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Inequality and Trust Dynamics

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Abstract. This chapter takes a close look at the interconnection between social trust and income inequality across countries. It argues that trust is both a consequence and a determinant of income equality. Small income differences create trust and trust feeds back on small income differences through an expansion of the welfare state. Together the two mechanisms, and the feedback process that they give rise to, explain how differences in history, institutions, or sudden adjustments can be enlarged over the long run—and give rise to a situation where countries differ significantly with respect to social trust and income inequality.

Keywords. Inequality, social trust, welfare state, social change

1. Introduction

In recent years, trust has been accepted as a central concept for understanding various aspects of social interaction. There is also broad agreement that high levels of trust have many positive societal effects and that trust in an important ingredient of what has been characterized “successful societies” [1]. When people trust each other, collective action problem are more easily solved, economic transactions run more smoothly, society is more inclusive and open, there is less corruption, and people are generally happier and have better health [2,3]. Many have pointed out that trust is particular important for effective cooperation in situations involving uncertainty, lack of information and unpredictability. Trust facilitates cooperation between individuals as well as cooperation between groups of individuals. Trust is also a central issue in international relations. When states trust each other, they can live in harmony [4]. Hence, trust is highly relevant for understanding the concepts of “peace, risk and security”, which is the main theme of this volume.

The increased awareness of the varied benefits of trust have led to an explosion of research on the topic in recent years, and we now have a reasonably good understanding of what trust is and why it is important [5,6]. Much less research has been directed at understanding where trust comes from. The aim of this chapter is therefore to contribute to the literature that seeks to understand the development of trust over time and space.

Social trust varies widely across countries.[2] Empirical research investigating the relationship between trust and various measures of quality of society usually draws on answers from survey questions such as the following: “Generally speaking, would you say that most people can be trusted, or that you can’t be too careful when dealing with

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[2] See e.g. Holmberg and Rothstein [7] and Tables A1 and A2 in the Appendix.

others?"[3] On average, in the world as a whole, around 25% state that most people can be trusted. On top of the list we find three Nordic countries (Norway, Sweden, and Denmark) and the Netherlands with scores around 64%–74%. Other countries with high trust scores are China and Finland (with 63% and 58%, respectively). The United States has a trust score of around 38%, while France and Spain are down at around 18%. Countries showing low levels of trust are Romania (7%), Brazil (7%), Colombia (4%), and the Philippines (3%).

Why this huge variation? Many scholars have noted the close correlation between trust and national income inequality [8–13]. Some also claim that the correlation is causal in the sense that low inequality produces trust [8]. This is explained by the idea that low income inequality reduces social conflicts and increases social identification. Less inequality reduces the distance between individuals at different points on the spectrum of income distribution, making the psychological distinction between those in "my group" and "the others" less noticeable. It becomes easier to identify with others and to trust others. In contrast, high income inequality produces hierarchies, social distance, and suspicion—and this erodes trust [14].[4]

Others claim that the causality between inequality and trust runs the other way around—that trust creates low income inequality [15–17]. The argument is that trust makes citizens more willing to support policies for social insurance and redistribution. That is, trust allows a more encompassing and generous welfare state to develop and to be fiscally sustainable in the long run, and a larger welfare state generally implies increased redistribution and lower income inequality [18]. But why should trust affect citizens' willingness to give the government the power to extract resources in order to build up a system of welfare state redistribution?

The welfare state is a large and complex collective action dilemma [19,20]. The welfare state is financed by taxes, and citizens are probably only willing to accept high taxes if they believe that the tax system is reliable and uncorrupt. Likewise, citizens need to believe that the government will use their tax revenues to set up welfare state arrangements in an unbureaucratic and efficient way. Probably equally important, people need to feel safe that their fellow citizens also pay their taxes and do not exploit the welfare system for their own personal gain. In sum, when citizens generally believe that other people and government institutions are trustworthy and honest, they are more willing to pay taxes and to support a policy for welfare state expansion. Without trust and trustworthiness, welfare states would run into problems.

This chapter argues that both perspectives sketched above should be considered in order to explain the long-run development of trust and inequality in society. Stated differently, the chapter argues that social trust is both a cause and a consequence of inequality. Trust leads to greater political support for welfare state expansion, and the equality created by the welfare state feeds back into trust. Higher trust leads to even greater political support for the welfare state, and so on. Over the long run, this feedback process has created a situation where some countries (e.g. the Nordics) have ended up with large welfare states and are well endowed with social trust, while other countries (e.g. the United States) have much smaller welfare states and lower levels of social trust.

