks respondents about the likelihood that their neighborhood could gather 500 signatures for a petition asking the government to fix the local sidewalks and streets. This is a non-trivial collective act, and confidence in the neighborhood's capacity to undertake it should reflect the type of social contract that respondents prefer and their willingness to support it.

Figures 8.2 and 8.3 compare respondents who believe their neighborhood can gather 500 signatures with those who do not. When asked whether public resources to improve public safety should be directed to the police or instead given to households to better protect themselves, those with a stronger belief in neighborhood collective action more strongly prefer the police option. They are also more likely to say that if they were the victims of a minor crime, they would report it to the police. These respondents are also more engaged in shaping the social contract: they are more likely to work on an issue of importance to the community and participate

in a march or demonstration against corruption. In fact, they are more willing to demonstrate on any number of issues: to improve health and education, defend democratic rights, or respond to climate change.

Figure 8.3 demonstrates the relationship between confidence in neighborhood collective action and greater trust in others and government; interpersonal trust and a preference for democracy are significantly higher among individuals who believe their neighborhood could collect 500 signatures. Those individuals are also more likely to believe that the local government would listen to them if they brought a neighborhood problem to its attention.

There are no broad country-level databases with information on collective action similar to the 500-signature question. However, data presented in Chapter 4 illustrates the close connection across countries between interpersonal trust and public good provision—health and education—and collective action for the monitoring of corruption and the quality of regulation.

Interpersonal trust significantly correlates with the provision of health and education services as well as with the control of corruption. Citizens universally condemn illegal practices such as bribes in exchange for obtaining a public service, but their limited capacity to act collectively constrains their ability to curb these practices. For example, corruption would end if every citizen refused to pay a bribe, but each individual prefers to pay the bribe in order to obtain public services that they value more than the bribe (You, 2018). They also want a world in which the quality of government regulation is high, but prefer to free ride on the efforts of others to supervise that quality. Trust in others is significantly associated with higher-quality regulation, reflecting the essential role that interpersonal trust plays in resolving collective action dilemmas.

Even at the neighborhood level, collective action is unlikely to be spontaneous; it usually requires some level of neighborhood organization, including leaders who monitor neighbors' effort and knock on the doors of those who do not participate. More generally, organizations are a crucial entry point into the triangular relationship among trust, collective action, and citizenship. When they are robust, they facilitate citizen collective action to enforce the social contract and increase citizens' confidence that others will adhere to it.

## Organizations: Support for the Social Contract

Organizations play an essential role in promoting collective action in practically all aspects of the social contract. Strong collective action hinges on a group's organizational arrangements: do leaders control free riding, do

group members select leaders who deter free riding, and can they remove leaders who exercise authority in their private interest instead of those of the group (Ostrom, 2000)? Three types of organizations are particularly relevant for the social contract. All are significantly weaker in Latin America and the Caribbean than in the countries of the OECD. One is the public administration. Ultimately, in every modern society, the public administration is responsible for implementing many elements of the social contract that are embedded in formal rules and regulations. The public administration ensures that citizens receive what they are owed under the contract and that they discharge their obligations.

The second type of organization is the political party. Citizens want the public administration to do its job and enforce the social contract. They typically do not supervise the public administration directly, but instead depend on politicians, who have direct responsibility for ensuring that the public sector is effective. Citizen oversight of politicians is often incomplete, however. When it is particularly weak, politicians are less interested in supporting a well-functioning public administration and more likely to shirk their oversight responsibilities. If they act collectively, citizens can bring pressure on politicians to ensure a well-functioning public administration. Political parties are one of the principal organizations that can reduce the costs of collective action by citizens to hold government accountable for its performance.

Civil society organizations (CSOs) are the third type of organization. They allow like-minded citizens to achieve collective goals, ranging from support of the arts to activism to support charitable work or sporting activities. Labor unions, employer associations, and chambers of commerce are other civil society organizations that solve the collective action problems of workers and firms. Unlike political parties, none of these organizations have a formal, direct role in the formation and conduct of government. They do not nominate candidates for political office. However, many CSO missions are directly related to the social contract: to urge that the contract be reformed or implemented more in accord with the interests of the organizations' members. In countries where civil society organizations are stronger and more capable of resolving the collective action challenges of citizens, civic-minded behavior by citizens is more common.

## The Public Administration: A Shaky Pillar for the Social Contract

Although not often described in this fashion, the public administration exists to overcome the collective action challenges that citizens confront in ensuring the implementation of the social contract. Citizens rely on it

to enforce the obligations of the social contract: to pay taxes, adhere to regulations, or refrain from opportunistic behavior in interactions with other citizens. They also depend on the public administration to distribute the benefits contemplated in the social contract: the efficient use of citizens' contributions to provide public goods ranging from education and health to national defense. Government plays such a fundamental role in solving the collective action problems of citizens that the core objective of political parties and many civil society organizations is to coordinate the efforts of citizens to oversee government direction of the public administration.

The public administration, though, is fundamentally an organization. It solves citizens' problems only if it is organized to pursue this mission. Are leaders committed to serving the public interest? Does the organization hire and promote individuals dedicated to and capable of undertaking this mission and pay them according to their success? Does it budget and allocate resources to efficiently serve the collective interests of citizens? One of the most important, albeit intangible, characteristics of an organization is whether it promotes trust. If employees do not trust each other, collaboration is difficult, although organizations exist precisely to promote collaboration. When leaders and employees distrust each other, the cost and difficulty of motivating employees soars.

Instead of serving the public interest, however, the public administration often appears to serve its own. Public sector workers are paid more than their counterparts in the private sector, particularly in poorer nations where governance issues—weak enforcement of the social contract—are most severe (Finan, Olken, and Pande, 2015). Using data from household surveys in 68 countries around the world, Gindling et al. (2020) find that the wage premium largely disappears if public sector workers are compared only to formal sector private employees, although this is not the most meaningful comparison in a region with high informality. Looking specifically at Latin America and matching public sector workers to their private sector counterparts, the average public sector worker earns more and the differential increased over the period 1992–2007 (Mizala, Romaguera, and Gallegos, 2011). The most qualified public sector workers—the ones most likely to contribute significantly to the public sector mission—are the exception to this pattern. Sadly, they confront a wage penalty. The public-private wage gap is unrelated to indicators of government effectiveness.

International evaluations demonstrate that public sector performance is relatively low in Latin America and the Caribbean. A wealth of more focused evidence from the region identifies the organizational shortcomings themselves, including low levels of trust among officials and

managers, that hinder the ability of the public administration to serve the collective interests of citizens.

Chapter 4 and other parts of the book already discuss the most widely used indicators of quality of the public administration: control of corruption, and regulatory quality in the Worldwide Governance Indicators. Each index ranges from -2.5 to 2.5. In 2019, the average scores of countries in Latin America and the Caribbean are approximately -0.20 for each of the two indicators (-0.15 excluding Haiti); for the OECD, the average (excluding the four Latin American and Caribbean countries in the OECD) is approximately 1.3 for each. The difference is enormous. Aggregating the two groups of countries (OECD and Latin America and the Caribbean), the standard deviation of the scores is approximately one and the difference in averages between the two groups approaches 1.5 standard deviations. Sixty-three countries outside of Latin America and the Caribbean and the OECD have index values above the Latin American and Caribbean average.

Funding and public policies certainly help explain differences in the quality of public administration across countries. Without adequate funding, public administrations cannot carry out their mandate to enforce the social contract. If the social contract itself is underspecified—permissive of rent-seeking by government officials and tolerant of low regulatory quality—then, even public administrations that perform their functions will not achieve good outcomes in these areas.

The fact that public sector workers are on average paid the same or more than their private sector counterparts suggests that resources are not the only obstacle to the quality of public administration. Organization is also key. The public administration falls short when leadership and employees do not embrace the goal of public service and when leaders are unable to control free riding by employees. Surveys and analyses of public sector organization in Latin America and the Caribbean indicate that decision-making processes are not organized to focus on the collective welfare of citizens.

To what extent is public sector management in Latin America and the Caribbean oriented towards delivering results to citizens? Results-based management is one of the many initiatives undertaken by countries eager to improve their delivery. It incorporates five pillars, including results-oriented planning and budgeting, financial and project management tools and standards, and monitoring and evaluation. According to an evaluation exercise performed by the IDB, on a scale of zero to five, on each of the five dimensions, the average in the region in 2013 was less than three, with significant shortcomings in results-oriented planning, results-based budgeting, public financial management, program and project management, and monitoring

and evaluation (Kaufmann, Sanginés, and García Moreno, 2015). Public sector organizations in the region evidently do not, on average, closely monitor and coordinate employees' efforts to increase citizen welfare. Based on an evaluation of human resource management systems in most countries of the region, along various dimensions that included merit and efficiency, in 2013, most countries scored below 50 on a 100-point index; only two scored more than 60 and none scored above 70 (Cortázar Velarde et al., 2014).

The absence of trust is an enormous obstacle to effective organization. If public sector employees do not trust the leaders of their organizations, they will not expect those leaders to manage their human and financial resources in fulfillment of the organization's public service mission. This dampens motivation and heightens the free rider problem: why work hard on behalf of the mission when others will not and the mission, therefore, will likely fail? When public sector employees do not trust their public sector peers, incentives to collaborate dissipate, thereby undermining the collective enterprise. In sum, like all organizations, the public sector struggles to achieve its mission when leadership and employees exhibit low trust.

Mistrust is a significant problem for public administration—and public sector workers—in the region. The 2020 IDB Public Sector Survey (Keefer, Perilla, and Vlaicu, 2020) of public officials from throughout the region documents high levels of mistrust. The survey captured responses from 2,155 individuals from 18 countries in Latin America and the Caribbean who had participated in Regional Policy Dialogues with the Inter-American Development Bank. All were currently, or had been, employed in the public sector. On average, only 51 percent of respondents said they trusted their coworkers, while only 26 percent expressed trust in public officials in general. Schuster et al. (2020) asked a large and representative sample of Chilean public officials about trust in their peers, direct superiors, and upper management (directivos). Not surprisingly, since Chile has one of the most effective public sectors in the region, trust is higher than in the broader sample. Nevertheless, more than one-third of respondents did not think their colleagues or direct superiors could be trusted. Only 46 percent agreed that upper management could be trusted.

One key challenge for any organization is to hire and promote individuals who are most successful in promoting organizational goals, that is, meritocratic human resource management.[3] In the public sector, meritocratic principles imply selecting and promoting individuals who are most qualified

[3] See, for example, Muñoz and Prem (2020), who use a civil service reform in Colombia to demonstrate that school principals hired under a more competitive and transparent process were more effective, with significant positive effects on student learning.

to pursue the public interest. However, in an environment characterized by mistrust, personal connections are more highly valued; firms prefer to delegate to less capable family members than more capable non-family members (see Chapter 3). In the public sector, this same dynamic takes the form of a preference for patronage-based over meritocratic personnel decisions.

Trust, therefore, should be associated with meritocratic personnel management in the public sector. Keefer, Perilla, and Vlaicu (2020) provide novel evidence of this using the IDB Public Sector Survey of public officials. In countries of the region that Kaufmann, Sanginés, and García Moreno (2015) classify as relying on merit criteria in personnel decisions, respondent trust in other public employees is almost twice as high: 39 percent of respondents indicate that they trust other public employees, compared to 21 percent in non-merit-based systems. The difference in interpersonal trust expressed by respondents is also large, amounting to nearly eight percentage points.

In addition to trust, citizenship is also key to public sector organization. In the public sector, citizenship takes the form of pro-social motivation—intrinsic motivation to improve social welfare. The importance of pro-social motivation is difficult to overstate. Public officials necessarily enjoy significant discretion in how they implement the social contract, from policing, education, and regulation to health care and tax audits. Absent pro-social motivation, discretion is more likely to be abused, harming public sector performance, as well as reducing public trust in government. Banuri et al. (2018) find evidence of the importance of pro-social motivation in experiments with public sector health care workers. Participants could treat poor patients, who required more time and effort, or richer patients, who were easier to treat. Participants who treated only richer patients could earn more money. Nevertheless, the share of poor cases seen by health care workers who were most intrinsically motivated to serve the poor was one-third higher than the share of poor cases seen by the least motivated. The impact of intrinsic motivation to serve the poor was greater than the impact of a monetary bonus for serving poor patients.

The only extensive survey of public officials in the region that captures their pro-sociality—their level of citizenship—was conducted by Schuster et al. (2020) in Chile.[4] Again, given Chile's relatively effective public administration, responses are unlikely to be representative of the region's public officials. Indeed, the paucity of surveys in the region suggests a lack of concern for the motivation and performance of public officials that is

[4] Dal Bó, Finan, and Rossi (2013) measure the motivation of job applicants in Mexico's public sector.

symptomatic of low levels of trust and citizenship. Nevertheless, the Chile survey is encouraging: about 80 percent of respondents agreed with these statements: "I am willing to make sacrifices for the good of society;" "I am strongly committed to public service;" and "The values of the public administration are similar to my own." A smaller fraction, 70 percent, agreed that "Being a public official is a key part of my identity."

The pro-social motivation of public officials is tied to their trust in citizens and affects how officials exercise their discretion in enforcing the social contract. When they mistrust citizens, they tend to advocate stricter, more intrusive measures to enforce the contract; when they trust citizens, they are likely to be more relaxed towards enforcement. Evidence of this in Latin America and the Caribbean emerges from the 2020 IDB Public Sector Survey. Only 41 percent of respondents agreed that citizens in general could be trusted. Their answers mirror their policy preferences. Those with greater confidence in citizens were more likely to support the expansion of on-line services, which limits their ability to directly oversee citizen behavior. Respondents with low trust in citizens and high trust in public officials supported significantly stricter government enforcement of social distancing guidelines during the pandemic (see Box 8.1).

Organizational changes to improve the public administration's oversight of the social contract can take myriad forms, but all require organizational objectives and employee incentives and capacity to be clearly aligned with citizen interests. Khan, Khwaja, and Olken (2016, 2019) present experimental evidence from Pakistan that introducing purely pecuniary incentives to pursue easily measured targets (higher tax collections) can improve performance in an environment where neither the objectives of the public administration nor the incentives of its employees are notably pro-social. However, effort on most public sector tasks is not easily observable (the quality of a regulation or emergency readiness) and the output that results from the effort is difficult to attribute to individual workers. A focus on prosociality both in the objectives of the organization and the management of its human resources may be a more effective, and potentially cheaper, way to improve public administration performance (Banuri and Keefer, 2016).

## The Potential of Political Parties

The problem of citizen oversight of government is a recurring theme in this book. Chapter 4 describes how citizen mistrust distorts political incentives to produce policies in the public interest. Chapter 7 further argues that institutions can offset mistrust in government. One of the institutions it emphasizes, political parties, plays a dual role. Parties are fundamentally

### Box 8.1 ▶ Trust and Responses to the Pandemic

From the outset of the pandemic, physical distancing was a central focus of individual behavior and government policy. A key point of contention around the world was the degree to which governments should enforce physical distancing. Trust and citizenship play a large role in both, as Chapter 5 also observes. The relationship between "civic duty" and physical distancing is well-established. Borgonovi and Andrieu (2020) show that U.S. counties with higher levels of a nine-component index of social capital reduced their mobility sooner in response to the pandemic. Barrios et al. (2020) show, with evidence from both Europe and the United States, that during the early phases of the pandemic, voluntary social distancing was higher when individuals exhibited a higher sense of civic duty, measured at the individual level by voter participation, at the U.S.-county level by the number of associations in the county per capita, voter turnout, census response rate, and the number of nonprofit organizations.

Less well-known is the impact of trust on the enforcement attitudes of government officials, revealed in Chapter 4. In a 2020 survey of public officials from around the region, those who expressed greater trust in citizens and less trust in other public officials favored less state enforcement of physical distancing. Those who trusted citizens less and public officials more favored more state enforcement.

These pandemic findings are relevant for government regulations more generally. Public preferences for regulation drop when generalized trust is higher (Aghion et al., 2010). Analysis of the responses to the 2020 IDB Public Sector Survey also indicates that trust in citizens and other public officials is likely to pervade officials' attitudes towards the entire range of government regulation and oversight: those who trust citizens less and other officials more are likely to favor tighter and more intrusive regulation than others.

organizations, but they are also embedded in the political institutions of countries. This chapter returns to the role of political parties, which is the second type of organization relevant for the social contract. It presents evidence that the organization of political parties in Latin America and the Caribbean does not facilitate collective action by party members. It also demonstrates that where parties are better organized to solve members' collective action problems, indicators of citizenship are stronger.

Political parties confront organizational challenges like those of the public administration and all organizations. Are leaders committed to the mission of serving the collective interests of members? Do they reward or discipline party members and candidates for their contributions or neglect of the party's mission? And do party members and leaders trust each other? Parties with these characteristics, "institutionalized" political parties, are necessarily dedicated to solving the collective action problems of

citizens, or at least of those citizens who share the party's vision for resolving the priority problems of society.

One key indication of party organization is how it selects its candidates. Are members more interested in advancing citizen welfare than in taking advantage of political power to enrich themselves? Besley (2005) discussed the institutional arrangements that encourage pro-social individuals to enter politics and the three functions they must perform: make politics more attractive to those who care about serving the public than those who primarily seek rents; increase the election possibilities of pro-social candidates; and provide sufficient accountability such that unmotivated incumbents either act as if they were motivated or are expelled from office. Political parties play a significant role in each of these.

Parties are important for voters and their demands for a more robust social contract. Evidence from the 2020 Latinobarometer survey highlights their significance in the particular case of support for resources for policing. Among respondents who trust political parties, a far larger percentage, 60 percent, prefer to allocate more resources to police to ensure public safety than direct resources to households to support their private efforts to improve security. Only 40 percent prefer to allocate the resources to households. Among those who do not trust political parties, however, the difference is insignificant: 51 percent prefer the resources be allocated to the police compared to 49 percent who are either indifferent or prefer the resources to be given directly to households.

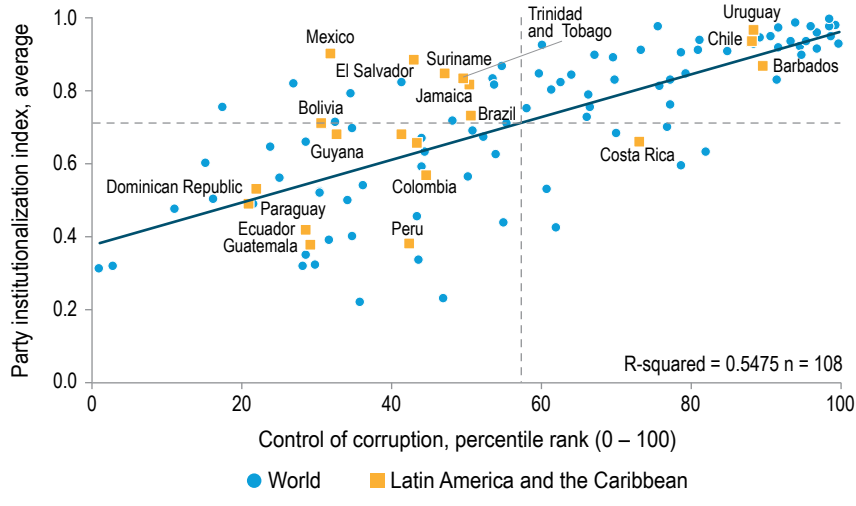
The organization of political parties has a direct bearing on the robustness of the social contract. The Varieties of Democracy project, or V-Dem (Coppedge et al., 2021), has collected unprecedented data on the political characteristics of countries, going back decades and up until 2020, that permits a closer look at this significant relationship. The V-Dem party institutionalization index (Coppedge et al., 2021) broadly captures parties' level and depth of organization, their links to civil society, whether they have cadres of activists and many supporters within the electorate, whether party platforms and ideologies are coherent, and whether party representatives in the legislature vote together. If party organization is shallow—if it lacks, for example, structures to administer human resources and budgets—its capacity to solve collective action problems of members is inherently weak. If parties have few supporters in the population, clearly they do not mobilize citizens for collective action. The lack of coherent platforms and ideologies means that parties do not even try to solve the collective challenges of citizens: they cannot mobilize citizens to solve a collective action problem if party platforms identify neither the problem

nor the solution. Finally, a basic indicator of whether parties control free riding by their members is the degree to which its legislators vote together.

Latin American and Caribbean parties score significantly lower on the V-Dem index than political parties in the OECD. The index goes from zero to one and the regional average is 0.65, while the OECD average is .91. The difference is huge, more than one standard deviation, and likely has significant consequences for collective action by citizens to hold government accountable (see Figures 8.4–8.10).

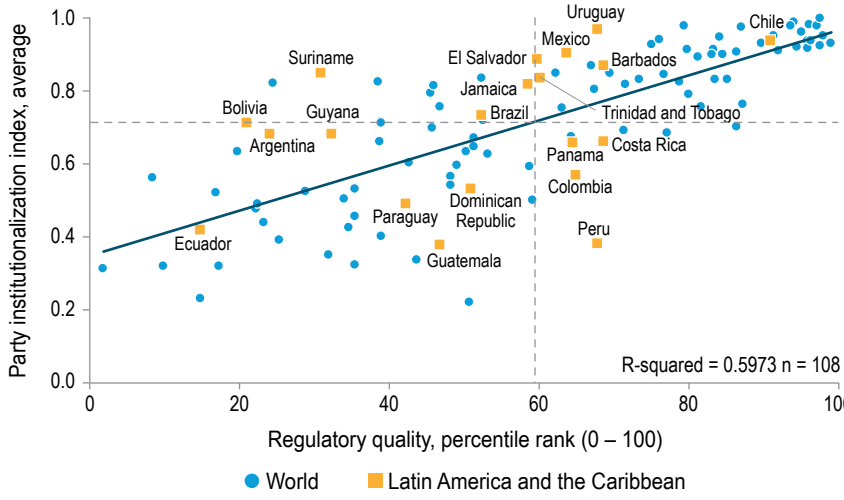
If institutionalized political parties help citizens act collectively to hold government accountable, then one outcome should be greater political commitment to control corruption and regulatory quality, both of which contribute to the collective welfare of citizens and offer citizens strong incentives to free ride—for example, to pay bribes to secure cheaper access to government services or to avoid the costs of complying with regulatory requirements. In fact, both corruption control and regulatory

**Figure 8.4 ▸ Relation between Political Party Institutionalization and Corruption**




*Source*: Authors' calculations based on data from the Varieties of Democracy (V-Dem) and Worldwide Governance Indicators.
*Note*: The party institutionalization index (2010–2020) comes from the University of Gothenburg V-Dem dataset. Control of corruption comes from the Worldwide Governance Indicators (2010–2017), and is the percentile rank among all countries, ranging from 0 (lowest) to 100 (highest). The sample is restricted to those countries categorized as democracies according to the classification in the V-Dem dataset. Each point is the simple average of the observations of each country for the years 2010–2017 and 2010–2020, x-axis, and y-axis, respectively. The dotted lines represent the average values in the entire sample for each variable. The total sample encompasses 108 countries including Argentina, Bolivia, Brazil, Barbados, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Guyana, Jamaica, Mexico, Panama, Paraguay, Peru, Suriname, Trinidad and Tobago, and Uruguay.

