DEPARTMENT OF COMPARATIVE POLITICS

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TRACKING TRUST

Investigating how social capital influences economic development in Latin America

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To trust people is a luxury in which only the wealthy can indulge; the poor cannot afford it.

Edward Morgan Forster, in Howards End 1910

ABSTRACT

This thesis investigates how social capital can lead to enhanced economic development through lowering transaction costs and promoting labour productivity and investment. The research question is: *How does social capital influence economic development in Latin America?*

Based on a combination of classical economic theory and social capital theory, three hypotheses concerning the causality between social capital and economic development are made. These suggest that social capital enhance economic development through the lowering of transaction costs (H1), promotion of productivity (H2) and promotion of investment (H3). By investigating these mechanisms, this thesis counters the frequently expressed critique of social capital theory, namely the lack of understanding of this causality. Furthermore, it expands the scope of the social capital theory in a developing context viz. a Latin American one.

The existence of a general relationship between social capital, measured as trust, and economic development, measured as growth in GDP, is determined by a regression analysis of 19 Latin American countries. The analysis also reveals Uruguay as the country with the highest value on the variable of interest, social capital. I thus select Uruguay as the case of investigation. The transfer mechanisms are investigated by process-tracing in an in-depth study based on interview data from Uruguayan businesses, where transactions, investment and productivity are crucial activities.

The results indicate that trust does have an economic pay-off through the lowering of transaction costs (H1). The effect of trust on labour productivity (H2) is also supported, but seems to be influenced by factors important in a development context, such as socioeconomic security and crime, apparently omitted in social capital theory. The effect of trust on economic development through investment (H3) is not supported by the data. The answer to the research question is therefore that in the Latin American case of Uruguay social capital influences economic development through lowering of transaction costs and through promotion of labour productivity.

PREFACE

During the work of this thesis, I have become conscious of my rich holding of social capital. I would never have been able to finish this work if it had not been for the help of so many:

First of all, thanks to my supervisors Kathryn Hochstetler, for always helping me back on the right track with her thorough comments when I was heading in all directions, and Michael Alvarez, for enthusiastic suggestions and corrections the last months. Thanks to Associate Professor at Aarhus School of Business, Christian Bjørnskov, for giving me access to his trust-data. Professor Per Selle and the method group have kindly provided me with helpful remarks on respectively the theory and methods chapter.

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1 INTRODUCTION

"Crear confianza es fundamental para reactivar el mercado interno, aumentar las exportaciones y crear el trabajo"[1] (Fernando De la Rúa, 2001)

This statement was articulated by the Argentinean president Fernando De La Rua during the economic breakdown in 2001 (*Diario del pueblo* 2001). He was stating the fundamental importance of trust for maintaining investment rates and production. This thesis investigates the relationship indicated by De la Rúa:

How does social capital influence economic development in Latin America?

Although much research has been conducted into the consequences and sources of social capital, I argue that the research question in this thesis represents a contribution to the literature. First, in De la Rua´s own region, Latin America, the economic consequences of social capital have scarcely been investigated. Secondly, criticism of the extensive work on the link between social capital and economic development is directed to the lack of focus on exactly *how* this relationship holds.

1.1 The importance of investigating this relationship

The overall answer to why one should investigate the impact of social capital on economic development is that on a continent where the poverty rate in many countries exceeds 50 percent, getting a better understanding of the *sources* of economic development is always important. This is highlighted by the frustrated comment of one of my interview subjects, Isidoro Hodara, the leader of Uruguay's largest free trade zone: "Economic development and Latin America are contradictory concepts" (Hodara 2009). The argument for investigating the particular economic contribution of social capital and its relationship with the economy is two-fold.

First, my research question is highly relevant because by understanding the implication of trust on economic output, measures of economic improvement can be developed. In order to

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[1] "Creating trust is fundamental for reactivating the internal market, increasing export and developing employment".

develop new policies and measures of improvement, knowledge is necessary. When mapping out how trust affects for example productivity, it will hence be easier to reform and improve the routines and policies concerning this mechanism, both on an institutional macro level and a business meso level. Further, by analogy, before you build a house you need to construct the foundation wall: All sources of economic development, that being trade, productivity, innovation or investment, rest on the micro platform within a society, the individuals, and their relation to these sources. Thus, an understanding of the influence of social capital on the economy, lays the foundation for a fuller understanding of other crucial development factors.

Secondly, I argue that my research question contributes to the existing literature by improving the ability to construct verified scientific explanations for the abovementioned aspects in Latin America (King et al. 1994: 15). It does so in several ways.

First, my thesis contributes to the theory of social capital by emphasizing the investigation of transfer mechanisms. Torsvik (2004: 257) stresses that in order for social capital to explain economic success, the interaction of the variables and the mechanisms behind the interaction must be specified. He claims that the theory of social capital falls short in this respect. This thesis contributes to a further understanding of this interaction by emphasizing the elaboration of the causal mechanisms between social capital and its economic outcomes. In order to do this, I first determine whether a general relationship between social capital and economic development actually exists in Latin America.

In section 3.2 I thus carry out a multiple regression analysis on 19 Latin American countries and find that social capital, here treated as a national characteristic and operationalized as the aggregate level of trust in each country, has a significant explanatory power on economic development, other variables kept constant. The regression analysis also functions as a case-selecting tool, since units with high or low values on the pertinent variables are good for generating theoretical and empirical insights (Lieberman 2005: 435). The case with the highest value on the variable of particular interest, social capital, is Uruguay. This means that Uruguay should be a particularly good case for looking into how social capital functions. Further, in order to specify the causalities, I formulate three hypotheses which are investigated by conducting within-case process tracing of the transfer mechanisms between trust and economic development based on interview data from Uruguay. By transfer mechanisms in this thesis, I refer to the influence of trust on the economy through its impact on transaction

costs (H1), production (H2) and investment (H3) – all of them fundamental elements in doing business.

Secondly, this study contributes to the theory of outcomes of social capital by conducting a quantitative and qualitative analysis in a geographic area scarcely investigated by social capital theorists. Putnam's original work on social capital studied the impact of social capital on regional development in Italy (Putnam 1993). In "Bowling Alone" he put emphasis on the decline of social capital in the USA (Putnam 1995). Rothstein, among others, has done extensive work on Europe and the Scandinavian countries (Rothstein 2003; Knudsen and Rothstein 1994; Kumlin and Rothstein 2005; Beugelsdijk 2005). India, Nepal, Ethiopia and Tanzania have been objects of case-studies on social capital (Ostrom 2000; Krishna 2004; Narayan 1999; Gabre-Madhin 2001), while numerous empirical studies have been conducted based on data from the whole world investigating the economic output of social capital (Knack and Keefer 1997; Zak and Knack 2001; Bjørnskov 2006a). Although De la Rua is not the only one emphasizing the importance of trust, few studies have had the main focus on Latin America when investigating social capital and its consequences, and I find no published work on mechanisms of social capital in Uruguay[2].

Thirdly, my study plays a part in modifying theories on the sources of social capital. The theory on sources of social capital is roughly divided in two. On the one hand, Putnam (Putnam 1993, 1995) claim that social capital stems from networks and organizations in society, while Rothstein et al (Rothstein 2003; Rothstein and Stolle 2008; Rothstein 2005) consider institutional macro structures to be most important for the creation of social capital When using process tracing on the causal mechanisms, I investigate the causal relationships from the beginning to the end in order to make the identification of the process more robust (Bennett and Elman 2006). I therefore go back to the sources of social capital. My empirical investigation shows that both institutional macro factors and meso networks are important and even closely connected. This thesis thus modifies the dichotomy between the meso and macro level.

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[2] *Some* work on social capital in Latin America has been done, viz. e.g. Booth and Richards (1998), Neace (2004), Klesner (2007).

Last, but not least, strengthening the hypothesis of the positive effect of social capital on the economy is meant to contribute to strengthening the understanding of economic development theory as well. Such a contribution is in itself valuable, because knowledge about development can even out economic disequilibrium. "Enhancing social capital is part of the key to successful development transformations" (Stiglitz 1998: 43).

1.2 Expectations

My expectance of trust enhancing economic development rests on the classical economic theory on economic development which defines investment and labour productivity as crucial for economic growth (Romer 1996: Ch. 1; Barro 1997). Given the increase in growth caused by increasing investment and productivity, this thesis focuses on how trust promotes those two economic engines.

The first theoretical expectation is that trust lowers the costs of transactions, which is positive for investment. Using time on assuring credibility towards a transaction partner requires resources that trust contributes to diminish (Bjørnskov 2006a). Trusty networks also make it easier to find a transaction partner, and lastly, high levels of trust enable informal transactions to a higher degree.

The second expectation is that trust promotes productivity. If a worker invests time in working harder, it is because he trusts in the pay-off of this action. In order to increase productivity you hence need a trust-relationship between the employer and the employee (Knack and Keefer 1997).

Lastly, hypothesis three expresses the expectation of trust enhancing investment. When allocating economic resources, both depositors and lenders are exposed to risks, which are minimized by trust (Calderon et al. 2002). High social trust makes a society more stable and predicable, which gives better incentives for investment (Bjørnskov 2003: 6-7).

Humphrey (Humphrey 1998: 43) stresses that sanctions and trust are additive. This implies, in theoretical terms, that states with good sanction possibilities, such as well-functioning institutions, need less trust for diminishing risk. Given that developing countries, such as many countries in Latin America, have less developed institutions, the role of trust can become even more important in transacting, producing and investing.

Figure 1 shows that a micro level concept such as trust can promote economic development through business. Furthermore, sources on both meso and macro level are important for social capital.

Figure 1.1 The argument

LEVEL	ARGUMENT	SOURCES
	ECONOMIC	*INSTITUTIONS,*
MACRO	**DEVELOPMENT**	*POLICY*

BUSINESS

MESO *NETWORKS, ORGANIZATIONS*

MICRO **SOCIAL CAPITAL**
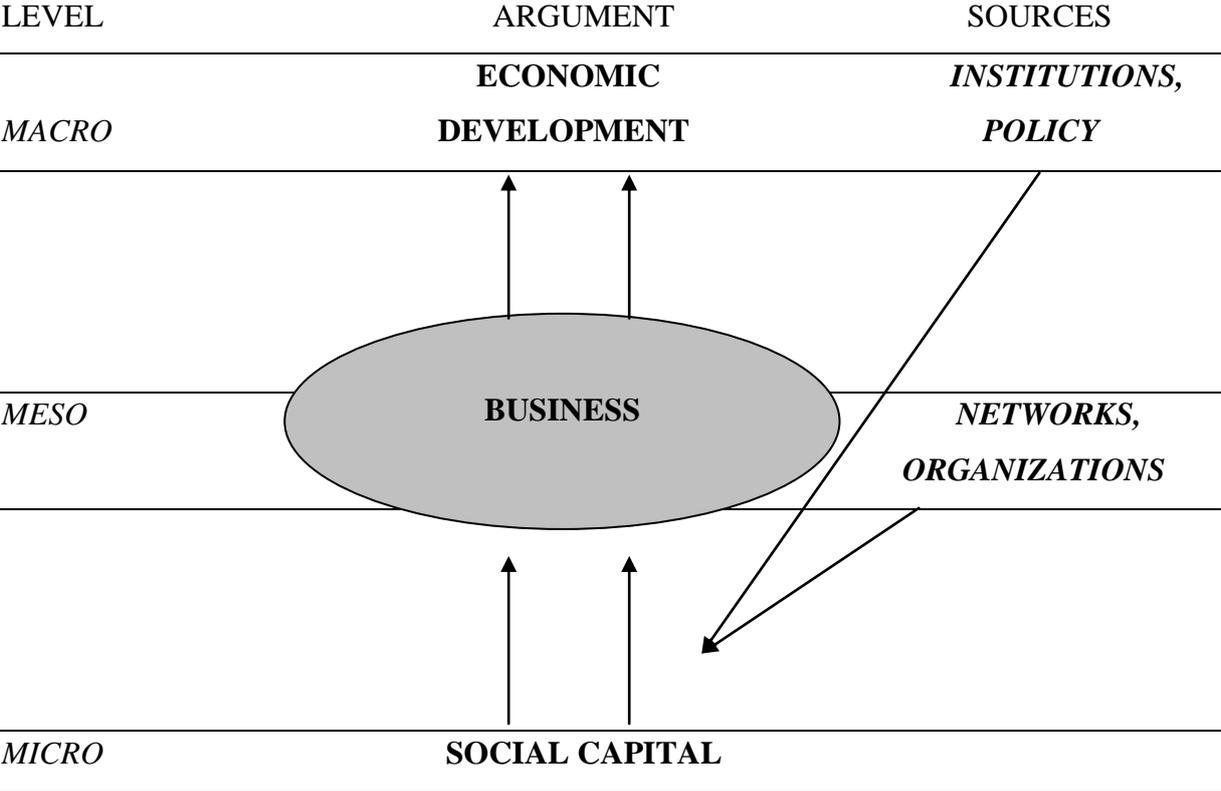
1.3   Structure of the thesis

Chapter 2 starts with elaborating on a definition of the term social capital. As the term is widely used and treated, it has numerous different definitions. In this thesis I emphasize previous work when constructing a definition. I argue that interpersonal trust is the core element in all the reviewed definitions. It is also parsimonious and widely used as an operationalized definition in empirical studies. Trust is treated as a national characteristic in the quantitative analysis, while as an individual property in the qualitative analysis. A brief discussion of the sources of social capital is also necessary due to its relevance in the tracing of processes between trust and economic output – the process shall be traced from its beginning to its end. Finally, theoretically, I place social capital within the economic discipline and elaborate on the transfer mechanisms between social capital and economic

development. Based on the theoretically expected causalities, I shall formulate four hypotheses. One general hypothesis is examined in the regression analysis: Social capital has a positive effect on economic development in Latin America. Three main hypotheses about the mechanisms of this relationship are investigated in the qualitative analysis: H1 Trust lowers transaction costs, H2 Trust has a positive effect on productivity, and H3 Trust increases investment.

In Chapter 3 I justify my use of a multiple regression analysis and why I follow up with a case-study and process-tracing to investigate the three main hypotheses. The case selection, which is not a random one, is also justified, before measurement and operationalization of the variables are treated, both for use in the quantitative and qualitative analysis. Trust is the measure of social capital in both the regression analysis and in the process tracing, although the scope of trust is somewhat expanded in the qualitative approach; the sources of trust are also taken into consideration in order to trace the whole process. Economic development is measured as growth in GDP per capita in the regression analysis, while economic gains at the business level are the dependent variable in the process-tracing. In the analysis in chapters 4 and 5, I maintain the same order: The quantitative regression analysis is presented first, followed by the process tracing analysis of the three theoretically elaborated hypotheses, based on first-hand interview data from Uruguay and on relevant secondary literature.

2 THEORY

This chapter will theoretically explore the possible effect of social capital on economic development. First, I discuss why I use trust as the definition of social capital throughout the thesis and what trust is. Secondly, I treat the sources of social capital, relevant for the qualitative analysis. Thirdly, I focus on how social capital can be placed within the economic discipline, and lastly, I focus on the mechanisms that link social capital and economic development. The main purpose of the theory chapter is to develop hypotheses explaining the transfer mechanisms between social capital and economic development. I will construct one general hypothesis to be analysed quantitatively and three specific hypotheses to be investigated in the qualitative analysis.

2.1 Social capital is trust

Social capital is a widely treated concept with many definitions, including both inclusive and parsimonious ones. In order to define social capital in this thesis I have investigated previous work on social capital, and found trust to be an indicator or definition of the concept in all of them (table 1). In addition to trust, Putnam refers to social capital as the social networks and norms that allow citizens to act together more successfully to pursue shared goals (Putnam 1995: 1, 2000). His definition is used in a large amount of work on social capital. Bourdieu (1985: 248) defines social capital as the resources which are linked to the possession of networks or relationships, while Woolcock and Narayan (2000: 226) write that "…the basic idea of social capital is that a person's family, friends, and associates constitute an important asset".

I agree with Putnam, Bourdieu, Woolcock and Narayan that networks, organizations and society have a great impact on social capital and that close ties to family and friends have positive outcomes. However, I stress a division between the cause, the effect and the content in the social capital concept. There should be a clear separation between the definition of the concept, theoretically and empirically, and its alleged effects (Portes 1998: 21). Otherwise, one may risk using tautological definitions. Social networks and organizations *create* trust among the individuals or groups involved which make citizen act together more successfully. Family, friends and associates constitute an important asset in this respect because they *create* trust and confidence in the surroundings. These networks, organizations and social ties are thus the *sources* of social capital, and the outcome is trust. Further, "acting together more

successfully" are the *consequences* of social capital, as well as the possible economic gains investigated in this thesis. I aspire to use a definition of social capital which does neither include the causes nor the effects, but rather the content. By distinguishing between sources of trust and trust itself, I avoid the "confusion of causes and effects" made by Putnam (Sobel 2002: 140). I also respond to the main critique of social capital, namely vagueness (Torsvik 2004), by explicitly stating a precise and parsimonious definition.

I measure trust in the quantitative analysis by answers to the survey question: "In general, do you trust other people?" Trust is conceptualized as a national characteristic in the quantitative analysis, while it is an individual property in the qualitative analysis. Lastly, trust is a concept that exists in all societies, applicable in different part of the world, including in a Latin American context. For all of my Uruguayan respondents, trust was a familiar and comprehensible word. When former president De la Rua encouraged the Argentinean people to *trust* the politicians in times of crises, he wished to increase the stock of social capital in Argentina in what I thus consider to be the core of the concept.

Table 1 shows the trust indicator to be a core element across a wide range of studies done on social capital in relation to economic output.