[3] This question is included in the European Social Survey, the American General Social Survey, and the World Values Survey. Respondents can answer in a binary way by agreeing either with "Most people can be trusted" or with "Can't be too careful." Data elicited by this question is available for respondents from many countries throughout the world and from several points in time.

[4] Other factors besides income inequality that appear to effect social trust are discussed in Nannestad [20].

The next section discusses how income inequality affects social trust and how trust affects welfare spending. A simple modelling frame where we combine the inequality–trust effect and the trust–welfare spending effect is formulated in Section 3. It is illustrated how the two effects give rise to a gradual process where seemingly similar countries may diverge and end up with widely different levels of social trust and income inequality over time. Concluding remarks follow in Section 4.

2. Links Between Inequality and Social Trust

2.1. What Is Social Trust?

The trust literature is filled with confusion over different concepts of trust [3,21]. This is not the place to try to sort out this confusion. It is enough to mention that when exploring the concept of trust, this chapter follows most of the empirical literature and deal with what is generally termed social trust or generalized trust.

Social trust stands in contrast to what is termed particular trust. Particular trust is "the type of trust formed in repeated transactions or other situations in which actions and reputations are built on either a history of transactions or other observable and relevant information" (p. 270) [17]. Particular trust means that you only have faith in people you know. Social trust is different. Social trust is an expectation that people in general, that is, people we do not have any information about, will act in an honest way—even when they have the opportunity to act dishonestly and earn something from this. Social trust "reflects a bond that people share across a society and across economic and ethnic groups, religions and races" (p. 45) [9].[5] When we use the concept of trust in this chapter, we always refer to social trust, as just defined.

2.2. Trust–Inequality Associations

As a first impression, Figs 1 and 2 provide scatter plots of the trust–inequality relationship, measured by the Gini index and welfare state expenditures, respectively. Figure 1 illustrates a negative association between income inequality and social trust, as previously identified in the literature.

Figure 2 illustrates a positive association between trust and public spending on health and schooling as a percentage of GDP.[6] The positive association between trust and welfare state size has also been noted in the literature in recent years.

Below we elaborate about the possible explanations for both the positive association between inequality and trust and the negative association between trust and the size of the welfare state.

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[5] The survey question mentioned in the introduction is meant to capture this notion of trust.

[6] Although health and schooling are an important part of the welfare system in most countries, public expenditures on health and education admittedly make up only a fraction of total public expenditures on welfare. An alternative measure of welfare state development is total public social expenditures as a percentage of GDP. One drawback of using total social spending data is that these statistics vary a lot with business cycles and the size of the target groups. Nevertheless, the broad picture is that the clear positive association between trust and welfare state size remains independent of the different measures of welfare state efforts that hitherto have been used in the literature.

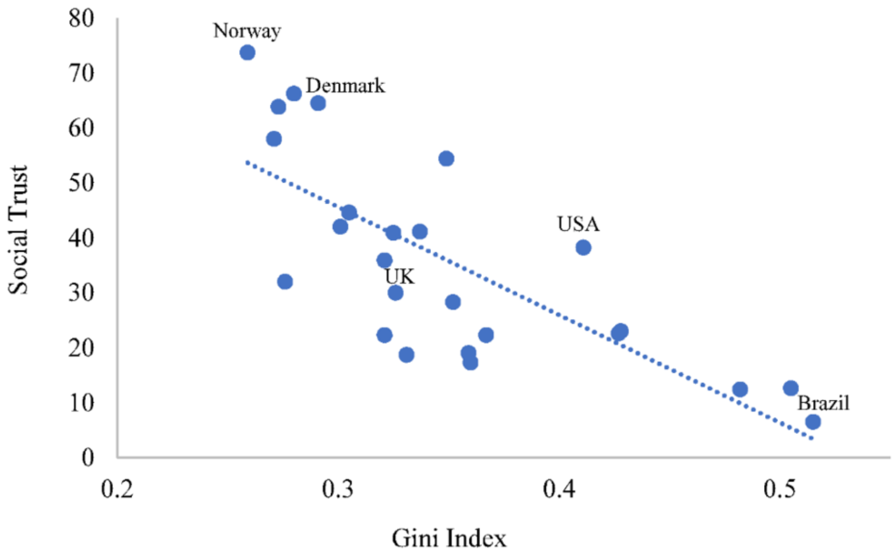

Figure 1. Income inequality and social trust. Sources: UNDP and World Values Survey.