**Figure 8.5 ▶ Relation between Political Party Institutionalization and Regulatory Quality**



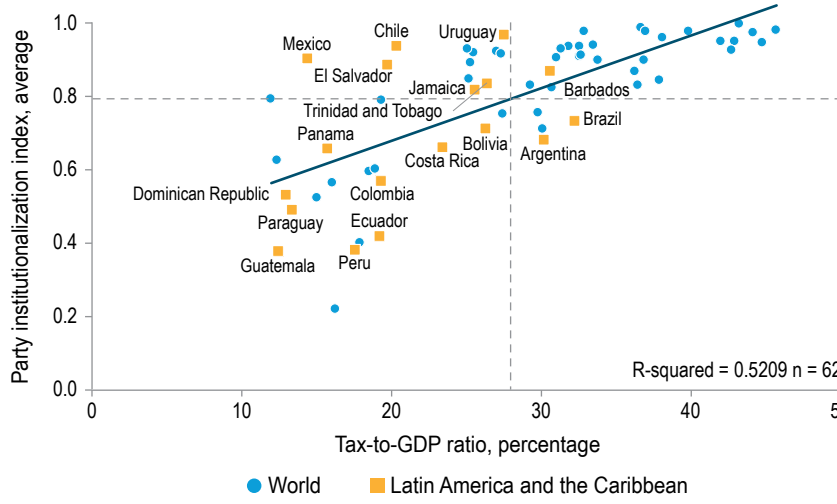

*Source*: Authors' calculations based on data from the Varieties of Democracy (V-Dem) and Worldwide Governance Indicators.
*Note*: See note to Figure 8.4. Regulatory quality comes from the Worldwide Governance Indicators (2010–2017), and is the percentile rank among all countries, ranging from 0 (lowest) to 100 (highest). It captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. The total sample encompasses 108 countries including Argentina, Bolivia, Brazil, Barbados, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Guyana, Jamaica, Mexico, Panama, Paraguay, Peru, Suriname, Trinidad and Tobago, and Uruguay.

quality are stronger when political parties are more institutionalized (see Figures 8.4 and 8.5).[5]

If institutionalized parties give citizens greater capacity to act collectively, the social contract can be more comprehensive and citizens can extend to each other, and enforce, greater collective benefits and obligations. For example, institutionalized political parties give citizens greater confidence that they can act collectively to oversee, via their influence on politicians, the effectiveness of the public administration in enforcing civic behavior—tax payment—among citizens. Figure 8.6 examines the primary indicator of citizenship: whether citizens pay

[5] Palanza, Scartascini, and Tommasi (2016) find a positive correlation in Latin America and the Caribbean between political party institutionalization and congressional institutionalization. Stronger congresses shore up the ability to hold public sector employees and politicians accountable, reinforcing the positive cycle.

**Figure 8.6 ▶ Relation between Political Party Institutionalization and the Willingness to Pay Taxes**



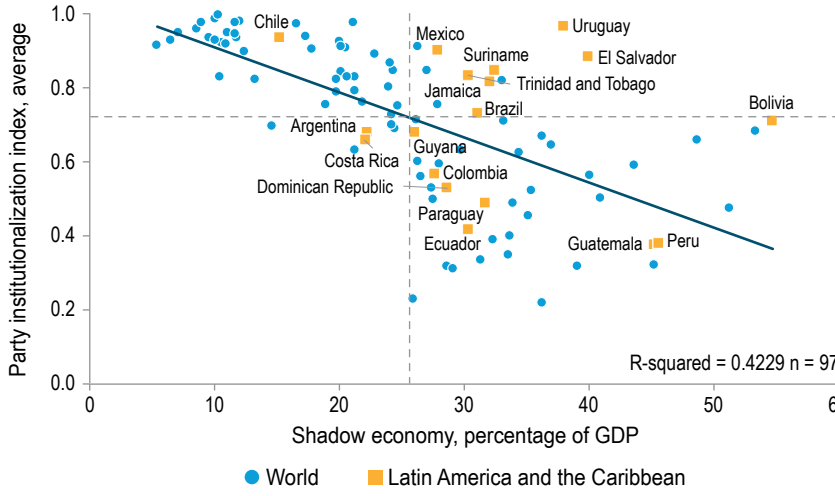

*Source*: Authors' calculations based on data from the Varieties of Democracy (V-Dem) and the Global Revenue Statistics Database, OECD.
*Note*: See note to Figure 8.4. Tax-to-GDP ratio (2010–2018) comes from the Global Revenue Statistics Database and uses the total tax revenue of a country. The total sample encompasses 62 countries including Argentina, Barbados, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Jamaica, Mexico, Panama, Paraguay, Peru, Trinidad and Tobago, and Uruguay.

taxes. In fact, the tax ratio is significantly higher in countries with more institutionalized political parties: the tax to GDP ratio and the party institutionalization index are correlated at 0.52. Most Latin American countries are in the lower left quadrant, with lighter taxes and less institutionalized political parties.

The relationship between political party institutionalization and adherence to the rules and regulations surrounding business activity is strong and positive (see Figure 8.7). Informality, as proxied by the size of the shadow economy, is significantly higher when the party institutionalization index is lower.

When government does a better job of enforcing the obligations of citizenship, individual attitudes about appropriate behavior should also change. First, individuals observe that other people comply more with the obligations of citizenship–those described in the social contract. Second, they see that government enforcement is effective, which in turn reflects the attitudes of other citizens. Hence, all of those organizations and elements in society that promote citizenship, including institutionalized political parties, should inspire more civic norms among individuals, consistent

**Figure 8.7 ▶ Relation between Political Party Institutionalization and Informality**

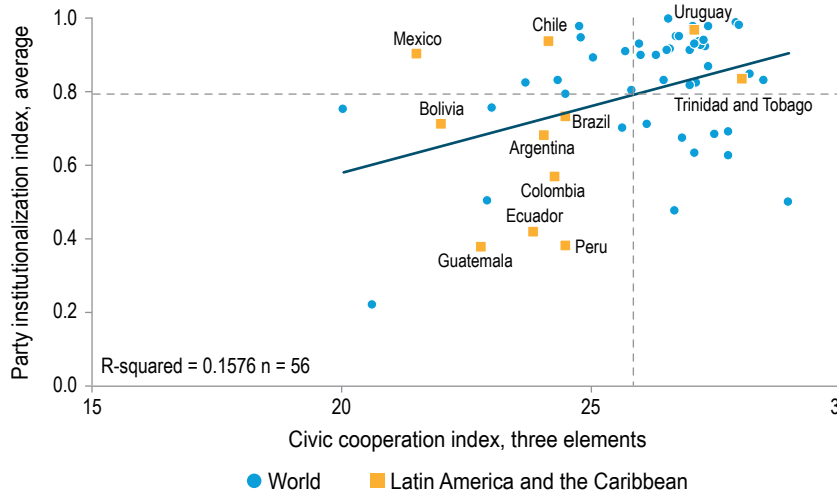



*Source*: Authors' calculations based on data from the Varieties of Democracy (V-Dem) and the Shadow Economy Index.
*Note*: See note to Figure 8.4. The Shadow Economy Index (2010–2017) comes from Medina and Schneider (2019). The authors define shadow or informal economy as "economic activities which are hidden from official authorities for monetary, regulatory, and institutional reasons. [. . .] The shadow economy, in this paper, reflects mostly legal economic and productive activities that, if recorded, would contribute to national GDP; therefore, the definition of shadow economy in the study tries to avoid illegal or criminal activities, do- it-yourself, or other household activities." The total sample encompasses 97 countries including Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Guyana, Jamaica, Mexico, Paraguay, Peru, Suriname, Trinidad and Tobago, and Uruguay.

with strong bonds of citizenship. Figures 8.8 and 8.9 indicate that this is the case. When political parties are more institutionalized, people are less tolerant of cheating on taxes, claiming government benefits to which they are not entitled, and evading fares for public transportation (Figure 8.8). And where party institutionalization is low, the percentage of lost wallets that are actually returned by people in a country is significantly higher (Figure 8.9).

None of these relationships attests to causality and, indeed, most of the evidence in this book points to the triangular relationship among trust, collective action, and citizenship. In the end, the elements of the social contract ecosystem, as with all ecosystems, influence each other. Strong bonds of citizenship promote the creation of institutionalized political parties, which in turn reinforce the incentives of government to enforce the social contract, which in turn increases citizen trust that their fellow citizens will adhere to civic norms, both formal and informal. The analysis

**Figure 8.8 ▶ Relation between Political Party Institutionalization and Civic Cooperation**




*Source*: Authors' calculations based on data from the Varieties of Democracy (V-Dem) and the Integrated Values Survey.
*Note*: See note to Figure 8.4. The civic cooperation index (2010–2020) is based on the Knack and Keefer (1997) methodology. Because of data availability, only 3 of the 5 original questions in the methodology are used: a) "claiming government benefits to which you are not entitled," b) "avoiding a fare on public transport," and c) "cheating on taxes if you have the chance." The scale of variables was adjusted so a higher number means higher civic cooperation. The total sample encompasses 56 countries including Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Guatemala, Mexico, Peru, Trinidad and Tobago, and Uruguay.

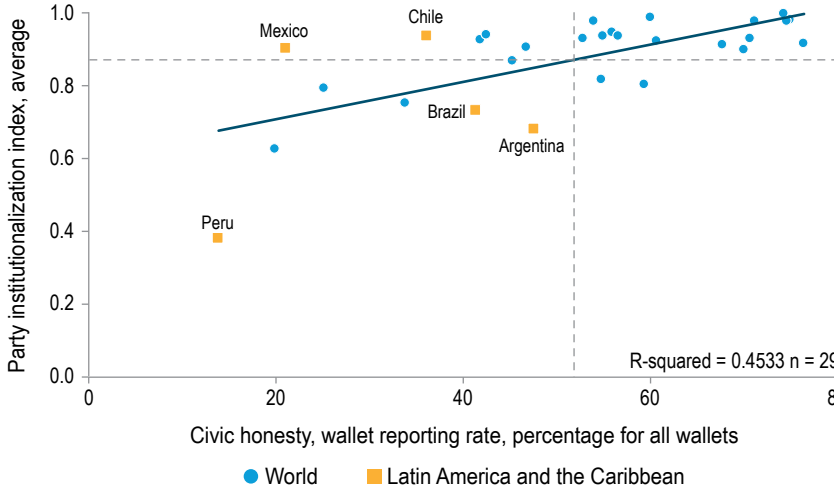
in this section confirms the intimate relationship among these various elements of the ecosystem.

## Civil Society Organizations: Resolving the Collective Dilemma

Citizenship is lower when citizens have few opportunities to participate in civic life. Governments can create those opportunities by devising ways for citizens to engage with and participate in government decision-making. Citizens can also develop those options for themselves, for example by forming civil society organizations (CSOs) or launching other local participatory initiatives.

Citizen participation and engagement frequently emerge as a strategy to ensure that public policy better addresses citizen needs and restores citizen confidence in government. For example, Sudarsky Rosenbaum (2001) and Moreno (2001) identify low participation as key reasons for low levels of trust and government legitimacy in Latin America. However,

**Figure 8.9 ▶ Relation between Political Party Institutionalization and Returning Lost Wallets**




*Source*: Authors' calculations based on data from the Varieties of Democracy (V-Dem) and the Cohn et al. (2019) wallet experiment data.
*Note*: See note to Figure 8.4. Civic honesty comes from the wallet reporting rate for all wallets dropped in the Cohn et al. (2019) experiment. The total sample encompasses 29 countries including Argentina, Brazil, Chile, Mexico, and Peru.

a review of research on participatory governance and political trust produces generally ambiguous conclusions in this regard (Rizzo, Janowski, and Roseth, 2020). An explanation offered herein is that organizations that facilitate collective action are key for citizen trust in government; to the extent that participatory systems do not encourage collective action, they need not increase trust.

Rizzo, Janowski, and Roseth (2020) characterizes participatory systems as offering citizens opportunities to deliberate, decide, and monitor the allocation of resources within their communities. In this sense, systems of participatory governance, just like elections, allow for collective action in the assignment of resources. However, they do not directly facilitate it. For example, systems of participatory governance hardly change the incentives of individuals with common preferences over budget allocations to free ride on the inputs of others into the process. This suggests that participatory governance may function more effectively as a vehicle for aligning budgetary choices and citizen demand precisely when citizens are better able to act collectively and the bonds of citizenship are stronger. Civil society organizations (CSOs) may serve this purpose.

CSOs often mobilize individuals in pursuit of missions closely related to the social contract, ranging from advocacy in favor of human rights, free markets, the environment, and prison reform to the collective economic interests of workers, employers, or professional groups. A central focus of CSO activity is to ensure that the rights enshrined in the social compact for certain groups are in fact enforced or, alternatively, to advocate for changes in the social compact that would expand these rights. The importance of organization is immediately clear. Individual efforts to protect rights and to ensure that others accept their responsibilities under the social compact have little effect relative to the costs that individuals bear. CSOs resolve the collective dilemma that individual advocates confront.

A category of civil society organization that illustrates their role in solving collective action dilemmas and building trust in the social contract is the labor union. Workers would like to secure better working conditions than those available on the open market, but any individual effort to do this is undercut by the willingness of other workers to do the same job for less. Workers would also like to protect themselves from arbitrary, potentially illegal treatment by firm managers, but this is difficult without a collective agreement by all workers to defend the interests of any one of them—a collective agreement that each worker has an incentive to free ride on.

Unions can solve these free-rider problems. If they do so successfully, they should increase worker trust in the groups with which they bargain: the government, in the case of public sector unions, and large companies, in the case of private sector unions. However, as with the public administration and political parties, they may not be organized to pursue the mission of increasing worker welfare.

Does union membership in the region resolve workers' collective action problems and increase worker trust? Garay and Schrank (2020) examine survey evidence from Latin America and the Caribbean to answer this question. The percentage of individuals who are union members in Latin America and the Caribbean is not known, but they collect information from different sources on the fraction of workers covered by collective bargaining agreements, although they may not be and frequently are not themselves members of the union. The figures range from very high (95 percent in Uruguay, 70 percent in Brazil, and 51.6 percent in Argentina) to very low (eight percent in Colombia, 0.7 percent in Paraguay, 1.8 percent in Panama, and 4.9 percent in Peru).

Variations in union membership have many explanations, such as historical efforts to promote or undercut union organization and the legal environment governing unions. The significant discrepancy between the

fraction of workers covered by collective bargaining agreements and attendance at union meetings illustrates the importance of these factors.[6]

Surveys cited by Garay and Schrank (2020) reveal that the fraction of respondents who never attend a union meeting in Argentina, Brazil and Uruguay (93.75, 89.67 and 91.03 percent) varies little from that in Colombia, Paraguay, Panama and Peru (96.42, 94.34, 96.97 and 89.27), suggesting that broad coverage of collective bargaining agreements in the first set of countries is a product of legal requirements rather than negotiation between unions and employers. Union organization in the region varies widely in other ways as well: some are organized to mobilize workers to achieve better economic conditions while others exert greater political influence; some are captured by union leaders and do not pursue workers' interests, and; in others, union leaders are exposed to significant risks of violence.

Despite the wide variations in union members, organization, and the legal environments governing unions across the region, union members tend to exhibit greater trust in large firms and government (Garay and Schrank, 2020). Both make promises to workers and both have the power to break those promises. Governments, for example, touch nearly every aspect of labor markets and union-employer relations, but they also employ public sector union members. To the extent that union membership leads individuals to feel they are collectively able to oblige governments and large firms to honor their commitments, trust should be greater.

In fact, compared to non-union members, union members do express greater trust in government (Garay and Schrank, 2020). Union membership increases trust in large firms as well; however, only private union membership has this effect. This is exactly as expected: large firms do not make promises to public sector workers, whom they obviously do not employ, but rather to private sector workers. When those private sector workers are part of a union, they feel more confident that large firms will keep their promises.

It is difficult to assess the strength of CSOs generally, given their numbers and variety. In fact, no data exist on the universe of civil society organizations in countries or their internal organizational strength, in contrast to the data reviewed in earlier sections on the public administration and political parties. However, data are available that capture whether the legal environment is favorable towards CSOs and whether membership in CSOs is common. They indicate that civil society organizations in Latin America and the Caribbean encounter more obstacles than they do in countries of the OECD.

[6] Murillo and Schrank (2010) explore some of the dynamics that explain the size and role of unions in Latin America.

Once again, the data come from the Varieties of Democracy project, whose V-Dem database includes variables measuring the robustness of civil society, summarized in the civil society index designed by Michael Bernhard (Coppedge et al., 2021).[7] It focuses on the entire range of CSOs except political parties, including interest groups, labor unions, spiritual organizations (insofar as they are engaged in secular civic or political activities), social movements, professional associations, charities, and other nongovernmental organizations.

The index differentiates countries according to whether these organizations enjoy autonomy from the state and whether citizens can freely and actively pursue their political and civic goals. Three V-Dem variables comprise the index: the degree to which CSOs can form and operate free of government control; whether governments actively repress CSOs; and the degree to which people are at least occasionally active in at least one of many diverse CSOs.

The average civil society index score in Latin America and the Caribbean in 2020 was 0.76 (on a 0–1 scale), which is significantly lower than the average in the OECD. Among OECD countries (excluding Chile, Colombia, Costa Rica, and Mexico) the index score is 0.87. The difference between the two, 0.11, is more than one-half of the standard deviation of the index score across the two regions (0.19).

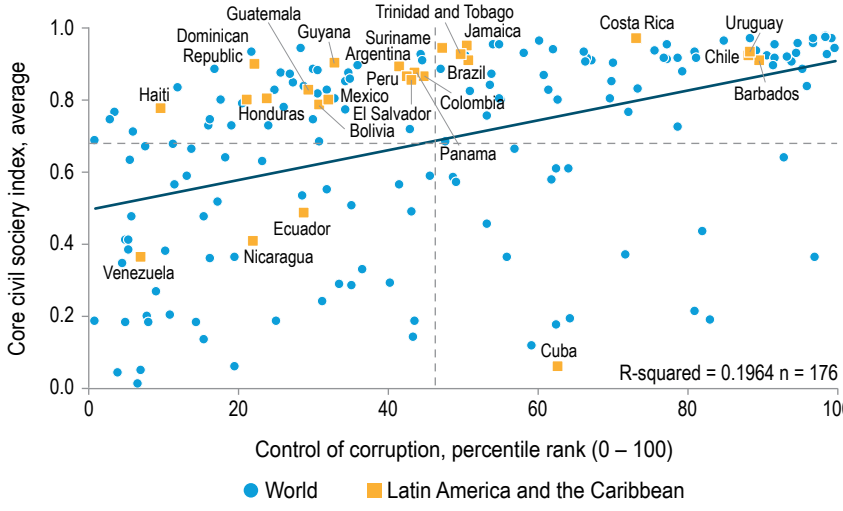
CSOs might be weak or fragile because of legal and institutional obstacles to their establishment, or because citizens have no interest in participating. These reasons are of course related; where citizens are uninterested in participating in collective civic activities, they are likely to be equally disinclined to resist laws and regulations that restrict CSOs. The index components offer some insight into these two different mechanisms.

The first two components relate to government control and oversight; the third reflects government actions that might discourage citizen participation, but also captures citizen interest in participation. Latin America and Caribbean countries have lower scores than OECD countries for each component. The region's scores are somewhat lower on the ease of forming CSOs and significantly lower with respect to repression and diversity of CSOs.

Similar to the mechanisms through which political parties affect citizenship and civic behavior, CSOs help resolve citizens' collective action

[7] No data broadly characterize the number and scope of CSOs in Latin America and the Caribbean relative to other regions of the world. However, the V-Dem database includes variables that allow comparisons of legal and political constraints on the emergence of CSOs.

**Figure 8.10 ▶ Relation between Civic Participation and Corruption**




*Source*: Authors' calculations based on data from the Varieties of Democracy (V-Dem) and Worldwide Governance Indicators.
*Note*: See Note to Figure 8.4. The civil society data (2010–2020) come from the University of Gothenburg V-Dem dataset. Control of corruption comes from the Worldwide Governance Indicators (2010–2017). Each point is the simple average of the observations of each country for the years 2010–2017 and 2010–2020, x axis and y axis, respectively. The dotted lines represent the average values in the entire sample for each variable.
The total sample encompasses 176 countries including Argentina, Bolivia, Brazil, Barbados, Chile, Colombia, Costa Rica, Cuba, Dominican Republic, Ecuador, El Salvador, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Suriname, Trinidad and Tobago, Uruguay, and Venezuela.

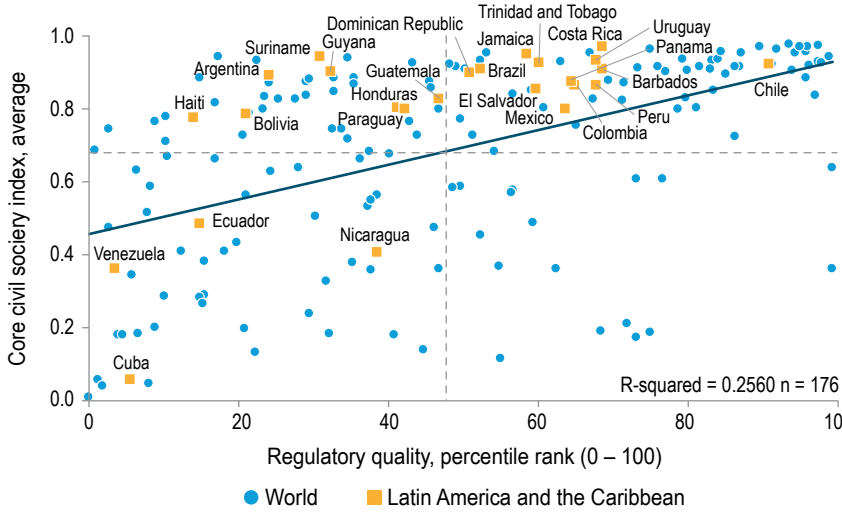
dilemmas in connection with the social compact, empowering citizens to act collectively to ensure that it is enforced. Hence, the same pattern of correlations observed with political parties in the earlier section should emerge in the context of CSOs. If citizens are better able to act collectively to prevent government officials and narrow interest groups from acting on their own behalf, then corruption should be lower and regulations more effective.

As expected, the strength of civil society (scores on the V-Dem civil society index) correlates significantly with the Worldwide Governance Indicators measures of corruption and regulatory effectiveness (see Figures 8.10 and 8.11).

## Trust and Organization... or Different Values?

Mistrust and weak organization are the sources of low levels of citizenship in the region—or are they? Despite the arguments put forth in this book, could

**Figure 8.11 ▶ Relation between Civic Participation and Regulatory Quality**




*Source*: Authors' calculations based on data from the Varieties of Democracy (V-Dem) and Worldwide Governance Indicators.
*Note*: See Note from Figure 8.5. The civil society data (2010–2019) come from the University of Gothenburg V-Dem dataset. Regulatory quality comes from the Worldwide Governance Indicators (2010–2017). Each point is the simple average of the observations of each country for the years 2010–2017 and 2010–2020, x axis and y axis, respectively. The dotted lines represent the average values in the entire sample for each variable. The total sample encompasses 176 countries including Argentina, Bolivia, Brazil, Barbados, Chile, Colombia, Costa Rica, Cuba, Dominican Republic, Ecuador, El Salvador, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Suriname, Trinidad and Tobago, Uruguay, and Venezuela.

there be another explanation? Could it be that citizens of Latin American and Caribbean countries simply do not value citizenship, are indifferent to government actions with respect to corruption and regulation, have no interest in the welfare of their fellow citizens, and have correspondingly little reason to participate in civil society organizations or political parties? Fortunately, this explanation is spurious, at best. Citizens of Latin America and the Caribbean are as patriotic and place as high a value on inclusive growth—and, implicitly, the institutions that underpin inclusive growth—as citizens of OECD countries.

Regional measures of national identity and pride in country from the World Values Survey are high.[8] Respondents from Latin America and the Caribbean are likely—and no less likely than respondents from the

[8] The data come from the sixth (2010-2014) and the partial seventh wave (2017- 2020) of the World Values Survey. The OECD group of advanced economies excludes Chile, Colombia, Costa Rica, and Mexico.