Table 2.1 Measurement in the development-related social capital theory

Author	Trust	Networks	Collectiveness	Other
Coleman 1988	+	+		+
Putnam 1993, 2000	+	+	+	
Evans 1996	+	+		
La Porta 1997	+			
Knack and Keefer 1997	+			
Zaheer, McEvily, Perrone 1998	+			
Temple 1998	+			+
Nayaran 1999	+	+	+	
Collier and Gunning 1999	+	+	+	
Zak and Knack 2001	+			
Woolcock 2001	+	+		
Clegg et al. 2002	+			
Glaeser et al. 2002	+	+		+
Knak Zak 2003	+			
Beugelsdijk 2004	+			
Neace 2004	+	+		
Krishna 2004	+	+	+	+
Francois et al. 2004	+			+
Bengtsson, Berggren, Jordahl 2005	+			
Rothstein 2001, 2005	+	+		
Bjørnskov 2006	+			

2.1.1 What is trust in this thesis?

In this thesis trust is considered to be the core element of social capital. However, there are diverging understandings of what trust is in different disciplines. In economics, trust tends to be viewed as calculative and rational or institutional (North 1990). In psychology, trust is more framed by the personal cognitive experience of the individual, while in sociology and political science trust is considered to be a risk-reducing feature, socially embedded in society or created by policy and institutions (Rousseau 1998). Across these disciplines, there are also divergent views on the definitions of trust: Multilevel trust, which is trust on different levels, e.g. individual, institutional, or within group and organizational trust, which focuses on the group based trust between organizations.

However, across disciplines, there is an agreement on the core conditions of trust: Risk and interdependence (Rousseau 1998: 394-395). Risk is the perceived probability of loss, as interpreted by a decision maker (Chiles and McMackin 1996). Trust is not needed when something is absolutely certain. If you trade with another person, there will always be a certain element of risk involved, unless you have a hundred percent formalized contract. However, almost all trades imply some risk, and trust is consequently nearly always needed.

Interdependence refers to the fact that the interest of one person cannot be achieved without reliance upon the other person. These two core components of trust constitute the basis for the understanding of trust used in this thesis. As this thesis has an interdisciplinary dimension comprising common aspects of political science, sociology and economy, my understanding and definition of the term trust mirror this interdisciplinary character.

Nannestad (2008: 416-417), along with Torsvik (2004), points at a gap between the theoretical meaning of trust and the empirical studies conducted. This is solved by stating the explicit *meaning* of it. In order to deal with the critique of lack of construct validity, I have briefly elaborated on what trust implies in this work. In the first place, it is seen as belonging to the individual, which can be aggregated to constitute a societal characteristic. In any case, it is an aggregate societal good. This is analysed first at a macro level where the good is growth in GDP, then at a meso level, where the good is economic performance and gains for Uruguayan businesses. Secondly, it is built on the assumptions of risk and interdependence, which form a solid foundation for moving between economy and political science. As such,

my approach to the term trust is adapted to the context of this study, viz. an empirical quantitative and qualitative one (Bigley 1998: 415; Krishna 2004)[3].

2.1.2 Does trust vary?

I argue that trust varies. If not, it would not have been fruitful to conduct this research, as no measures could have been done in order to increase the level of trust and consequently the level of economic development. However, it is a slowly changing feature. This is a relevant consideration when I aim to investigate if trust affects economic output in Latin America.

Whether trust is path dependent, a product of interaction in society or created by institutional factors is disputed. The answers to this question can, again, be grouped into two groups. 1. All forms of exchange are embedded in comparatively fixed social relationships (Putnam 1993; Granovetter 1985). 2. Trust is dependent on policy and institutions. It is not a given form, but a result of political practices, which shapes the possibility of economic advancement (Rothstein and Stolle 2008; Rothstein 2005; Coleman 1988; Paldam 2000; Weber 1978).

Granovetter (1985) stresses that trust is path dependent, which implies the indifference to government action and intervention (Fukuyama 1996). Putnam also stresses that the trust in the Italian regions was established a long time ago, and is not easy to change through policy. However, he stressed a decline in social capital in the US (Putnam 1995) Further, according to Lagos (2001: 143) "[t]he low levels of trust in Latin America derive from deeply rooted historical, social, and institutional factors".

According to the more liberal social capital theorists this not the case; they regard state-society relations as potentially fruitful for trust. The state can "nurture a stable, progressive and predictable environment in which a vibrant civil society can emerge" (Woolcock 1998: 157). Similarly, the welfare state is considered as a good promoter of trust. It is the best environment for trust to surge, according to Rothstein (2005), who argues empirically that the Scandinavian countries hold the highest level of trust. Does his point of view indicate that we should not expect a high level of trust in Latin America? On the one hand, yes, due to the limited welfare state in many countries. On the other hand, no, since a strong welfare state *could crowd* out the trust, as it is no longer needed when the state is a complete supplier of

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[3] Coleman and Bourdieu are not considered when treating the nature of trust in this thesis. Although they hold trust as the key element of social capital, they see trust as an individual advantage (Bourdieu 1983, 1984, 1991; Coleman 1988), while I focus on the societal output of trust.

necessities (Van Oorschot 2005). This view constitutes an optimistic approach on the level of social capital in Latin America. Strong family ties and voluntary engagement are in place, as the state does not contribute total social security. As Coleman states, it is the closest ties that create the primordial social organization (Coleman 1991).

The explanation of both trust generated by policy and institutions, and from networks and community activity, implies slow changes. Even tough policy-related trust is more exposed to governmental changes; it will develop slowly, and not change radically from one year to the next. As Bjørnskov (2006a: 10) states: "[…P]anel estimates are infeasible as the variation over time used to identify effects is likely to be almost random in most countries". I thus treat trust as a varying concept, though slow-moving.

2.2   Sources of trust

Philosophers like Immanuel Kant and David Hume highlighted the importance of trust and grappled with a definition of the term (Hume 1888; 2006a: 10; Kant 2007 [1909]). But in order to create a definition, it was necessary to know where trust came from. There has not been, and there is not, an agreement of the sources of trust.

In the literature I find a dichotomy regarding the creation of trust. One approach focuses on a community level while the other is on a society wide level. The communitarian approach emphasizes organizational and local activity as the creator of trust, and the effect that this trust has on the local community (Putnam 1993). The macro level approach on the other hand focuses on the creation of trust at an aggregate level, embedded in the institutions and performance of a country (Rothstein and Stolle 2008). Both approaches have focused their empirical work on developed countries such as the US, Italy and the Scandinavian countries, while I will apply the theory to the Latin American countries. I find that both approaches are relevant in the case-study of Uruguay, and will therefore briefly present them.

2.2.1   Trust stems from networks

It all comes down to who you know, is a common understanding of personal outcomes, even though it may seem unfair. You may be intelligent and hardworking, but if you do not have the right friends or if you lack a social network, it is unlikely that you will go far. The network is already established at school, when cooperation is a part of the learning process and evaluated positively (Woolcock 1998: 158). The social gathering factor continues with

football teams, voluntary community work, or other leisure time activities, where the social factor may not be the primary *goal*, but it is definitely the *means* (Putnam 1993). The emphasis on trust rests, on the one hand, on the importance of these day-to-day habits and activities in the development of a community. In Latin America these activities correspond to the activities stated by Putnam, but in addition, many Latin American countries have such experiences as active Catholic groups, frequent family celebrations etc.

Putnam's - in some ways pioneering – work, reveals variation in those given social factors which co-vary with important developmental outputs (Putnam 1993). The features of social life, networks and trust enable participants to act together more effectively (Loury 1992: 100; Putnam 1995: 664-665). Thus, the trust of a community is first and foremost based on network activity. According to Wollebæk and Selle it is not so relevant whether individuals are active or passive in the network, but that they are affiliated (Wollebaek and Selle 2002: 32). All connections within a network can constitute a source of trust – whether active or not (Wollebaek and Selle 2002).

2.2.2   Trust stems from institutions

Rothstein disagrees with Putnam on this point. Rothstein maintains that political and legal institutions channel and create trust (Hall 1999; Rothstein 2005; Bretzer 2005). Networks can consist of untrustworthy agents, which play a destructive role in society[4]. For example, networks can be held together by distrusting agents who are outside the network. There is thus no logical reason why membership in networks per se should be a desired social value (Rothstein and Stolle 2008: 3). Furthermore, a network can nurture a high level of trust inside the network, but exclude people outside this group, which actually decreases the generalized trust or trust in people that you do not know.

An example is the jewellery market in Buenos Aires, which is mainly Jewish with a high degree of intermarriage. It is a rather closed community where everybody knows everybody. They share the same religion, language and culture. This is fruitful for the commercial interest of each individual, as it promotes trust and the security necessary to facilitate transactions in the market *within* the community (Coleman 1988). Following Rothstein's logic, however, this is not necessarily fruitful for society because it remains inside a closed group, although it does provide something to the individuals inside the group.

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[4] Guerrillas, terror groups or military organizations can also hold a high stock of social capital.

2.3 Economic development

2.3.1 Why investigate sources of economic development?

The dependent variable of the thesis is economic development. The main objective of my work, along with so many others before it, is to investigate the reasons for the variation in levels of economic development.

Although seen as the most important question in economics (Barro 1997), and treated as an obvious good for every citizen, development is not an undisputed benefit. The effect of growth in GDP on happiness and well-being has been questioned. Investigations based on cross-sectional data, including both developing countries and developed countries, have questioned whether the subjective feeling of happiness follows the level of development (Easterlin 2005). It is not given that sources that contribute to *positive change* in the economic situation have a constant relationship with improved subjective life quality. There are also many cases of countries where there is a positive growth rate, while the distribution of the economic resources in the population is poor. In these cases the outcome of economic development ends up in the hands of a small minority of people and cannot be said to have a decidedly positive effect on the macro level. Finally, the latest environment report from the UN, points at countries with a high economic level of development as consuming cultures that have brought the world into a climate crisis. Sources of economic development sustainable for the climate are urgently needed (UN 2009).

However, development is semantically a positively loaded word, indicating that an object moves from one state towards a better or greater one. The economic situation for a country is heading in the right direction if it is developing. Inglehart (2008) and Hagerty (2003) argue that this occurs both on macro and micro levels. Cross-sectional comparisons of nations show that variation in the happiness of their people and economic development are strongly correlated. The extent to which a society has freedom of choice has an impact on well-being and happiness. The freedom of choice in turn, is increased by economic development (Inglehart 2008: 264-266).

Furthermore, economic development contributes to better institutions and legal systems, a higher employment rate, and improved infrastructure (Berkowitz 2003; Démurger 2001). Development and improvement in material goods lay the groundwork for the possibility of

improving the quality of life. Basic needs for material goods need to be covered before you can question the source of your happiness or well-being (Maslow 1976). A higher level of gross domestic product (GDP) has positive payoffs on both micro and macro levels (Barro 1997; Inglehart 2008; Kenny 2005; Lipset 1959). The hope is that a "simple" factor as trust could thus indirectly improve quality of life.

2.3.2   What is economic development?

In this thesis, economic development is measured as growth in GDP per capita in the quantitative analysis. In the qualitative analysis economic development refers to the economic output and gains of business at the meso level, which is expected to influence the national growth in GDP at the macro level. However, these particular measures are not given:

Economic development is a multifaceted concept, which may imply a broad variety of measures and operationalizations. Nevertheless, the term economical development boils down to constituting a measure of how the level of a unit moves forward, in terms of its economic features. As a political economy term it tells us how *well off* a country is. Basic economic developmental goals are sustained growth, equity, and democracy (Portes and Landolt 2000). However, the *goal*s and the *development level per se* should not be mixed. In the measurement of economic development, equity and democracy are not necessarily included, or even relevant. There are divergent purposes for measuring development and also different understandings of the content of this concept.

 In his theory on the causal relationship between economic development and democracy, Lipset used the number of telephones in a household to measure development (Lipset 1969). In modernization theory then, economic development is reflected through material and technological progress. Jackman (1973) estimated the effect of economic development on democracy by looking at energy consumption per capita as the economic development indicator (Cutright 1963, 1969). A traditional measure of economic development is also annual change in GDP, known as the growth rate, which is the basis for my measure.

Krishna (2004) investigated if social capital helped to improve development in the third world by studying villages in India. He used a more inclusive definition, and did not only investigate the *economic development* outcomes, but also the *developmental* changes. In his extensive study he used four different measures of development, adjusted to the local conditions of the

areas investigated. Livelihood stability is a principal development requirement, as it enables the most important industry in the region, namely agriculture. Water availability is also covered by this measure. The other three measures of development constituted poverty reduction, employment generation and quality of health and education (Krishna 2004). Krishna's measure of development reflects the broad, pragmatic and fundamental meaning of the word. It also imparts the fact that development, focusing on only the economic dimension or not, should be measured according to the area or purpose of the research project.

The quantitative analysis of my thesis investigates if trust can explain economic development at a general level on a whole continent – Latin America. My project is thus distinguished from Krishna's Indian project as regards the area dimension, since he carries out case-studies within a small geographic area as the basis for investigation (Krishna 2004). I will therefore not be able to adapt my measure of economic development locally to the same extent, which is neither desirable nor my purpose. However, in the following qualitative approach, I *do* concentrate my investigation on a small geographic area, and I adjust the measure according to the *purpose* of my research, namely the influence of trust on economic development.

Growth in GDP as a measure of economic development has some disadvantages. It only includes formal economic activities, which excludes relevant information, at least in developing countries where the informal part of the economic life is highly important. In Uruguay this is evident, since the informal economy is estimated to be 37 percent of the total economy in 2008 (Brasca et al. 2009). Moreover, it does not reflect the degree of distribution: Growth may be high, and also increasing, but the level of GDP, which is the basis of the growth estimate, can be highly influenced by outliers – a few inhabitants with a high percentage of the total GDP. This is especially relevant for small oil-producing countries (Diamond 1992) and also for Latin America; According to the UN development report 2008, Bolivia scores 60.1 on a 0-100 GINI scale[5] which measures inequality, and Colombia, Paraguay, Brazil, Panama and Guatemala above 55 on the same scale. Finally, the growth level does not estimate the level of human development in a country, such as literacy, life expectancy or schooling.

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[5] GINI is a frequently used measure of income inequality. It derives from the Lorenz curve, which displays the cumulative share of total income accruing to successive income intervals (Todaro 2000: 215-215).

In spite of its limited range, growth is the core measure of the development of the economy of a country at the macro level. Hence, the growth in GDP will be the best measure of the development of the economy from one year to the next in the quantitative analysis. The analysis is conduced on a macro country level. The qualitative analysis focuses on economic output at the business meso level, consequently, the measure of economic development will be economic progress for the businesses rather than the economy as a whole.

Empirical investigations on the link between trust and economic development support growth in GDP as a measure of the dependent variable, as presented in Table 2.2. Thus, although growth in GDP does not capture distribution; it is a *comparable* and clear measure of development (Bjørnskov 2003; Cutright 1963; Diamond 1992; Jackman 1973).

Table 2.2 Measures of economic development in social capital–related theory

Autor	Measurement
Evans 1996	Growth in GDP *
La Porta 1997	Growth in GDP
Knack and Keefer 1997	Growth in GDP
Temple 1998	Growth in GDP
Nayaran 1999	Household income
Collier and Gunning 1999	Growth in GDP
Zak and Knack 2001	Growth in GDP
Woolcock 2001	Growth in GDP *
Knak Zak 2003	Growth in GDP
Beugelsdijk 2004	Growth in GDP
Neace 2004	Growth, entrepreneuring
Krishna 2004	Index of development performance
Francois et al. 2004	Production, entrepreneurship
Bengtsson, Berggren, Jordahl 2005	Growth in GDP
Bjørnskov 2006	Growth in GDP

*These authors have not conducted empirical studies, but acknowledge growth in GDP through discussion and usage of articles that did use growth in GDP in empirical investigations.

2.4 How does trust lead to economic development?

In this section I will outline a theoretical understanding of why trust affects economic development, measured as per capita growth quantitatively, and as the economic output for firms qualitatively. Four hypotheses will be formulated.

The inclusion of norms and social values in the economic development debate is nothing new. Modernization theory, for example, analyzed processes of broad social change in connection with economic outcomes. It aimed to explain sources of economic development from these

processes, and investigated how this influenced democracy (Lipset 1959). Two main directions can be distinguished within modernization theory: the Weberian, which focuses on the psychological and cultural elements, versus the system-oriented approach emphasizing the integration of social differences in the systems and structures (Arat 1988; Randall 1985: 20-22). The former direction of modernization theory is relevant here, as it highlighted voluntary and civic organizations as the basis for social pluralism nurturing democracy. Already in the Weberian tradition economic issues were thus mixed into the sociology, where what can be called social capital were central in those concerns (Weber 1978; Woolcock 1998). Introducing the concept of "Enforceable trust", Weber (1978) suggested that different kinds of institutions and groups used different mechanisms for ensuring compliance with rules and agreements. Bureaucracies used contracts, while family and other informal relations used social forms of security. Also memberships in golf clubs, which counted as an indicator of social capital, could be helpful in oiling the wheels of business life (Bourdieu 1984: 291). And these mechanisms of compliance had a positive impact on the economy[6].

Initially, the idea of describing social ties as capital was a metaphor, implying that social connections can be profitable, like other forms of capital. One can invest in it and expect efficiency gains from non-economic goods (Paxton 1999). This is highly simplified but places social capital within the economic term (Fields 2003: 12-13). Furthermore, Granovetter argues that all economic action is inherently enmeshed in social relations of one configuration or another (Granovetter 1985). But how does social capital pay off?

There is broad consensus in the literature that economic development depends on two main contributors: *Investment* and *labour productivity*. This is called the Solow model. The latter is defined as output per person per hour (*The world bank, wdi online* 2007). Extensive empirical work supports that an increase in investment and labour productivity leads to an increase in economic development (Barro 1997; Romer 1990).

So, the worker needs to have incentives to work harder, which first and foremost relies on his belief in the possibility of higher wages or other forms of benefits. This reflects a form of

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[6] There is a vast amount of literature on other sources of economic development. The post-war literature has been dominated by some main theories: The linear stages of growth model, the theories and patterns of structural change, the international dependence revolution and the neoclassical free market counterrevolution, and the later more actor-oriented approach. I will not discuss this, since it is not directly relevant to or within the scope of this thesis. For further readings, see Baran (1975), Bauer (1984), Buchanan (1954), Fei and Ranis (1964), Lewis (1954), Nurkse (1953), Rostow (1959), Solow (1994, 1999), Meier (2001), Hall (2001) Shapiro (1999).

investment from the worker in expectation of future reward: He invests in work, in order to get something back. The expectation of some kind of reward is precisely the core of an investment mechanism: If you invest in something, you have the optimistic idea that it will pay off in the future; a forward looking expectation which is critically influenced by *trust*. Investment requires an optimistic behaviour which in turn is determined by the level of trust in a functioning system. Trust in the government and also trust in the legal system imply that the investor has confidence in the sanctioning potential of the state, which in turn makes him invest since he feels safe. But the first and foremost trust needed is in the person you work for or do business with. This leads to the argument that trust has a positive effect on investment, which in turn is crucial for economic development.