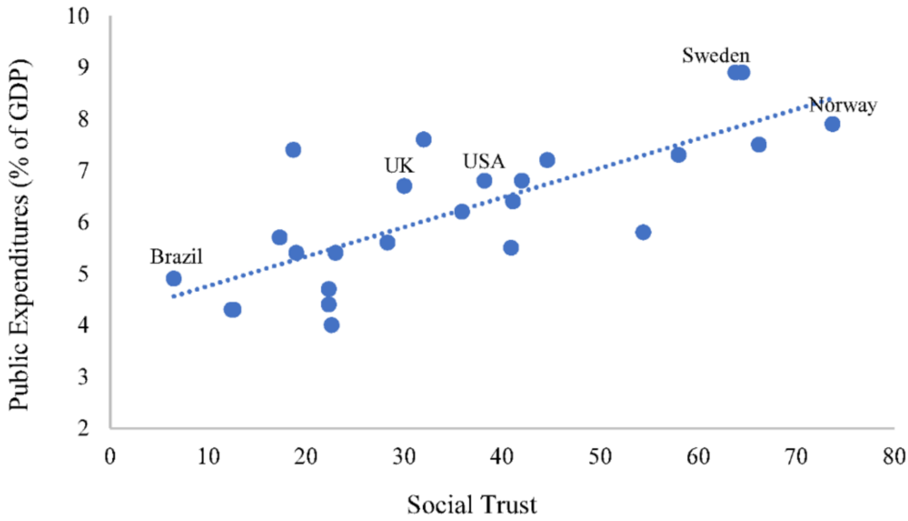

Figure 2. Trust and public expenditures on education and health. Sources: UNDP and World Values Survey.

2.3. How Income Inequality Affects Trust

Cross-country studies suggest that economic inequality carries a negative influence on trust [12,13]. People in societies with moderate income differences trust each other more than people do in more unequal societies. Several mechanisms can explain this relationship.[7]

[7] See Jordahl [22] and Hastings [14] for an overview and further references.

Social mixing may be reduced by higher income inequality, a process referred to by Bjørnskov [10] as "social fractionalization". Greater differences across the income distribution easily lead to a situation where different socio-economic groups live separate lives. People have little contact with others outside their own group. Since people are generally less disposed to trust strangers, increased social fractionalization may lead to a situation where people feel safe with insiders and do not trust outsiders [2]. As a result, social trust declines.

When the economic distance between rich and poor increases, a feeling of injustice and a belief that others have unfair advantages may unfold. The conflict between the rich and the poor is viewed as a zero-sum game, and this produces distrust [9].

A third factor that may explain why inequality reduces trust is what Wilkinson and Pickett [23] termed "status anxiety". They argued that people have different psychological strategies to deal with different social interactions. Social interaction in a setting with small income differentials evokes cooperation, trust, and reciprocity, while high income differentials accentuate status differences, which crowd out social preferences.

2.4. How Trust Affects Policies for Redistribution

Countries differ markedly if we compare their systems of social welfare and redistribution. Even if we concentrate on countries that are relatively similar with respect to basic economic, social, and political conditions, we observe huge variations in their welfare systems [24].

The so-called power resource theory, which is well established within the comparative political economy literature, explains the variation in social welfare across countries with reference to political mobilization and working-class power [25–27]. The more political strength the working class can activate, such as a strong and unified union movement offering support to Social Democratic parties in elections, the more generous and redistributive the welfare state will be. According to the power resource theory, rich market-oriented liberal countries, with access to the same technology and markets, have developed different systems for social welfare and redistribution because the potential for class-related collective action has varied within different countries.