OECD—to see themselves as part of their country or nation and be proud of their country.

Similarly misleading is the suggestion that one of the ultimate goals of citizenship—inclusive growth—is unimportant to citizens of the region. While considerable debate may rage about how the benefits of growth should be shared and private economic activity regulated, there is less debate that economic growth is likely to be faster if people work harder, firms compete, individuals are permitted to accumulate wealth, and firms are privately owned. If the citizens of a country are, for whatever reason, antagonistic towards these values, they are similarly less likely to exercise citizenship in defense of the institutions that sustain inclusive growth. In fact, however, on many dimensions, citizens of Latin America and the Caribbean are as—or more—sympathetic to these values as citizens of the countries of the OECD.

The World Values Survey asks respondents whether they tend to agree more with the statement, "People can only get rich at the expense of others," or with the statement, "Wealth can grow so there's enough for everyone." The responses from the region echo those from the OECD; both have somewhat positive views on wealth accumulation (around 6 on a 10-point scale). Respondents from Latin America and the Caribbean are somewhat more positive on average, but also significantly more variable. When asked whether they most agree with one of the following statements, "In the long run, hard work usually brings success" (one on the one to ten scale) or "Hard work doesn't generally bring success," (ten on the ten-point scale), average responses are nearly identical in the two regions: around 4.6. Respondents from both regions are similarly, though only slightly (around 4.25 on the 10-point scale), sympathetic to the statement that competition is good compared to the idea that competition is harmful.[9]

Latin American and Caribbean citizens agree with citizens of richer countries on other dimensions of inclusive growth as well. For example, opinions on equality are statistically identical: respondents in both regions exhibit weak agreement (just above five on the 10-point scale) that incomes should be made more equal, but also that larger income differences are necessary to spur effort. Respondents from both regions weakly agree (between five and six on the 10-point scale) that government ownership of business should increase, but also that people should take more responsibility to provide for themselves.

[9] The data come from the sixth (2010-2014) and the partial seventh wave (2017- 2020) of the World Values Survey. The OECD group of advanced economies excludes Chile, Colombia, Costa Rica, and Mexico.

## Cultivating a Healthy Ecosystem

Organizations are key vehicles that permit citizens to solve the collective action problems that distort the design and hinder the enforcement of the social compact. Although mistrust and frayed bonds of citizenship are themselves obstacles to the emergence of organizations, other factors contribute as well, factors that governments can address to facilitate organizational development.

A great deal is known about how to strengthen public administration (see Kaufmann, Sanginés, and García Moreno, 2015). Useful strategies include firmly establishing the public mission of agencies, orienting human resource and financial management towards that goal, and regularly and rigorously evaluating progress in meeting the needs of the public. However, although well-understood, this agenda has proven difficult to implement and remains a priority in the region.

Political party institutionalization is a more complex and less well-understood phenomenon. For example, Mainwaring (2018) argues that party systems are more institutionalized when parties are better organized and have deeper roots in society. This underlines the importance of institutionalizing parties themselves but does not explain how this comes about. This development priority is a central question for future research. Political party institutionalization is more likely when elections are considered legitimate. Investing in electoral institutions is a must for party institutionalization (Jones, 2010).

In the case of civil society organizations, reforms extend to the rules and regulations that can make them more difficult to establish than, for example, private businesses. Such legal obstacles constitute one of the indicators of the Civil Society Index, which indicates that these obstacles are more daunting in Latin America and the Caribbean than in the OECD.

The performance of the public administration, political parties, and civil society organizations in Latin America and the Caribbean generally lags behind the OECD and is wanting in several critical areas. Strengthening these organizations would go a long way towards fomenting the trust, citizenship, and collective action required to sustain the ecosystem for a fruitful social contract.

# 9

# The Power of Information

*Information about the trustworthiness and civic behavior of others is the foundation of trust and citizenship. Unfortunately, exposure to traditional and social media may not build this foundation. On the contrary, because of biases in the way human beings acquire and process information, they may weaken it. However, intentional information interventions show promise. They can overcome these obstacles and change attitudes and beliefs for the better.*

Paula is an accountant. She regularly encounters clients who refuse to provide her with complete information about their finances, worried about exposing themselves to tax authorities. When she points out the potential problems this could cause them, they raise their eyebrows and quip that everyone knows the government wastes money and no one pays taxes; it would be foolish to be entirely transparent. Not surprisingly, Paula needs a break from her work and plans her first trip abroad to Buenos Aires. She reserves a room in an apartment using a home-sharing site, such as Airbnb. Short on savings for the trip, she finances part of it with a loan she secures online. Paula buys her luggage from an online store and has it delivered to her house. From her home, she makes a reservation to dine at a trendy restaurant in Buenos Aires by providing them with her credit card number. Once she arrives in Buenos Aires, she jumps in a car with a total stranger who is driving for a ridesharing app, such as Uber, Cabify, or Lyft.

These transactions would have been unthinkable years ago. In fact, 20 years ago, one might have questioned Paula's judgment: how could she—a total stranger to the country—expect someone in Buenos Aires to rent her a room in their home, or hold a restaurant reservation for her instead of giving it away to a local customer? How could she believe that

someone would lend her money sight unseen, or actually deliver luggage to her door that she paid for online? How could she feel secure that a driver across the continent would not rob her and leave her stranded?

Previous chapters focus on institutions and organizations as important responses to mistrust and weak bonds of citizenship. However, the availability of information—not institutions or organizations—has changed dramatically in recent decades and accounts for all the options that Paula now has for her trip to Buenos Aires. Her experience illustrates the fundamental role of information in building trust and citizenship, which is the focus of this chapter.

At the heart of trust and citizenship are beliefs about others: whether they are trustworthy and whether they contribute to the collective endeavors of society. Information, naturally, has an enormous effect on beliefs. Based on their own experience about how others behave and by what is told to them by others, whether family, friends, teachers, or newspapers and social media, people absorb information from different sources, process it, and use it to shape their beliefs about the trustworthiness and civic mindedness of people. Since people have different sources of information and transform information into beliefs through different cognitive processes, beliefs can vary significantly.

Information also affects beliefs indirectly by influencing the incentives of others to behave in trustworthy and civic-minded ways. People are more likely to misbehave when they know that others are unlikely to find out about it. When incentives to act badly are strong, people observe more untrustworthy or uncivic behavior and revise their beliefs about others accordingly. Hence, in the absence of information, people's beliefs about others are more pessimistic; when information is scarce, people reasonably expect others to take advantage of them.

Given how beliefs depend on information, it is no surprise that 20 years ago Paula would have approached her trip to Buenos Aires differently. In an information-scarce world devoid of online platforms to aggregate information, she would have had reason to expect the worst from the apartment owner and driver in Buenos Aires, even if they were in fact trustworthy people. However, once online platforms allowed her to access information about their past performance, she could take her trip with greater confidence.

Incorrect beliefs about the world and other people are pervasive and undermine trust and citizenship. Therefore, increasing the supply of complete and accurate information would seem to be a simple solution. However, nothing about this solution is simple: the availability, acquisition, and processing of accurate and complete information are distorted

by failures in information markets, the preferences of information consumers, and cognitive constraints and biases. Unfortunately, incorrect beliefs are not self-correcting.

On the contrary, people seek information that conforms to their beliefs more and struggle to process information that contradicts them. If Paula believes taxi drivers behave worse than Uber drivers, she may avoid seeking out and reading information that reports the reverse; even if she sees such information, she may not let it sway her beliefs. When she navigates in social media to find out what others say about hotels in Buenos Aires, she may value only the opinions of people like her, even if other groups have more experience with hotels in the city. When she returns from her trip and reads about the experiences of other travelers in Buenos Aires, she may like and share the reviews that confirm rather than contradict her beliefs, although they are based on a single trip.

The lack of trust and citizenship in and of itself complicates the role of information. Individuals are more likely to acquire and process information from sources they trust, but when trust is low, trustworthy sources may be few and particularly unlikely to convey (correct) information contrary to (incorrect) beliefs. When the bonds of citizenship are weak, people more likely believe that others will manipulate information to take advantage of them. Under these circumstances, exposure to (correct) information contrary to their (incorrect) beliefs may reinforce rather than weaken their commitment to those beliefs. Hence, it may take an extraordinary feat to ensure that individuals acquire and process accurate and complete information that contradicts their beliefs about the trustworthiness of others and the value of citizenship.

This chapter discusses these issues in detail. Incorrect beliefs are pervasive, but efforts to correct them often fail. In the specific context of trust and citizenship, the evidence is more hopeful; some information interventions are effective, at least under some conditions. Information can increase trust in economic and political markets, with corresponding gains in productivity and the effectiveness of public policy. Even in low-trust settings, individuals—whether as consumers or voters—respond to the availability of more accurate information by embracing the scrupulous and avoiding the unscrupulous. Information that other citizens behave civically increases citizenship among those who receive the information. But more elaborate information strategies are needed to deal with the fact that people seek out information consistent with their own prior beliefs, reject information that conflicts with their beliefs, transmit information that reflects their own beliefs, and tend to communicate with those who share their beliefs.

## Information: Feeding Incentives and Beliefs

People's social, economic, and political decisions depend first upon the incentives of others; people are less likely to cooperate with individuals who have strong incentives not to reciprocate. Second, their decisions depend upon their beliefs about the character and behavior of others: people are more likely to cooperate with individuals they know are well-meaning and altruistic, or who have a demonstrated record of fulfilling their commitments. Third, these decisions depend on people's beliefs about the state of the world: they are more likely to invest or support greater financing for the police when they believe the economy is growing or crime is high.

Information affects both the incentives and beliefs that influence personal decision-making. People understand that when information about the behavior of others is scarce, bad behavior is less likely to be punished. The incentives to engage in bad behavior—for example, to sell faulty products or to evade taxes—are greater. They may also be more pessimistic about the state of the world: for example, if they do not have information on crime, they may suspect authorities are withholding it because crime is extremely high.

Information also affects beliefs about others and the state of the world. When information is scarce, people rely on personal experiences and those of family and friends. Since experiences are idiosyncratic, beliefs based on a few experiences are unlikely to be accurate even if people believe they are (availability bias).[1] They may also be systematically biased—for example, if people recall and disseminate only the information that upholds beliefs (confirmation bias).[2]

The effects of information on incentives are well-understood and largely unambiguous: when individuals know their behavior is monitored, they are more likely to behave well. Evidence reported below on the effects of information on incentives to act in a trustworthy and civic manner support this conclusion. The more difficult question is, does information align beliefs more closely with reality? Unfortunately, the answer is an ambivalent *maybe*. More information increases the accuracy of people's beliefs

[1] Most people are subject to several cognitive biases related to the way they process information. Availability bias is one of them; the human tendency is to think that examples of things or events are more representative than they are. Other biases include insensitivity to sample size (people evaluate the probability of an event independent of sample size) and anchoring (people rely too much on the first piece or existing information they have to make a decision). These cognitive biases underly many of the issues evaluated in this chapter, even if they will not be explicitly referred to in the text.

[2] Because of confirmation bias, people tend to seek information that confirms their existing beliefs. It even affects the type of information people are willing to pay for (Jones and Sugden, 2001).

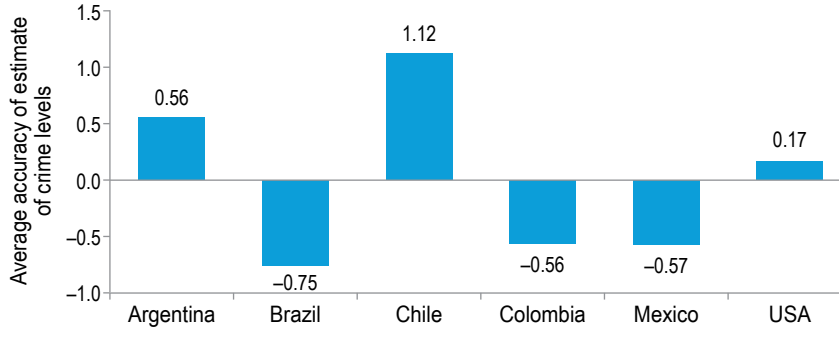
about others and about the state of the world when it is unbiased, when people believe it, when cognitive limitations and biases do not excessively distort whether people receive it and how they process it, and when people allow the new information to change their beliefs. Unfortunately, in many contexts, these conditions are not met. Hence, incorrect beliefs borne of ignorance can persist even in the face of corrective information.

## The Dangers of Incorrect Beliefs

Ambiguities about the effects of information on beliefs would not matter if people held generally accurate beliefs about others and the state of the world. Unfortunately, incorrect beliefs about fundamental issues that undermine trust and citizenship are widespread.

For example, beliefs about the prevalence of crime significantly impact support for either harsh or lenient policing and incarceration policies; they also affect trust in others. In the United States, Gallup polls consistently reveal that since the early 1990s, a majority of respondents believe that crime rose over the previous year.[3] Actually, crime fell by about half over those 30 years. In Latin America and the Caribbean, where people rank crime as one of their top concerns, their estimates of crime are even more dramatically divorced from reality (see Figure 9.1). U.S.

**Figure 9.1 ▸ Under- and Overestimation of Crime**




*Source*: Authors' elaboration based on data from IDB-LAPOP crime online survey. For more information about this survey, see Cafferata, Domínguez, and Scartascini (2022), and Domínguez and Scartascini (2021). *Notes*: The figure shows the average accuracy of estimates of crime levels in the country (excluding the top and bottom 2.5 percent of the distribution to reduce variance because of the existence of outliers).

[3] While violent crime has been falling steadily since the early 1990s in the United States, more than 60 percent of people interviewed responded that crime is higher than the year before in 23 of the past 27-year rounds of Gallup https://news.gallup.com/poll/1603/crime.aspx.

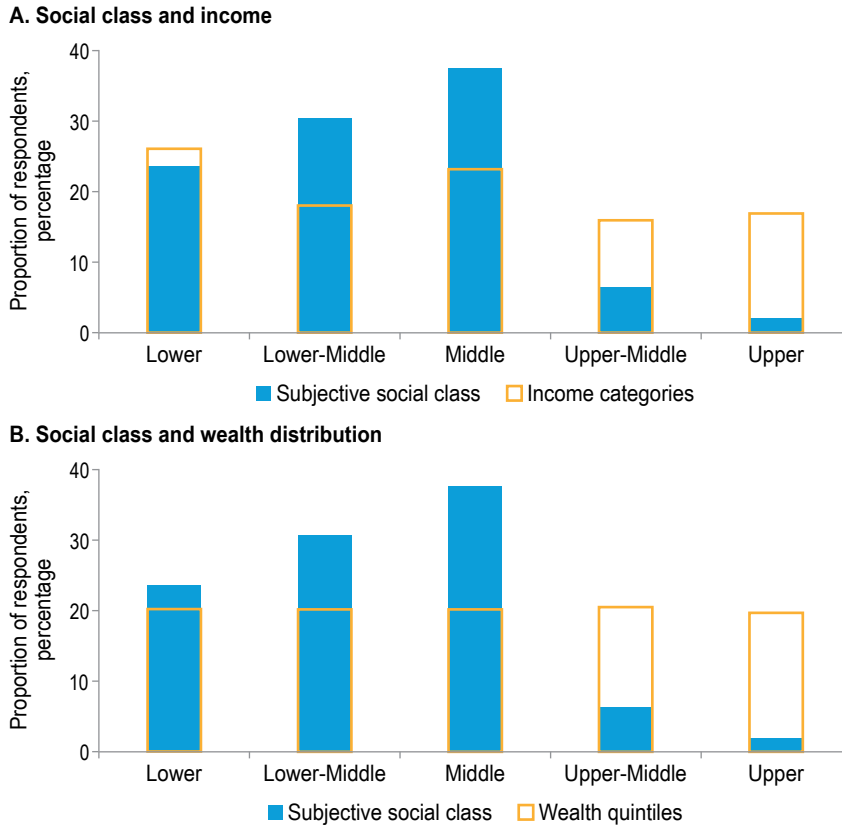
respondents overestimate the rate of homicides by about 17 percent. In Argentina, though, the overestimate is about 50 percent; in Chile, respondents estimate crime at more than double the actual rate. On the other hand, crime is very underestimated (between 50 and 75 percent) in Brazil, Colombia, and Mexico.

Beliefs about immigrants have a substantial effect on trust and citizenship: individuals tend to trust migrants less than the local population and their support for public goods and redistribution declines when they think migrants enjoy a large share of the benefits. However, individuals regularly overestimate the number of migrants in their country. Alesina, Miano, and Stantcheva (2018) report that in the United States, survey respondents estimate the share of immigrants in the population at about 35 percent when in reality it is only 10 percent. Differences of more than 10 percentage points also exist in the United Kingdom, Sweden, Italy, Germany, and France.

People also have vastly different and incorrect beliefs regarding income inequality. This relates directly to trust and citizenship since they affect individuals' judgments about how others are behaving and whether institutions have been set up fairly or not. Those who do not think that the distribution of income is fair are also less likely to believe that others are trustworthy (Scartascini and Valle Luna, 2020a). Over the past decade prior to the COVID-19 pandemic, Chile's economic and governance indicators were improving, or at least not deteriorating, and they led the region. However, Chile has recently experienced significant turmoil and in December 2019, only 6 percent of people thought the country was moving forward; trust in government institutions plummeted (Velasco and Funk, 2020). Discontent and perceptions of the income distribution are not correlated with the actual income distribution; hence, the probability that people will hold unfulfilled expectations can't always be predicted by looking at hard data.

People systematically over- or under-estimate where they stand in the distribution of income and wealth (see Figure 9.2). Panel A compares the distributions of respondents' self-declared household income (translucent bars) with that of their self-declared social class (solid bars). Panel B does the same, this time comparing self-declared wealth to self-declared social class, where wealth is calculated with an index based on household assets. In both panels, individuals in the higher quintiles of the income and wealth distribution consider themselves to be in a class lower than the one that corresponds to their self-declared income or household wealth. Few people identify themselves as upper or upper-middle class, even though their income or wealth indicates they belong there. These

**Figure 9.2 ▶ Under- and Overestimation of Income and Wealth**




*Source*: Scartascini and Valle Luna (2020a).
*Notes*: The wealth quintiles were created from the HH Asset Wealth Index (PCA) using a set of binary variables that states different household assets and characteristics. The ones considered are: (1) TV, (2) fridge, (3) landline, (4) mobile phone, (5) vehicles, (6) washing machine, (7) microwave, (8) computer, (9) drinking water, and (10) indoor bathroom. The PCA was done per country, year, and urban/rural. After that, according to the score, each household was assigned to a bin from 1 to 5 to generate wealth quintiles, as a proxy for household income. Social class is a self-assessment from the respondent and comes from the question: *"People sometimes describe themselves as belonging to a social class. Would you describe yourself belonging to... ?"* In both panels, the blue bars represent the share of population, in the sample, self-assigned to each social class. For Panel A, the income categories come from a self-reported income, and the monthly household income is categorized in one of 17 brackets going from zero (no income) to 16. Those 16 brackets were aggregated as following: from 0 to 3 to the lower class, 4 to 6 to lower-middle, 7 to 10 to the middle class, 11 to 13 to the upper-middle class, and 14 to 16 to the upper class. The no income bracket was included in the lowest class, and it comprises 3.99 percent of the entire sample. Panel B uses wealth quintiles. The sample includes data from 3 waves: 2014, 2016, and 2018/2019.

divergences between perception and reality suggest that if people in the region had more accurate beliefs about income distribution, they might radically revise their views about society's fairness, and hence, about how trustworthy others and institutions are. Of course, this assertion does not minimize the region's huge disparities in income.

## Mistaken Beliefs Die Hard

Incorrect beliefs can be changed if people receive and process correct information and use it to revise their beliefs. Unfortunately, however, this often is not the case. Cognitive limitations and biases distort the information people choose to acquire, how they process it, and whether they allow it to affect their beliefs; consequently, the supply of complete and accurate information may have no effect on beliefs. When failures in the market for information reduce the information available or encourage the diffusion of incorrect information, accurate and complete information may not be available. And when people do not trust the sources of accurate and complete information, they will not use it to update their beliefs.

Most information interventions seek simply to supply individuals with correct information since they assume that lack of information explains incorrect beliefs. Once again using the case of crime, survey evidence supports this premise and suggests lack of information about crime rates accounts for incorrect beliefs about them (Esberg and Mummolo, 2018). The crime perceptions of less educated individuals and those who do not follow current affairs are also less accurate—that is, those who are least likely to be exposed to information or to be interested in it.

Similarly, incorrect beliefs about income distribution can also be traced to lack of information. Those beliefs are largely determined by reference groups specific to the individual. Generally, the idiosyncratic choice of reference groups leads people to place themselves higher or lower on the income distribution than they really are (Cruces, Perez-Truglia, and Tetaz, 2013; Karadja, Mollerstrom, and Seim, 2017; Norton and Ariely, 2011). Valle Luna and Scartascini (2020) find that local factors, particularly the condition of their neighborhoods (e.g., the public services available there) is the most significant determinant of beliefs about the fairness of income distribution.

Therefore, the provision of more systematic information should, in principle, yield more accurate beliefs. Despite the potential for information interventions to correct beliefs, however, their record of success is mixed due in large part to cognitive factors that distort how individuals process information.

Information interventions often seek to boost individual support for worthwhile policies by anticipating objections to the policies and informing people that their objections have been addressed. However, the effects of this information depend on how salient the issues are to people. Particularly among the least informed, neither the objections nor the policy are likely to be on their radar: if they had been, people would have invested

more in informing themselves. The communication effort, therefore, has two effects: it exposes individuals to the information, but it also increases the salience of the issues. Exploiting a natural experiment in Italy, Mastrorocco and Minale (2016) show that greater exposure to crime-related news raises concern about crime.

By increasing the salience of the objection to a policy, information interventions that indicate the objection has been addressed may, in fact, deepen opposition. Alesina, Miano, and Stantcheva (2018) hypothesized that resentment of immigrants might reduce support for redistribution. Consequently, they informed people that immigrants were fewer in number than they thought and that they came from countries more culturally and economically similar to the respondents' own country. Nevertheless, respondents who received the information were no more likely to support redistribution: simply by reminding people of immigration, the survey increased the salience of this objection to redistribution. Similarly, in Panama, people who receive information that crime is falling express greater support for harsh measures to suppress crime than those who receive no information about crime rates at all, which conflicts with the authors' prior assumption that lower crime would lead to lower punitiveness (Gingerich and Scartascini, 2018).

The COVID-19 pandemic provides another example. More than 45 governments launched contact tracing apps to curb the spread of infection, but individuals have been hesitant to download and use the apps. Martínez, Parilli, Rojas et al. (2021) conducted a survey experiment of 23,000 individuals in Mexico to test whether reassuring people about privacy concerns would increase their willingness to use the app. On the contrary, however, respondents who were told that "the government is working hard to ensure data privacy protection," were 3 percentage points *less* likely to say they were willing to download the contact tracing app than respondents who were told nothing at all. The information increased the salience of an objection—privacy—that individuals had not thought much about prior to the survey, outweighing the effect of information that the government was working to protect privacy.