Thus, first, if an investor feels safe and trusts his surroundings, he develops the opportunistic behaviour necessary for investing, as trust is a risk-reducing factor (Luhmann 1979). Secondly if the *worker* trusts his boss, and/or also trusts the legal system and the government to protect him from being exploited by his boss, this gives incentives to work harder and invest in more productivity per hour. Thirdly, a general trust by the capitalist in his workers also facilitates investment, as he counts on his workers to form a secure part of his business team.

Consequently, both general trust in other people (workers trust the boss, workers trust workers, and the boss trusts his workers) and trust in institutions (the workers and the boss trust the government, the legal system, and the capitalist system) is crucial for the variation in fundamental indicators of economic development, investment and labour productivity. As Ana Laura Fernandez from the Uruguayan Chamber of Commerce and Service provided one example, saying: "The law of collective negotiation increases the trust in institutions because the law secures [the worker] the right to influence the conditions of his work" (Fernandez 2009). She pointed to the workers feeling of influence, caused by trust in the institutions, as important for productivity.

Before looking more into the transfer mechanisms, the rationality of trust will be briefly introduced. Is it really rational to trust other people? I argue that agents often trust one another, and that trust is often repaid, given that the individuals have a time perspective and that sanction mechanisms are in place (Bruni and Sugden 2000: 2). Even though Torsvik (2004: 264-265) stress that the notion of trust is restricted to situations where there are no third

parties (sanction mechanisms) involved, I have argued that third parties such as networks and institutions always will be present where there is trust, since they are the sources of trust. Further, I have argued that trust and sanctions are additive (Humphrey 1998: 43). In a long time perspective it is not necessarily the threat of punishment that makes people trust, trust has become the rational choice. This is illustrated by figure 2.1: Juan and Maria are trading.

Figure 2.1 Trust affects investment behaviour
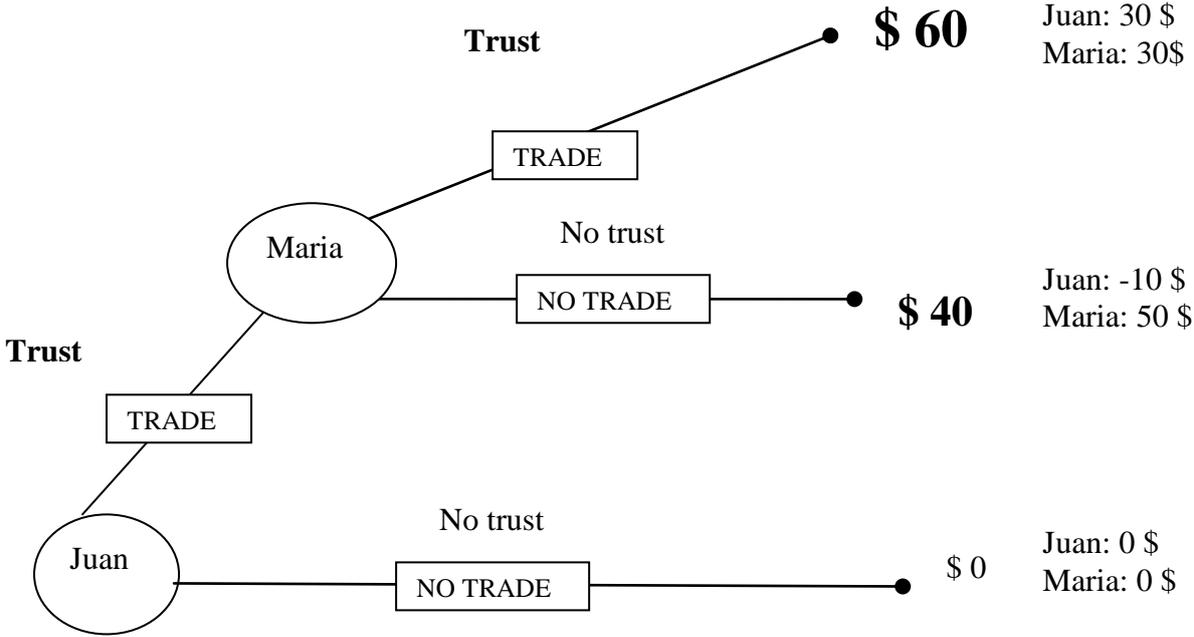
Source: Torsvik 2004: 263

Trust is necessary for Juan to stake money on a trade. The figure shows that if Maria and Juan hold a no-trust relation, there will be no trade and hence no money. Given that Juan trusts Maria, but she does not trust him - a moderate-trust relation, Maria will gain money, but Juan will lose. This will be the case if it is the only trade they engage in because Maria has the option of gaining more and she knows that Juan trust her. If both trust each other, a high-trust relation, both will gain money and the total amount of economic output will be higher than the lower trust-relations. However, this requires that both have a time perspective and that both have learned that no trusting in the end will give no trade.

In an imaginary total economic output, no trust gives 0 $. One-way trust gives 40$, while mutual trust gives 60$.

2.4.1   The rationality of trust

Economic theory rests on the principle of individuals acting rationally. There have been endless discussions of the characteristics of rational behaviour and the scope of the description, which I will not go into within the framework of this thesis. Nevertheless, the main purpose of this work is to place trust within the boundaries of economic variables, explaining economic output. I will thus give a brief discussion of whether it is rational to trust or not. Do economic actors, that is to say all consuming people, understand that they are better off if they cooperate for the common good? Is the reasoning behind the figure of Juan and Maria trading present in the consumer's mentality? I will argue that cooperation - not necessarily fruitful for the individual itself in the short run- can be counted as rational behaviour.

If cooperative action is to be achieved, individuals must trust that the people with whom they cooperate will not act contrary to shared objectives (Putnam 1993: 163-164 in Wollebaek and Selle 2002). First of all, the main modern conventional account for the rationality of trust is based on the idea of *reputation*. As a trader or consumer you care about your economic self interest, and the reputation you leave behind (Bruni and Sugden 2000). This is also according to what Hume states is the primary motive for justice, viz self-interest. Hume stresses that there are three rules of justice in society to make the common goal of increasing your material property possible: The stability of possession, the transference of possession by agreement, and the performance of promises (Hume 1888). The laws are necessary because justice is too impartial for humans to have natural sentiment for it. They can only feel human compassion, first and foremost for relatives and friends. Self-interest is hence the primary motive for justice. However, rational behaviour in the name of self-interest can then promote cooperation and also action where the individual gets no direct advantages in the first place. With a time perspective, it is rational to cooperate and it is rational to behave with solidarity (Todaro 2000; Torsvik 2003).

Secondly, cooperative networks of civic engagement tend to promote trust, because a person's reputation in one social setting or network easily transfers to other networks. Person with networks will therefore have incentives to preserve their reputation wherever they are (Granovetter 1985; Putnam 1993). The justice according to Hume will function by punishing a person through reputational sanctions. Conversely, a person's opportunistic actions in one association may exclude him from benefits in others (Bruni and Sugden 2000).

This reputation-based trust is an individualistic, ego-philosophical approach to the rationality of trust. Hollis argues that this approach fails to capture the *social* conception of what persons are: role-related and products of their obligations (Hollis 1998). Rationality is, according to Hollis, a collective matter developed in a group. "Thus, social institutions do not merely set the parameters within which rational choices are made; they influence the content of rationality itself (Bruni and Sugden 2000: 27).

Trust fits into both the collective and individualistic approach to rationality: *Individualistic* in the sense of self-interest as the foundation for all actions, *collective* because the collectiveness in many cases promotes the self-interest case. Given this brief discussion of trust as rational, one can develop the theoretical expectation that trust can have economic payoffs. If Maria trusts Juan and vice versa, the total output is the biggest in the long run.

2.4.2 Transfer mechanisms

We have seen that trust can have positive outcomes, including in the economy. Spontaneously, trust gives the association that all sorts of things simply will go smoother, in social, economic, and political life. But how does it promote economic growth specifically? What are the micro transfer channels of social trust to a measurable economic output? Torsvik states that a good explanation of differential economic success must satisfy one crucial requirement: the mechanisms of how the variable works must be clearly presented (Torsvik 2004: 257). He thinks the theory of social capital fails this standard, but I argue that the transfer mechanisms *can* be clearly presented.

Trust is, at its core, a set of institutionalized expectations that actors will reciprocate cooperative overtures to each other (Boix 1998; Knack and Keefer 1997: 1252). All economic activity that requires agents to believe in others or their actions is best in high trust environments, and societies where force is an instrument prior to cooperation are less effective and pleasant (Gambetta 1990). According to this logic, cooperation should be central to all mechanisms in the transfer channels. But cooperation is a vague concept - cooperation in what, and where? I will present the three main transmission channels emphasized in this thesis: transaction costs, productivity and investment. I focus on these mechanisms because they are rooted in my theoretical framework and they all rely on trust on the micro level. A fundamental challenge in investigating trust in economic exchange is extending an individual-

level phenomenon to an organizational/society-level of analysis. This is a challenge because one may commit a cross-level fallacy (Rousseau 1985). However, social capital can constitute a macro level characteristic when aggregated to country level. Further, I specify theoretically who trusts whom: The individual members of a firm rather than the firms themselves are the trusting figures even though the firms get the advantages. For example, in lowering transaction costs for a firm, it is the micro level individuals that trust each other, lowering the costs of the organization-level firm they represent. The general hypothesis is thus:

Social capital has a positive effect on economic development in Latin America.

In the following I will elaborate on how this relationship holds.

Transaction costs

> "The inability of societies to develop effective, low-cost enforcement of contracts is the most important source of both historical stagnation and contemporary underdevelopment in the Third World" (North 1990: 54).

Transactions are a key element in development according to North. Nobel laureate Kenneth Arrow agrees, writing that virtually every commercial transaction has within itself an element of trust, and certainly any transaction conducted over a period of time does (Arrow 1972: 357). The logic behind his argument is that if you trust and know people well, it is more likely that the transaction first of all takes place, secondly goes smoothly, and thirdly lowers the costs related to transactions. The importance of lowering transaction costs is reflected by the existence of a broad literature highlighting transaction costs as a crucial part of economic organization. A central part of this transaction costs literature is how operating parts in an organization should relate one to another (Williamson 1981: 549). In relating to each other, trust holds a key position.

Zak and Knack (2001) conducted an experiment which illustrates the impact of trust on investment and transactions in contract making. Consumers were randomly matched to an investment broker for a short period. The consumers showed the degree to which they trusted their brokers by the amount of time they spent verifying the broker's history of trustworthiness. The more time the consumer spent on verifying the broker, the less time

he/she could spend on production and wage-earning activities. In the experiment, they assumed that the consumers only could access capital through the brokers (Zak and Knack 2001: 296-297). None of the consumers knew the brokers beforehand, which could well be the case in real life experiences. The network of a consumer could thus be an advantage in the more solid foundation for trusting the broker, which would lower the time spent on controlling or verifying the broker.

Thus firstly, *contract making* in a transaction goes more smoothly with trust between the contract makers. The smoothness of this operation does not only, or even necessarily, include skipping formal procedures, but refers to how much time they spend on assuring the credibility of the contract-making part (Fuscaldo 2009). If you require an assessment or bank account transcript in advance, you will use more time and resources on the transaction than if you have reasons for trusting the person in the first place, reflected by the experiment of Zak and Knack (2001).

Secondly, transaction cost can also refer to how much time you spend looking for a proper partner to transact with. Personal connections or former experience with possible partners promote a trust experience that will ease the process.

Furthermore, societies with a high stock of social trust are less dependent on formal institutions to enforce agreements. Informal credit markets is dependent on strong interpersonal trust that can facilitate investment where there is no well-developed formal system of financial intermediation, or where a lack of assets limits access to bank credit (Knack and Keefer 1997: 1253). When having a time horizon, the buyer can develop a trust relationship with a seller, without formal institutions in place (Kollock 1994: 314). In order to run an informal business you need customers or investors who are willing to take the risk of buying something unauthorized, not marked by content or not bearing an already known brand. According to Luhmann (2000: 95), "[…] trust is a solution for specific problems of risk". This is highly evident in Latin America, where there is a culture for "ferias", markets, and the economic informalism is considerable (Schneider 2007b). In Uruguay, the informal economy was 36.9 percent in 2007 (Brasca et al. 2009; Lombardi 2009), which was a subject of concern for many of the interview subjects. I argue that trust is needed in the informal business for two reasons. First of all, the consumer must trust the seller's quality and price level. Trust is required because there are neither formal price regulations nor á priori security

of quality. Secondly, the consumer must trust the mechanisms of social punishment if the quality of the products appears to fail. The total lack of transaction costs for the seller, as he is doing an informal business with no fees or additional costs is based on the trust mechanism between him and the consumer. Informal business can function within such communities if the members trust each other and feel no need for formal compliance with quality measures.

Dell´Anno (2008) finds empirical evidence showing that both the informal and formal economic sectors are fruitful in Latin American countries. This is because the unofficial economy to a certain degree competes with the formal economy and forces efficiency. Informal economy is thus considered as beneficial to sustain economic growth (Dell´Anno 2008: 185). A certain positive influence of the shadow economy on the efficient functioning and development of the official economy can thus be expected (Schneider 2007b).

However, excessively close ties in transactions, or in other words abusing contacts and network for personal gains, can in some cases be called corruption. Corruption harms the economy by transferring funds from public purposes to private gain, which slows economic growth (Uslaner 2004: 5). Trust in expected to prevent such abuse of personal contacts.

Let us take the Principal agent theory (PAT) as a point of departure for explaining this. According to PAT, a principal delegates power to an agent for the agent to act in the principal's interest. This is a common form of power pyramid in any kind of democracy within states, organizations or firms. The problem occurs when the agent does not act in the interest of the principal, but rather in his own interest, or that of a person X who bribes him (Della Porta 1999). Trust between the principal and agent is thus fundamental to *avoid* corruption. If the principal does not trust his agent, he will need a bigger apparatus of control, which raises the costs of transaction between them. Consequently, trust is expected to contribute to the equilibrium between unnecessarily high transaction costs – and damagingly low transaction costs. "Social capital, measured as the extent to which people in a given society trust fellow citizens, is a significant cause of less corruption" states Bjørnskov and Uslaner (Bjørnskov 2003: 3; Uslaner 2002)[7].

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[7] Although the causality of social capital and corruption could be endogenous (an honest population that enforces the law fairly and provides little opportunity for private gain, can lead people to having greater faith in each other), Uslaner shows empirically that the causality goes from trust to less corruption (Uslaner 2002: 3).

Trust thus oils the machinery of business-making. "In short, the supply of a commodity in many respects complementary to those usually thought of as economic goods is not itself accomplished in the marketplace but rather comes as an unrequited transfer" (Arrow 1972: 346). Hence, the first hypothesis about the mechanisms that link trust and growth is:

H1: Trust lowers transaction costs.

Productivity

Labour productivity is a crucial factor for economic development (Lewis 1954; Schumpeter 1962). Thus, an increase in labour productivity promotes growth. However, the worker needs to have incentives to work harder, which first and foremost rely on his belief in higher wages, safety or other forms of benefits. The expectance of some kind of reward is precisely the core of this mechanism: If you invest in something, in this case harder work, you have the optimistic idea that it will pay off in the future, a forward looking expectation which is critically influenced by *trust*.

If the *worker* trusts his boss, and/ or trusts the legal system and the government to protect him from being exploited by his boss, this gives incentives to work harder and "invest" in more productivity per hour. Workers in a high-trust relationship are more likely to give that something extra. It promotes a positive motivational force which enhances efficiency (Sako 2006: 7). Furthermore, following the argument of trust saving time in transactions, trust in a society can be defined as the aggregate time that agents do not spend in verifying others' actions. Stated in other words, the time the agents save on securing a business can be used for production instead (Zak and Knack 2001: 303; Knack and Keefer 1997).

Thus, trust has a positive effect on productivity which in turn has a positive effect on economic growth. This transfer mechanism between trust and growth leads to the second hypothesis:

H2: Trust has a positive effect on productivity.

Investment

Zak and Knack (2001) show empirically in their article "Trust and growth" that low trust environments reduce the rate of investment. In allocating economic resources, both depositors

and lenders are exposed to risks in solving the optimization problem that normally occurs. How much these risks matter and shape the negotiating of course depends on institutions, but within that institution building, trust plays an important role (Calderon et al. 2002).

Further, in trading, when you buy something from a stranger, you do not necessarily know if this person is charging you the right price, or if the object you buy is of the quality that you are willing to pay a certain amount of money for. So why trust the seller and do the deal? Experimental studies show that people tend to trust sellers or other people even though there are no rational reasons for it (Torsvik 2003). One possible explanation is that there exist some sanctions of punishment for such cheaters: Formal institutions, such as for example security companies and judicial systems, and informal institutions such as the feeling of guilt associated with violating moral norms, 'afterlife sanctions' associated with religious dictates, bad social reputation, and loss of profits through business-related reputational effects (Zak and Knack 2001: 298). Investments occur within a social structure, and this structure determines the rewards for cooperation or penalties for deviation (Becker 1974; Zak and Knack 2001: 299).

Due to differences in both formal and informal possibilities of sanctions, social trust is expected to vary between societies and countries. If you know that the possibility of revealing or punishing a cheating seller is small, you will as a consequence trust him less. However, social networks also constitute sanctioning possibilities, as informal institutions. If a person is part of a network, the possibility of reputational sanctions is large and the person is consequently best off by acting trustworthy. Thus, there will be reasons for trusting the surroundings. Hence, trust has a twofold task in increasing investment: First, it strengthens the informal institutions, by being a resource of control and sanction mechanism. Secondly, given that the institutions are in place, trust makes you invest more and also more quickly. Both these forms of trust lead to a better environment for investment, indirectly and directly. As De la Rua highlighted in 2001, trust was fundamental in order to get Argentinean investment back on its feet. Further, Bjørnskov stresses the risk-reducing factor of social trust. High social trust can make a society more stable and predicable, which gives firms better incentives for long-term investment (Bjørnskov 2003: 6-7).