In a recent paper, Barth and Moene [28] were also interested in explaining the huge variation between countries with respect to both welfare spending and wage inequality. As in the power resource theory, political competition and distribution of power are central in their analysis, but the mechanisms are different. Barth and Moene [28] focused on the link between how wages are decided in the labour market and what type of welfare policy will emerge via political competition in elections. A key result in their analysis is that compression of wage differences in the labour market increases the demand for social insurance simply because a majority of workers (voters) become richer. When people become richer, they want to buy more of everything—also insurance against income loss that the welfare state can deliver.[8] Political parties react by offering more generous welfare programs. In essence, this explains why some countries have low wage differentials and high welfare spending and others have high wage differentials and low welfare spending—a kind of double dissimilarity that can be observed in many OECD countries [28].

Both the power resource theory and Barth and Moene [28] offer important insight into why similar market-oriented economies have developed such varying systems for

[8] Typically, the welfare state can deliver insurance against income loss due to sickness and unemployment.

redistribution and social insurance. At the same time, there is an underexplained link in both approaches. If the majority of voters are increasingly interested in insurance against loss of income, or if the majority of voters are increasingly interested in redistribution, it is not at all a given that they will turn to the state for a solution.[9] Voters are likely to turn to the state and support state-organized welfare systems and redistribution only if they perceive the state as trustworthy, competent, and uncorrupt. It is not an exaggeration to say that these conditions are not present in all countries.

At the same time, citizens need to perceive that their fellow citizens are also trustworthy and honest in order to support a system of state-organized welfare. As mentioned in the introduction, the welfare state is a large and complex collective action dilemma. The welfare state produces a broad range of collective goods that are mainly tax financed. A large welfare state therefore calls for high taxes; this puts it at risk of engendering low tax morale. If people generally believe that others cheat on taxes, it is difficult to uphold a system that requires everybody to pay high taxes. Likewise, the welfare state is vulnerable to groups taking advantage of services and transfers that the system delivers without these individuals' having legitimate qualification of actual need. If people generally believe that others cheat on the welfare system, the political support for the system will erode.

To sum up: Social trust is a measure of how people view the moral fabric in their society. If people do not trust the state apparatus or their fellow citizens, it is not likely that ambitious policies for state-organized social security and redistribution will gain much political support. We do not deny that working-class mobilization (the power resource theory), collective bargaining, and equalization of pre-tax income (Barth & Moene, 2016) are important to understand welfare state expansion. What we do is to bring in a commonly overlooked factor, namely social trust. Social trust is important if demand for social security and redistribution should be transformed into actual political support for state-organized, collective risk sharing and income equalization.

3. Putting the Pieces Together

Combining how trust affects welfare policy with how welfare policy affects trust via redistribution of income, we see how equality may feed equality through a gradual accumulation of trust. Trust leads to political support for a more active redistributive welfare policy, and more generous welfare policy leads to higher trust as more welfare means less income inequality. The combination of the two mechanisms, and the feedback process that they give rise to, make it possible to more fully understand how differences in history, institutions, or exogenous shocks can be enlarged over the long run. A sudden decrease in income inequality, due to more progressive taxes for instance, leads to an increase in trust, which again leads to increased support for more welfare benefits. More welfare benefits in turn leads to lower income inequality, which again leads to an increase in trust, more welfare, lower inequality, and so on. We see that the feedback process enlarges the initial change.

The link between trust and welfare works through politics and voters' support for different types of welfare systems. We label it the "trust–welfare relationship". The link between inequality and trust works through social interaction at the society level. We label it the "equality–trust relationship". We use a simple graphical illustration to show

[9] See also Rothstein et al. [16] for a related discussion.

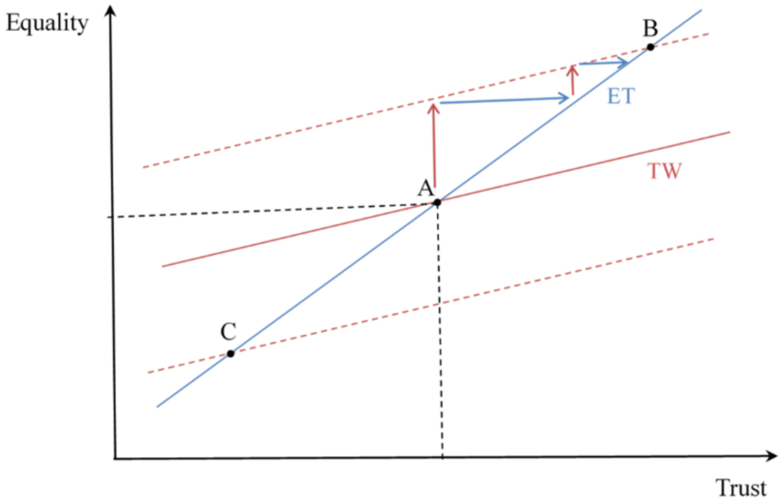

Figure 3. The feedback between trust and equality.

how the two relationships work together and feed back on each other, and how the path towards an equilibrium may be disturbed by random shocks.