Like salience, trust also affects how people acquire and process information. In low-trust societies, using accurate information to change incorrect beliefs is even harder. People everywhere are more likely to acquire and believe information from sources they trust, but the lower is generalized trust in a society, the more likely that trusted sources are only people just like themselves: those with similar politics, cultural tendencies, socioeconomic status, and regional origin. Naturally, information from these sources is more likely to validate people's own beliefs. In low

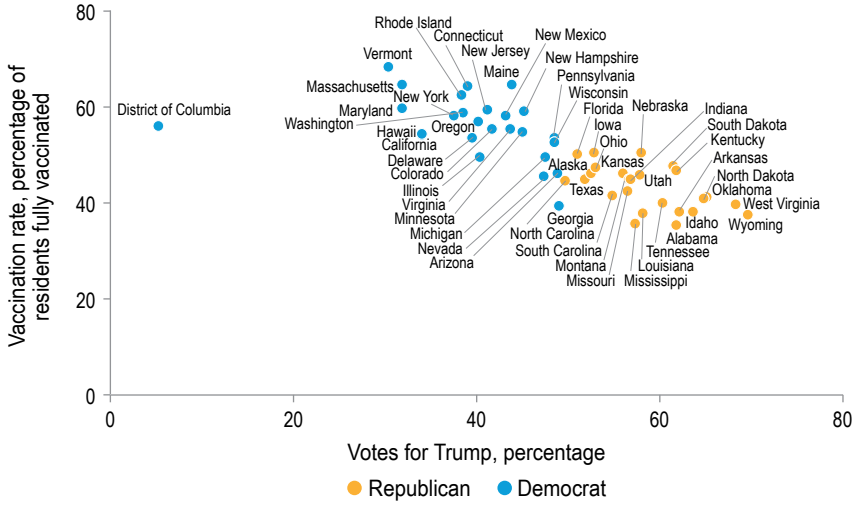
trust societies, people are even less willing to seek out or accept information that is more representative of the experiences of all people, since such information is more likely to come from sources who do not share their social and demographic characteristics.

Incorrect information from trusted sources may intensify incorrect beliefs. Correct information from sources that are not trusted can have the same effect. When individuals hear correct information contradicting their beliefs from sources they do not trust, they may regard it as part of an effort to manipulate them, convincing them that their (incorrect) beliefs are true. Hence, true information from mistrusted sources may strengthen the incorrect beliefs of those who receive it (Aruguete, Calvo, and Ventura, 2021a; Aruguete, Bachmann et al., 2021).

During the COVID-19 pandemic, many examples emerged of the interaction of trust, information, and beliefs. Albornoz, Cruces, and Lombardi (2021) find that experts' advice about social distancing actually *reduced* individuals' willingness to social distance in a sample of about 10,000 respondents from Argentina, Bolivia, Colombia, Ecuador, Mexico, Peru, and Uruguay. Again, this reaction is blamed on mistrust. Partisan differences also affect trust in experts' advice.[4] After the Brazilian president challenged the advice of experts regarding social distancing and quarantine policies, social distancing fell most in pro-government municipalities, where residents were more likely to trust the information (Ajzenman, Cavalcanti, and Da Mata, 2020). Opposition voters in Brazil responded to a presidential speech about COVID-19 by revising upwards their beliefs about job and health risk compared to independents; no changes were perceived among government partisans (Calvo and Ventura, 2021). A similar phenomenon has occurred in the United States, where the source of information matters for actions. State government leaders' recommendations were more effective in reducing mobility in Democratic-leaning counties than in Republican-leaning counties. However, among Democratic-leaning counties, recommendations from Republican leaders generated larger mobility reductions than recommendations from Democratic leaders because they internalize how much partisanship was affecting political discourse (Grossman et al., 2020). Divergent information and partisan lenses translate into

[4] Those who believe in conspiracy theories generally have a harder time reacting to evidence. Conspiratorial thinking contributes to the rejection of science (Lewandowsky, Oberauer, and Gignac, 2013), which also leads to lower acceptance of vaccination and other potentially life-saving behaviors (Jolley and Douglas, 2014). Conspiracy theories help magnify prejudice against groups, which may have potentially damaging and widespread consequences for intergroup relations and hence, for interpersonal trust and social cohesion (Jolley, Meleady, and Douglas, 2020).

**Figure 9.3 ▶ Vaccination Rates and Political Preferences**




*Source*: Ivory, Leatherby, and Gebeloff (2021), updated with information from Carlsen et al. (2021).
*Note*: Data on the share of state residents who have been vaccinated come from the Centers for Disease Control and Prevention and reflect vaccinations through August 9, 2021. Election data is from Edison Research.

different specific actions. As Figure 9.3 shows, the share of people vaccinating across the United States was highly correlated with partisanship 9 months after the first vaccines were administered and a few months after the vaccines had been approved for anybody older than 12.[5]

## Who Wants What? How People Complicate Information Markets

Incorrect beliefs persist or even intensify thanks to a fundamental characteristic of human beings: they are reluctant to change their beliefs and to seek out, accept, or disseminate information that contradicts their beliefs. This leads to significant distortions in the way markets for information work.

Examples of this behavioral bias abound. One illustration from the region echoes the partisan theme discussed in the previous section (Calvo and Aruguete, 2020; Aruguete, Calvo, and Ventura, 2021b). Information was

[5] Gallup polls conducted around the same time (July 20 – August 2) show that stated willingness to vaccinate differs strongly across party lines. While 81 percent of Democrats expressed their willingness to vaccinate, only 47 percent of Republicans did (Mullen O'Keefe, 2021).

shared on Twitter relating to a report that during a debate among presidential candidates, the incumbent was assisted by an earphone. The initial report was widely shared by the president's opponents, but not by supporters. A renowned fact-checking firm subsequently confirmed that the initial report was false. The information by the fact-checking firm was shared by the president's supporters, but not his opponents. In other words, people share what they believe and are not necessarily willing to update their beliefs based on new information.[6] In a meta-analysis of the literature, Barberá et al. (2015), using a dataset of nearly 150 million tweets, observe that information on political issues circulates primarily among individuals with similar ideological preferences.[7] An analysis of millions of tweets in Twitter and other social media environments following shocking events shows that people "live in neighborhoods" populated by peers and they receive mostly (or only) information related to the beliefs of the group (Calvo, 2015). Walter and Murphy (2018) conclude that corrective messages have a moderate influence on belief in misinformation. However, the effect is significantly less when it comes to politics and marketing, where preaching to the choir is more common and beliefs may be more strongly held for ideological or economic reasons.

Media markets are naturally sensitive to the behavioral tendency of people to seek out information consistent with their beliefs.[8] If media companies are profit-driven, but otherwise independent, they will strive to provide customers with the information they are most willing to pay for. Unfortunately, what people most seek out in media is information that coincides with their view of the world.

Accuracy is still relevant to traditional media; although individuals prefer to consume information that reflects their beliefs, they also want it to be authoritative. Compared to the new media, traditional media has greater

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[6] While only the opposition shared the disinformation and only the president's allies shared the correction, a positive result of the intervention by the fact checker was a decline in the "sharing rate" (and amplification) of the initial message. Consequently, while the opposition did not share the correction, it stopped sharing the false content (Aruguete, Calvo, and Ventura, 2021b).

[7] In Latin America, this may be even more dominant given that one of the main sources of information is WhatsApp. In a sample that includes Argentina, Brazil, Chile, Colombia, Mexico, and Peru, WhatsApp was the second most used source of information (Newman et al., 2021). Between 36 and 45 percent of respondents in those countries use WhatsApp. On the other hand, in advanced countries such as Canada and the United States, only about 6 percent of respondents use the platform as a source of news.

[8] As Durante and Knight (2012) shows, viewers respond to changes in the ideological leaning of news by switching the channel they watch.

incentives to restrict reputational costs and disseminate *true information*. Unlike social media, traditional media has higher barriers to entry, sunk costs, and a cartelization that raise the economic returns to investing in accuracy. Worried about the potential effects of misinformation and facts, traditional newspapers and broadcast media invest heavily in fact checking operations (Tsfati et al., 2020).[9] During the twentieth century, local and national media oligopolies in print and broadcast sustained journalistic norms of objectivity and balance, norms created as a backlash among journalists against the widespread use of propaganda in World War I (Lazer et al., 2018).[10] In equilibrium, traditional media invest in acquiring and disseminating accurate information, but use their editorial discretion to emphasize information that mirrors customer beliefs while ignoring information that does not. Traditional media can also be an unwilling but significant amplifier and disseminator of false stories by covering fake news with the intent of setting the record straight and correcting the fabricated information (Tsfati et al., 2020). In some cases, providing true information could actually feed incorrect beliefs. For example, prominently displaying a recent homicide could increase people's perception of crime.

Traditional media markets are not always organized simply to sell information for profit. In some markets, media owners pursue malign objectives and disseminate information to increase support for a regime, or for a corporate group seeking to use government privileges to increase its rents (Beattie et al., 2021).[11] These media seek to turn the behavioral biases of people to their favor by publishing false information that coincides with people's beliefs and supports media owners' interests. Importantly, while competition in media markets should be able to discipline any supply-side bias towards misinformation, distortions on the demand side may prevent this from happening. That is, when consumers themselves demand biased or less socially relevant news, greater competition may not work (Gentzkow and Shapiro, 2008).

Media markets also respond to other behavioral distortions that can be particularly destructive for trust and citizenship. One of these distortions

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9 Graves (2016) offers a detailed analysis of the operations of fact-checking organizations and their growing presence in traditional media.

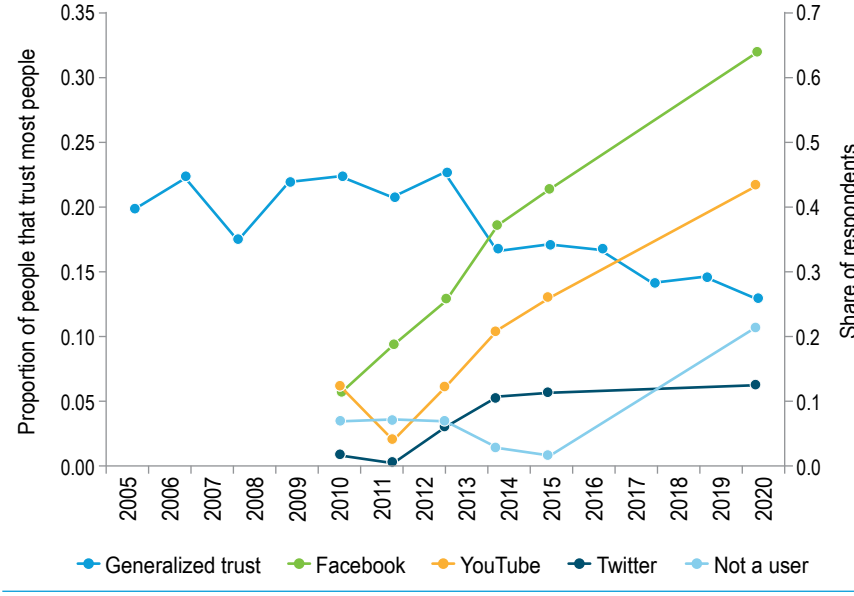
10 Budzinski and Kuchinke (2020) provides a good framework for understanding the industrial organization of media markets. Islam (2008) presents a summary of evidence on the workings of media markets, their incentives to deliver information, and the impact on political outcomes.

11 Media bias can have a substantial impact on political decisions, even potentially tilting the result of an election (DellaVigna and Kaplan, 2007). Therefore, the incentives to deviate are high.

is people's preference for negative news. The average person reacts more strongly to negative than positive news stories (Soroka, Fournier, and Nir, 2019). Stories about untrustworthy and uncivic behavior are, therefore, likely to attract more attention, reinforcing individuals' beliefs that others are untrustworthy and uncivic.[12]

Social media has the reach to correct biases in traditional media markets that undermine trust and citizenship. According to recent data (Statista, 2021b), more than 150 million people in Brazil and 100 million people in Mexico use Facebook. In Argentina, the number is close to 35 million (about 75 percent of the population), and in Peru, 32 million (about 85 percent of the population). Facebook's use has grown rapidly as many people rely on it for news (see Figure 9.4).

**Figure 9.4 ▸ Evolution of Social Media Use in Latin America and the Caribbean**




*Source:* Authors' calculations based on data from Latinobarometer.
*Notes*: Generalized trust (primary axis) comes from the question, *"Generally speaking, would you say that you can trust most people, or that you can never be too careful in dealing with others?"* The secondary axis is the share of respondents that uses social media. The sample of Latin American and Caribbean countries (18) is: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay, and Venezuela.

[12] In some cases, the media can reduce civic behavior by generating animosity among ethnic groups within a country. Nationalistic media radio broadcasts from Serbian radio triggers ethnic hatred toward Serbs in Croatia by those Croats who listen to Serbian public radio (intended for Serbs in Serbia) (DellaVigna et al., 2014).

There are reasons to be optimistic about the role of social media. Antoci et al. (2019) use data from an experiment on Facebook to demonstrate that people exposed to civic content on social media report greater interpersonal trust while un-civic content lowers trust. Moreover, it provides citizens with access to otherwise unavailable information relevant for judging government performance. For example, greater internet access may provide citizens access to more information on corruption which may increase accountability in the long run (Guriev, Melnikov, and Zhuravskaya, 2021). That same access allows citizens to become more engaged in the political process and better coordinate their protests (Enikolopov, Makarin, and Petrova, 2020; Fergusson and Molina, 2019). It can also generate opportunities to attract disenchanted or demobilized voters, converting *exit* back into *voice* (Campante, Durante, and Sobbrio, 2018). More generally, in countries with rampant public grievances over corruption, subversion of power, and control of traditional media by autocrats, free Internet and social media improve accountability by informing the public and facilitating the organization of protests (Zhuravskaya, Petrova, and Enikolopov, 2020).

Nevertheless, over the same period that trust has declined in the region, social media use and reliance on it for news have increased. Access to broadband internet has caused a large and significant decline in newspaper circulation (Gavazza, Nardotto, and Valletti, 2019). Citizens who gain access to mobile broadband internet become less confident in the country's government institutions (Guriev, Melnikov, and Zhuravskaya, 2021). Figure 9.4 shows on the left axis the share of respondents that use social media (Facebook, Twitter, etc.), which has grown steadily since Latinobarometer started asking the question in 2009, and generalized trust, which has been falling ever since.

For several reasons, social media actually magnifies the limitations of traditional media in more closely aligning people's beliefs with reality. First, because it is internet-based, social media has low barriers to entry—no investments in spectrum or printing presses—and zero cost for disseminating information. These investments provide traditional media with an incentive to be truthful;[13] social media, however, are less concerned with

[13] Because of the sunken investments, reputational losses can have large costs. Thus, even when they are interested in behaving opportunistically, competition mitigates those biases (Beattie et al., 2021). Additionally, with fewer incumbents in the industry (entry barriers are higher), coordinating the rules of the game is easier. The creation of media/newspaper associations, prizes for good journalism, etc., are all institutional solutions to maintain the equilibrium.

accuracy. Second, social media outlets can cater to small niche audiences and still earn a significant return on investment. About 2 million podcasts (that have generated 47 million episodes) are available just on Apple's dedicated app (The Podcast Host, 2021), and over 2.5 billion blog posts are published each year worldwide (Byers, 2021). Some 600 million tweets flood the airwaves each day (Internet Live Stats, 2021). In contrast, the World Association of News Publishers reports only about 18,000 newspapers in the entire world (WAN-IFRA, 2021).

The ability of social media to thrive with small audiences and the tendency of people to seek out information that confirms their beliefs reinforces the echo chamber effect: when media outlets can target ever narrower, more homogeneous audiences, the information users receive becomes less diversified and increasingly reinforces their world view. In the United States, individuals from both major parties are about 15 percent more likely to believe ideologically aligned headlines; this ideologically aligned inference is substantially stronger for consumers of ideologically segregated social media networks (Allcott and Gentzkow, 2017).

Third, social media companies profit from user engagement with the website, which increases when users can easily find information that interests them. Companies use algorithms to sort through a nearly infinite supply of information and identify the interests of each user. These algorithms reinforce the walls of the echo chamber. Bakshy, Messing, and Adamic (2015) look at data from over 10 million Facebook users and find that Facebook presents them with more political content aligned with their own views than with opposing ideologies. Facebook's algorithm is less likely to supply individuals with posts from counter-attitudinal news outlets which exacerbates polarization: exposure to counter-attitudinal news diminishes negative attitudes toward the opposing political party (Levy, 2021). Outside interests can further manipulate these algorithms through the use of bots. As many as 60 million bots may be active in Facebook (Lazer et al., 2018).

Fourth, the great advantage of social media is that it is social—it facilitates the dissemination of information among users. However, it turns out that falsehoods diffuse significantly faster, to a broader audience, and with deeper impact on their beliefs than true information, according to a study by Vosoughi, Roy, and Aral (2018) that looked at Twitter data from 2006 to 2017.[14] Acemoglu, Ozdaglar, and Siderius (2021) offer an explanation

[14] This effect seems to be driven predominantly by older people. On average, users over 65 shared nearly seven times as many articles from fake news domains as the youngest age group (Guess, Nagler, and Tucker, 2019).

for this effect. When individuals are presented with misinformation, they can either share or check it. People enjoy sharing stories and getting likes, but may incur a cost if they share blatantly false information. However, the incentives to share when the network is more homogenous in terms of beliefs go up because the chance of anyone checking goes down.

Since people prefer negative stories to positive ones, the falsehoods they disseminate are also more likely to be negative. In the same vein, false content appears to accentuate people's emotional response to information, possibly because *fake news* is presented in a more emotionally charged manner (Vosoughi, Roy, and Aral, 2018; Zhuravskaya, Petrova, and Enikolopov, 2020). These effects widen the distance between reality and individuals' beliefs and strengthen people's resistance to reason-based information. This has adverse implications for trust and citizenship. Campante, Durante, and Sobbrio (2018) point to a significant negative impact of social networking site (SNS) use on trust (be that in strangers, neighbors, or the police). This effect seems to be driven mainly by the diffusion of anti-social, user-generated content on social networking platforms often referred to as *hate speech*.

Engaging in social media can damage trust even when the actions between the information received and the interactions demanding trust are disconnected. Aruguete, Calvo et al. (2021) conducted an online experiment using a modified trust game with panels of 2,400 Brazilian and Mexican respondents each. The authors test whether respondents trust others to act on their behalf (by entrusting other players to cast votes for them) and whether they are trustworthy with respect to the resources (votes) entrusted to them. Trusting behavior increases the potential rewards perceived by the participants (more votes), but may carry a significant cost if the players' trust is betrayed (that is, if their candidate loses the election). The *players* (in this case the respondents to the survey) receive prizes if their candidate wins the election and raffle tickets for each vote they contribute to the win. Respondents' incentives are well-aligned with collecting as many votes as they can. After an initial round of the game, a subset of respondents receives negative and positive tweets from incumbent and opposition politicians; changes in trust and trustworthy behaviors are measured. Trust declines significantly among voters exposed to negative messages from out-group political figures (dissonant messages) even though those messages are irrelevant for the task at hand. *Dosage* matters: incidental exposure to social media has modest effects on trust. The effect is more pronounced (greater declines in trust) at higher levels of engagement with tweets. Differences in trust between the control and treatment group are larger when they "do" Twitter (like, retweet, reply) as opposed to when they

"read" it (no engagement). These findings point to differences between social media platforms and more traditional news outlets.

## Can Information Interventions Raise Trust?

The picture presented is not encouraging. Incorrect beliefs are difficult to change and, moreover, people seem to prefer information that *reinforces* beliefs that others are untrustworthy and uncivic. People do not seem to seek out information that supports beliefs in the trustworthiness and citizenship of others, nor use that information to revise their beliefs; neither traditional nor social media seem to produce and disseminate such information. Given this evidence, can intentional information interventions to increase trust be effective?

Information interventions are crucial even if the institutions and organizations discussed in Chapters 7 and 8 function well. Third-party enforcement institutions like courts reduce the need for people to make their own assessments of the trustworthiness of others, but they do not eliminate it since courts can be expensive and time-consuming to use. Regular, open, and competitive elections allow citizens to punish opportunistic behavior by politicians, but work less well if voters are uninformed about the character and behavior of candidates. This section considers information to resolve the challenge of opportunistic behavior in the private and, particularly public, sectors.

Reputation is a key strategy for firms and customers to confront the threat of opportunistic behavior. Customers prefer a firm with a demonstrated history of customer satisfaction both because it is indicative of the character of firm management and its employees (they are trustworthy) and because it is a valuable asset that the firm could lose if it treats a customer badly. Reputation is difficult to build without information on performance, however, and without a means to disseminate that information.

The information revolution and the emergence of online platforms demonstrate the power of information. Airbnb, for example, has more than 5.6 million listings from almost every country in the world. More than 4 million hosts have received more than 800 million visits since its creation in 2007. In general, each of these visits is a separate transaction between strangers, each with scant hope of using third-party institutions to resolve disputes and with almost no way of finding and verifying information either on past performance or personal character. A key to its success, as with similar online platforms such as car-riding apps, is the ease with which users can share information about their experience. More than 3.6 million listings received active reviews during 2018–2019 (Adamiak, 2019).

This information is valuable, giving rise to transactions that would otherwise not have occurred in the absence of the information (Bridges and Vásquez, 2018; Houser and Wooders, 2006). In contrast to social media, online platforms counter the behavioral tendency to mistrust others based on misconceptions, stereotypes, and homophily (people trust more those who are like themselves) (Abrahao et al., 2017).

Of course, nondigital information has also always played a role in facilitating transactions. Firms anxious to reassure potential buyers when the quality of their products is difficult to observe can turn to third parties to verify the quality. Software, for example, can have hidden flaws that are difficult to detect and software firms can request a third-party audit of their software construction practices to reassure buyers of its high quality. Such audits boost demand for a firm's products precisely in those markets where buyers are less likely to be familiar with them (Gao, Gopal, and Agarwal, 2010).

Information solutions provided by online platforms or third-party audits may be more effective than, or at least crucial complements to, traditional regulatory approaches to preventing opportunistic behavior in private transactions. The success of online platforms provides such evidence: given the choice of using heavily regulated hotels or lightly regulated Airbnb rentals, individuals frequently opt for the latter. Similarly, when choosing between heavily regulated taxi drivers or Uber or Lyft, individuals often choose Uber or Lyft.

Trust clearly affects economic decisions. New technologies that might improve productivity require adopters to believe in the promised productivity improvements. In low-trust environments, sellers of new technologies are more likely to overstate their benefits, while potential buyers are more skeptical even of accurate representations of the costs and benefits of adopting new technologies. In low-trust societies, technology adoption is, therefore, slower (see Chapters 1 and 3).

The problem of trust and the role of information in political markets are distinct and more challenging. At home, citizens must decide whether to rely on the promises of politicians and government officials. When information about them and their performance is scarce, people are naturally—and rationally—mistrustful of them. They know that politicians and officials have the incentives to take advantage of the lack of information by shirking their obligations to voters. Therefore, trust should be low when government decision-making is not transparent, particularly when allegations and examples of corruption and mismanagement are present in the news.