Trust also has a positive impact on innovation. People with a higher level of trust are more likely to engage in innovation processes since they believe their ideas will be listened to and

may be useful (Clegg 2002: 410). This in turn promotes investments, as many types of firms and investment actions rely on continuous technical innovation.

On the basis of this theoretical passage, I formulate the third hypothesis:

H3: Trust promotes investment.

Figure 2.2 The link between trust and economic development

```
┌─────────────┐      ╭─────────────╮      ┌─────────────┐
│             │      │    Lower    │      │             │
│             │ ---> │ transaction │ ---> │             │
│             │      │    costs    │      │             │
│   Trust     │      ╰─────────────╯      │  Economic   │
│             │      ╭─────────────╮      │ development  │
│             │ ---> │ Production  │ ---> │             │
│             │      ╰─────────────╯      │             │
│             │      ╭─────────────╮      │             │
│             │ ---> │ Investment  │ ---> │             │
└─────────────┘      ╰─────────────╯      └─────────────┘
```
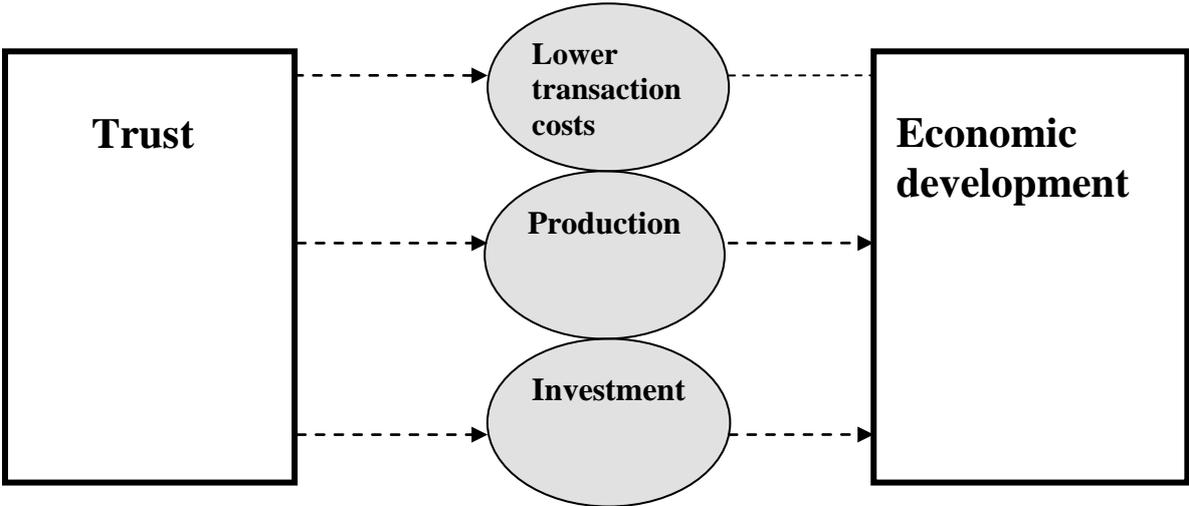
2.4.3 The endogenity issue

Endogenity refers to the problem of knowing the direction of causality. Which came first, the chicken or the egg? Stated differently, values of the explanatory variable could be a consequence, rather than a cause, of the dependent variable (King et al. 1994: 185).

Economic policy can affect the behaviour of social actors. For example, in a country with well established institutions that can secure the effectiveness of the judicial system and the police the inhabitants would probably be more trusting since, as described earlier in the theory section, trust develops better with sanctioning mechanisms in place. Following this logic, the causality of my research question is turned upside down.

The data for researching the questions and hypotheses of this thesis are collected and observed in the real world. This inhibits the total control and manipulation of variables which can be conducted in an experimental study, suitable for fully controlling the endogenity problem. However, I am not the first to investigate the explanatory power of trust on growth.

Frequently cited and well-known articles on trust have supported the direction of the causality both theoretically and methodologically (Bjørnskov 2009; Coleman 1988; Francois 2005; Glaeser et al. 2002; Knack and Keefer 1997; Knack 2003; Zak and Knack 2001; Bjørnskov 2006a). Furthermore, the theoretical expectations for my empirical investigation are clear as regards the direction of causality. All the scholars studied in this chapter, from the macro-centred approach and the community-centred approach stress the effect of trust on economic output (Bourdieu 1983; Brehm and Rahn 1997; Clegg 2002; Coleman 1988; Dasgupta 1999; Francois 2005; Fukuyama 1996; Glaeser 2002; Grootaert 2002; Neace 2004; Putnam 1993, 2000; Rothstein and Stolle 2008; Rothstein 2005; Van Oorschot 2005; Weber 1978). I thus rely on extensive theoretical work when claiming the direction of causality between trust and economic development.

2.5   Control variables

There are numerous factors that theoretically are expected to have considerable impact on economic development in Latin America, many of them with even greater impact than trust. In the quantitative analysis control variables are therefore needed. Following conventional economic development theory, the control variables are: *Population growth, Level of GDP (PPP), Investment share* and *human capital* (Barro 1997; Romer 1990; Benhabib 1994; Levine 1992; Ramey and Ramey 1995). All the control variables are expected to have a positive effect on the level of economic development. As these are included in this thesis mainly for methodological reasons, they will be dealt with in the methodology chapter.

2.6   Chapter summary

This chapter has presented the concept of social capital, and shown through a discussion of the literature that trust is a core concept in social capital theory, independent of its sources. Furthermore, the theory demonstrates that trust can be highly rational, and is expected to pay off economically, which lays the ground for the general hypothesis of the thesis: trust increases economic development. The theoretical causal reasoning behind the hypothesis is that trust is expected to lower transaction costs (H1), increase production (H2) and increase investments (H3). The general hypothesis will be empirically examined in a multiple regression analysis, before I use process-tracing to investigate the three hypotheses in a qualitative case study of Uruguay.

3 METHODOLOGY, DATA AND MEASUREMENT

In this chapter I will discuss the methodological procedures used to investigate if and how trust affects variation in economic development. According to the social capital analyst Krishna, a combination of case-study and statistical methods should be employed to study the impact of trust (Krishna 2004: 207). My point of departure is a quantitative approach, namely a multiple regression analysis, which is used because it enables an evaluation of the possible existence of a general relationship between growth and trust in Latin America. Trust is aggregated to a macro level and constitutes a national property. At the same time, I argue that the case-oriented approach is useful for exploring the mechanisms behind the causality: *How* does trust affect economic development? I select the specific case for a case-oriented qualitative analysis based on the quantitative analysis. Uruguay turns out as the country with the highest value on the most pertinent variable in the analysis, social capital. This indicates that it might be a particularly good case for tracing how the mechanisms of trust functions. As social capital is an individual micro level concept in the qualitative analysis, elite interviews are used to explore behavioural patterns among the micro level creators of economic development: Business leaders in Uruguay. Problems and challenges with both the regression analysis and the case study of Uruguay will be treated and weighted thoroughly. I will first present the methodological procedures and the arguments for my selected. Secondly, the data and the operationalization will be discussed, and finally, issues regarding bias, validity and reliability of data will be treated, as well as my strategies to overcome these obstacles.

3.1 A combination of goods

> "Research in social science should be both general and specific"
>
> King et al. 1994: 43.

There are several approaches to causality[8]. Each has affinities with different methods. Hence, in order to approach causality from different angles, the best approach is a combination of methods (Johnson 2004; Mahoney 1999; Mahoney and Rueschemeyer 2003).

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[8] Four types are explicitly mentioned by Bennett and Elmann (2006): a neo-Human regularity approach which establishes causation through constant conjunction and correlation. The counterfactual approach that compares similar worlds and asks whether differences can be attributed to a change in a particular cause; The manipulation account investigates the effects of manipulating a cause in a controlled setting. And causation that can be thought of as a process involving the mechanisms that lead from cause to effect. The neo-Human regularity requires large-n regression analysis; for counterfactual and manipulation theories the experimental research is consistent, and case studies are best in the search for mechanisms and capacities (Bennett and Elman 2006).

Both statistical quantitative studies and case-oriented qualitative studies aim to establish empirical relationships between variables while controlling for the effects of other variables (Liphart 1971). They differ in their relation between variables and cases. While the small-n case-study seeks to maximize the variance of the independent variable in a small number of cases, the quantitative study is variable-oriented, aiming at generalization to a broader universe of cases (Liphart 1971: 685-686). The most appropriate method for establishing inferences is a much debated issue (George and Bennett 2005; King et al. 1994; Liphart 1971; Ragin 1987). However, they can be both be used for inferences, and should be seen as complementary methods rather than as rival ones, and also as a *desirable mix*, mitigating the strengths and weaknesses found in single method designs to better reflect reality (Jick 1979: 602).[9] In this respect, the combination of two methods is the best choice to meet what Skocpol calls the main challenge of social science: The doubly engaged question, answering a real world question and at the same time respecting theoretical and methodological considerations (Skocpol 1979).

Whether and how trust can explain variation in economic output in Latin America is a good example of a double engaged question. First because it is rooted in the real world - the variation in economic development is of great concern to the inhabitants of a continent, and secondly because it aims to test the theory of social capital and also investigate the possible transfer mechanisms. According to Downward (2006) the best way to conduct this research is by combining a quantitative large-n study with process tracing in a qualitative case study. The quantitative approach is superior at identifying causal effects, *whether* trust explains variance in economic development, while with the case-study elaborates on *how (King et al. 1994: 84).*

3.2 The effect of causes - Regression analysis in search of causal inference

To investigate whether trust has an effect on economic development requires a complex procedure. In revealing complex relations, the qualitative method is considered superior, capable of preserving this complexity (George and Bennett 2005). I will look more closely at the causal mechanisms, but first, it is crucial to investigate whether there is a tendency of a general relationship between trust and economic growth. Thus, I use a quantitative method and a multiple regression analysis as a tool because I seek a *general* knowledge of a relationship, concerning a whole continent (King et al. 1994; Skog 2004). The tool is

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[9] Among many interesting projects where triangulation is used, see Stokes (2001) and Mendelberg (2001).

appropriate for my research question as it first of all, conducted correctly, enables an estimation of the strength of a causal relationship: To what extent does trust have an effect on economic growth? Secondly, when including several variables in a multivariate model, I will be able to determine the relationships between all variables in the analysis, and check for the effect of trust, while keeping other variables relevant for economic performance constant (Hair et al. 2006; Midtbø 2007). According to Lijphart, you "[…]cannot be sure that a relationship is true unless the influence of other variables is controlled for" (Liphart 1971: 683). Hence, the *complexity* of the question is taken into account, while giving a *general* answer.

Trust is considered as neither crucial nor sufficient for alone increasing economic output. Hence I claim "no more than that the type of independent variable in question appears to favour – make more likely – the occurrence of a certain type of outcome" (George and Bennett 2005: 190). In a regression analysis I will still be able to estimate the strength of the relationship, whether it is strong or not[10].

In a regression analysis, the effects are normally estimated on the basis of a *sample* (selection of units), made from a population (all units). Generalizing and predicting of results from the sample which hold for the whole population require significance testing to avoid identifying spurious relationships. I write *prediction* because the probabilistic relationships in social science do not permit, in contrast to nature-like phenomenon investigated in chemistry or physics, the exact *calculation* of relations. However, I use all the Latin American countries but Cuba and Haiti in my analysis[11]. These count 19 countries when including Puerto Rico. Since I aim to generalize only to the countries included, significance tests are not as relevant, because I am not generalizing to additional (unobserved) cases. For a further discussion on the

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[10] The mathematical expression of my analysis is the following:

$$Y = a_0 + b_1 X_1 + b_2 X_2 + b_3 X_3 + \ldots + b_k X_k + e$$

The ordinary least square (OLS) equation aims to minimize the sum of squared errors. This means to adjust the regression line so that it corresponds in the best possible way with the data (Skog 2004). In this equation Y is economic output, X1 is social capital and $X_{2,3}$ are the control variables theoretically expected to have an impact on economic output. e is the error term, which represents the variation in the dependent variables caused by unknown factors. The coefficients b show the effect on the dependent variable when the independent variables change one unit, with all others held constant (Hair et al. 2006; Midtbø 2007).

[11] Due to lack of democracy and instability it is challenging to conduct surveys in respectively Cuba and Haiti, and neither Latinobarómetro nor World Value Survey conduct surveys there.

importance of significance testing see among others Cox (1977), Morrison and Henkel (1970) and Cohen (1990).

My analysis is restricted to the period from 1996 to 2007 due to the limited availability of trust data. Latinobarómetro's data collection for most of the countries started in 1996. Hence I use the data from all years available. I use the mean of those years in a cross sectional model which contributes to robustness without causing unnecessary autocorrelation, and most importantly a variation caused by randomness. The reason why I do not use annual data is a theoretical one; trust is not expected to vary much over short periods of time (Portes and Sensenbrenner 1993; Putnam 1993, 2000; Rothstein 2005; Van Oorschot 2005). If there is any annual variation it is most likely random and insignificant (Bjørnskov 2006a). However, over longer periods of time, higher levels of trust should be associated with higher levels of growth and development.

I conduct the analysis in two steps. First I include the conventional economic control variables that are assumed to have an influence on economic output. In step two I include the explanatory variable, trust. This two-step procedure is done to verify if the explanatory effect of the model increases with the inclusion of trust[12].

3.2.1 Bias precautions

To prevent bias, I need to deal with some elements: *Outliers* are single units that are highly distinguished from the rest of the sample, affecting the coefficient in a disproportionate manner. *Multicolinearity* means that some of the independent variables overlap in explaining variation in the dependent variable, which makes it difficult to know which of the variables explain what. Conducting preliminary descriptive univariate and bivariate analyses before the multivariate regression will help to map out possible problems and avoid such sources of bias (Pennings 2006:152-164; Hair et al. 2006). As already mentioned, major problems of autocorrelation are avoided by aggregating time units. Other assumptions that will be dealt with are specification error, normally distribution of the dependent variable, and non-correlated error terms (Hair et al. 2006).

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[12] The adjusted R square is used as a measure of the explanatory effect of the model, as it adjusts for bias concerning the number of variables included in the analysis, in contrast to adjusted R which tends to increase with the number of included variables. However, Achen (1982) argues that the importance of R^2 could be limited and that a low R^2 does not necessarily imply a low degree of the variance explained. The criticism consists of the variances being a function of the *sample*, not the underlying relationship. This criticism kept in mind; I still think the R square information is useful.

3.3 The cause of effects - Case study in search of descriptive inference

In order to explore the underlying mechanisms of trust that might have an explanatory power on variation in the level of economic output, I use a qualitative case study. I will in the following section explain how the causes-of-effects approach is *not* a second-best strategy to be followed when circumstances do not allow the use of quantitative methods (Bennett and Elman 2006).

A huge number of studies on the effect of trust on the economy exists, but only a few emphasize the function of the mechanisms and the nature of *how* this relationship works[13] (Torsvik 2004: 266). A deep and extensive study permits close attention to the complexity of a phenomenon viz. trust and is hence appropriate in order to elaborate on explanations of the theoretically explained link (Mahoney and Rueschemeyer 2003: 305). Intensive, versus extensive, does not only refer to the number of units of analysis in this context, but also to the number of variables[14]. The fewer the cases studied, the more intensive the study may be, other factors being kept constant (Eckstein 1975: 83). I focus on the mechanism behind *one* explanatory variable in order to *go deep*, setting aside all the other explanations for variation in economic growth. While causal inferences made on the basis of one case, viz. Uruguay, have limited possibilities for immediate generalization, an intensive study offers the possibilities of detailed descriptions of the effect of social interaction and trust on economic output in this case, as well as the causal mechanisms involved (Ragin 1987; King et al. 1994; Polsby and Greenstein 1975). These can be used to generate hypotheses about the mechanisms in other cases.

Case studies, as any other method, have their strengths and limitations. In this thesis, the case study's inability to generalize should not be seen as a limitation, but rather as a trade-off between saying something general about trust and economic growth, and exploring this inference in depth (Collier 1997; Ragin 1987; Collier 1993; Mahoney and Rueschemeyer 2003; Gerring 2004). Another trade-off between the qualitative and quantitative method is parsimony versus breadth (King et al. 1994; Przeworski and Teune 1970). The parsimonious

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[13] For quantitative work on the field, see among others: (Bjørnskov 2006a, 2006b; Francois 2005; Grootaert 2002; Knack and Keefer 1997; Neace 2004; Van Oorschot 2005; Zak and Knack 2001)

[14] This is a source of debate. One critique of qualitative work is that it is subject to the same causal inference rules of degrees of freedom, but lacks an awareness of this. This concern is treated in e.g. Campbell (1975) and Yin (1981).

model is rigid and clean at the expense of richness and broadness. In my case, the complex phenomenon investigated concerns *social behaviour* and its effect on economic performance, which requires a complex explanation. Following King et al (1994: 20) "The theory should be just as complicated as our evidence suggests", parsimony versus breadth is not a question of inherent superiority, but a question of adapting theory and method to the nature of the research question. By using process-tracing I will acquire additional understanding of the complex mechanisms involved in this theoretic causality, as process tracing "[…] complements other research methods […] and contributes to theory development and testing in ways that statistical analysis cannot" (George and Bennett 2005: 207-208).

3.3.1   The process-tracing method

The process tracing method is able to identify intervening causal processes - the mechanisms that drive trust to cause an increase in economic output, in a world marked by multiple interaction effects (George and Bennett 2005: 206; Bennett and Elman 2006: 456). I thus establish causation not through comparison of cases, but by within-case research of how trust affects production, transaction costs and labour productivity in Uruguay (Bennett and Elman 2006).