In Fig. 3, the two relationships explained above are represented by two curves, both of which describe a positive relationship between trust and income equality (redistribution).[10] The first curve in Fig. 3 (in red) represents the link between trust and welfare, where the causation runs from trust to equality. More trust leads to a more generous welfare state and more equality. We call it the "trust–welfare curve" (TW curve). The second curve (in blue) represents the link between equality and trust, where the causation runs from equality to trust. More equality leads to more trust. We call it the "equality–trust curve" (ET curve).

The socio-political system is in equilibrium at point A in Fig. 3, where the two curves cross. We have an equilibrium in the sense that trust in society is at a level that maintains the political support for the welfare state, which in turn generates an income distribution that preserves the level of trust (everything else given).

A shift in one of the relationships leads to a chain of adjustments. Assume for example that a new government is formed with the ambition to expand the welfare state. The policy is put into practice. For a given level of trust, the welfare state expands. The first thing that happens is that income inequality goes down. This can be illustrated as a shift upward in the TW curve in Fig. 3. For a given level of trust, the welfare state expands, and we get a more equal distribution of income. The next thing that happens is that the level of trust in society increases as a result of more equality, illustrated with the blue arrow against the ET curve. In the next run, the increased trust leads to increased demand for welfare goods that further equalizes income, illustrated with the red arrow against the new TW curve. More equality increases trust in society (the blue arrow against the ET curve), which in turn increases the political demand for welfare goods, and so on. We end up in a new socio-political equilibrium at point B, with more social trust and less income inequality. This equilibrium may resemble the situation the Nordic

[10] The graphical illustration is inspired by Barth and Moene [29], but the mechanisms that we focus on are different. The interpretation of the two curves is therefore also different.

countries (Denmark, Norway, and Sweden) face today, with their high trust scores and low income inequality.

The chain of adjustments can of course also run the other way, producing a gradual process of higher inequality and lower social trust. Assume a retrenchment of the welfare state, leading to a shift downwards in the TW curve in Fig. 3. This leads to a chain of adjustments (higher inequality, lower trust, more inequality, lower trust, and so on), producing a new socio-political equilibrium at point C. This chain of adjustments may illustrate the development in trust and inequality in the United States. In the 1960s, the United States had trust scores that were about the level we find in the Nordic countries today. In 1964, 77% of Americans expressed trust in the government. Today, this figure is down to 18%. At the same time, income inequality in the United States has risen to its highest level since the Great Depression [18]. It looks like the United States has moved from equilibrium B to C in Fig. 3.

4. Discussion

This chapter have argued that social trust is necessary to create support for public policies that hold income inequality down. At the same time, low income inequality is necessary to maintain high social trust. The first effect works through politics and voters' support for different types of redistributive policies. The second effect works through social processes at the society level. Together, these two effects, and the feedback process that they give rise to, explain how differences in history, institutions, or exogenous shocks can be enlarged over the long run.

Social trust and income inequality are variables that do not change much in the short run. Drastic changes in trust and inequality do not happen overnight. The social and political dynamics we have emphasized must therefore be interpreted as creating change over a long period of time. When looking at the data on social trust and income inequality across countries, it is difficult not to notice that some countries have low levels of inequality and are well endowed with social trust (e.g. the Nordics), while other countries have a lot more inequality and lower levels of social trust (e.g. the United States). However, the theoretical model presented in this chapter needs to be confronted with data in a much more rigorous way. It is beyond the scope of this chapter to test the model just outlined, but (as also noted in the introduction) there are several papers that have documented the close empirical association between income equality and trust. More income equality appears to go hand in hand with higher social trust. There are also several papers that have noted the close association between trust and the size of the welfare state. More social trust appears to go hand in hand with larger welfare states.