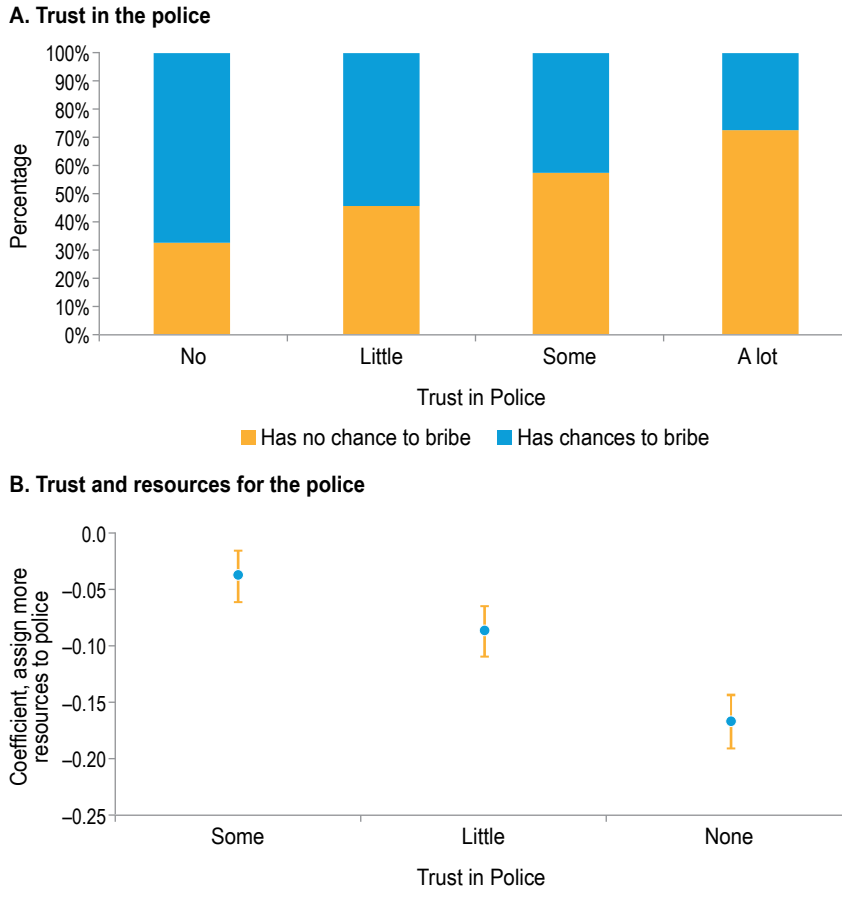
Evidence supports the prediction that people's expectations about opportunistic behavior move in tandem with mistrust. People who trust public officials or government are less likely to regard corruption as a problem. Figure

9.5A demonstrates this with survey evidence from the region on attitudes towards the police. Police officers abdicate their responsibility when they choose not to enforce the law in order to increase benefits for themselves. Among respondents who trust the police *a lot*, more than 70 percent believe that it is not possible to bribe the police to avoid arrest; among those who express no trust in the police, the reverse is true: nearly 70 percent believe they can avoid arrest by offering a bribe. Figure 9.5B echoes the conclusions in Chapter 4. Trust in the police affects how people prefer to allocate resources. As trust falls, people are less likely to favor providing resources to the police and prefer giving them to people to provide their own security. Compared to the baseline case of high trust, those who trust only somewhat are about 4 percentage points less likely to prefer the resources be allocated to the police. The difference is greater than 15 percentage points for those who do not trust at all (and about 10 percentage points for those who trust a little).

Two dimensions of the information problem make it difficult to provide Paula with information to increase her trust in politicians and public officials. One is the collective action dilemma discussed in this book. Paula receives all the benefits of the online information she discovers about a restaurant or a hotel and therefore has correspondingly high incentives to search for it. In contrast, her incentives to collect costly information about politicians are weak since, by herself, she can do little to encourage politicians and officials to act in a trustworthy manner. The only action she can take if she is unhappy with what she discovers is to vote with her feet. However, leaving her country is a momentous decision, quite unlike the decision to cancel a reservation in a hotel with bad reviews.

However, even for voters who care about politics and policy outcomes and are not dissuaded by the collective action dilemma, a second information problem remains: it is difficult to disentangle the contribution of governments to the outcomes that voters experience from the effect of external shocks that might vary from person to person. The hotel and restaurant experiences documented by consumers online are largely under the control of these establishments. In contrast, citizen welfare is a product of many factors, both exogenous shocks that politicians can do little about and policies for which they are solely responsible. These two dimensions of the information problem in political markets explain why no digital apps exist for rating political candidates and governments. Information about individual experiences is less useful and individuals can do less with the information. Still, additional information would help Paula make more accurate evaluations. How have politicians performed in the past? Have they kept their promises? And what is the character of politicians—are they trustworthy people, do they respect the law and widely shared social norms?

**Figure 9.5 ▶ Beliefs about Corruption, Trust in the Police, and Providing Resources to the Police**




*Source*: Authors' calculations based on data from Latinobarometer.
*Notes*: Trust in the police and chances to bribe comes from 2017 Latinobarometer data. For Panel A, the variable of chances to bribe comes from the question, *"Imagine that a foreign friend of yours, who does not know our country, asked you what his chances are here of being able to bribe the police to avoid an arrest. What would you say?"* The options to the question are: "*He has no chance, he shouldn't even try; He has little chance; It depends on the case; He has a good chance; He has a high probability."* Answers were aggregated so *"has a chance"* includes the last two options; and "*has no chance"* includes the first two options. Trust in the police (Panel A) comes from the question, *"Please look at this card and tell me, how much trust do you have in the police?"* The answers for trust values are a lot, some, little, or no trust. For Panel B, the dependent variable comes from the question, *"Imagine that the state has two solutions, and you have to choose only one. One is to give resources to the police so they can fight crime. The second is to provide the resources to the people to fight crime in their neighborhood with alarms, private security, etc. Which one do you prefer? Resources to the police are much better than direct resources to the people; Resources to the police is better than direct resources to the people; I do not care; Direct resources to the people is better than resources to the police; Direct resources to the people is much better than resources to the police."* An Ordinary Least Squares (OLS) regression was used with robust standard errors, at a 90 percent confidence interval. Dots represent coefficients of regressions, and the lines are confidence intervals. The total sample is 20,200 observations in 18 countries: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay, and Venezuela.

Information about politicians' performance should increase trust if citizens act on it to hold politicians accountable, and if they are not subject to the power asymmetries discussed in Chapters 2 and 10. In some settings, they do. Ferraz and Finan (2008) show that disseminating the results of random audits of the accounts of municipal governments in Brazil affected the reelection probabilities of incumbents. The effect was more pronounced where there was more dissemination. Cruz, Keefer, and Labonne (2021) demonstrate that merely providing information about the existence of a government program in municipalities in the Philippines raises voter expectations of politician performance and encourages people to vote against those politicians who do not meet those higher expectations. Keefer and Khemani (2014, 2016) demonstrate significant effects of information, obtained via community radios in Benin, on access to public education and malaria nets. A broad review of the evidence by the World Bank (2016) finds that providing information has generally, but not uniformly, positive effects on citizen welfare.

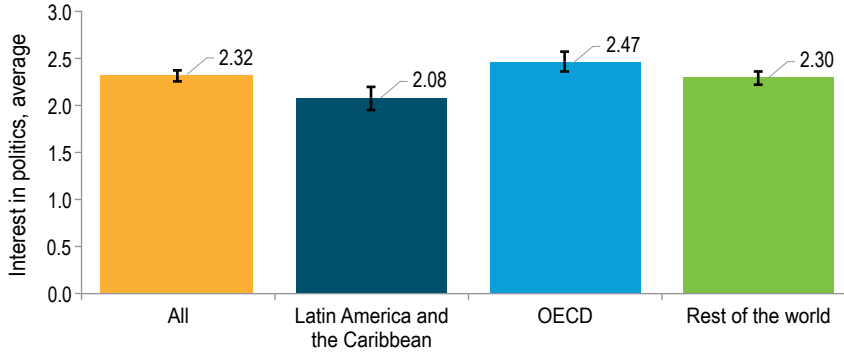
Still, the demand for political information, and its impact on beliefs, is likely to be context dependent. For example, Chong et al. (2015) find different effects in Mexico when they distribute information on how mayors use public money: bad reports do not lead to electoral sanctions for malfeasant mayors, but instead to a decrease in voter turnout.[15] Apathy in politics does not help increase trust, though, since it reduces the chances for the citizenry to create accountability. Apathy is particularly high in Latin America and the Caribbean (Figure 9.6).

Other research indicates that simply making information about government performance available may not be enough; a more active effort to put it in front of people may be needed to change beliefs about government trustworthiness. In other words, "opening up the government" may not be enough to increase trust. Given the high costs of acquiring and processing information, collective action problems, and the limited value of becoming informed if others do not or are unwilling to act on the information, most people tend to remain ignorant.

The complexity involved in carrying out an effective information campaign is illustrated by a local government effort in Argentina. As part of a broader process of increasing transparency, the mayor of Buenos Aires

[15] Chen and Yang (2019) show that in China, free access to politically sensitive information by itself does not induce individuals to acquire politically sensitive information, but temporary encouragement can lead to a persistent increase in acquisition. Once acquisition happens, it can bring broad, substantial, and persistent changes to knowledge, beliefs, attitudes, and intended behaviors.

**Figure 9.6 ▶ Interest in Politics across Regions**



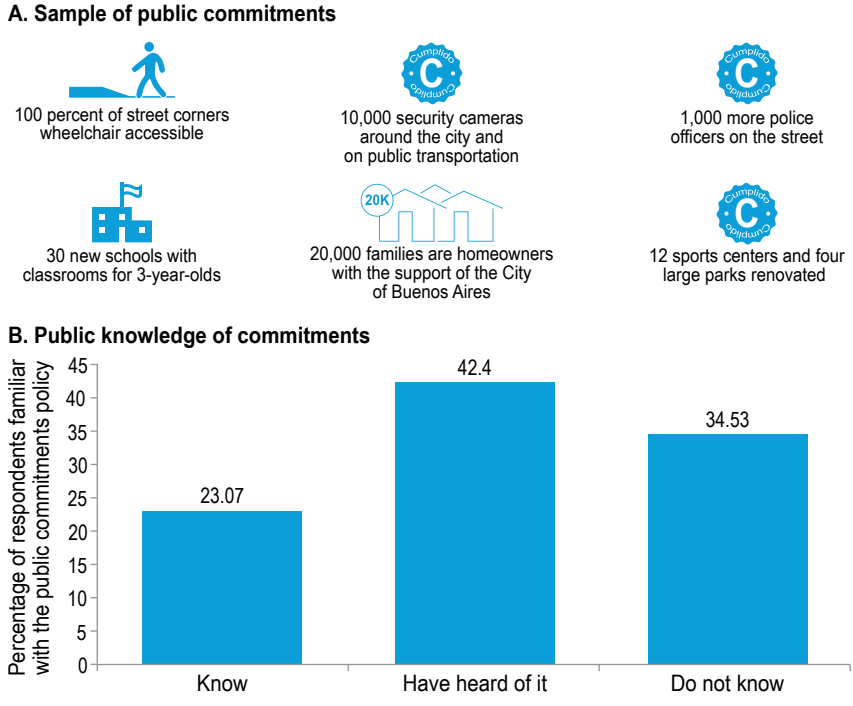

*Source*: Authors' calculations based on data from the Integrated Values Survey.
*Notes*: Interest in politics data come from the Integrated Values Survey (2010–2020), which compiles the sixth and seventh wave of the World Values Survey (1981–2020) as well as the fifth wave of the European Values Study (2017–2020). It is measured from the answers to the question, *"How interested would you say you are in politics?"* The answers are based on a scale from 1 (*very interested)* to 4 (*not at all interested*), and it was reversed from its original coding, so a higher value means higher interest in politics. Each bar is a simple average from country-level data. The OECD group of advanced economies excludes Latin American and Caribbean countries: Colombia, Chile, and Mexico. The total sample encompasses 95 countries including Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Guatemala, Haiti, Mexico, Nicaragua, Peru, Trinidad and Tobago, and Uruguay.

issued a series of government commitments to the citizens of Buenos Aires. These commitments were clear and measurable goals across many government areas and based on citizens' priorities and the Sustainable Development Goals of the United Nations (UN). The city government webpage tracks and explains more than 50 goals.[16] One goal is to make 100 percent of street corners handicapped accessible. Another is to install 10,000 security cameras around the city and on public transportation. The undertaking is novel, large, has received significant news coverage, and offers a dedicated website available to all. Nevertheless, a large share of the population remains ignorant of the policy (Figure 9.7) (Alessandro et al., 2021; Otálvaro-Ramírez, Scartascini, and Streb, 2021).

Evidently, information sitting on a website is insufficient to change beliefs. However, efforts to deliver it to citizens can have a large impact. Providing information increases the perception of government transparency by about 8 percentage points (Alessandro et al., 2021). This may seem obvious, but the perception that government is transparent is a crucial ingredient of trust; voters then know they can find out if the government acts opportunistically. Providing information about the existence of the commitments increases trust in the government by about 0.10 standard deviations, according to

[16] The website is available at http://www.buenosaires.gob.ar/compromisos.

**Figure 9.7 ▶ Public Knowledge of Buenos Aires City Government Commitments**

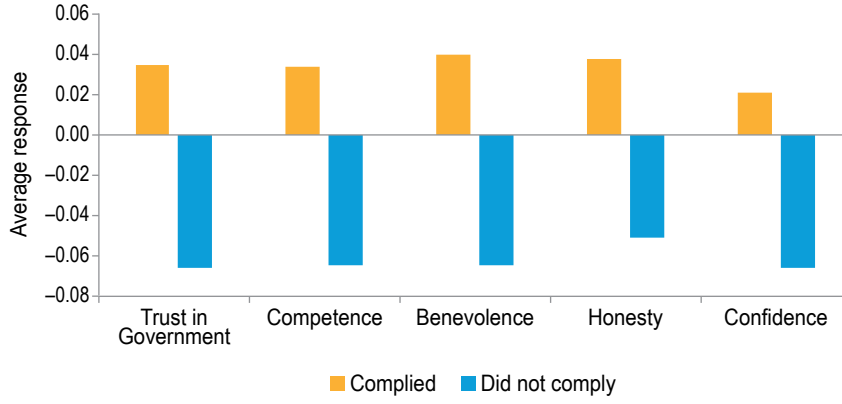



*Source*: Buenos Aires Ciudad (2021) and Otálvaro-Ramírez, Scartascini, and Streb (2021).
*Note*: This figure presents the share of people who indicated that they know/have heard of/do not know the commitments (*Compromisos*) policy. People answered the following question: "The Government of the City of Buenos Aires has a public commitments policy that explains its plans and levels of compliance. Please indicate if you are familiar with the policy (know), if you have heard of it but do not know for sure what it is, or if you have never heard of it."

the results of a survey experiment on 2,375 individuals in Buenos Aires (Otálvaro-Ramírez, Scartascini, and Streb, 2021). Disseminating information that the government not only made these commitments but also complied with them increased it even more. In addition, city-level fulfillment increases the probability of trusting information provided by the government itself (5.7 percentage points). This trust effect is important because it boosts the chances that future government information may be more influential.

While transparency should increase trust by giving people the opportunity to verify whether promises are fulfilled, it may also lessen trust if governments do not fulfill their promises. In fact, differences in performance seem to matter. Alessandro et al. (2021) implemented a survey experiment on a sample of 1,999 individuals living in Buenos Aires. Individuals who received information that the government was over-performing on its goals exhibited significantly greater

**Figure 9.8 ▶ The Importance of Complying with Promises**




*Source*: Alessandro et al. (2021).
*Notes*: Bars show the average response for those treated with the message that showed that the government had complied with the commitments (orange) and those who received the message that the government had not yet complied (blue). These variables are indices that summarize several survey questions and are standardized with mean 0 and standard deviation equal to 1. For more information see Alessandro et al. (2021).

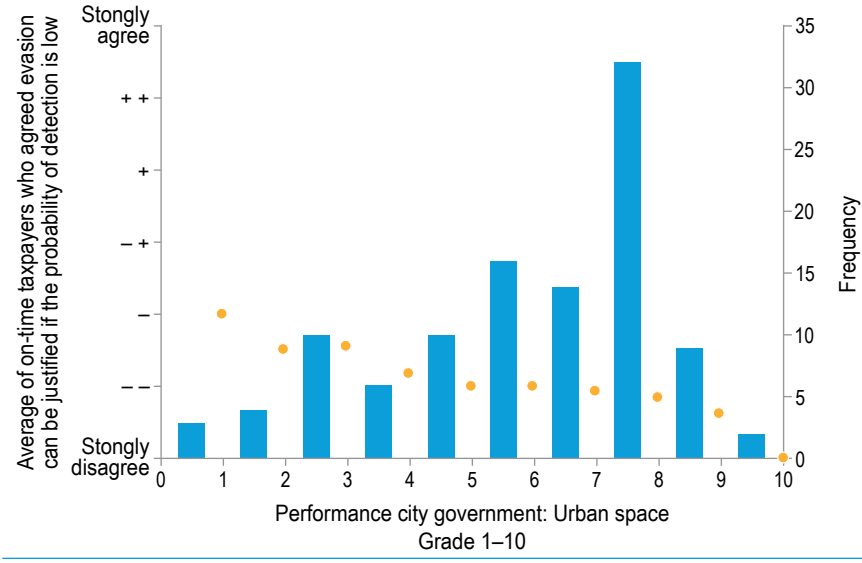
trust than those who received information that the government was underperforming on its goals. The difference (shown in Figure 9.8 as the variation in height between the bars) is equivalent to about 0.10 of a standard deviation. This difference increases to 0.30 of a standard deviation for people seeing this information for the first time (Figure 9.8). These results are consistent with Ardanaz, Corbacho, and Ruiz-Vega (2014), who find that providing respondents with information about decreasing crime rates improves citizens' perceptions of safety and leads to greater trust in police.

## Words Matter: Using Information to Boost Citizenship

Interpersonal trust is the foundation of stronger bonds of citizenship, the willingness of citizens to make individual sacrifices in pursuit of the collective endeavors that are central to a society's success. Unfortunately, as Chapter 1 reports, the bonds of citizenship are weak in Latin America and the Caribbean; individuals are more likely to make choices that yield private benefits at the expense of the broader community. This section presents hopeful evidence that providing people with information about the citizenship of others increases their own likelihood of acting civically.

Two key reasons for low levels of citizenship are the widespread belief that collective action by citizens has no effect on collective welfare (e.g., tax revenues are wasted rather than used to promote citizen well-being)

**Figure 9.9 ▶ Evasion and Government Use of Public Funds**




*Source*: Castro and Scartascini (2018).
*Notes*: The data come from a survey implemented in December 2015 in Junín, Argentina. Survey respondents were 568 people who had paid their taxes on time in the last billing period before the experiment (July to August 2015). Bars correspond to the share of taxpayers who rated the municipal government's performance regarding urban space (measured on the vertical right axis). The scale ranges from 1 (very low) to 10 (very high) (horizontal axis). The left vertical axis shows the share of people who agreed with the statement that tax evasion can be justified if the probability of detection is low. The orange dots (measured on the left vertical axis) indicate to what degree taxpayers who assigned a certain score to the performance of the municipal government agree with the statement that evasion can be justified, from very justifiable (++) to very unjustifiable (--). For example, taxpayers who gave municipal government performance a score of 10 consider evading taxes unjustifiable.

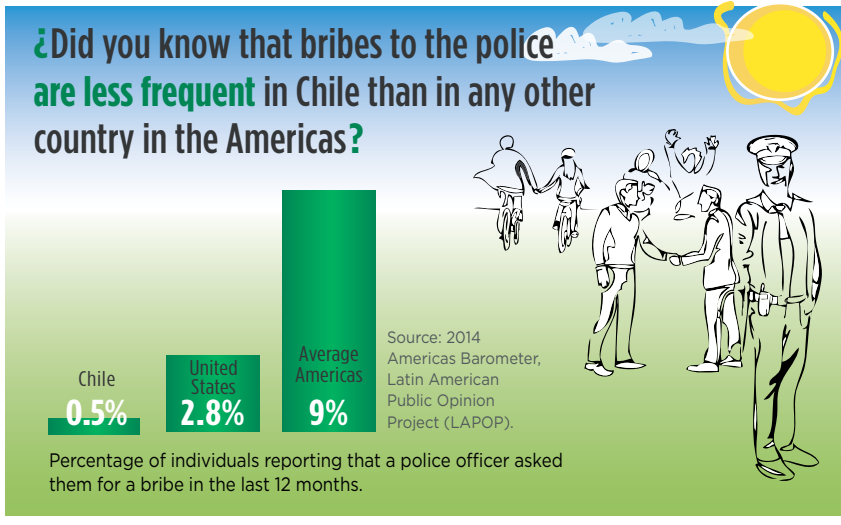
and that, in any case, other citizens do not do their part (e.g., they do not pay taxes). Figure 9.9 illustrates this point with evidence from Junin, Argentina. Taxpayers who believe that the city does a good job of managing public spaces in the city were less likely to agree that tax evasion is justifiable when the probability of detection is low.

Information about government effectiveness and the citizenship of others can increase civic attitudes or behavior. Cafferata and Scartascini (2022) look at the effect of providing information to individuals about the relative levels of police corruption in several countries (corruption being a measure of government nonperformance). In Chile, where corruption of the police was low at the time of the survey experiment, informing citizens that corruption was much rarer than in the United States or the rest of Latin America increased respondents' willingness to tax themselves to pay for policing (see Figure 9.10).[17]

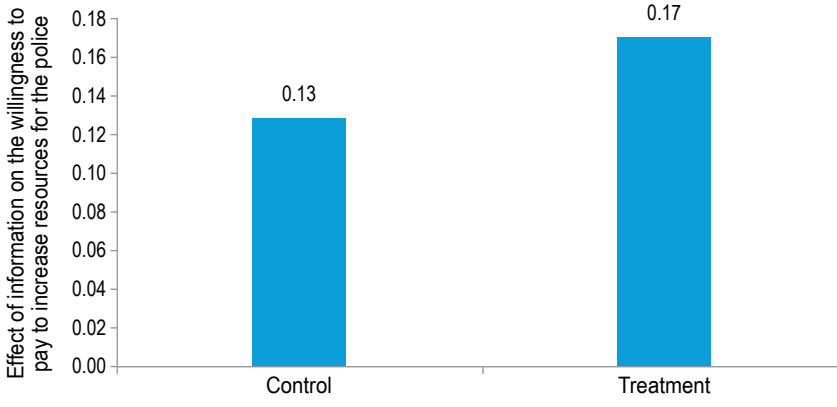
[17] This information influenced Chilean respondents, who overestimated corruption levels among the police and, therefore, increased their funding preferences upon receiving the

**Figure 9.10 ▶ Information about Police Corruption and Support for the Police**

**A. Information given to individuals**




**B. Effect of information on willingness to pay**




*Source*: Authors' calculations based on Latin American Public Opinion Project (LAPOP).
*Notes*: Left figure shows the information provided to individuals in a survey conducted in Chile. Right figure shows the effect of this information on the willingness to pay (wtp) to increase resources for the police. Respondents were asked the following: "Suppose that the National Government were evaluating different measures to combat crime. One such action would be to increase the number of police officers. To do this, the government would have to have more resources and raise money from all Chileans. Would you be willing to pay an additional $40,000 (Chilean) pesos each month?" Bars indicate the share of individuals that answer yes to the question. The sample included 1,540 observations from a 2017 LAPOP survey in Chile.

information. In other countries, prior beliefs about corruption in the police corresponded more closely to actual corruption levels; thus, the information treatment had no effect.

In a large-scale field experiment in the United Kingdom, Hallsworth et al. (2017) find that providing information about the civism of others increases compliance with civic behavior. They inform tax delinquents that most taxpayers pay their taxes on time. Their text read, "Nine out of ten people in the U.K. remit their tax on time. You are currently in the very small minority of people who have not paid us yet." This wording, emphasizing that the individual was in the minority, was the most effective in convincing individuals to remit their taxes. Information about the benefits of paying taxes is also effective. People who received the message, "Paying tax means we all gain from vital public services like the NHS [National Health Service], roads, and schools," increased the likelihood that taxpayers would pay their taxes on time.