I intend to be rigorous in the empirical investigation of the transfer mechanisms between trust and economic development. I thus follow Bennett and Elman (2006: 459-460) who establish some key points that make the within-case investigation more persuasive, all other factors kept constant. First, the causality should be thoroughly investigated from the beginning to the end in order to make the identification of the process more robust. I first examine the degree of trust in the mentality of business leaders in Uruguay, which constitutes the beginning of the causal chain, and then identify how this affects their companies' economic behaviour in specific ways. By carrying out interviews I manage to follow the chain from the beginning, the individual, to the end, the effect on economic outputs. However, the interview subjects could be biased due to their wish to appear in a positive light, which in turn could influence my understanding of the chain. This will be further discussed in the data part.

Secondly, the preferred processes are those with no interruptions in their causality. In a complex causality chain this is difficult to control for. Many interruptions could occur on the long road between trusting persons at the starting point and economic output at the end. However, the causality is well described in the theory, and I will seek to fulfil the requirement

by carefully reading and referring to relevant theory at each step towards the outcome (George and Bennett 2005: 30).

Thirdly, the process tracing will be stronger if the researcher is able to support the main link with diverse evidence. Within the framework of a master thesis, the number of kinds of evidence I am able to investigate is limited. However, I have conducted nine interviews, which constitute a minimum of diversity. I also support and challenge my findings with secondary data where this is available.

Fourthly, the process tracing is also stronger if the evidence is inconsistent with other alternative explications. This is highly challenging and not even desirable in the investigated process of this thesis. Also, in general, social causality is often complex and multiple (Ragin 1987). As will be shown in the analysis chapter, there are other important features that influence economic growth, and also the relationship between trust and growth. The small size of Uruguay is an example. However, I will describe the link between the trust and the economic advantages as relevant and important in comparison to other possible explanations, and also distinguish between them. This does not necessarily imply that other explanations are less important, but that social capital constitute an important variable.

Finally, I shall avoid confirmation bias in my search for explaining economic output with social trust, and also seek other possible explanations. As mentioned, this is highly evident, since trust is neither the only nor the most important explanation for economic development (Ostrom 2000: 172). The qualitative interview data material has been treated critically in order to filter out the trust mechanisms and has been carefully validated to avoid confirmation bias.

With the five key points in mind, process tracing in this thesis means to map out the existence of trust in the Uruguayan business culture, and interpret its importance in economic behaviour, decisions and possible success.

3.4 Case selection

I am developing hypotheses about causal mechanisms, which tend to be clearest in the cases with highest values on the explanatory variables (Eckstein 1975). Since the main focus in this thesis is the effect of trust, my primary concern is the value of the trust variable. Uruguay is

the case with the highest level of trust. According to the Latinobarómetro 27.3 percent of the population have high trust. However, Uruguay has the lowest level of economic growth, the dependent variable, next to Paraguay. Given the comparatively high level of social capital this is not consistent with the theoretical expectations. According to Liebermann (2005: 435), Uruguay is thus not a perfect choice, as he stresses that outliers - units with high or low values on both dimensions - are best for generating theoretical and empirical insights. Yet, I argue that the comparatively low level of growth mainly is explained by influential control variables. Furthermore, *if* the relationship between social trust and development is apparently weaker in Uruguay than in other Latin American countries, it is still an interesting case because whatever mechanisms appear to be at work they might be even *more present elsewhere* (Eckstein 1975: 119-120).

When choosing Uruguay as the case of investigation due to its level on the most pertinent variable trust, I avoid the bias caused by selecting cases on the dependent variable. Such conditional independence is important in order to avoid bias that can cause an underestimation of the effects of the independent variable (King et al. 1994: 115-117).

Figure 3.1 shows how Uruguay stands out from the sample in the most crucial dimension of this thesis, namely in the relationship between trust and economic growth

Figure 3.1 The placement of Uruguay in the trust - economic growth dimension.
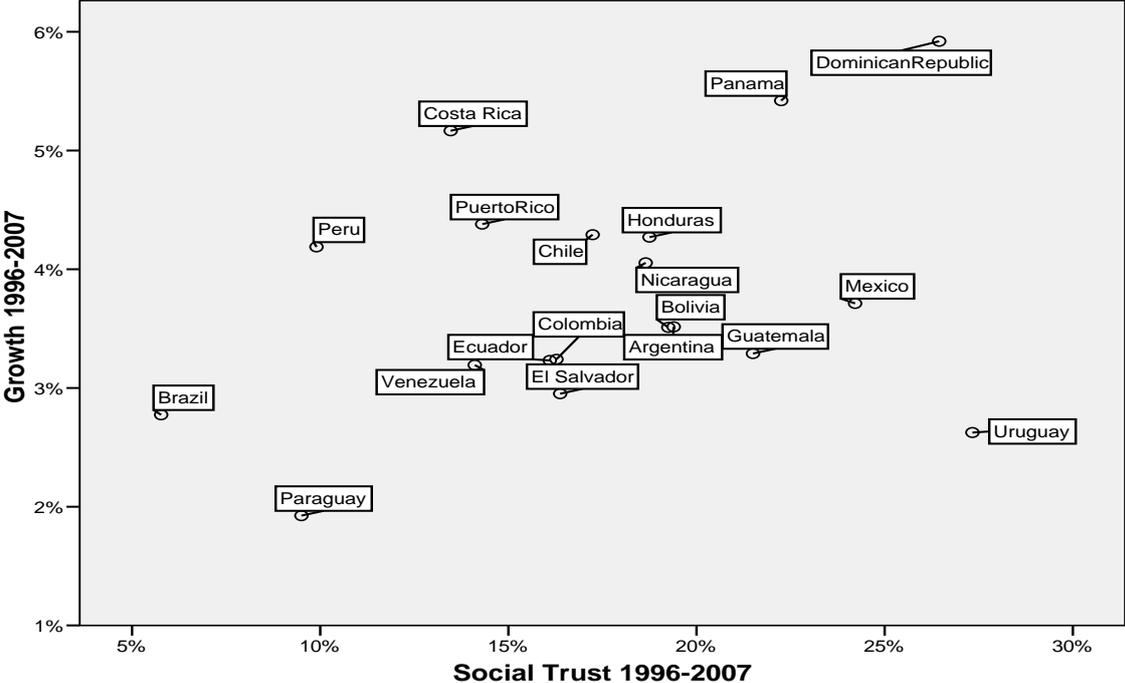
There are, however, some elements to be aware of concerning trust and its causal effect on economic development in Uruguay. First of all, Uruguay has one of the most *internationally* dependent economies in Latin America, and I conceptualize trust as a *national* characteristic. The majority of the big firms mainly export to Brazil (18.2%), China (9%), Argentina (7.1%), Germany (6.3%), Mexico (5.5%), Netherlands (4.4%), and Russia (4.2%) (IMF 2009a). The value of export in 2008 was $ 7.1 billion, which is quite high for a rather small country with a GDP in 2008 of $43.16 billion (Estadística 2009). This implies that Uruguayan business people carry out a lot of negotiation and business with foreigners, which in turn means that how trust works also depends on the level of trust in other countries. I argue that this is not a source of bias: in the quantitative analysis trust is estimated through the question "In general, do you trust *other people*?" The emphasis is added by me, to underline that the question does not specify nationality. It maps out whether you trust *people*, not Uruguayans, Argentineans or people with a certain characteristic. Consequently, the attitudes of Uruguayan businessmen still represent the trust levels of Uruguay, doing business with whomever. Also, at the aggregate level, one could expect to find levels of trust and of trustworthiness to be correlated, which implies that the trust of Uruguayan businessmen is not necessarily dependent on other countries just because of the open economy (Nannestad 2008: 415). Nevertheless, I will take into consideration that businesspeople may have more contact with foreigners and the international environment than the average Uruguayan inhabitant. For the same reason, it is also important in the sample selection that all interview subjects are Uruguayan, and that the firms they represent are Uruguayan.

Furthermore, according to the World Bank, 24.7 percent of the population lives under the poverty line. The unemployment rate in July 2009 was 8 percent, and the crime rate is characterized as quite high (Estadística 2009). Even though the country is comparatively developed in a Latin American context, it is still a developing country in a global context and has substantial social challenges[15]. This social reality is highly relevant in relation to Uruguayans´ conception of trust. They will base their foundation of trust on a different reality than Italians or Americans do, who were the original units of analysis for Putnams elaboration of the concept (Putnam 1993, 2000). Beyond awareness of the issue of conceptual stretching, which I will come back to in part 4.3, the issue of adapting my interview guide to this reality was crucial. Also, I was fully aware of this fact when I carried out my field work.

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[15] Uruguay is classified by IMF as an emerging and developing country (IMF 2009b).

3.4.1 The single case study

Comparison between two or more cases can be an advantage, highlighting differences or similarities that help to keep all other than the independent variable constant (Landman 2008). Furthermore, one may argue that maximizing the n, even in qualitative studies, gives more robust results (King et al. 1994). However, in qualitative methodology, the *within-cas*e method is highly appropriate for investigation of *causal mechanisms*. Process tracing allows inferences about causal mechanisms within the confines of *one single case* (Bennett and Elman 2006: 459). As my focus is on the causality between trust and economic development, precisely by conducting process tracing, two or more cases are neither desirable nor necessary. Comparing Uruguay with another case would not necessarily increase my understanding of the mechanisms per se. Having one single case, Uruguay, on the contrary allows a deeper and more thorough analysis. The results from the analysis could be used for comparison at a later stage.

3.5 Data

The quality of the data is crucial in order to present unbiased results. According to King et al the control of data quality should be done in several ways (King et al. 1994: 27-28, 63-65, 97-99). Data should be collected on as many of its observable implications as possible to better evaluate the theory. In order to fulfil this, I have collected both secondary and unique primary data from different sources. Primary data consist of interviews collected on a field trip. For secondary sources I use reports gathered during the field trip, as well as relevant literature found in journals and recommended from scholars in the field. This is supplemented by International Country Risk Guide (ICRG) ratings, and data from Latinobarómetro, La Pop and The World Bank. The combination of sources allows me to study the theory's many implications of the theory (King et al. 1994). My effort to comply with the requirement of presenting the process of data generation, ensuring validity of measurement, and making replicable analysis will be presented below. First I describe the process, before I discuss validity.

3.5.1 Quantitative data generation

The data for the quantitative empirical section comes from three different sources, the Latinobarómetro, The World Value Survey and the World Bank.

Latinobarómetro is cross-national and contains survey data ten years back in time on 17 Latin American countries. The Dominican Republic was added to the survey in 2002. Latinobarómetro is inspired by World Value Survey and European Social Survey, focusing on changes in attitudes, values and trust in democracies, institutions etc (www.latinobarometro.org). It is a non-profit NGO. The data are based on personal interviews with a random sample of approximately 19000 persons per year representing over 400 million people[16]. I use Latinobarómetro because it is the most complete survey dataset on Latin America with relevant variables. Where Latinobarómetro lacks data, data from the World Value Survey are supplied.

There are some elements to be aware of when carrying out surveys in developing countries in general and Latin America in particular. These include the de facto freedom of speech, the poverty rate, literacy, infrastructure and linguistic diversity in the sample. The Latin American countries differ from each other on in his respect, although the freedom of speech with respect to the questions treated in Latinobarómetro is assumed to be good in the whole sample. There are great differences between the countries concerning their political situation. Some of the countries included in my analysis can be considered as having been authoritarian during the period of analysis (1996-2007)[17] (*The world bank, wdi online* 2007). The poverty rate is a much bigger source of bias since it is difficult to interview very poor people both because of access to slum areas and because of lack of census data. In Rio de Janeiro in Brazil approximately 30 percent of the population lives in "favelas", many of them too dangerous for an interviewer to enter. Nevertheless, poverty and literacy are taken into consideration as the data are weighted on education due to an over representation of well-educated people. The geographical representation has in recent years been good, following the actual demographic distribution of the inhabitants in each country. For example, in Bolivia, in 2007 64 percent was urban population and 36 percent rural. The sample for the survey is thus distributed proportionally. However, during the initial years of the survey, sampling in many countries was urban-biased. All the interviews are carried out in the official language of the country. This is also a potential source of bias as many of the Latin American countries included have indigenous groups of people who speak poor or no Spanish/Portuguese.

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[16] The technique of personal interviews realized by going from door to door has the advantage of a higher response rate. However, it violates the sample criteria of randomness and may cause bias by over representing people who want to participate in survey activities.

[17] Mexico, Colombia, Peru and Paraguay scored below 4.5 on a scale 1-7 between 1996 and 1999 on Freedom House democracy classification.

The interviews are carried out by professional firms in each country. The economic data is from the World Bank, which is widely used all over the world by scholars and researchers and considered to be reliable and suitable for comparisons.

3.5.2 Qualitative data generation

I got the primary data sources for the qualitative part of the thesis from interviews and reports carried out on a field work trip to Montevideo, Uruguay, over 3 weeks in August 2009. I did nine interviews during my stay: Seven with directors or subdirectors of big firms in Uruguay, and two with interest-organizations for the private business sector[18]. All interviews were carried out in Spanish. This was a clear advantage as the interview subjects felt more secure and were able to express themselves in their mother tongue. Also, I think they felt closer to me as an interviewer speaking Spanish, showing knowledge of and interest in their country.

Arranging interviews on this topic by emailing to Uruguay from Norway proved difficult. I received a list of the biggest firms (in economic terms) from The National Chamber of Commerce of Uruguay, but with no contact information. Although I did manage to get in contact with a few relevant persons before I left for Uruguay, we did not make fixed appointments with time and date. Once settled in Montevideo, the personal contact made things easier. I used a snowball sampling approach to get relevant interview objects. This means that the interview objects themselves gave me recommendations and contacts to other relevant firm leaders (Thagaard 2009). This sample method is not problematic on this occasion since the sample is strategic, not random (George and Bennett 2005; Gerring 2004).

The interviews were semi-structured. The reason for this is that semi-structured interviews are appropriate for the in-depth knowledge which I was seeking (Patton 1990). I used an interview guide (appendix 1) which I followed, though not rigorously. For example, it often happened that I changed the order of the questions if the interview subjects touched themes related to upcoming questions, or I asked follow-up questions in order to clarify issues and answers. On some occasions I did not have to ask all the questions, as the person himself brought up the relevant topics. Also, if the interview subject chose to speak about an interesting topic not included in the guide, I followed it up. There were also occurrences where the interview subjects talked about topics that were somewhat irrelevant as well. I tried

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[18] See the complete list of interviews in table 3.1.

not to intervene too much in order to make him/her at ease and not to be rude, but at the same time, it is important that the interviewer sets the agenda for the conversation (Kvale 2008). Mapping out trust is not controversial or sensitive at this level of analysis. I did not ask questions that were perceived as very uncomfortable or threatening in any way and the interview subjects were quite relaxed. However, the interview subjects always wanted to give a good impression and appear in a positive light, which may be one source of bias in such data. The possibility of going to Uruguay and conducting interviews in Spanish, gave me unique first-hand data.

Why Business leaders?

One can think of many interesting interview subjects for mapping out how trust affects production, investment, transaction costs and labour productivity in Uruguay. However, this is a master thesis, and interviewing is a quite time-consuming activity. I thus had to limit my sample and try to make it as relevant and informative as possible. All the theoretical elements mentioned above are found in the everyday activities of a firm or organization of any kind. Business directors can have a significant impact on economic growth and the well-being of their communities (Neace 2004: 706). If the firm or organization deals with a big sum of capital, the amount of capital affected by the transmission channels will in turn be greater, which thus has a greater impact on the economy than a firm dealing with small sums of capital. My logic for choosing the biggest firms in Uruguay as my sample is thus the same as choosing Uruguay as a case: The units with the clearest and most explicit characteristics will give me the most information. Furthermore, the impact of the mechanisms in larger firms affects the Uruguayan economy on a larger scale.

Table 3.1 Interview subjects and their position

Name	Position	Date
Ana Laura Fernandez	Consultant in the National Chamber of Commerce and Service	10.08.09
Ignacio Bartesaghi	Consultant in the National Chamber of Industry	11.08.09
Gualberto Muñoz	Director of Human Resources, Zenda Leather, tannery	12.08.09
Isidoro Hodara	Director, Zonamerica, free trade zone	13.08.09
Nicolas Jodal	Director and Founder of Artech, soft ware	13.08.09
Marcelo Lombardi	Director of Tres Cruces Shopping and Bus Terminal	17.08.09
Elbio Fuscaldo	Director of Pelsa, clothing factory President Chamber of Clothing	18.08.09
Jose Luis Rial	Financial Director of Conaprole, dairy	21.08.09
Moises Maman	Director of Hisud, wool factory, President of The Uruguayan Industrial Textile Association	21.08.09

3.5.3 Bias in the data material

The reports from the national Chamber of Commerce, the national Chamber of Industry as well as the documents from the firms, can be biased in trying to present Uruguay and the firm in a positive manner, defending their interest. Also, *the access* to second hand sources can be a potential source of bias. It is more difficult to access controversial material. The fact that Uruguay had presidential elections in October 2009, shortly after my interviews were conducted, also influenced both reports and my interview subjects. It happened more than once that my interview subjects turned their responses into political speeches supporting their preferred candidate, which was almost exclusively the opposition candidate. The fact that I am Norwegian, coming from a developed country, might also have influenced their reluctance to transmit the reality of their less developed country. Moreover, another source of bias in qualitative interviews is the desire to answer the right thing, in other words leaving a good impression of him/herself and the company to the interviewer (Ringdal 2001). It was thus important that I kept a poker face during the interview not revealing my expectations or preferences, but at the same time encouraging the person to continue speaking and to feel comfortable. A second concern in this matter was my presentation of the purpose of the interview. The interview subjects must be treated with respect and given information about to

whom he/she is talking. This is an ethically important issue. Nonetheless, telling too much about my hypothesis could bias the answers.