If larger welfare states lead to lower income inequality, which is highly plausible, we get a positive feedback dynamic. Low income inequality increases social trust, and social trust increases the political support for welfare state redistribution, further promoting low income inequality and an increase in social trust, and so on. Bergh and Bjørnskov [11] have tested this feedback process empirically. Using a large country sample, they found that trust facilitates welfare state expansion and equality in disposable (after-redistribution) income. They also found a two-way causal relation between market (pre-redistribution) income and trust, but no feedback from disposable income to trust. Hence, larger welfare states appear to increase equality in disposable income but do not increase trust. But the authors note that these results should be regarded as preliminary and that more empirical work is needed before we can draw final conclusions. We hope to be able to contribute with this in the near future.

The main argument of this chapter is that a high level of income inequality erodes social trust, which again weakens political support for a policy of inclusive social welfare and redistribution of income. From a policy perspective, this is admittedly a rather pessimistic message. Countries with little social trust and a high level of income inequality may easily be trapped in a vicious cycle: social trust will not increase because inequality abounds, and the policies that could fix this situation cannot be established because there is a lack of trust. The optimistic message, however, is that a virtuous cycle is also possible. Low income inequality maintains high social trust, which makes it possible to sustain public policies for keeping inequality low. A straightforward policy lesson follows from this: if the government wishes to secure or build social trust, it must use all policy options available to hold inequality down.