Castro and Scartascini (2015) sent a message to taxpayers in a city in Argentina to reinforce the belief that government spends resources to improve collective welfare: "In the first 6 months of this year, [the local tax] collection contributed to placing 28 new streetlights, water connections in 29 streets, and sewerage networks in 21 blocks." The message increased compliance significantly among people who were less likely to be informed about how government uses public monies. Among taxpayers living outside the city, who cannot easily observe the government at work, payment rates increased 14 percentage points. The earlier claim is borne out: when there is little information, taxpayers assume that government will shirk its duties. Information can correct these beliefs.

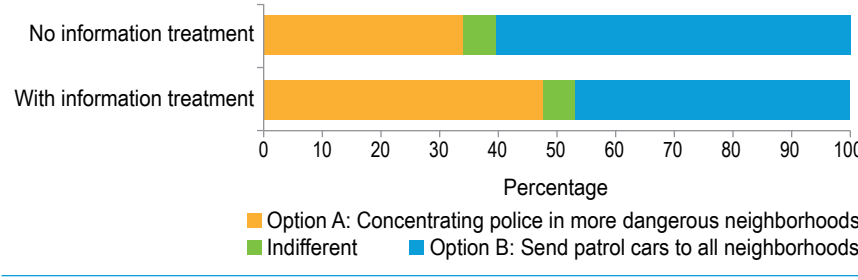
Citizenship is not only evident in the willingness to contribute to a collective effort to promote the common good, it also manifests itself in a willingness to accept fewer services from the government in order to free up resources to invest in areas that will have a greater positive impact on overall citizen welfare. Patterns of support for hot spot policing provide a striking example of this civic attitude. With hot spot policing, government targets law enforcement resources to high-crime areas and, therefore, provides fewer resources to safer areas.

Hotspot policing is highly effective, since most crime occurs in a small part of a city. Still, some crime may be displaced from these dangerous areas to other areas where crime was lower. Therefore, while hotspot policing makes everybody better off on average, some individuals who receive less police attention may be worse off. Data from Latinobarometer reveal that preferences for hotspot policing seem to depend little on whether people are worried about being a victim of a violent crime and more on levels of interpersonal trust (see Chapter 8). However, the most important determinant of support for hotspot policing is evidence of its effectiveness—that is, the sacrifice of citizenship (lower policing in one's own backyard) will be rewarded with reduced crime everywhere.

In a survey of individuals in seven capital cities in Latin America conducted for the IDB Capital Cities project, fewer than 40 percent of respondents said they prefer hotspot policing to distributing resources equally around the city (see Figure 9.11). However, among those who received information about the effectiveness of hotspot policing, this figure rose to 50 percent, or 25 percent more. Public policy reforms often require citizens to make sacrifices. This evidence shows that citizens can be persuaded to make these sacrifices if they are convinced that the reforms are effective. However, information campaigns that support reform—which are themselves few in number—do not routinely include this information.

The rise of social media raises unique issues for civic behavior, but research remains incipient and based more on access to different types of traditional media. This work centers around the influential argument of Robert Putnam (2000) that civic behavior rests on the interaction of citizens with each other. The use of social media does not seem to limit the interactions of people with others, in particular family and neighbors (Olken, 2009; Bauernschuster, Falck, and Woessmann, 2014). However, it seems to limit political participation. In a pre-internet study, Olken (2009) finds that participation in important village meetings in Indonesia was lower in areas with better radio reception. Durante, Pinotti, and Tesei (2019) find similar effects after the introduction of commercial TV in Italy in the 1980s. After the *New York Times* implemented a national distribution strategy that expanded delivery to over 100 cities, local newspaper circulation declined among college-educated readers, pointing to disengagement

**Figure 9.11 ▸ Information and Support for Hotspot Policing**




*Source*: Authors' elaboration based on data from the 2017 IDB LAPOP Capital Cities Survey.
*Notes*: Answers come from the question: "When the police deploy their resources, especially their patrols, they have to choose between two options that have the same cost. Option A is to concentrate the police and patrols in the most dangerous neighborhoods and send fewer police and patrols to the other neighborhoods. Option B is to send patrol cars to every neighborhood in the city regardless of whether they are dangerous or not. What option do you prefer?" The total sample is seven cities: Santiago, Chile, Bogota, Colombia, Tegucigalpa, Honduras, Mexico City, Mexico, Panama City, Panama, Lima, Peru, and Montevideo, Uruguay.

from the local community by educated consumers (George and Waldfogel, 2006).[18] In some cases, though, the media can be a positive force for building social cohesion. In Rwanda, thanks to the government's use of its controlled radio station, listeners were more likely to trust members of other ethnic communities. The efforts of the Rwandan government showed how consistently framed propaganda messages can have a positive effect on inter-ethnic trust (Blouin and Mukand, 2019).

## Beyond Information

When people cannot independently assess how trustworthy an individual or an institution is, they rely on information from others. In private markets, reputation matters. When dealing with the government and political agents, the problem is more complicated: there are large informational asymmetries and the results of government actions are affected by external shocks. Henceforth, looking only at results or easily accessible evidence may not be enough to assess the trustworthiness of government officials. However, actively providing information seems to help. Several interventions have shown that providing information about results from audits can affect voters' behavior at the polls and providing information about whether government officials keep their promises can help increase trust.

Most people do not actively pursue information. Consequently, simple vanilla transparency has a limited impact. Moreover, the way information is provided matters. In a context in which intermediation is fragmented, governments can generate communication lines directly with citizens. Participation and engagement tend to work. The impact of information, and the generation of information itself, is not independent of the trust environment in which this information is provided. Some transparency initiatives do not work when trust is low. Trust in experts has not been constant across countries and, hence, neither has people's adherence to recommendations. Dissemination and consumption of information is not

[18] Similar mixed results can be encountered in the literature that looks at the role of internet access on participation. Some studies have found that concerning the advent of high-speed Internet, the literature has found mixed evidence of a negative effect on participation in civic activities. On the one hand, Geraci et al. (2018) finds that poorer Internet connection due to being further away from a local exchanger induces a lower likelihood of being part of a civic association, a trade union, or a political party in the United Kingdom, even though the effect proves to be rather small. Bauernschuster, Falck, and Woessmann (2014), on the other hand, find no evidence of an effect of Internet access in engagement in local politics or political party membership in the context of Germany civic life in the 2000s.

independent of the role intermediaries play in collecting and disseminating information. In other words, the structure of media markets influences beliefs. Partisanship and other individual characteristics weigh heavily in the information people consume in low-trust environments. Social media tends to deepen the informational silos. People react very differently to tweets and information provided in social media according to party affiliation. Engagement with social media can damage trust in many realms.

In settings where information is absent or distorted by market and behavioral biases (e.g., such as those that arise in social media), regulation is a possible response. However, a regulatory response may not be the best choice when information-based solutions can be found and have been shown to emerge naturally and massively in the market.

Whether and how to regulate social media to curb the well-known and important information distortions that it facilitates are both important open questions. Unfortunately, as chapters throughout this book demonstrate, the quality of regulation is wanting in societies characterized by low trust and citizenship. Moreover, capacity problems in the region may hinder government efforts to effectively regulate social media in their countries. Data from the V-Dem database used extensively in this book show that the region has lower cyber security and internet filtering capacity than the rest of the world.

The central recommendation of this chapter is that public policies designed to improve transparency in low-trust societies must go beyond the collection and display of information. They must also invest in disseminating information in ways that increase its relevance and credibility—efforts that could be as costly, but even more important, than collection itself. Narratives, anecdotes, and emotionally evocative ways of conveying information tend to be more effective than hard facts. Social media brings another set of complicated challenges. Policies must aim to heighten its potential for increasing transparency and trust while weakening its glaring negative effects.

10

# Navigating a Sea of Mistrust

*The reform agenda to build trust and citizenship requires a focus on power and information asymmetries. These erode incentives for trustworthy, civic behavior. Advancing on this reform agenda will dramatically expand government options to meet the significant social and economic challenges of the region: slow growth, high unemployment, inequality, climate change, and fiscal crisis.*

Nine out of ten people in Latin America and the Caribbean do not believe that others can be trusted. Only three in ten trust their government and even fewer trust institutions that are fundamental to government accountability, Congress and political parties. Compared to other parts of the world, a larger fraction of citizens in the region are reluctant to accept the civic obligations essential to build fast-growing, equitable societies. Their willingness to pay taxes and adhere to the laws and regulations established by their governments are among the lowest in the world. Though intangible and harder to measure than the other crises that afflict the region, from COVID-19 and climate change to unemployment and inequality, mistrust and weak citizenship demand equally urgent attention.

The people who live in the region believe they are Charlie Browns surrounded by Lucys, convinced that, given the chance, others will take advantage of them, the same way Lucy takes advantage of Charlie Brown by moving the ball away every time he attempts to kick it. The creator of Peanuts, Charles Schulz, could have made Lucy a trustworthy person with literally a stroke of the pen. Much more than a stroke of the pen is needed to increase trust and citizenship across entire societies. How, then, should the region confront the trust and citizenship crises? And how can governments navigate a sea of mistrust to address their other pressing concerns?

The difficulty of responding to the crisis is as great as its urgency. In their daily lives, people react to mistrust not by building and restoring it, but by avoiding and exiting situations where they encounter it. They leave spouses, fire employees, spurn suppliers, reject friends, and abandon politicians who cannot be trusted. When they find themselves in organizations riven by dissent and free-riding, people do not reform them; they abandon them. These strategies are hardly sustainable for entire societies. On the contrary, they give rise to precisely the many negative consequences of mistrust and weak citizenship that this book documents. Societies have no choice but to build trust and citizenship; government, the essential vehicle through which citizens solve their collective problems, is essential to this effort.

Chapters 3 and 4 illustrate the serious consequences that emerge in the private and public sectors as people adjust to low-trust environments. To limit problems of opportunistic behavior inside firms, owners and managers hire family members, even if they are not the most qualified. Firms use relational contracts to deter opportunistic behavior, but these function only when consumers pay more than they would in competitive markets. And they write more thorough, detailed—and costly—contracts, covering a broader array of contingencies. In the public sector, mistrustful citizens refrain from demanding the policies that most increase their collective welfare since they cannot count on politicians to carry out their promises to enact such policies. Instead, they demand private benefits that do little to promote sustainable and equitable growth, and which flow only to those citizens who enjoy clientelist links with politicians.

More hopefully, earlier chapters indicate that trust evolves with information and experience, even if it has historical and cultural roots. For example, trustworthy and civic behavior increases if governments strengthen formal institutions, more systematically sanctioning those who engage in opportunistic and uncivic behavior; or if governments pursue organizational reforms that permit them to reliably transform collective resources into benefits for all. The more people observe trustworthy behavior, the more their own trust and citizenship should grow. Indeed, the mere fact that formal and informal institutions sanction those who engage in opportunistic and uncivic behavior can indicate a shift to more trustworthy and civic norms.

This chapter broadly outlines measures governments and societies can take to build trust and citizenship. The focus of the measures is on incentives to engage in trustworthy and civic behavior. This does not exclude a role for communication campaigns that exhort people to change their behavior. Nor does it ignore capacity—the fact that individuals may

be insufficiently trained and equipped to deliver on the promises made to customers by their firms or citizens by their public sector organizations. However, communication and capacity-building have little impact on trustworthy and civic behavior if incentives reward the opposite.

The emphasis on incentives would be unnecessary in a perfect world, where all individuals would be intrinsically motivated to do the right thing—to act in a trustworthy manner and to contribute to collective enterprises that make all citizens better off. In the real world, though, extrinsic incentives matter and are shaped by institutions, the formal third-party institutions that enforce agreements and the informal social norms that guide people's behavior in society. By strengthening these institutions, societies increase the likelihood that people will deliver on their promises and adhere to social norms. Incentives also come from organizations. From firms to government agencies, organizations cannot deliver on promises if they are unable to marshal the collective efforts of their members (employees) to produce goods and services that improve people's welfare at a reasonable price. This, however, depends on whether they can design and enforce incentives that encourage the organization's members to work collaboratively to achieve the organization's mission.

Building trust and citizenship takes time; neither can be turned on with a switch. Governments will necessarily operate in an atmosphere of mistrust and weak citizenship as they address the looming challenges of the region, from stagnant productivity to climate change. The final section of this chapter delivers two key messages: reforms to address these challenges will be more effective if they account for the constraints imposed by mistrust and weak citizenship; and many reforms that increase trust and citizenship are also essential to confront more tangible challenges such as slow growth or climate change.

## Trustworthy and Civic Behavior: A Question of Incentives

Whether in the private or public sectors, creating incentives for trustworthy behavior means holding the "trusted" accountable to the "trusting." If individuals pay a price for opportunistic or uncivic behavior, and are rewarded for the opposite behavior, they are more likely to act in a trustworthy and civic manner. Accountability weakens in the face of asymmetric information and asymmetric power. Governments can remove both obstacles.

Individuals cannot hold others accountable for opportunistic or uncivic behavior if they cannot observe it. In the best case, they can directly witness such behavior. However, they can also indirectly infer opportunism if they see outcomes that can only be explained by untrustworthy behavior:

bankers can infer that bankrupt borrowers have acted opportunistically if all other firms in the borrowers' sectors reap record profits.

In the presence of asymmetric information, whether in the public or private sectors, individuals cannot easily make these inferences. Indeed, as this book argues, ignorance breeds suspicion precisely because the absence of information in and of itself reduces trust. It is difficult for people to know who or what is responsible for the experience they have with a consumer product or a government service. If the product or service is not of the quality they expected, is that because they misunderstood what quality the supplier intended to provide, or because the supplier provided a different quality than promised? If their children do not learn in school, is it because their children did not work sufficiently or because the quality of instruction was poor? If they encounter an abundance of employment opportunities, is it because of their skill or because of government management of the economy? More informed people can better infer who is responsible for their good and bad experiences and reward or punish them accordingly.

Asymmetric power also distorts incentives. Whether in the private or public sectors, the more powerful can act opportunistically towards the less powerful with substantial impunity, even if the less powerful are fully informed about that behavior. In the private sector, impunity arises when markets are fragile and uncompetitive; victims of opportunistic behavior cannot go elsewhere to purchase a product or to find employment. It also exists when institutions of third-party enforcement offer little recourse to the less powerful.

In the public sector, accountability is a unique challenge since governments have greater coercive power over individual citizens than even private sector monopolies. The power asymmetry between government and citizens increases when citizens cannot act collectively; when institutions provide individuals with no recourse to appeal government decisions; and when citizens have no exit options—for example, no ability to choose among competing service providers. Governments have a significant role to play in reducing power asymmetries, from increasing the competitiveness of markets to ensuring the proper functioning of third-party enforcement institutions.

It would be convenient if the reform agenda to improve incentives for trustworthy behavior consisted of removing information asymmetries or power asymmetries. Unfortunately, its success depends on removing both obstacles. Neither information without power, nor power without information, are sufficient to shift incentives so that individuals engage in trustworthy rather than untrustworthy behavior. Customers cannot change the incentives of a monopolist even if they know the monopolist

regularly sells them goods that do not meet promised quality standards. Nor can they change the incentives of sellers in competitive markets if they cannot assess the quality of the products. Voters who are unable to coalesce for collective action cannot hold governments accountable for their performance even if they know that the performance is poor; nor can mobilized voters, fully capable of coalescing around support for a superior candidate, hold governments accountable if they have no information at all on their performance.

## Tackling Asymmetric Information

In all countries, private sector actors grapple with well-known information asymmetries. They concern all aspects of a transaction from the quality of the good or service to the trustworthiness of the counterpart. Firms utilize many strategies to reduce these asymmetries and facilitate exchange. Many, though, require a supportive legal environment. The public sector, therefore, has an important role to play in reducing information asymmetries in the private sector.

Brand names and trademarks are one response firms use to validate the quality of their products in the marketplace. Customers trust that branded products are higher quality because firms that skimp on quality lose the ability to charge higher, quality-adjusted prices for their branded products. This ingenious solution is vulnerable to counterfeiting and trademark appropriation by competitors. Hence, its success hinges on the effectiveness of public sector institutions that protect firm property rights to their trademarks. The shortcomings of judicial institutions in Latin America and the Caribbean, discussed in Chapter 7, suggest that such private sector solutions to consumer trust are less effective than they should be.

More generally, firms and customers can always contract for product quality. Customers can demand as much information from the supplier as they need about the product, reducing the information asymmetries that undermine trust. However, supplier representations about the quality of their products are less trustworthy in settings where customers have no judicial recourse if suppliers misrepresent quality.

In many sectors, brand names and well-enforced contracts are insufficient to elicit full customer trust in the quality of a product. In pharmaceuticals and construction, potentially catastrophic product defects may be revealed only with a substantial lag or obscured by actions of the consumer (failure to maintain the building, for example). Even firms with valuable brand names may shirk their responsibility to uncover product flaws that have rare, but catastrophic consequences.

Regulatory agencies play an important role in these situations. They enforce quality standards, thereby resolving information asymmetries that might otherwise disrupt markets: reassuring depositors that bank assets are as safe as banks claim, homebuyers that their homes will not collapse in an earthquake, workers that their workplace has no unknown hazards, or building tenants that the elevators are reliable. Throughout Latin America and the Caribbean, regulatory agencies charged with building and workplace safety are known as much for increasing the costs of doing business as for their contribution to public safety. Reforms of public sector institutions, by improving their ability to resolve information asymmetries, can increase trust in the private sector.

In other markets, the important information asymmetries do not concern the quality of the product, but of the customer. In particular, it is well-known that information asymmetries hinder the development of credit markets. Banks are more willing to lend when they have more, credible information about loan applicants (Brown, Jappelli, and Pagano, 2009; Flatnes, 2021). Credit markets are severely underdeveloped in the region, in no small part because of the paucity of credit information. Governments in the region can do much more to facilitate the exchange of information by strengthening the legal environment that supports informative accounting standards and credit bureaus.

The problem of asymmetric information is even greater in the public sector. Society asks the public sector to support growth and employment creation, the education of its children, the health of its people, as well as public safety, a clean environment, and protection from external threats. However, governments often have inadequate information about the social problems they are asked to correct, and citizens little information about the steps governments take to resolve those problems. The consequence of the first is that governments approve and implement policies that do not, despite promises to the contrary, meet citizen needs. This reduces trust. The consequence of the second is that citizens cannot hold governments accountable for their actions, since they do not know what government did. Again, trust falls.

The information reform agenda for the public sector outlined below focuses largely on the quality and quantity of information flows between government and citizens during the actual process of governing. However, as earlier chapters, especially Chapter 8, discuss, elections are key institutions for informing citizens, triggering massive flows of information about candidates. They create incentives for candidates to discover the issues of greatest concern to voters. All countries of the region should remove obstacles that distort the information value of elections. Feeble political

parties fail to convey information to voters about candidate policy preferences and candidate quality; biased media distort information flows; lack of education inhibits voter ability to use information to hold governments accountable; and economic volatility makes it difficult for voters to distinguish changes to their welfare that are due to government actions or to exogenous forces.[1]

In general, although the region boasts notable instances of successful transparency initiatives,[2] few have adopted comprehensive strategies aimed at lowering the costs to citizens of answering basic questions: What are the laws, regulations, and expenditures that affect them and how can citizens access the benefits due them or comply with the obligations imposed upon them? What are the effects of these: are policies implemented well or badly, are regulations enforced evenly, are households receiving their legally established share of expenditures? What is the impact on citizen welfare? And finally, what recourse do citizens have if they believe laws or penalties have been wrongfully enforced against them or they have not received program benefits to which they are entitled? Every agency, from the central bank to the institute charged with vaccine approval, can apply these questions to its activities and design transparency strategies that lower the costs to citizens of acquiring this information.[3]

Budget transparency is among the most important priorities for governments, since how governments spend the collective resources of society is so closely tied to trust and citizenship. When public sector spending is opaque, citizens cannot easily, or at all, infer whether government policy has improved their citizen welfare, whether by educating their children, raising families out of poverty, or creating jobs. Unfortunately, the region is not known for providing the budget information that citizens need to hold governments accountable.

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[1] The region is particularly affected by the positive shocks of commodity booms (Powell, 2016), and by negative shocks coming from changes in the terms of trade and sudden stops (Calvo, Izquierdo, and Mejía, 2004; Cavallo, Izquierdo, and León-Díaz, 2020). These extremely relevant external shocks (sudden stops can be identified as the triggers of the Mexican crisis in 1994, Argentine crisis (1995), Asian crisis (1997), Russian crisis (1998), and Brazilian crisis (1999)—among others, Eichengreen and Gupta [2016]) create a disconnect between the content and quality of public policies and outcomes.

[2] See, for example, De Michele and Pierri (2020). Vieyra et al. (2019) explores how to build a comprehensive strategy for extractive industries that can be used as a benchmark for others.

[3] Duryea and Pereira (2021) explore the role of transparency for the COVID-19 vaccine distribution plans.

Arenas de Mesa and Mosqueira (2021) analyze the ministries of finance of the region and conclude they are not organized to make budgets that align fiscal constraints with citizen expectations.[4] This requires systems of program evaluation and results-based budgeting that would both provide decision-makers with a better guide to allocating expenditures, and citizens with information on government performance. Such systems are absent, leaving citizens in the dark and mistrustful of government intentions to serve their interests.

The Open Budget Survey report for 2019, based on its survey of 90 countries, concludes that ten of the 15 Latin American and Caribbean countries in the sample have limited, minimal, or scant transparency. They fail to publish some or all of the following: the executive's draft budget proposal, details of legislative amendments and votes on the budget, details of budget execution, and reviews by the supreme audit institution and legislature regarding budget outcomes. Williams (2015) distills many transparency indicators into two indices of Political Transparency and Information Transparency. Over the 30 years from 1980–2010, Latin America and the Caribbean have index scores of 55 out of 100 on each, significantly below the high-income OECD countries (73 and 70).

Where power asymmetries between governments and citizens are less pronounced, greater budget transparency is sufficient to trigger an increase in accountability and a shift in government incentives. Providing information about local school budgets changes how school directors in Uganda spend education resources, reducing rent-seeking (Reinikka and Svensson, 2005). Alt and Lowry (2010) present data from U.S. states showing that budget transparency also increases trust in incumbents; when budgets are more transparent, voters are less likely to reject governors who raise taxes and more likely to embrace greater government spending (larger fiscal scale). This, again, likely relates to trust and citizenship: the willingness to pay taxes depends on people's confidence that the money will be well-spent, which increases when budgets are transparent.

Beyond budget transparency, another reform priority for the region is to reduce information asymmetries related to integrity in the public sector. These amplify citizen concerns about corruption, and therefore increase mistrust in government. A wide array of instruments can reduce these information asymmetries. Budget transparency itself provides information about integrity: the expenditure tracking analyzed by

[4] As Schick (2011) observes, these problems are not unique to the region—OECD countries suffer from them as well—but Arenas de Mesa and Mosqueira (2021) argue that they are much more acute.

Reinikka and Svensson (2005) did not specifically identify corruption, but simply revealed that the amount of money flowing to local schools was far greater than parents thought. Other interventions involve disseminating the results of audits of public sector performance. Those audits uncover discrepancies or poor financial practices. They may or may not reveal actual corruption, but they clearly indicate the inefficient use of public resources; informing citizens of these audits improves their ability to hold governments accountable (e.g., Ferraz and Finan, 2008), and may, therefore, increase trust in government.

Other interventions aim to remove information asymmetries related to malfeasance by government officials (Rose-Ackerman and Palifka, 2016). For example, to reduce information asymmetries regarding officials' decisions to use public resources for private gain, officials can be required to file disclosures of their personal assets and, for elected officials, their sources of campaign finance.