The reliability concern is more challenging as regards my primary data, since I will never know if the interview subjects would have given the same answers to a different interviewer. However, "for reliability to be calculated, it is incumbent on the scientific investigator to document his or her procedure" (Kirk 1986: 72). I taped and transcribed all the interviews. As regards reliability, although time-consuming, transcribing is preferable to summarizing or writing down key words, as it leaves the material in its original form unbiased by the researcher (Silverman 2006: 227). To meet this concern, all the interviews are transcribed in their original language, Spanish, which leaves little room for personal interpretation, and I used secondary literature to challenge or support the results. Finally, none of my interview objects are anonymous. This opens the possibility of contacting the interview subjects if that is seen as desirable or necessary. Also, they need to stand totally responsible for the information given as they are identified by name. The requirement of reliability is easier to fulfil concerning the statistical data. All the data are available at the Department of Comparative Politics at the University of Bergen, and the dataset for this particular analysis is available from the author.

3.6 Measurement

3.6.1 Social trust in general

Measuring complex social phenomena like trust requires a thorough consciousness (Sartori 1970) both with respect to definitions and empirical indicators. Nannestad (Nannestad 2008: 416) argues that there are many different understandings of the term social capital, and putting them all into the same bag does not tell much about the merits of one theoretical concept over another. I have discussed different understandings of social capital in chapter 2, concluding that general trust is the main indicator of the concept in quantitative studies. I do agree with Nannestad on the importance of knowing exactly what you intend to measure[19]. However I do not think this consciousness conflicts with using a general trust indicator, a view which is well defended in the literature. I follow the work of quite a wide range of scholars (Cox 2009; Fukuyama 1996; Knack and Keefer 1997; Putnam 2001; Van Oorschot 2005; Zak and Knack

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[19] Generalized trust is an exact and concrete measurement. In this context this is preferable to an index established by different kinds of trust which almost always will be less specified. Using an additive index inhibits the exact interpretation of which indicator explains what of the variation in economic growth.

2001; Bjørnskov 2006a) – measuring general trust with the survey question "In general, do you trust other people or can you never be too careful?" In Latinobarómetro and World Value Survey this is a dichotomy, where 2 is no trust and 1 is full trust. I use the aggregated mean of all years available with trust data, and supplement with data from the World Value Survey in some countries poorly covered by Latinobarómetro[20].

There is a validity problem with the generalized trust question asked in Latinobarómetro. This validity problem is typical for any survey: The room for personal interpretation and different understanding of a question. Given that A trusts B concerning a specific issue X, the question does not give room to the replier for specifying those relations, consequently, it is up to each replier defining B and X, and the variation in interpretation among the sample may exist (Nannestad 2008: 416-417). This challenges the possibility for comparison. Furthermore, almost nobody trusts nobody or everybody. With a dichotomy where 1 indicates high trust and 2 low trust, it is difficult for the interviewee to answer this question in a nuanced way. Hence the chance for randomness and limited reflection in the replies increases (Ringdal 2001). Nonetheless, the question is usually found to be a good indicator of what is intended to be measured at an aggregate level, since national social trust scores have proved to be a fairly valid measure of honesty, trust and trustworthiness (Uslaner 2004: 12; Bjørnskov 2006a: 9). Moreover, Knack shows that the scores on this question correlate with the share of wallets returned in the experiment of wallet drop arranged in big cities around the world (Knack and Keefer 1997). Cox, Ostrom, Coleman et al. also conclude that this measurement of trust is appropriate when the experiment is of an economically relevant size, in this case on the aggregate country level (Cox 2009).

3.6.2 Economic development

The growth rate of each country, which is the yearly change in percent of GDP, is the measure of economic development applied here. This is a traditional and acknowledged approach to development. I use the mean growth from 1996 to 2007 in order to achieve more robustness. The data is from The World Bank, a much used data source which covers a wide range of variables, years and countries. Growth rates of values are computed from constant price series, and rates of change from one period to the next are calculated as proportional changes from the earlier period (The World Bank 2009).

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[20] The mix of data from those sources has been done by for example Bjørnskov (2002, 2009). As the scale and question are identical, there is no problem comparing the two.

Many small contributions are necessary for an increase in GDP of a country. The macro economy of Uruguay rests on decisions and attitudes of a lot of single individuals, running large or small firms, and/or negotiation on behalf of them. Economic output is thus not only the growth in GDP of a country, but all the small pieces that contribute to this growth. In the qualitative analysis economic development is operationalized as any output or gain that is fruitful for a company, which *directly* or *indirectly* contribute to growth in GDP. Such a broad empirical definition is appropriate because it captures more variation and organizes a big amount of data (Andersen 1997: 70).

3.6.3 Control variables

In order to avoid an omitted variable bias, the inclusion of all relevant variables in the analysis is an important assumption to be met in regression analyses (King et al. 1994). Thus, in order to investigate the effect of trust on economic growth, it is necessary to control for other possible effects on growth, since trust is expected to have a rather small effect.

When investigating literature that uses growth as dependent variable, I find diverging practices. There seems to be no theoretical consensus on which, or how many, variables should be kept constant while conducting statistical investigations on relationships between growth and other variables (Levine 1992). Some state that over 50 variables have been found significantly correlated with growth (Levine 1992), while others uphold parsimony as the primary concern, allowing few explanatory variables (Przeworski and Teune 1970; Achen 1982). I intend to take care of validity and parsimony, as well as theoretical considerations of expected effects. However, as my analysis is only based on 19 countries (units), the inclusion of many variables would drastically reduce the number of degrees of freedom (Perotti 1996: 12-13) [21]. I hence use the four most conventional variables that are proven to affect economic growth: Population growth, investment share of GDP, human capital and level of income of a country (Ramey and Ramey 1995).

Population growth is expected to have a positive effect on economic growth (Barro 1997; Levine 1992; Ramey and Ramey 1995). Operationalized, it is the rate of growth in the population in the Latin American countries, over a given period. The variable in my analysis is the mean of annual population growth from 1996 to 2007. Population numbers in the World

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[21] The degrees of freedom refer to the relation between the number of variables and the number of units (Skog 2004).

Bank data are either current census data or historical census data extrapolated through certain demographic models.

Investments share of GDP is operationalized as the level of the investment share of GDP per capita. This variable is expected to have a positive impact on growth. Borenstein (1998) argues that investment is an important vehicle for the transfer of technology, while many promote it simply as an engine for psychical and human capital, which in turn affects growth positively (Aghion et al. 1999; Berkowitz 2003; Coatsworth 2008; King 1993; Loayza 2005; Solimano 2005; Solow 1994; Todaro 2000).

Human capital is included in the analysis on the basis of the presumption that an educated labour force is better at creating, implementing, and adopting new technologies, thereby generating growth (Romer 1990; Knack and Keefer 1997). Differences in human capital should thus affect the growth rate of a country (Benhabib 1994). Human capital is measured by secondary school enrolment in the population.

Level of Gross Domestic Product is the last control variable included in the analysis. It is identified by Ross Levine and David Renelt as one of the important control variables for cross-country growth equations (Levine 1992; Ramey and Ramey 1995). It refers to the mean of the market value of all goods and services made within the borders of a country between 1997 and 2007 (*The world bank, wdi online* 2007).

3.6.4   Social trust in Uruguay

The definition of a concept should be more inclusive, or "thicker", in a qualitative analysis since the purpose of the qualitative analysis is to get a broader and more complete picture of a phenomenon (Geertz 1973). Hence, social capital refers to sources of and indicators of generalized trust as showed in figure 3.2. The inclusion of sources is done because trust in many cases is hidden and implicit in actions or attitudes that *create* trust. An example is a network or a group that works together. This network has a positive effect on their ability to negotiate with each other because they have developed a general trust towards each other. Hence it is not the group that directly creates this positive environment; it is the trust stemming from being in a group.

Functional institutions can also be trust-generating. The presence of a judicial system which people can rely on has a positive effect: You do not trust a person (or an agency) to do something merely because he says he will do it: you trust him because you know the consequences and sanctions of his possible dishonesty (Dasgupta 2000: 51). Indicators of trust thus refer to groups, networks, institutions or other trust-generating elements. Consequently, in operationalizing social capital, I follow the main approaches of Putnam, who emphasizes the creation of trust at community level enhanced by networks and group activities, and Rothstein, who sees trust as a product of institutions and policy (Putnam 1993, 1995; Rothstein and Stolle 2008). In table 3.2 I also briefly present my understanding of the transfer mechanisms.

Table 3.2 Operationalization for qualitative analysis

Variable	Operationalization
Social capital	Trust and the sources of trust, which are networks and institutions.
Economic output	Economic output refers to any economic gain both for the single company and for the macro economy of Uruguay.

Transfer mechanism	Operationalization
Transaction costs	Transaction refers to an agreement carried out between two or more persons, exchanging goods, services or other items of value. The costs of transactions are thus the costs of participating in this exchange/ agreement.
Labour productivity	Labour productivity is the amount of goods and services that a labourer produces during a given period of time (*The world bank, wdi online* 2007). It can refer to not only a person, but also a firm or a country.
Investment	Investment is a choice made by an individual or a firm to place (or borrow) capital in a product or other element of value (O'Sullivan and Sheffrin 2003).

3.6.5 Measurement validity and reliability

Validity refers to the accordance between what a person intends to measure and what he actually measures (King et al. 1994; Sartori 1970; Silverman 2006). Does my measurement of social capital fit the theoretical description of the concept? This is a major concern in social science, and particularly with a concept like social capital. To deal with this challenge, I have looked thoroughly at the social capital theory, with special emphasis on the methodological considerations – how has former research measured social capital? I also asked the interview objects several questions regarding different kinds of trust, in order to see if there is consensus among the interviewees.

Validity is of concern both in a qualitative as well as in a quantitative analysis. Adcock and Collier underline the many advantages of establishing shared standards of validity for quantitative and qualitative scholars. Substantial progress can be made in formulating shared standards for assessing measurement validity as the consciousness around validity in the two disciplines are closely connected (Adcock 2001: 529). I will thus treat the validity of both the qualitative and quantitative measurement together. The measurement of social capital poses the greatest validity challenge of this thesis. By measurement validity I do not mean the theoretical discussion of what social capital really is. Rather, it relates to the consistency between the concept and the empirical observations of social capital.

Trust is a person's subjective feeling and hence almost impossible to compare interpersonally. It is also culturally dependent, which makes it difficult to make comparisons between countries. Including countries from a big and diverse continent as Latin America in the analysis thus creates problems for measuring variables in a consistent way across countries. The fact that several of these countries are developing and poor countries makes the possibility of measurement error even bigger (Barro 2000: 11). Moreover, as a personal and value- oriented element, trust can easily be influenced by surroundings known or unknown to the data collector, as well as the current situation of the respondent or the interviewer. However, as I have already discussed in the measurement section, this is always a concern with survey data, and does not mean that one should stop measuring complex and subjective concepts, as there are tools available for facing these challenges.

First of all, to compare different sources and measurements in the existing literature in the field is crucial. There are numerous studies on the link between economic pay-offs and social

capital. Having read a wide range of literature on operationalization of social capital, I have found that it is a common and well-tested practice to use the general trust indicator for measuring trust. Secondly, familiarity with the case of Uruguay and the theory is another way of facing the challenge of trust. Going to Uruguay and get access to relevant reports etc on the topic contributes to familiarize with the case. And thirdly overlapping with the second point, I use interviews to acquire further knowledge on the issue and to ensure that my understanding corresponds to theirs. The interview subjects answered several questions regarding trust on different levels and consequently contributed to a broader picture.

Nonetheless, I emphasize carefulness in balancing the interpretation of the statements of the interview objects, not over- or underestimating the meaning of them (King et al. 1994). This is important as I do not wish to *stretch* the concept of social capital. Sartori stresses that concepts do not necessarily travel well. Applying the concept of trust in a "new" continent involves the risk of stretching it, at the risk of loosing intensity and distinctness (Sartori 1970). "New" because the theoretical framework of trust was developed based on empirical studies in Italy and later in USA. Nevertheless, I have already stressed the importance of using trust as an explanatory variable of economic output also in Latin America as well. Moreover, the risk of conceptual stretching is diminished by conducting a case study since closeness to the case helps me to define and observe the phenomenon with accuracy.

4 QUANTITATIVE ANALYSIS

In this chapter, I will report my empirical findings and comment on them in the light of the hypothesis drawn in section 2.4.1 from social capital theory: *Social capital has a positive effect on level of economic development in Latin America.* I will first briefly present descriptive statistics on the variables included, before I comment on the results and the regression model and its implications.

4.1 Preliminary quantitative analysis

Table 4.1 Descriptive statistics

	N	Mean	Std. Deviation	Minimum	Maximum
Growth	19	3.8	1	1.9	5.9
Social trust	19	17.4	5.6	5.8	27.3
Population growth	19	1.5	.50	.30	2.4
Level of GDP PPP	18	6862.2	2920.2	2144.4	11906.5
Investment share	19	20.1	5.9	10.9	32.4
Human capital	18	73.8	15.3	44.2	104.1
Total	19				

My dataset includes 19 countries. *Level of GDP PPP per capita* and *Human capital* lack one observation, which is Puerto Rico. This is due to the calculation of purchasing power parity (PPP). An international dollar has the same purchasing power over GDP as a U.S. dollar has in the United States. However, the rankings of The World Bank include only those economies with confirmed PPP GDP estimates, which Puerto Rico does not have (*The world bank, wdi online* 2007).

The standard deviation for the dependent variable *Growth* is 1 and the mean is 2.8 between a maximum level of 5.92 and a minimum level of 1.93. This indicates a normal distribution. It is crucial for the regression analysis that *Growth* is normally distributed as it is the dependent variable in the analysis (Pennings 2006). The mean level of *growth* between 1996 and 2007 is highest in the Dominican Republic, while the minimum value held by Paraguay. In spite of the apparently normal distribution of growth, I ran a DFbeta analysis to check for influential cases. The DFbeta analysis determines that the Dominican Republic is almost on the limit of being characterized as too influential (Long and Freese 2006). However, I do not exclude it from the analysis. As my analysis is based on few units, I prefer not limiting the analysis´ coverage (Hair et al. 2006: 76). The standard deviation is defined as the squared root of the

variance, referring to the diffusion of units. More precisely it is the mean deviation from the mean. The standard deviations of the control variables are all acceptable, as well as the DFbeta analysis.

The mean of 17.4 in *Social trust* indicates that there is a big majority who believes that most people can NOT be trusted. The original question is a dichotomy; hence the aggregated values show the answers on the trust-category in percent: 17.4 percent as the mean percent of the trusting people on the continent. Brazil, with 5.77 is the least trusting country, and in Uruguay, which holds the maximum value, 27.3 of the population trust other people. Nonetheless it is not very high. Evidently, no country in Latin America has an over-abundance of trusting people. In the case of social trust, the standard deviation is 5.6 while the mean is 17.4, which indicates a normal distribution.

4.2 Bivariate analysis

The Pearson correlation between *Population growth* and *level of GDP PPP per capita* is -.515, significant at a 5 percent level. This is not surprising, as growth in the population of developing countries will affect the amount of gross domestic product divided on this same population (Coale 1958; Mankiw et al. 1992: 407). *Human capital* also correlates at .68 with *population growth*. A high correlation implicates difficulty in distinguishing their explanatory power on variation in the dependent variable. As a consequence, their joint influence will be less than the sum of their separate influence on the dependent variable. The Persons R of .68 and -.515 is not very high, but I will keep a careful eye on the tolerance values in the multiple regression analysis (Hair et al. 2006: 230).

The unstandardized coefficient of a bivariate regression of the effect of *social trust* on *growth* shows that if social trust increases by one unit, growth increases by .58 units, which is significant at a 17 % level when no control variables are included. A small sample enables a more liberal significance threshold, as is 17 % (Hair et al. 2006; Morrison 2006). However, as my sample equals the population, the significance level is of less importance.

Table 4.2 Bivariate regression analysis

	B	St Error	Beta	P-value
Constant	2.76	.74		.002
Social trust	.58	.04	.33	.17
N: 19	Dependent variable: growth			Adjusted R square: .055

4.3 Multivariate regression analysis

Table 4.3 Model 1

	B	St Error	Beta	P-value	Tolerance
Constant	-1.88	2.41		.446	
Population growth	.68	.57	.33	.249	.496
Level of GDP PPP	6.90E-005	.00	.197	.419	.668
Investment share	0,123	.04	.73	.005	.816
Human capital	.02	.20	.32	.297	.419
Total					
N: 18	R2: .515	Adjusted R2: .366			

Table 4.4 Model II

	B	St Error	Beta	P-value	Tolerance
Constant	-5.73	2.46		.038	
Social trust	.09	.03	.497	.021	.729
Population growth	1.33	.53	.64	.027	.392
Level of GDP PPP	4.51E-005	.00	.13	.524	.657
Investment share	0,119	.03	.71	.002	.814
Human capital	.04	.02	.64	.038	.342
Total					
N: 18	R2: .695	Adjusted R2: .568			

Model I, table 4.3, contains only the control variables for the model, while social trust is included in model II, table 4.4. This is done to consider the possible change in the explanatory power of the model when including social trust. The adjusted R square increases from .366 to .568 when including the explanatory variable. The adjusted R square of .568 indicates that predictions of the values of individual cases on the basis of the regression model is quite high, as .568 is considered as an high explanatory effect in social science, and even more when conducting research with survey data. All variables but one are not significant in model 1, but turn significant when including trust in the model, except level of GDP PPP. This could also have an effect on the adjusted R squared. The increase in the adjusted R squared in model II, together with the results of the bivariate regression, gives support to the general hypothesis of the thesis: *Social capital promotes economic development.*

The sample size of this research should be subjected to special considerations, as it is one of the most influential elements in a regression analysis concerning the strength and generalizability of results (Hair et al. 2006: 194-195). With a sample of only 19 units, which equals the small population, the inclusion of control variables should be done with caution to prevent too few degrees of freedom. Including 5 variables in a model with 19 units means decreasing the power of the analysis (Hair et al. 2006). Also, by having too few degrees of freedom, I risk making the model too specific to the precise sample. However, there is a kind of trade-off between the theoretical and methodological considerations. At the expense of

parsimony and sufficient degrees of freedom, comes the theoretical assumption that other variables are needed when analysing causes of variation in economic growth. As social trust is expected to have a modest influence on growth, the model should include crucial control variables peeling of some effects. Being aware of the limited possibility of generalization and power of the model (Selvin 1957), I still argue that important *tendencies* can be read out of the results. Furthermore, social trust is shown to have an effect on the level of growth that is significant at a 17 % level when no other variables are included.