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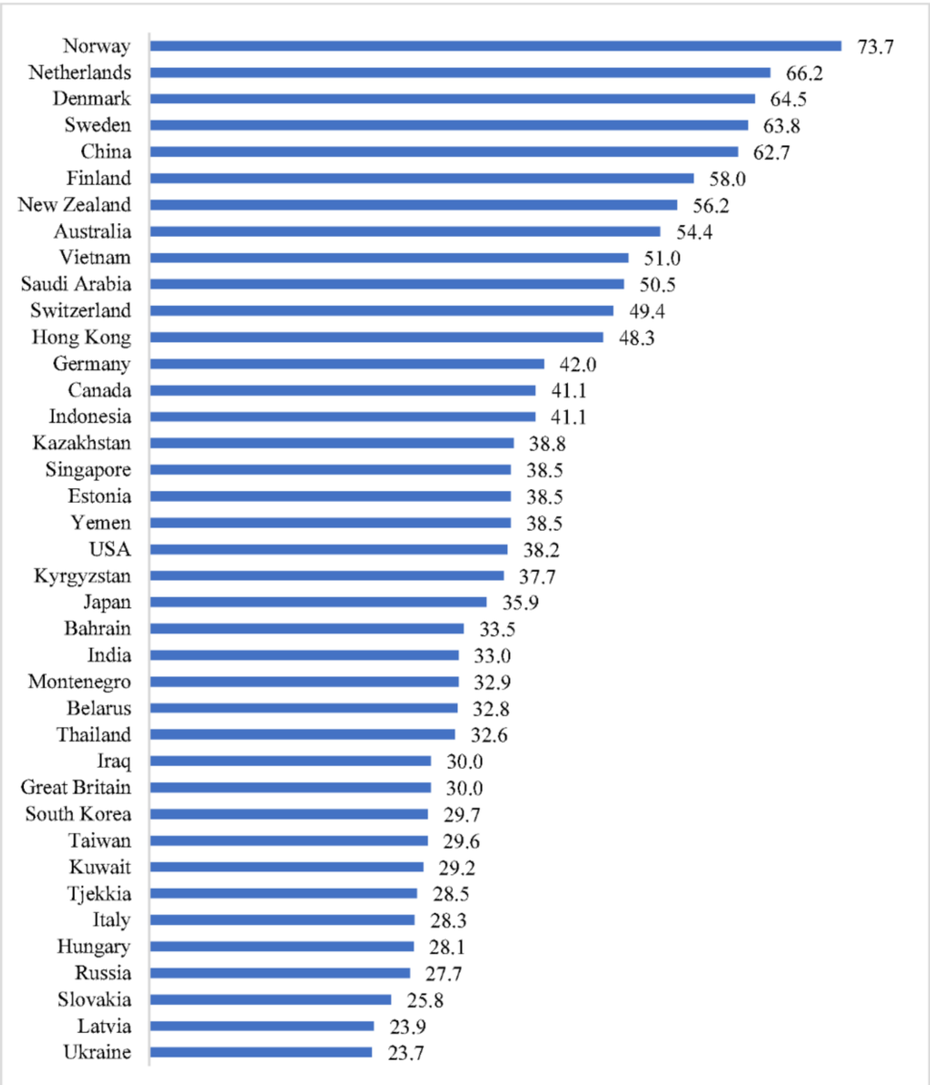
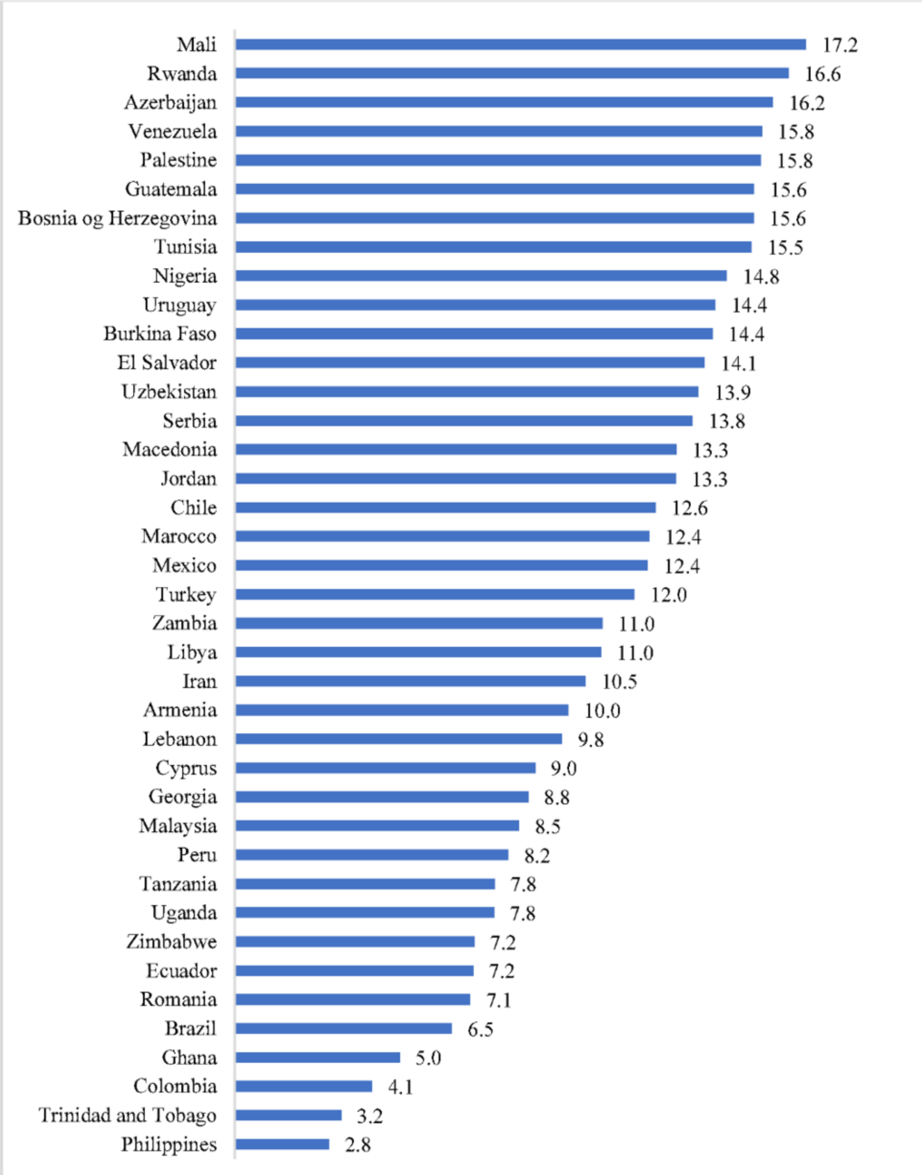
Appendix

Table A1. Social trust around the world. Top 40 countries.



Note: Responses to the World Value Survey. The question asks: "Generally speaking, would you say that most people can be trusted or that you need to be very careful in dealing with people?" 1 = Most people can be trusted, 0 = Otherwise. The numbers in the figure are the percentage of people who think that most others can be trusted.

Table A2. Social trust around the world. Bottom 40 countries.



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