Citizens cannot process granular information about all aspects of public sector spending, but successful sector-specific interventions make it easy for them to find enough information to hold government accountable. Many initiatives provide information to citizens about public sector programs to support local infrastructure development. These efforts are straightforward since citizens require little information or education to draw conclusions about government performance on local infrastructure projects. Rossi, Vázquez, and Vieyra (2020) evaluate an internet-based platform, MapaInversiones, that allows people to track the physical and financial progress of geo-referenced public investment projects in Costa Rica. When the information appears on the platform, progress on both accelerates. They do not examine the effects on trust and citizenship, but a positive impact would be expected on these as well.

Even announcing that the government has a program to construct infrastructure in an area may be sufficient for people to hold government accountable. In the Philippines, when households were informed of a previously unknown program to finance projects in their area, they could infer that mayors had taken advantage of their ignorance and had not built projects (Cruz, Keefer, and Labonne, 2021). This had electoral consequences for the mayors and likely reduced trust in government since citizens drew negative conclusions about government performance.

Governments should take the lessons from information interventions in the local infrastructure sector to all areas of public sector service delivery. In education, parents should have easy access to school test scores, budgets, and class sizes and be able to easily compare these numbers across schools. In health, finding mortality rates for common surgical procedures

across hospitals should be straightforward. Public transport users should have no difficulty discovering rates of on-time performance, and customers of the electricity company should be told the frequency and severity of power cuts. Municipal and other subnational governments should report rates of job and firm creation. Across Latin America and the Caribbean, these types of information are only sometimes accessible to citizens and even more rarely is the information one or two clicks away from the relevant home pages.

The design and success of interventions to curb information asymmetries also depend on people's cognitive capacity and behavioral biases (see Chapter 9). The entire point of transparency initiatives is to better enable citizens to distinguish the government's contribution to their well-being from other forces that affect them. Hence, education is indispensable. The more educated people are, the easier it is for them to do this and the more accurate their inferences about accountability from the information that governments provide them. The educated are more trusting and can better disentangle the role of opportunistic behavior from other factors when they interpret their life experiences (see Chapter 2). People who are more informed about their disease and its treatment options can better assess whether their medical condition improved because of the expensive treatment prescribed by the doctor, or whether a cheaper treatment—perhaps less favorable to the doctor's own interests—would have worked just as well. People who understand more about the economic shocks that buffet a country can better judge the impact of government decisions on their households.

A remarkable study in Chile demonstrates the striking effect of education on trust and provides yet another reason for the region to redouble its education reform efforts. Thousands of students in their last year of studies in vocational (technical) secondary schools attended a workshop on personal finance, including pensions and saving for retirement. Compared to the control group of students who did not attend the workshops, those who did were not only significantly more knowledgeable about these subjects, but also expressed significantly greater trust in Chile's pension system (Bosch et al., 2019).

The government is not the only, or even primary, source of information that citizens receive about government performance. The media play a key role, as Chapter 9 explains. The information that individuals have available to them and choose to consume naturally affects their perceptions of trustworthiness and citizenship in the society at large. While the world is grappling with how to address the role of social media, traditional media are still important players and their relationship with government is

better understood.[5] For example, societies should curb government influence over the content of media (e.g., through the selective purchase of government advertising in favorable media) because incumbent governments have strong incentives to exaggerate the untrustworthy behavior of their opponents.[6]

All of the foregoing focuses on information asymmetries as an obstacle to government accountability. When asymmetries are large, governments have weak incentives to refrain from opportunistic behavior towards citizens. However, information asymmetries also operate in the other direction: citizens are better informed about what they want than are governments. Elections are one solution to this problem: competing candidates make their best guesses about what voters most desire from government and voters reward the candidates whose proposals come closest. However, elections in low-trust settings distort the types of promises that candidates make (see Chapter 4). This disrupts the value of elections as vehicles for citizens to deliver information about their demands to governments.

One way to compensate for the low information content of elections is to encourage direct citizen participation in government decision-making. Governments consult citizens directly on their preferences regarding budgets or local infrastructure priorities, even allowing them to choose those projects referendum-style. The region has many examples of such participatory initiatives, especially at the subnational level. The program Buenos Aires Elige is a good example of this type of initiative. The city set aside public funding, which in January 2020 amounted to 3,000 times the yearly minimum wage, to finance projects selected by the community. It also set up a transparent, web-based platform both to collect proposals from citizens and for citizens to vote for their preferred proposals. Proposals have ranged from the installation of security cameras in a neighborhood to building running tracks or installing other types of recreational equipment in parks of the city. In 2019, citizens created more than 28,000 proposals; city government financed 108 of the proposals that received the highest number of votes.

Ardanaz, Otálvaro-Ramírez, and Scartascini (2022) report results of a survey experiment with more than 2,000 residents of Buenos Aires: merely

[5] A good measure of its relevance is that politicians may strategically time unpopular measures to coincide with newsworthy events (Durante and Zhuravskaya, 2018).

[6] Durante and Knight (2012) find evidence that ideological content can be manipulated for electoral purposes. Still, some people may switch information providers if that is the case. Of course, it can still have electoral effects (DellaVigna and Kaplan, 2007).

informing people about Buenos Aires Elige increases trust in government. Moreover, as this book has continuously argued, citizenship and trust are inextricably linked. In this experiment, trust rises most for those respondents who also received information about the participation of other people and among those who believe that collective action to improve public goods provision is likely. A similar outcome emerged in Indonesia. In Indonesian villages that held plebiscites allowing people to choose local development projects, villagers reported a greater willingness to contribute to the projects—a key indicator of citizenship (Olken, 2010).

The wealth of evidence supportive of interventions to curb information asymmetries are sufficient justification for governments in the region to embrace transparency and participatory reforms. However, it does not obscure the fact that such reforms are only necessary, not sufficient, to build trust. Power asymmetries also stand in the way of trust and citizenship. For example, the Open Budget Report indicates that Brazil, the Dominican Republic, Guatemala, Mexico, and Peru have substantial or extensive budget transparency (the United States is rated as substantially transparent). However, greater budget transparency in these countries has not necessarily been accompanied by better public sector performance nor greater trust in government.

Gaventa and McGee (2013) review the scope and efficacy of numerous transparency initiatives, ranging from public expenditure tracking surveys and citizen report cards to budget transparency and Freedom of Information (FOI) initiatives. Like Khemani et al. (2016), who argue that transparency initiatives do not necessarily change the incentives of elected officials to respond to citizen demands, Gaventa and McGee (2013) also conclude that these initiatives do not systematically align government decision-making more closely with citizen interests.[7] They and others, such as Fox (2007) and Fung, Graham, and Weil (2007), attribute this in part to these initiatives' lack of regard for whether more informed individuals can actually act on this information. Gaventa and McGee (2013, p. 18) conclude that transparency initiatives may be more likely to succeed when they are linked to "collective rather than, or besides, individual action."

Similarly, participatory initiatives have a mixed record of success (Rizzo, Janowski, and Roseth, 2020; Waddington et al., 2019; Molina

[7] Malesky, Schuler, and Tran (2012) find that higher transparency, in the form of higher internet penetration in the villages in Vietnam where the legislators come from, reduced rather than increased their criticisms and participation in the legislature; in other words, higher scrutiny and information backfired. Tauberer (2014) summarizes the literature on unintended consequences of transparency.

et al., 2017), again because their success depends on whether power asymmetries are large or small. In Indonesian villages, they seem to be large. Hence, although plebiscites increase villager satisfaction and willingness to contribute to village public goods, Olken (2010) finds they have no effect on the actual projects that are chosen. Madajewicz, Tompsett, and Habib (2021) find that delegating decisions about water usage to villages in Bangladesh leads to much greater usage of safe water compared to top-down prescriptions, but only if the influence of local elites is suppressed. Humphreys, Sánchez de la Sierra, and Van der Windt (2019) gave $1,000 to each of 457 villages in eastern Congo, half of which had been targeted with an intervention to increase community participation in village decision-making, but with no special efforts to reduce the influence of local elites. They find no difference in how the $1,000 were utilized across treated and control villages.

In contrast, participatory initiatives that are accompanied by more intense efforts to mobilize local communities do seem to change the incentives of local decision-makers. Björkman and Svensson (2009), for example, find compelling effects of an intense intervention in Uganda, consisting of two rounds of village meetings to support community mobilization to hold local health providers accountable for their performance. A year after the intervention, child mortality had fallen significantly.

In sum, full accountability—the basis of trust—demands not only that citizens be informed, but that they be able to act on their knowledge. Power asymmetries prevent this.

## The Other Asymmetry: Towards a Balance of Power

The problem of asymmetric power is naturally more daunting than that of asymmetric information since, of course, powerful actors are better positioned to block reform than the less powerful are to promote it. Power asymmetries are less acute in the private sector, but public sector action is required to reduce them. Asymmetric power in the private sector emerges when economic actors have no choice: they must buy from a particular firm or work for a particular company. The most noxious sources of asymmetric power are barriers to entry that foster monopolies and monopsonies. In some cases, as with patent protection, societies allow asymmetric power in order to encourage innovation. However, in many cases, government regulation impedes competitive entry with no offsetting social benefits. When it makes competitive entry difficult, it exacerbates the problem of asymmetric power and mistrust. The entire discussion of capture and the control of government by powerful private sector actors is motivated by

the desire of these actors to manipulate the tools of the public sector to increase the rents they can extract from the economy.

For example, using data on regulations and firm productivity from 1,800 Peruvian municipalities, Schiffbauer, Sampi, and Coronado (2021) find that entry restrictions (e.g., to form local bus companies or to erect cell towers for mobile telephony) have large negative effects on productivity and the quality of goods and services offered to consumers. That is, they facilitate opportunistic behavior by firms towards customers, giving rise to mistrust.

Asymmetric power can also be a consequence of market size, a significant issue in many areas of Latin America and the Caribbean. In more remote areas, markets are thin and opportunities to find alternative employers and suppliers are correspondingly scarce. Trust also tends to be lower in these regions. The freedom to emigrate out of remote areas can limit asymmetric power; firms that exploit their asymmetric power too severely, for example, can find that their workers have left. Hence, government policies to lower the costs of emigration out of remote areas (particularly by supporting education and improving credit markets) can reduce power asymmetries. Alternatively, public policies can encourage immigration into these areas, expanding market size (with investments in transportation and communication, public service provision, and regulatory and governance reforms that make remote areas more attractive to firms). With larger markets come more competitors, again reducing the problem of asymmetric power and increasing trust among economic actors.

As with information asymmetries, government regulation plays a significant role in power asymmetries, but represents a two-edged sword. While it can unnecessarily impede competition and exacerbate mistrust, it can also have the opposite effect by directly suppressing power asymmetries in economic markets. Labor regulation can address the concern that some (more powerful) citizens act opportunistically when they employ other (less powerful) citizens. Too often, though, it cements the position of insiders (formal workers) at the expense of outsiders (informal and unemployed workers), exacerbating mistrust. Financial market regulation can prevent publicly owned companies and banks from taking advantage of small shareholders and depositors, increasing trust. But it can also have the opposite effect, raising the costs of capital for new entrants and reducing competition. An important part of the reform agenda for governments seeking to boost trust and citizenship is to adjust private sector regulation to ensure that it resolves, rather than contributes to, problems of asymmetric power.

In the public sector, accountability is a unique challenge since governments have greater coercive power over individual citizens than even

private sector monopolies. Moreover, rather than moderating these asymmetries, governments often exacerbate them. They adopt laws, regulations, and practices that deny individuals recourse in the event of abusive behavior, ranging from judicial standards (guilty until proven innocent, rather than the reverse) to administrative practices (those that prevent citizens from claiming legitimate benefits that they have been denied or to protest decisions that are contrary to the law). Denying citizens even simple administrative information—what are the procedures? whom should they contact to initiate action?—magnifies power asymmetries.

To reduce asymmetric power in the public sector—between individuals and government, and between individuals and narrow, vested interests—governments can embrace three parallel courses of action. One is to strengthen institutions that empower individuals to act on their own to hold government accountable. Institutions that provide citizens with institutional and legal avenues to contest public sector decisions place them, as individuals, on equal footing with public sector agencies. Since institutional reforms are weaker without the backing of citizens, removing obstacles to citizen collective action, enabling individuals to work together to hold government accountable, should be another key priority of government. Finally, just as in the private sector, competition increases accountability and, therefore, trust: if citizens can choose between competing government—or government and nongovernment—service providers, they are less exposed to opportunistic behavior and their trust in government should correspondingly increase. All of these strategies increase trust and citizenship.

Since the dawn of civilization, and even in societies that exhibited significant asymmetries of power and information, institutions have emerged to limit opportunism by the powerful towards the less powerful and by governments towards individuals. Stronger institutions limit opportunistic behavior; as people encounter less opportunistic behavior, trust increases.

Judiciaries are the most prominent example: the Aztecs, Incas, and Mayans all had strong legal institutions. The courts can offer individuals the opportunity to seek third-party enforcement of obligations they are owed by the powerful or by government. Unfortunately, although essentially all countries have judiciaries, many do not offer individuals this opportunity. To strengthen trust, recourse to judicial review should be accessible and the review itself should be independent and rooted in a shared understanding and interpretation of the law.

Beyond courts, modern societies have created hundreds of specialized organizations to deal with the different sectors of the economy and daily life. All have a common purpose: to reduce power and information asymmetries

between parties by providing equal access to third-party enforcement. However, they only serve this purpose when appropriately structured to give equal treatment to all and provide individuals with easy recourse to institutional assistance to defend against opportunistic behavior. In many situations and countries, however, institutions effectively do the opposite; they deny individuals recourse and favor the interests of the powerful.

The reform of public sector agencies to lessen power asymmetries has two dimensions. One is external: changing the rules that govern citizen access to the agencies. The other is internal: organizational reforms that align the incentives of agency employees with the mission of the agency, improving citizen welfare.

Externally, to build trust governments must give citizens the legal right to challenge government decisions without fear of retribution. They must also make such challenges practically and logistically feasible by providing ample information to citizens about how to proceed, streamlining processes, and adequately staffing the venues for adjudicating complaints to reduce delay. The digital transformation plays a large role in this.

Tax systems, for example, increase trust and citizenship when tax codes reflect a social consensus about how the obligations to finance government activity should be shared, and when tax administrations enforce the tax code fairly and effectively. The introduction of e-invoicing, or electronic fiscal devices, improvements in tax administration, and the use of behavioral interventions for increasing voluntary tax compliance are recent innovations that work in that direction (Barreix and Zambrano, 2018; Castro and Scartascini, 2015; Carrillo, Castro, and Scartascini, 2021; Ortega and Scartascini, 2020). Evidence that discrimination on the basis of race, wealth, or connections does not enter into the enforcement of tax laws—and all other laws and regulations—increases trust. Some innovations solve both information and power asymmetries: easy access to individual requests for information and efficient administrative procedures to resolve tax disputes between individuals and government further build trust (Scartascini and Zamora, 2021).

Internally, organizations must be structured to provide incentives that reward trustworthy, citizen-oriented behavior by employees and punish opportunistic behavior towards citizens. How do they do this? In a nutshell, they structure their budgetary and human resource policies around the pursuit of citizen interests. Spending flows to those activities with the greatest impact on welfare. Decisions about hiring, promotion, and raises are based on contributions to the agency mission of serving citizens. Indirectly, all of these reforms curb incentives for self-seeking, corrupt behavior. Societies can also adopt other institutional arrangements to directly reduce

power asymmetries that lead to untrustworthy, corrupt behavior. These include laws that regulate conflicts of interest and punish illicit enrichment, and dedicated enforcement of anti-corruption laws (Rose-Ackerman and Palifka, 2016).

The incentive agenda inside organizations goes beyond extrinsic incentives such as raises and promotions better aligned with agency missions. It extends to decisions about recruitment and corporate culture that favor intrinsic incentives to pursue the agency mission. Pro-social public officials are more likely to exhibit trustworthy behavior in their interactions with citizens.

The importance of intrinsic incentives is evident throughout the public sector, but perhaps nowhere more than in police agencies. Law enforcement agencies are essential for trust and citizenship, but support neither if they protect only the powerful, prosecute only the powerless, and erect a wall of immunity around their own agents. Institutional arrangements that strengthen their capacity to pursue crimes by the powerful, build bridges to less fortunate communities, and prevent abuse of discretion by their agents all increase trust and citizenship.

Pathbreaking studies of policing conclude that citizens perceive police as legitimate and trustworthy when police behave fairly (Tyler, 1990). They treat people with dignity, allow them to tell their side of the story, make decisions in the field fairly and based on facts rather than prejudice, and project a sense of goodwill. Legitimacy—trust—has consequences for public safety: in its absence, crime and violence are higher because individuals who view the law and police as illegitimate are less likely to comply, to report crime, or to cooperate with police (Kirk and Matsuda, 2011; Sunshine and Tyler, 2003; Tyler and Fagan, 2008). It is difficult for police chiefs to observe the behavior of their subordinates in the field, however. How can they be sure that their officers are treating civilians with respect? One way is to recruit police who are intrinsically motivated to be fair and respectful.

Lessons from policing apply to all parts of the public sector. Government services affect all citizens; consequently, service delivery can have a large impact on trust and citizenship—both negative and positive. If individuals receive inadequate services and have no way to appeal for better services, and if the agencies charged with service provision are run for the benefit of service providers themselves (private sector contractors, teachers, doctors and nurses, workers) and not beneficiaries (students, patients, and consumers), then trust suffers. On the other hand, when governments fulfill their service delivery promises, which they can only do when service providers are organized to focus on the welfare of their customers, then trust grows.

These organizational reforms in the public sector strengthen trust and citizenship. When the public sector organizations responsible for service delivery and public investment are internally structured to better deliver benefits to citizens and collect obligations from them, treating all individuals equally under the law, citizens are more likely to make individual sacrifices for the collective benefit of all. When judicial and administrative institutions ensure that those who do not meet their obligations are punished, citizenship is further strengthened.

Building institutions is one way governments can allow individuals to defend themselves against opportunistic behavior by more powerful actors, public or private. Governments always have the capacity to undermine institutions, however, and often the incentive to do so.[8] Tinkering with the independence of the central bank to be able to increase the monetary base, or relaxing fiscal rules to open up fiscal space for short-term transfers, are examples from the region in which institutions are sacrificed at the altar of electoral expediency.[9] One clear lesson from this book is that the short run, political gains from such a sacrifice are tiny compared to the long-run costs for society. However, the incentives of political actors are often unrelated to the long-run consequences of their actions. As a result, governments everywhere often make the expedient choice at the expense of trust.

Hence, to build trust and citizenship, it is critical to strengthen collective action by citizens. Ultimately, the behavior of government and the quality of institutions depend on the capacity of citizens to act collectively to influence them. Elections are one obvious vehicle for strengthening collective action, as Chapter 7 argues. The threat of government interference also lurks here, but strong and independent electoral tribunals can limit opportunities for interfering with fair elections. Naturally, like other institutions, tribunals are not impervious to government pressure, but they make election interference more costly.

At the national level, rules governing political parties, civil society organizations, and elections should be reviewed to ensure they do not discourage the mobilization of citizens for collective action.[10] The central

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8 Even in the European Union, where institutions are stronger, authorities find it convenient to break them (Reuter, 2019).

9 Dincer and Eichengreen (2014) present an index of central bank independence over time; Latin America and the Caribbean lags behind developed countries.

10 Electoral laws and procedures affect trust, and trust affects participation in national elections (Carreras and İrepoğlu, 2013; Hooghe and Stiers, 2016). Ross and Escobar-Lemmon (2011) argue that poor macroeconomic conditions induce less distrust among those Latin American survey respondents who live in countries where electoral rules encourage voters to hold parties, not individuals, accountable for government performance.

principle is to encourage the formation of organizations that mobilize citizens for some collective purpose. These kinds of organizations are the most likely to increase trust and citizenship, in contrast to organizations intended to advance a particular individual's political career. Electoral rules that allow presidential candidates to prevail with a small fraction of the popular vote or that obscure the sources of party financing are areas where reform could ultimately increase trust and citizenship.[11]

## What about Capacity?

Trust depends fundamentally on capacity and, indeed, capacity is typically a primary focus of governments and international organizations seeking to build institutions and trust in government. After all, people do not trust the work of plumbers, accountants, butchers, agronomists, lawyers, surgeons, or economists who are poorly trained and inexperienced. Citizens have less incentive to contribute to collective welfare (e.g., pay taxes) if they have no confidence in the capacity of public sector employees to teach, build roads, or audit taxpayers.

Nothing about the incentives agenda precludes attention to capacity. The emphasis in this chapter on incentives—on correcting power and information asymmetries—draws attention to two key issues. One is that employee capacity has little effect on trust if not accompanied by appropriate incentives. On the contrary, if accountants have weak incentives to do their jobs honestly, well-trained accountants may be better able to embezzle funds from their employers than poorly trained accountants. Initiatives to train employees and to equip them with better tools to do their jobs are often, however, not linked to organizational reforms that change incentives.

The other key issue is that the most significant capacity issue that reduces trust relates to the capacity of organizations more than to that of individuals: how capable are organizations of coordinating the collective efforts of firm or agency employees to better serve customer or citizen interests? Chapter 7 presents substantial evidence of institutional shortcomings in institutions in the region; they relate more to organizational than employee capacity.

Organizational capacity is not as easy to improve as employee human capital or the computer systems they use. It is a function of incentives inside organizations and demands more of leaders—owners and managers, in the case of firms, or elected officials and agency heads, in the case

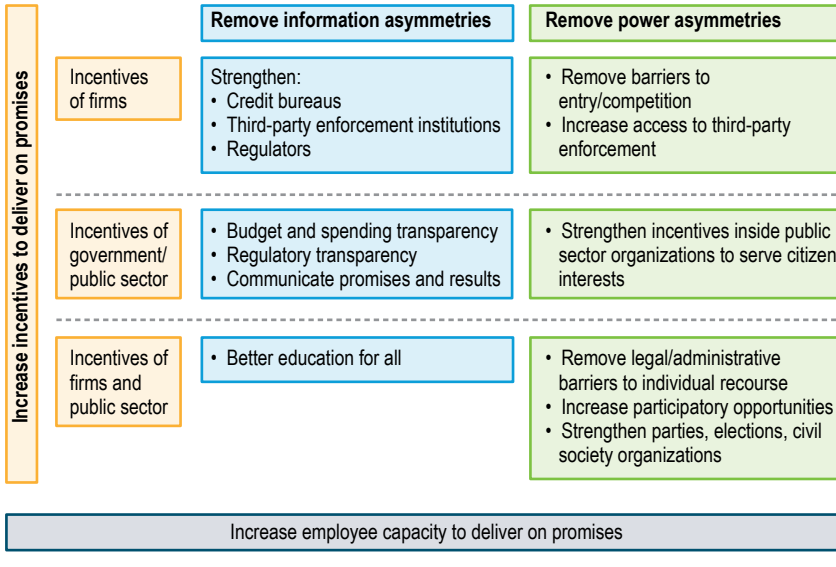
[11] Electoral procedures can affect clientelism and corruption, weakening trust (Gingerich, 2013).

of the public sector. Do their decisions support organizational norms of service to customers, citizens, and customers or, instead, are management decisions dedicated to the pursuit of private objectives, regardless of organizational norms? Do their employees trust them? The answers to these questions depend significantly on the intrinsic and extrinsic incentives of organization leaders to make decisions that advance the organization's mission.

Improving organizational capacity—the incentives of workers inside government agencies to pursue their mission of improving citizen welfare—should be a central priority of governments in the region. In fact, it is a central part of the incentives agenda. It should not, however, be confused with the much different measures required to improve employee capacity.

Figure 10.1 summarizes the reform agenda to increase trust and citizenship in the region. In both the private and public sectors, governments can take steps to remove both information and power asymmetries. In some cases, the agendas overlap: the institutional reforms that increase firm access to third-party enforcement (for example, to the judicial system) also give citizens recourse to appeal government decisions affecting them that they believe are in error.