Tolerance is a measure of collinearity. Hair et al (2006: 230) mentions .1 as a liberal tolerance threshold, but argues that an absolute number of an acceptable tolerance value is problematic, as it will always be a matter of *degree* of collinearity, dependent on sample and other considerations. I operate with a .3 limit, which is quite strict. All the variables included exceed this level.

All the variables except Level of GDP PPP are significant at a 5 percent level. They have positive substantial effects, which is according to the theoretical expectations. This means that an increase in investment share of GDP, human capital (education), and population have a positive effect on growth. I will not further comment on the *effects* of the control variables here because the effect of social capital on economic growth is the main focus on this thesis. The level of the control variables is however relevant in explaining the low growth level in Uruguay which I will comment on in the next section. Ultimately, and most important, social trust has a positive significant effect on economic growth. The unstandarized coefficient for social trust is .09, which means that one unit increase in trust gives .09 unit increase in growth. This strengthens the general hypothesis*: Social capital has a positive effect on the variation in economic development in Latin America.* This justifies a qualitative study of how this relationship holds.

4.4   Why low growth in Uruguay?

In section 3.4 I pointed at Uruguay having comparatively low economic growth, theoretically unexpected given the level of trust. Does the comparatively low economic growth in Uruguay indicate a weakening of the theoretical expectation of trust as growth-promoting? I argue that it does not. Since some of the control variables in the analysis are expected to influence growth, and to a greater extent than trust, it is relevant to take a closer look at their level in order to explain the comparatively low growth rate.

First, Uruguay, followed by Puerto Rico, has by far the lowest *population growth* of the Latin American counties included in the sample, with a mean of .27 percent per year from 1996 to 2007, visualized in figure 4.1. As mentioned, population growth is expected to influence the economy positively, and can thus be one explanation for the comparatively low mean growth of 2.63 percent in Uruguay. The regression analysis of the Latin American countries showed that population growth had a significant positive effect on growth.

Figure 4.1 Population growth 1996-2007

Population growth
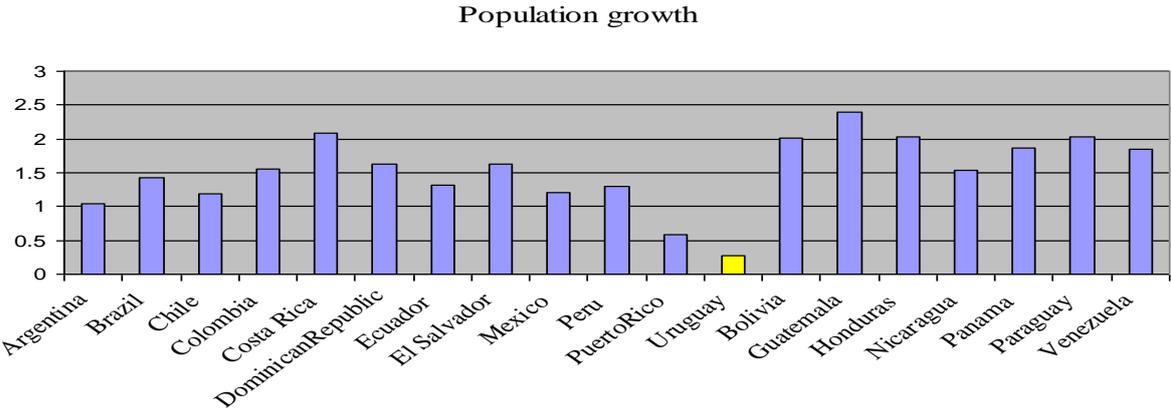
Furthermore, figure 4.2 shows that the investment share of GDP is also comparatively low in Uruguay. Only Bolivia has a lower investment share of GDP among the sample. Investment is a necessary vehicle for the technology development, which is crucial for the economy to grow (Borensztein 1998). This variable also had a significant strong positive effect on growth in the quantitative analysis.

Figure 4.2 Investment share 1996-2007

Investment share
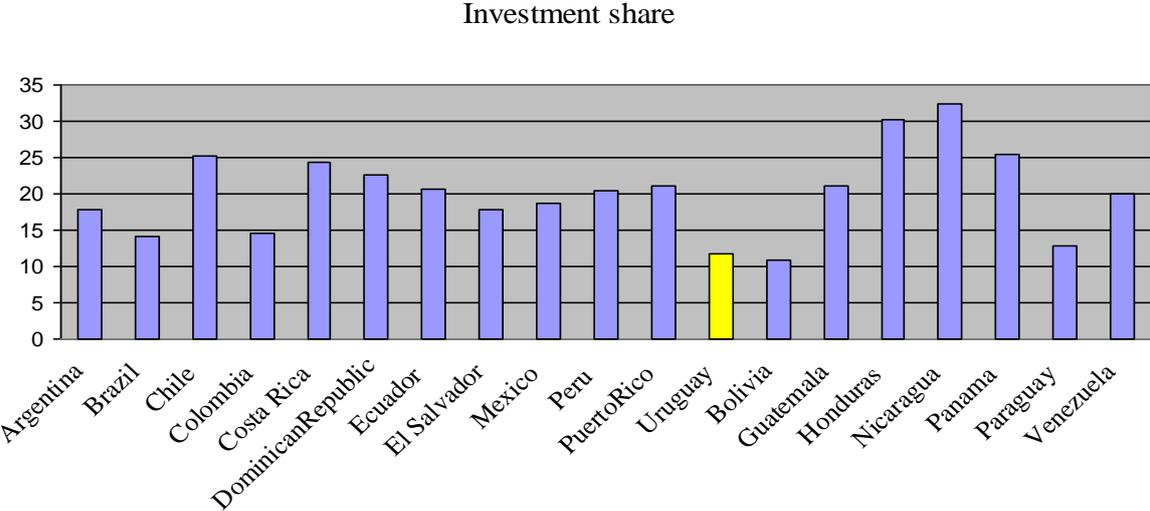
The level of GDP in Uruguay is not comparatively low. On a scale from 11082 in Chile to 2144 in Nicaragua, the mean level of GDP in Uruguay between 1996 and 2007 is 8924.5. Uruguay thus seems to be quite well off, in spite of the low growth during the last ten years. There is not a consensus in the economic theory whether level of GDP has a positive or negative effect on growth. The convergence theory explains low growth exactly by the richness of countries; if they have a high GDP they grow more slowly, however, it is criticized for not gathering much empirical support (Romer 1996).

Figure 4.3 Level of GDP (PPP) 1996-2007

Level of GDP
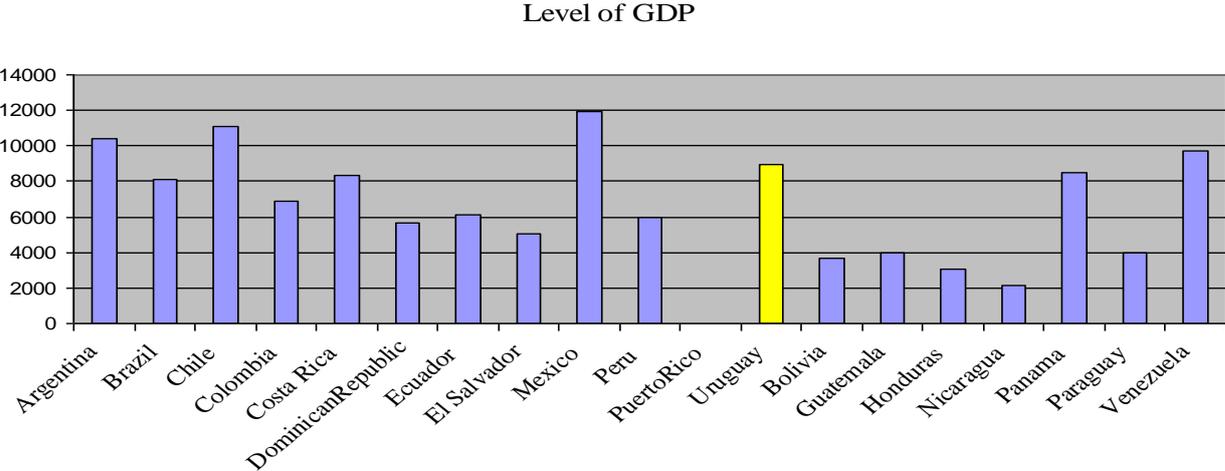
Human capital on the other hand seems to run the growth engine together with social capital in Uruguay. Next to Brazil, Uruguay has the highest social capital in the sample. As underlined by some of my interview subjects, Uruguay has a skilled labour force which attracts foreign investment (Bartesaghi 2009).

Figure 4.4 Level of Human Capital 1996-2007

Human capital
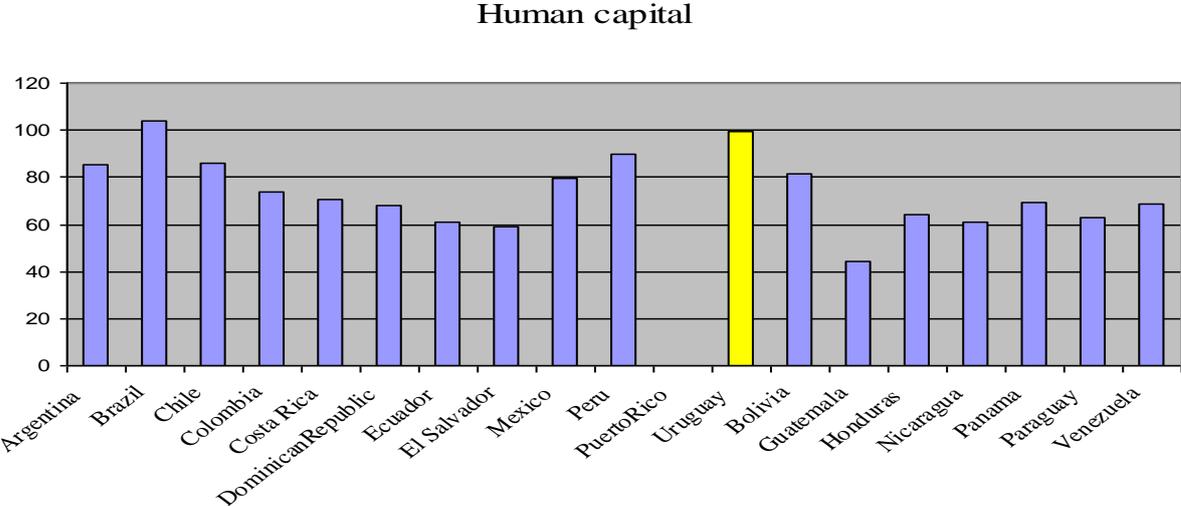
The purpose of this discussion is to highlight that Uruguay is a relevant case for investigation. Intuitively, the high trust level and the low growth rates can give the impression that the transfer mechanisms do not work as they are expected to. Instead, according to the tables above, it seems that the control variables explain the comparatively low growth. As such, taking the effect of the control variables into account, Uruguay still stands out in the sample, but not as a case where the mechanisms of trust necessarily not give economic outputs. The pertinent dimension of this thesis is affected by the significant effect of other variables. As George and Bennett (2005: 122-123) state, many contextual factors must be taken into account.

4.5 Concluding the analysis

The significant positive effect of social trust on growth supports the overall hypothesis and research question of this thesis: Social trust *is* good for economic development in Latin America. This strengthens the theoretical claim that trust is an economic promoter and producer of a societal good (Putnam 1993, 2000; Rothstein and Stolle 2008; Rothstein 2005).

The empirical support for a general relation between social trust and economic growth justifies the case study of Uruguay for investigating how the mechanisms behind this relationship work. With the highest trust level in the sample, it is suitable for tracking the impact of trust. The analysis also shows that the control variables seem to explain the comparatively low economic growth in Uruguay. Overall, the tendencies concerning trust revealed statistically will be traced using first hand data from interviews in Uruguay and hence contribute to a more robust analysis.

5 QUALITATIVE ANALYSIS

Although "gathering hard data is indispensable, the qualitative aspects of social capital should not be neglected. In many respects, it is something of a contradiction to argue that universal measures can be used to capture local idiosyncratic realities"(Woolcock 2001: 79). I have carried out a qualitative analysis, and preserved the local complexity and characteristics of the concept following Woolcock, tracing the processes of transmission between trust and economic gains based on first hand data from qualitative interviews that I conducted in Uruguay. According to the statistical analysis, trust is highly present in Uruguay, and the comparatively low economic growth seems to be mainly explained by low values on influential control variables. I aim to see how individuals shed light on why and if these mechanisms are functioning in the way they are theoretically supposed to do. As presented in section 3.5.2, the interviews were conducted with representatives from seven large firms in Uruguay and two interest organizations; the Chamber of Commerce and Service, and the Chamber of Industry.

The analysis chapter is organized according to the three hypotheses elaborated in the theory chapter: The effects of trust on *transaction costs, investment* and *labour productivity*. While all forms for social capital are essential for development, none of them are sufficient in and of themselves (Ostrom 2000: 172). Therefore, throughout the analysis intervening variables on the relationship between trust and economic output, such as the size of Uruguay, will be dealt with.

5.1 Trust lowers transaction costs

The theoretical expectation of this section is that trust leads to economic benefits through the lowering of transaction costs (Collier 1999). On the basis of the theoretical discussion, I initiated the interviews with the expectation that certain patterns of behaviours would result from trust. My first assumption was that the smoothness of contract-making can lower the costs of transaction. Less time spent and less documentation and bureaucracy needed means economic gain for the company.

Secondly, transactions will take place more frequently with the presence of trust. According to Luhmann (Luhmann 1979), trust is a risk-reducing factor and it thus could make society more stable and predictable, which would ease transactions and enable firms to undertake

longer-term commitments. Trusting the surroundings makes the road to contracts shorter. I also study how this road could be too short, ending in informal economic activity. In other words, a close business network where the participants trust each other could as a consequence make them skip the formal contracts and move into informal economic activity. Ultimately, I will comment on corruption in relation to trust and transactions.

5.1.1 The advantage of trust for large firms

I divide the advantages of trust in lowering transaction costs according to the size of the companies, as tendencies from the data reveal that this matters.

Ana Laura Fernandez represents the National Chamber of Commerce. She states that the Chamber senses a culture of trust and knowing each other among the business people in Uruguay (Fernandez 2009; Bjørnskov 2006a: 7). This is mainly because Uruguay is a small country where "everybody knows everybody", which almost promotes a kind of forced trust environment (Fernandez 2009). She does not reply affirmatively when I ask if it lowers the use of written contracts. As unwritten contracts have a negative connotation and might be associated with corruption, it would be rather radical to admit such a thing. Also, I suppose it is not very likely that firm leaders would give information about informal contract-making to The Chamber of Commerce. Instead, Fernandez describes the trusting culture as a form of control mechanism for the contrary. It is difficult to cheat or play unfairly, since the network of firms is so transparent due to the small size, and the fact that firms are inclined to follow formal rules. Accordingly, her statements lead to the conclusion that networking and trust among big firms do not lower transaction costs in terms of resulting in informal business arrangements. This is supported by the fact that none of the seven firm leaders said they had made transactions with unwritten contracts.

However, the ease of contract-making highlighted by Zak and Knack (2001) does not necessarily mean skipping formal contracts. The financial director of Conaprole[22], Jose Rial, expressed explicitly that he is more likely to make contracts with people he knows than with people he does not know, given that the conditions of the agreement are not favourable with the unknown person (Rial 2009):

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[22] Conaprole is the national cooperation of milk producers, which historically has been the main exporter of products in the Uruguayan economy. Today it is a leading dairy producer for Uruguay and the neighbour countries.

> "If I have two economically similar offers, and I know one of the persons better than the other, I surely end up making the contract with that person. I prefer to concretise with whom I know, who I am sure has a good reputation, has satisfied others with his contracts, and with whom I am closer" (Rial 2009) [23].

It is thus not the lack of contracts, but the road towards the contracts that is promoted by networks and trust: He uses less time on formal negotiations. Consequently, it pays off for Rial to have a network because it saves time and thus lowers transaction costs early in the deal-making process, but not at the contract stage. Furthermore, given that you have reasons for trusting those with whom you are conducting business, there will be less questions and requirements for documentation in order to conduct the transaction. Fuscaldo highlights that this is important for him when doing business:

> "My experience is, that in Uruguay, no one even thinks about requiring a balance sheet when transacting, and if someone asks for it, you just turn your back and leave the room. The transaction in the commercial sector thus functions much more fluidly than the transaction in e.g. a bank which has to follow the procedures" (Fuscaldo 2009).

As such, these tendencies in the data support the theoretical expectation of contract making being easier with the presence of trust. In relation to Zack and Knack's experiment on the consumers trust in brokers mentioned in the theory section (Zak and Knack 2001: 296-297), the researched Uruguayan business environment seems to function in a similar way. There is an informal agreement that you do not require bank balances, as Fuscaldo said. As the environment is small, you still have a form of control as the reputational sanction possibility is present.

A second expectation drawn from the theory is that personal connections or former experience with possible partners promote a trust experience that will ease transactions (Bjørnskov 2006a). As Uruguay is small, networks are established easily, which creates trust. The general director of the main bus terminal and shopping centre in Uruguay, Marcelo Lombardi, explicitly states that:

> "The network of relations contributes to the ease of making deals" (Lombardi 2009).

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[23] All quotations are translated from Spanish by the author. The original transcriptions in Spanish are available on request.

He explains this by the size of the business community. You always have a friend or a friend of a friend who can help you find the trustworthy partner, and thus save time and resources you would have spent if you had to do this formally. Also, he states that access to the desk of whoever is possible.

> "If you need to talk to an important politician that is normally not a problem" (Lombardi 2009).

The fact that the director of a big firm states this highlights the easy access to bureaucrats and state institutions. My interviewees would probably never admit that they have excessively close relationships with representatives from control organs, and neither did I ask if they had. The information given by Lombardi indicates that first of all, it is absolutely possible to have close relations with bureaucrats, and secondly, this possibility is widely known and accepted. Easy access to persons with high positions is supported by my experience as an interviewer. Data collection for this thesis was made possible thanks to business directors in Uruguay being so easily available for me. The snowball sampling method functioned well, as it tends to do if the relevant group of people knows each other (Grønmo 2004).