**Figure 10.1 ▸ Summarizing the Reform Agenda to Increase Trust and Citizenship**




*Source*: Authors' elaboration.

## Results, Trust, and Citizenship

A common and reasonable argument is that citizens trust governments that deliver results on the ground. Evidence from Mexico supports this belief. A survey taken just before and after the 2017 earthquake that rocked Mexico City revealed that those who received post-earthquake assistance were 9.1 percentage points less likely than others to say that politicians do not fulfill their promises (Frost et al., 2021). The impact of results on trust is encouraging in one fundamental respect: the trust agenda is not just for the medium and long term; governments can take steps to increase trust in the short term.

The logic of information and power asymmetries outlined in this chapter defines the potential and limitations of the results-based approach to trust-building. On the one hand, results are information and tell citizens that governments have made an effort to serve their interests. Citizens may be unsure about whether the effort is as great as it could have been, but seeing concrete results provides some reassurance that governments do what they promise. Moreover, results are indicative that power asymmetries have not overwhelmed citizen interests. While powerful interests might have succeeded in diverting some resources away from citizens, enough resources remained to make a notable contribution to citizen welfare.

However, the logic of this chapter also indicates that the greater the asymmetries of power and information, the less able governments are to deliver results sustainably, or at all. Certainly, student learning, health care, and the fair administration of the tax system are difficult to improve when the incentives of public employees are not aligned with those of citizens, or when information about performance is opaque. Hence, in countries with significant asymmetries, successful measures to boost citizen confidence are most likely to consist of the distribution of easily-administered benefits, such as transfers or tax reductions. Such measures may be a reasonable part of a medium-term reform agenda, but by themselves they are likely to increase fiscal stress in return for only a fleeting increase in trust.

## Policymaking in the Interim

Latin America and the Caribbean confront pressing challenges, from growth and inequality to immigration and climate change. However, the optimal policy responses to these challenges may not work in an environment of low trust and weak citizenship. For example, people have little reason to support higher taxes to meet the challenges of climate change

if they do not trust governments to use the revenues for that purpose or if they do not believe that other citizens will pay the taxes. Hence, mistrust and weak citizenship oblige policy makers to design reforms in one of two ways. Either they must find responses that demand little trust and do not depend on strong citizenship, or they must embrace reforms that simultaneously address the tangible challenge—of low growth, for example—and the intangible challenges of low trust and weak citizenship. This section reviews reform strategies that take trust and citizenship into account in addressing the region's growth, equality, climate, and fiscal challenges.

## An Agenda of Growth and Trust

Trust and citizenship are deeply embedded in the growth challenge confronting the region. The challenge is severe: between 1980 and 2020, the average per capita growth rate of real GDP in Latin America and the Caribbean was below the world average and the region has not caught up to the United States as other regions have (Cavallo and Powell, 2018). The main reason for this lackluster performance has not been the failure to deploy capital and labor, but rather to use them productively (Pagés, 2010). The countries in the region with the highest productivity have only a fraction of the productivity of the United States, and slow productivity growth accounts for most of the region's growth challenge.

Most of the trust and citizenship reform agenda outlined earlier in this chapter supports the region's efforts to accelerate productivity growth. After all, economic actors are particularly vulnerable when incentives for trustworthy behavior are weak. They therefore benefit from reforms that shrink the information and power asymmetries that favor opportunistic behavior.

The demand for their products rises when their customers can rely on government regulators to deliver, at a reasonable cost to firms, clear and unbiased opinions about product quality. Credit markets, essential to economic growth, are more likely to thrive when government policy supports institutions such as credit bureaus that permit lenders to identify trustworthy borrowers. Firms also benefit from reforms that curb power asymmetries. Institutional reforms that give citizens recourse when confronted with arbitrary government decisions also benefit firms and encourage them to invest. Organizational reforms that align public sector missions with citizen needs protect not only citizens, but also firms, from opportunistic behavior by government officials, such as tax authorities. Such reforms give rise to regulatory environments that are both more closely tailored to their social mission and more predictably implemented.

Judicial reforms that improve third-party dispute resolution in the region reduce transaction costs.

Informality is another area in which the trust and citizenship agenda overlaps exactly with the growth and productivity imperatives of the region. High informality among firms is symptomatic of weak bonds of citizenship, but it is also true that informal firms grow more slowly and are less productive (Pagés, 2010; Busso, Fazio, and Levy, 2012). Informality is high because, by definition, governments do not enforce the tax and regulatory obligations of mostly small firms, which creates incentives for firms to remain small.[12] The incentives to operate informally are enhanced by tax and social policies that directly encourage firms to remain small—for example, with employment-based special tax regimes—or to contract outside of the formal system—for example, with social policies that provide non-contributory benefits, lowering the costs to workers of remaining informal (Pagés, 2010; Levy, 2008, 2018). Policy changes that encourage formality directly increase citizenship and accelerate growth.

A third way in which the trust, citizenship, and growth agendas overlap is with respect to barriers to entry, which protect incumbent firms from competition and reduce incentives to innovate, thereby slowing productivity growth. This issue, too, relates to citizenship and trust: when governments authorize competitive advantages for some firms at the expense of citizens generally, it both reduces trust in government and weakens the bonds of citizenship. Government efforts to remove barriers to entry accelerate growth and increase trust and citizenship.

One telling example of trust-inducing reform relates to the allocation of subsidies to firms. In a low-trust, low-citizenship environment, subsidies are perceived to flow—and frequently do flow—to beneficiaries whose activities have few spillover benefits for society at large. Such subsidies fail on two fronts: they do not support growth and they undermine trust in government. A better system for distributing subsidies can improve results in both areas (Crespi, Fernandez-Arias, and Stein, 2014). Goñi Pacchioni and Reyes (2019) evaluate the allocation of incentives to Peru's Dynamic Entrepreneurship Program and find that subjective criteria (based on a jury's evaluation of the quality of an applicant's investment pitch) fared much worse in predicting subsequent entrepreneurial success than objective criteria (related to their business ideas, their actual

[12] Latin America is plagued by partial, inadequate, and biased enforcement of regulations (Ronconi, 2010). De jure and de facto regulations differ greatly (Kanbur and Ronconi, 2018). Enforcement of regulations, such as labor laws, is affected by political conditions and external shocks (Ronconi, 2012).

firms, and applicants' own personal characteristics). They find that a reform shifting decision-making from subjective to objective criteria would have doubled the impact of the program. Such a decision-making process would also have strengthened trust.

The foregoing reforms may target trust, but they also deliver growth. Specific growth initiatives, such as those set out in the IDB's Vision 2025 agenda (IDB, 2021), do not directly affect trust, but are more effective when they are designed to take low trust and weak citizenship into account. For example, the region's proximity to both Europe and North America has prompted greater attention to its potential as a production center for export to those markets (so-called near-shoring). However, the production decisions of multinationals are also sensitive to the threat of opportunistic behavior by governments, other firms, and workers. Governments tend to offset these concerns with subsidies. These raise multiple concerns, ranging from inefficiency and mistargeting to fiscal cost. An alternative strategy is to set rules of the game that reduce uncertainty, as occurs with preferential trade agreements supported by the IDB and other multilateral organizations. These build mutual trust in trading partners' institutions (Limão and Maggi [2015] demonstrate theoretically and empirically that trade agreements increase trade by reducing trade policy uncertainty). Another strategy for a more successful and sustainable program of near-shoring could focus on institutional reforms targeted at firms, such as the creation of a dedicated office that adjudicates disputes between near-shoring firms and all other government agencies. In both cases, the growth of near-shoring is supported by legal and institutional arrangements that increase trust by limiting the reach of potentially dysfunctional and trust-reducing institutions.

Other growth initiatives focus on increasing the productivity of small- and medium-sized enterprises. Once again, the trust and citizenship agendas and the SME-growth agendas coincide. For example, efforts to remove barriers to entry and reduce arbitrarily enforced regulations not only increase trust and incentives to behave civically, they also ease the entry of more productive SMEs into new markets, promoting growth. Strengthening judicial institutions and regulatory agencies also particularly benefits more productive SMEs, making it easier for them to enter supply chains and encouraging them to invest in innovation.

## Addressing Inequality by Expanding the Circle of Trust

Latin America and the Caribbean also has an inequality crisis. The richest tenth of the population captures 22 times more of the national income than

the bottom tenth, and the richest 1 percent takes more than double the national income in the region than in the industrialized world (Busso and Messina, 2020). Other forms of inequality, based on sex, race and ethnicity, are also rampant and affect access to health care, education, employment, and the legal system.

Here, too, reforms aimed at increasing trust and strengthening citizenship help countries achieve their equity goals. Earlier chapters report survey results from the region that indicate high levels of skepticism about whether taxes raised to redistribute to the poor will, in fact, reach the poor. Such skepticism reduces support for expanding the social contract to include more redistributive fiscal policies. However, successful and transparent efforts to redistribute can also increase trust. A key obstacle to transparency, however, is that most governments in the region have limited information about household incomes and wealth, in part because so few households file income tax returns. This is a case in which mistrust arises not only because citizens question the incentives of governments to redistribute; they also question its capacity. By increasing their capacity to implement redistributive fiscal policies, governments also amplify the positive impact of those policies on trust.

Labor market informality is also related to trust and citizenship, on the one hand, and inequality. It affects one of every two workers in the region (Busso and Messina, 2020). Formal salaried workers enjoy benefits, such as health and unemployment insurance and pension rights. Informal workers have either no access to such benefits or access to limited benefits through alternative, noncontributory schemes for which formal workers are not eligible (thus discouraging informal workers from seeking formal employment). This fragmentation generates resource misallocation, discourages formality, increases inequality, and leaves a large part of the labor force exposed to negative shocks (Busso and Messina, 2020). It also attenuates incentives to act civically. Policies that curb labor market informality therefore serve the equity agenda, but by increasing incentives to comply with government regulations, also increase citizenship.

Mistrust also makes it more difficult to solve this problem, however, and labor market reforms must therefore be designed to account for mistrust. Mistrustful informal workers do not believe that formal employers will keep them in their jobs long enough for their formal benefits to vest, and often doubt that their formal sector employers even register them for those benefits. Realizing the value that workers attach to benefits is often lower than the costs to firms of employing formal workers, firms respond by reducing employment or keeping the workers informal. Even if

not fiscally optimal, therefore, benefits reforms should contemplate provisions that inspire trust, such as shorter vesting periods.

While regulatory and fiscal reforms designed to curb informality should promote growth, equity, trust, and citizenship, they can also have unintended negative consequences. To the extent that firm and worker informality are widespread and long tolerated, they can be viewed as part of the region's current social contract, as imperfect as it may be. Efforts to enforce previously unenforced regulations, to demand tax payments from firms that never paid them, or to reduce benefits for some workers in order to offer similar benefits to all, might be viewed as a breach of the social contract. In other words, though meant to increase trust and citizenship, the reforms could have the opposite effect. To reduce the chances of this perverse outcome, reforms can be introduced gradually, with ample communication of their rationale, and accompanied by institutional changes that ensure that the changes will be implemented fairly and transparently by capable public sector officials.

The unequal treatment of women and minority groups is a significant concern in the region and form part of its inequality agenda. The region's international partners also prioritize gender and diversity (IDB, 2021). Progress on the trust and citizenship agendas goes hand in hand with expanding opportunities for all the diverse communities of the region. For example, in the private sector, as Chapter 3 emphasizes, mistrust promotes recruitment and promotion from within families and close social circles. Members of diverse communities are almost always outside of these circles. Hence, regulatory frameworks that allow firms to have greater trust in the administration of labor regulations also increases their willingness to hire the most capable individuals, rather than those who are socially proximate to the hiring managers. In the public sector, organizational reforms to ensure equal treatment under the law of all citizens should reduce the prejudices and ill-treatment to which members of diverse communities might otherwise be subject.

Just as importantly, though, specific measures to enhance opportunities for members of diverse communities should account for the low levels of trust and citizenship in the region. When citizenship is weak, individuals who are not members of these communities are more likely to seek benefits meant for the members; program design should account for this. Furthermore, in low trust environments, programs to create opportunities for diverse communities are more likely to be perceived as vehicles for delivering benefits to politically favored individuals. To increase the legitimacy of these programs, and the reputations of their beneficiaries, care must be taken to administer them transparently.

## Climate Change and Global Citizenship

Governments around the world confront unrelenting pressure to address climate change. The economic costs of climate change will equal approximately 2.5 percent of the region's annual gross domestic product (GDP) and the annual adaptation costs will reach approximately 0.5 percent of the region's annual GDP (ECLAC, 2014). The Caribbean region is particularly vulnerable to sea rises and more frequent and violent storms. The frequency of natural disasters in the region and their cost continue to rise, from a high level: natural disasters have already cost the region more than US$200 billion in the last two decades (Cavallo, Powell, and Serebrisky, 2020). Air pollution costs millions of lives every year (Cafferata, Hoffmann, and Scartascini, 2021).

Climate change is a priority challenge for the region and its partners (IDB, 2021). Meeting the challenge requires both global and national citizenship. The commitment of countries to the global effort to combat climate change depends on their confidence that every country will do its part. However, the ability of countries to meet their global commitments depends on the trust and citizenship of their citizens. Can governments convince their citizens that the sacrifices it asks of them will achieve the international goals to which the country has subscribed (or the reductions in pollution it seeks to achieve) and that the sacrifices are fairly allocated across all its citizens?

It is not only mistrust between countries that cripples progress against climate change, but also mistrust within them. People resist the significant costs of adaptation and mitigation when they do not trust each other or government and when the bonds of citizenship are weak. In their analyses of survey evidence from North America and Europe, Jacobs and Matthews (2012) and Fairbrother, Johansson Sevä, and Kulin (2019) find that greater political trust is associated with greater support for reforms that yield benefits only in the long term, including those associated with climate change. By taking the constraints of trust and citizenship into account in the design of climate change policies, governments of the region can improve both the regional response to climate change, narrowly, and trust and citizenship more broadly.

For example, reducing fuel subsidies is, from a climate perspective, low hanging fruit. It sharply reduces incentives to emit and increases incentives to improve productivity. In a low-trust environment, though, the removal of such subsidies can be seen as breaking the social contract. Governments often realize this and attempt to offset their removal by promising to make transfers to low-income households. Mistrust disrupts

even this mitigating policy: low-income households do not believe that the transfers will actually be made, while higher-income households do not believe government promises regarding either the climate or fiscal benefits from removing fuel subsidies.

This does not mean that governments in low-trust countries should maintain fuel subsidies, only that when they remove them, they do so with meticulous communication and institutional reforms that convince low-income households that they will receive transfers, and higher income households of the payoff to them, in climate and fiscal terms, of the higher fuel prices they will pay. For this reason, the IDB's support for national decarbonization strategies typically embraces extensive dialogues with key stakeholders, particularly those likely to be adversely affected.

Similarly, subsidies for clean energy or for climate adaptation are often highly opaque: citizens are unclear about what the expected emissions benefits are, when they will arrive, or how applicants who receive the subsidies are better able to achieve these benefits than those who are not selected. Where trust and citizenship are weak, both perceptions and reality are likely to coincide in regarding these as opportunities for rent-seeking to benefit a few. These programs must be similarly designed to offset trust concerns.

Carbon taxes combined with lump-sum redistribution of proceeds to households is a policy option often favored by economists, but rarely by politicians. It produces significant benefits in a low-trust context, however, with the potential to increase trust and citizenship. Lump-sum redistributions to all households offer no room for opportunistic behavior by governments. Carbon taxes are technically and administratively challenging, but in principle are paid according to the objective characteristics of products (their carbon intensity). Capacity, both to implement carbon taxes and inspire trust in government to implement them, is a significant issue but the principle behind both legs of this policy program is highly desirable from a trust perspective. Citizens are subject to the tax and eligible for the benefit regardless of who they are and based only on what carbon-based products they choose to consume.

Lower fuel subsidies and higher carbon taxes increase the incentives of all market participants to make decisions that account for their impact on the climate. However, these reforms have been slow to advance. Nevertheless, many consumers and investors are still willing to pay a premium for "green" products and assets. Such investors, for example, are willing to accept a lower interest rate on "green" bonds. Mistrust is an important obstacle to the development of markets for green bonds, however. How can investors be sure that the proceeds from "green" bonds

will, in fact, be used in a climate-friendly way? To advance the climate goals stablished in its Vision 2025, the IDB has created the Plataforma de Bonos Verdes. This platform uses blockchain technology to post third-party certification of the claims of "greenness" made by issuers of green bonds, increasing investor trust in issuer claims.

## Trust in Government and the Fiscal Crisis

The region's fiscal crisis is well-known, particularly as it begins to emerge from the COVID-19 pandemic. The resolution of the crisis will strike at the heart of the social contracts of the region's countries. Increasing taxes (especially the value-added tax) triggered protests around the region, particularly in Chile in 2019 and Colombia in 2021, largely because of mistrust—protesters did not believe government assurances that tax increases were necessary, nor that promised compensatory payments to low-income households would be made. The harsh response to tax increases by voters in Latin America and the Caribbean is not seen in the other OECD countries (Ardanaz, Hallerberg, and Scartascini, 2020). Alt and Lowry (2010) find that transparency—a key input into trust in government—is associated with significantly more support for larger government in the United States.

The fiscal crisis is rooted in widespread evasion on the tax side and waste and inefficiencies on the spending side. In terms of lost tax revenue, it is estimated that evasion of the value-added tax in the region is on the order of 30 percent (Gómez Sabaini and Morán, 2020).[13] In terms of spending, inefficiencies could represent as much as 4.4 percent of the region's GDP (Izquierdo, Pessino, and Vuletin, 2018). Individuals also take advantage of every opportunity to claim benefits they are not entitled to, which creates large leakages of almost 2 percent of GDP (Izquierdo, Pessino, and Vuletin, 2018).

These data harken back to the early chapters of this book, which described how the crisis of citizenship and trust is strongly manifested in taxation and spending. Mistrust and weak bonds of citizenship make efficient tax collection and spending harder. Not only are citizens reluctant to fulfill their tax obligations, they also demand more subsidies instead of better education, more private benefits rather than more public goods (Keefer, Scartascini, and Vlaicu, 2018). Mistrust weakens the demand for

[13] Gómez Sabaini and Morán (2020) review 2017 estimates of the evasion of the value-added tax across 13 countries of the region. Estimates range from 14.8 to 45.3 percent. In the European Union, in contrast, the average rate of evasion in 2017 was 11.5 percent.

investments in the future. Hence, the region invested only 2.8 percent in infrastructure over the last decade, half of what Asia invested (Cavallo, Powell, and Serebrisky, 2020), far less than the 5 percent of its GDP that it should spend to close its infrastructure deficit over the next 20 to 30 years (Izquierdo, Pessino, and Vuletin, 2018).

Most reforms to improve tax and spending efficiency entail removing information asymmetries. They therefore not only improve efficiency, but also increase trust. Digital transformation is central to these efforts (IDB, 2021). Seco and Muñoz Miranda (2018) describe the range of digital tools available to improve the administration of fiscal policy. For example, by bringing artificial intelligence to tax administration, countries can improve the efficiency of tax audits and increase compliance—addressing their fiscal crisis, on the one hand, but also increasing trust and citizenship on the other. Electronic invoicing facilitates the collection of value-added taxes. The digitalization of procurement levels the playing field, restricting opportunistic behavior by procurement officials and their private sector contacts, and permitting new suppliers to enter with lower prices and higher quality (De Michele and Pierri, 2020). Budget transparency is fundamental and the implementation of information systems for financial administration plays a key role in this (Pimenta and Seco, 2019).

## Steering the Region to Port

This book has shown that people in the region swim against a current of mistrust. Few believe that others, including government actors, will not act opportunistically against them if given the opportunity. In a sea of mistrust, efforts to build growing, inclusive societies are bound to sink. People avoid interacting with others and take excessive precautions, firms refuse to grow and hire managers they don't know, neither people nor firms ask governments for public policies that will provide benefits in the long run, and governments worried that some may take advantage of benefits not available to all, put obstacles in the way.

This chapter has described some reforms that could calm the waters and help governments navigate through their myriad challenges. First, countries can address the power asymmetries that reduce trust in the public and private sectors with judicial and public sector reforms that give firms and citizens greater recourse to predictable and rapid judicial and administrative resolutions of their disputes with each other and with government. They can structure and manage public sector organizations to align the incentives of employees with those of citizens. Second, they can remove information asymmetries that undermine trust, requiring public

sector agencies to carefully communicate the decisions they make, and take responsibility for those decisions and their consequences. Parents should not have to struggle to find school test scores, nor patients the mortality rates of hospitals, nor citizens the rates of crime, arrests, and accusations of police abuse, nor communities the status of local infrastructure projects.

Third, they can integrate concerns about trust and citizenship into their efforts to address the major economic and social challenges of the region: slow growth, high inequality, climate change, and fiscal crisis. Country goals in all of these areas can be advanced with reforms that build trust, such as digital transformation in the administration of fiscal policy, uniform administration of tax and regulatory policies, and creation of new institutions, such as the Plataforma de Bonos Verdes.

Beyond advancing the many specific measures identified in this chapter, politicians have a large role to play. They are, after all, the representatives of all citizens and have nobly assumed the responsibility of providing for the collective needs of people that, individually, citizens cannot obtain for themselves. There is no collective goal that is more fundamental than a trusting, civic-minded society. When politicians exhibit trustworthy and civic behavior, they exercise a strong influence on the rest of the public sector and society in general. Such behavior begins with transparency: about the promises they make, the implementation of their promises, and the results for citizen well-being. It extends to their oversight of the public sector. Do they demand the same behavior of the agencies they oversee? Do they equip the public sector with the tools it needs to fulfill citizen demands and expectations?

The reform agenda laid out in this chapter also points to a virtuous, self-reinforcing circle. Whether in the public or private sectors, more trustworthy and civic behavior will lead to better results on the ground: government revenues increase when tax officials are more trustworthy; student learning improves when more trustworthy teachers are absent less; patient access to medicine increases when more trustworthy health workers do not sell supplies into the black market; employment increases when more trustworthy regulators do not demand bribes from entrepreneurs. Better results lead to greater trust in government, leading citizens to demand more and better public goods, improving their well-being even more. It also builds citizenship: people are not just proud of a country that functions well, they are proud of each other and more willing to participate in the collective effort that supports a thriving, peaceful society.

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# Index

Trust is the most pressing and yet least discussed problem confronting Latin America and the Caribbean. Whether in others, in government, or in firms, trust is lower in the region than anywhere else in the world. The economic and political consequences of mistrust ripple through society. It suppresses growth and innovation: investment, entrepreneurship, and employment all flourish when firms and government, workers and employers, banks and borrowers, and consumers and producers trust each other. Trust inside private and public sector organizations is essential for collaboration and innovation. Mistrust distorts democratic decision-making. It keeps citizens from demanding better public services and infrastructure, from joining with others to control corruption, and from making the collective sacrifices that leave everyone better off. The good news is that governments can increase citizen trust with clearer promises of what citizens can expect from them, public sector reforms that enable them to keep their promises, and institutional reforms that strengthen the commitments that citizens make to each other. This book guides decision-makers as they incorporate trust and social cohesion into the comprehensive reforms needed to address the region's most pernicious challenges.

"*Trust* makes a powerful case that social trust is a critical factor influencing development outcomes across the board, and that Latin America and the Caribbean, of all the world's regions, is facing an acute crisis of trust. The book points to concrete ways in which governments and societies can reverse these trends, as they deal with the lingering effects of COVID and economic setback."

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**The Inter-American Development Bank (IDB)** is an international institution created in 1959 to foster economic and social development in Latin America and the Caribbean.

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