Networking as a creator of trust is present in Uruguay, whether it is forced by the transparency because of the small size or not. The data show that trust lowers transaction costs by facilitating business, and by facilitating the creation of a possible channel of influence toward politicians.

Still another function from the second expectation that personal connections will promote transactions (Bjørnskov 2006a), which I trace in my first-hand data, is the facilitation of the *creation* of a firm. Nicolas Jodal is the director and also the founder of Artech, the largest software firm in Uruguay. He highlights that the establishment of a new business is eased by networks of contacts.

> "Although you would always confront obstacles, such as a big bureaucracy, high taxes, and extensive regulation when establishing a new business, the network to some extent eases those processes" (Jodal 2009).

Jodal did not elaborate on this statement, and thus did not specify which processes had gone more smoothly. Nevertheless, it is easier to deal with the bureaucracy concerning permissions and rules if you know the bureaucrat. As Lombardi openly claimed:

> "Getting on to anybody's desk is easy in Uruguay" (Lombardi 2009).

The size of the country explains the close networks that my sources were part of, and size can even be an explanation for easy transactions. However, it does not change the theoretically expected causal order: The size of the country creates business communities, which in turn contribute to explain the amount of trust. Thus, trust is the proximate explanation of why it is possible and preferable to make contracts with already known people, and/or why it is not possible to play unfairly within a given community.

5.1.2 Trust and informalism for small firms

The discussion so far has focused on the experiences of large firms in Uruguay. However, much of the Uruguayan economy is based on the economic activity of very small companies, and trust plays a different role for them (Fernandez 2009). The experience from these small firms also seem relevant for highlighting the third theoretical assumption for transactions costs being reduced with trust: That the informal business, such as markets, is promoted by trust.

The representative of the national Chamber of Industry, Ignacio Bartesaghi, largely agrees with Fernandez, Lombardi and Rial on trust playing a controlling role as mentioned in previous section, but goes on to indicate that not all economic actors share that experience:

> "I don't think the degree of informalism regarding contracts is very high. I don't consider
> that as likely. But yes, in many small firms they base their informal economic activity on
> the contacts they have, although that does not happen in the well established and serious
> firms" (Bartesaghi 2009).

I argued in section 2.4.2 that trust is needed in informal business for two reasons. It is first of all needed between the transacting parts because informal business has no formal price regulations or a priori security of quality (Kollock 1994). Secondly, the consumer trusts the mechanisms of social punishment if the quality of the products appears to fail. Is this reflected in the empirical data?

The big, established and well known firms that have a broad public reputation to take care of seem to follow the formal transaction rules. The small and trusting environment is, as mentioned, an incentive for this. However, small and often family-driven enterprises with around 2-10 employees are numerous in Uruguay and more resource-consuming for the government to control (Hodara 2009; Fuscaldo 2009; Fernandez 2009; Bartesaghi 2009).

The reality among these kinds of companies can thus be quite different. Informal networks in the commercial sector are frequent and well functioning, but operate for some firms to an exaggerated extent. By using the word exaggerated, I refer to informal networks producing an informal economy: the informalism in Uruguay counts 33.3 percent of the total economy, according to the report "La informalidad en Uruguay: Diagnosis y propuestas" (Brasca et al. 2009) [24]. This number refers to the firms running all their total economic activity outside the formal frame. Firms may also carry out informal *acts* although their main activity is registered and within formal frames.

The report, and also secondary literature in this field, point to taxation and regulation policies and the unemployment quota as the main forces driving a shadow economy (Schneider 2007b). The size of government spending and the lack of incentives from the government are also connected explanations (Fernandez 2009; Hodara 2009; Fuscaldo 2009; Brasca et al. 2009; Schneider 2007b). In addition, Fernandez highlights the strict rules concerning for example indexes of content and packaging implemented by the current government.

> "Another element that heavily influences the firm owner is one regulation after the other
> from the government. These are obstacles that end up increasing the price of the activity.
> For example the importation of toys, which causes a lot of work concerning tags after
> importation" (Fernandez 2009).

This falls into the long list of other bumps in the road that a manager needs to deal with, and which "makes life impossible" for them (Fernandez 2009). However, Johnson, Kaufman and Zoido-Lobatón (1998) find that the unofficial economy accounts for a larger share of GDP

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[24] In a comparative Latin American perspective, Uruguay does not suffer from a disproportionate high level of informality (Schneider 2007a: 25).

when there is more corruption and trust in the rule of law is weaker. In accordance with this argument, I find that *trust* has a role to play in enabling the unofficial economy.

This trust mechanism that enables informalism stands in contrast to the mechanism that *prevents* the informalism mentioned earlier, making the environment transparent and easy to control. Jodal emphasizes that informalism is common at one stage in a firm's development, based on the contacts in your surroundings (Jodal 2009):

> "I think there is a strong correlation between the size of the company and the degree of informalism. Practically all Uruguayan firms start with a high level of informality. You don't have anything written when you start, and you don't follow the rules, because you always *have a friend or a contact"* (Jodal 2009).

It might seem that I, in formulating the hypotheses, have overstated the importance of trust in explaining informality. In many cases people go to informal markets because they simply do not know the formal rules yet or need to lower the cost of living, regardless of trust (Lombardi 2009). Seeing no other choice, they start selling and working outside the legal market. Also, according to Olson they get a too small advantage from contributing to the collective good (Olson 1971: 35): "The larger [companies] bear a disproportionate share of the burden of providing the collective good. The smaller [companies] by definition get a smaller fraction of benefit of any amount of the collective good they provide than a larger member, and therefore have less incentives to provide additional amounts of collective good". Still, trust *enables* such activity.

However, although this point highlights that there is hardly ever trust *instead of* other elements or trust *alone* that can explain the possibility of lowering transaction costs, trust is a contribution, an oiling of the machinery, an X-factor that enables the already existing possibilities. Hence, it is in accordance with the social capital theory which claims that trust plays a role in decreasing transaction costs. First of all as a control mechanism for visible firms playing their game well and preserving their good reputation, and secondly, in the informal production activities, making the distribution of products with no formal guarantee possible.

5.1.3 Benign informalism?

Given that trust plays a somewhat positive role in the functioning of the informal economy, is it indirectly damaging for the macro economy of Uruguay? Dell´Anno (2008) states that the informal economy is considered beneficial for sustaining economic growth because the unofficial economy competes with the formal economy and forces efficiency (Dell´Anno 2008). A certain positive influence of the informal economy on the efficient functioning and development of the official economy thus cannot be denied (Schneider 2007b). Also, it will lower the de facto unemployment rate. In the absence of formal work, many seek to make their living inside the informal economic sphere.

None of my interview subjects mentioned any positive effects that the informal economy may have, which is understandable and somewhat obvious since they all work within the official economy. They focus on informality as a problem, mainly caused by the current government – probably because they disagree with the current political rulers.

It is necessary to reflect on the background and the agenda of my interview objects. All of them, except one, stated explicitly that taxation in Uruguay is too high and constitutes a negative incentive to the business culture in the country and for the country as a whole. The tax level was an issue that was used as an explanation of many evils in society, and seen as an important cause for corruption, informalism and a poor investment culture. As such, the effect of networking or knowing each other (too) well was totally overshadowed by the focus on shortcomings in the tax policies of the current government. When interpreting these statements, it is relevant to bear in mind that there were, as mentioned in the methodology chapter, presidential elections two months after I conducted the interviews, and that Uruguay then had a leftist government[25]. Even though they all knew that I was not qualified to vote in Uruguayan elections, I think they still argued from the conservative side of the political landscape trying to inform me about their view of the best interests of the country. Fernandez was explicit about the opposition position of the Chamber of Commerce, and Lombardi did not hide his negative attitudes towards the leftist presidential candidate, Jose Mujica (Fernandez 2009; Lombardi 2009).

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[25] Tabaré Vasquez was the president of Uruguay for the leftist-wing coalition Frente Amplio until these elections. He was the first president from this party in Uruguayan history, and was elected on the 31st of October 2004. On the 29th of November José Mujica was elected the new president of Uruguay after a second round. He represents the same party. Mujica won against the opposition leader Luis Alberto Lacalle.

5.1.4 Trust and Corruption

"People who have faith in others are more likely to endorse strong standards of moral and legal behaviour" (Uslaner 2002: 2).

The last assumption explained in section 2.4.2 regarding hypothesis 1: trust lowers transaction costs, is that trust between a principal and an agent is fundamental to avoid corruption, including in transactions (Bjørnskov 2003; Della Porta 1999). And corruption harms the economy, by transferring funds from public purposes to private gain (Uslaner 2004: 5). What is the culture within firms in Uruguay with regards to corruption? It is complex and difficult through interviews to find out whether an agent acts in the boss´ interest or his own. As corruption per se is a negatively loaded concept, one could not expect admittance of corrupt actions within a company through identified interviews such as those conducted for this thesis. However, the subjective perception of the corruption level in society is crucial for how people act, as a principal or as an agent. If the perception of corruption is high, there is a general reason for not trusting people, and one can expect a certain level of corruption in almost every firm. If, on the other hand, the general opinion is that the corruption level is low, the trust is expected to increase correspondingly. Why? Because where there is much corruption, the costs of *not* acting corruptly would be high, while in societies with low corruption a corrupt action could be heavily punished, both by law and reputation.

The subjective corruption level in Uruguay is seen as comparatively low according to most of my interview subjects, with the majority of them using Argentina as a comparative reference and point at that country as an outstanding example of high corruption rates. Fernandez from the Commercial Chamber stresses that customs are the biggest problem of corruption concerning her Chamber. Letting illegal goods pass in exchange for small bribes is very common. However, the government has received a loan from the Inter-American Development Bank in order to reform the customs bureau. Furthermore she states:

> "I tell you about this kind of corruption because concerning the corruption level within
> the government we are doing well. Uruguay is not a country characterized by corruption.
> It is not like corruption cases always appear. But once in a while you hear about them,
> still it is not common. And when they appear, everybody gets to hear about it"
> (Fernandez 2009).

Citations from the responses by Bartesaghi, Muñoz and Jodal highlight the same tendencies:

> "There is some corruption, but comparatively we are not bad compared to Argentina for example" (Bartesaghi 2009).

> "There is corruption, but there is also control. I trust the Uruguayan government more than the Argentinean for example" (Muñoz 2009).

> "The phenomenon of corruption exists, but you do not by far face it every day. I think that the spirit in the business world is good and something that we need to preserve in Uruguay. I think the corruption in general exists on a micro level, like avoiding traffic fines, but I do not encounter more serious situations" (Jodal 2009).

The level of corruption seems to be perceived as quite low, but probably not only due to the level itself, rather due to the cases of comparison they have in mind. In Latin America Uruguay seems well off in corruption measures, although they all admit that it exists. As mentioned, the subjective *perception* is what is mapped out here, since it says something about the climate of trust. Lombardi sheds light on this:

> "A priori [of a business] I trust that I will not have any difficulties of corruption from the State in order to realize the business or investment. This is not taken into consideration in a single moment of a decision – which illustrates that corruption is not perceived as a problem for the business community in Uruguay, like it is in Argentina, in Ecuador, surely in Venezuela and also in Brazil" (Lombardi 2009).

Again, the size is a plausible partial explanation of the transparent environment, and the division of small and big firms is evident also concerning the frequency of corruption. All my respondents know and represent the big business environment. How corruption is perceived in other environments within the same country has not been investigated in this thesis.

The role of trust as a mediator for preventing corruption is strengthened by the small size of Uruguay.

5.1.5 Section summary

Hypothesis 1: trust lowers transaction cost, finds support in the analysis conducted. In large firms networks of trust function on the one hand as a control mechanism for following formal

rules, on the other hand, they facilitated these formal procedures. Trust minimises risk, and spending little time on documentation and risk-minimizing elements when transacting lowers costs. Within the small firms of Uruguay, informal acts and also informal business occur. It is challenging to investigate the topic of informalism through interviews, since systemized informalism is illegal. However, trust seems to facilitate informalism in the sense that trust networks make it possible. As Jodal said: "You don't follow the rules, because you always have a friend or a contact" (Jodal 2009). Trust between a principal and an agent is fundamental to avoid corruption. I looked for the perceived corruption level among my respondent in order to investigate this mechanism, and in their opinion it did not seem very high. The comparatively high level of trust in Uruguay found in the quantitative data from Latinobarómetro thus gains some support in the qualitative data and supports hypothesis 1.

5.2 Trust promotes productivity

On the basis of the theoretical expectations outlined in section 2.4.2, I tried to map out how the existence of trust in the Uruguayan companies could have positive effects on productivity.

The reasons for the worker to produce, and also for sticking with the same company, are emphasized. In accordance with the theory (Sako 2006), could I trace that the directors had any motivational elements of trust in their tools for promoting productivity? I find that incentives for working hard in the investigated firms in Uruguay seem to be connected to trust, but not necessarily in the sense of trusting in receiving an extra reward. Rather, trust in the safety of maintaining the same employment, in other words, *having a job* seems crucial for productivity to increase. With the financial crisis of 2001/2002 in mind where the unemployment rate reached 20 percent, trust in preserving a monthly income appears to be the core incentive of the mechanism for the majority.

5.2.1 No need for rewards?

One of the main sources of trust is as mentioned networking and grouping together, as trust is a network-mediated benefit (Bourdieu 1983). When describing the Jewish jewellery market in Buenos Aires in section 2.6, I emphasized the role of the community network in the enclave as crucial for their success. Such a network can also be created in the workplace, although not based on the members sharing the same religion or ethnicity. Rather, class identities can function in a similar manner. In Marx's analysis of emergent class consciousness in the industrial proletariat, workers learned to identify with each other and

support each other's initiatives (Marx 1998[1894]). This trust-relation was not something coming from a culture outside, or from each workers personality, but an emergent product of a common fate (Portes 1998). Consequently, there exist some tools for the employer in order to lay the grounds for this feeling of fellowship, increasing the trust environment at work and consequently the overall productivity. One of those tools can constitute any form of social activity outside the regular work activity in the firm, or other activities that can make the workers feel part of the same unit.

Among the business leaders in Uruguay there seems to be a lack of awareness of this. In Fernandez´ opinion firm leaders are mostly myopic, solving the challenges on a day-to-day basis, which contrasts with investing time and resources on non-obligatory activities. Human resource philosophy requires the capacity for long-term thinking (Fernandez 2009). Bartesaghi strongly agrees and calls human resource policy non-existent in Uruguay, at least in the Chambers experience.

> "No, no, no. The field of human resources in the companies, or even something corresponding, is non-existent. That form of mentality is very rare. In Uruguay we have had some cases of companies with a good human resource policy, but they have been influenced by multinationals. At the local level we do not have that custom" (Bartesaghi 2009).

The few cases of this kind of conscious thinking about creating a feeling of fellowship at work have come from multinational companies, not from Uruguay (Bartesaghi 2009). However, these two respondents, who represent the chambers of commerce and industry, are far more negative than the firm representatives themselves in this concern. This is not too surprising, since the firm representatives want to give a good impression of their company and thus show that the well-being of their employees is being taken care of. Also, when asking a question where an affirmative answer seems to be the right answer, you can get a kind of confirmative bias.

All the firm representatives gave some examples of engagement in their company concerning non-work activity. Muñoz from Zenda mentions two football teams within the company, although they now, after the global financial crises, play without the economic support of the company. The economic support had earlier covered all the costs related to training, even contributions to bus tickets in order to get to the practices etc.

> "We have two football teams. They now play without much economic support. In some periods we covered everything for them, even the bus tickets to the practice. Now we have a very low social budget" (Muñoz 2009).

The employees of Tres Cruces shopping centre and bus terminal receive a present on their birthdays, and their kids also get school-related gifts when school starts each year. Other social gatherings like going out for a drink etc are mainly initiated by the workers themselves. The director, Lombardi, tried to emphasize the fact that the employees are already so busy that he did not want to bother them with more activities after work. In the greatest free trade zone in Uruguay, Zonamerica, there are several benefits for the employees in the companies within the free zone. Isidoro Hodara, who is the Director of Zonamerica, highlights family days or birthday celebrations as examples. However, factors that are more crucial for the working climate at Zonamerica, are simpler and of a more day-to-day character. Nice places to have lunch where the boss sits with the other employees, well developed surroundings, and promotion of the free trade zone as a good place to work are as well important.

> "There is something important in the everyday of the workers: Everybody that visits Zonamerica always says "how nice!", "What a good place to work". This strengthens the spirit of the workers" (Hodara 2009).

Hodara as such shows an understanding of the importance of these factors in order to maintain a stable labour force. The fact that an employee can sit down for lunch next to the boss is, according to him, an important feature of the open lunch areas. He states explicitly that he thinks this has a positive effect on the employee.

Nicolas Jodal, the Director and founder of Artech which is located within Zonamerica supports the information from Hodara, also by highlighting nice lunches as the most important trust-building and team-building factor for his firm. However, the environment in Zonamerica which is highly influenced by international firms is not typical for most Uruguayan enterprises. Also it is a business and technology park, not an industrial park, which means that many of the employees have higher education. In the clothing factory Pelsa the reality is quite different. Situated in the quite poor industry zone, La Teja, the family-

driven company has employees with other expectations and backgrounds. Director Elbio Fuscaldo does not offer any spare-time activities for his employees.

5.2.2 Trust in economic security

Whether the mentioned activities had any pay-off in the promotion of productivity as the theory expects, was difficult to confirm. The interview subjects did not always understand what I had in mind when asking for the motivational pay-offs. Good colleagues play football together, and maybe go out for drink once in a while, but an institutionalized social environment at work did not seem familiar to all my respondents. For the ordinary Uruguayan worker, a substantial economic risk seemed to be the loss of a stable income. Trust as a risk-moderator is thus important with respect to the employer's ability to offer a safe working place, and not so important with respect to the theoretical expectations outlined, that trust in rewards for investing in working harder is necessary for increasing productivity. There are primary concerns that are more urgent in order to achieve trust to enhance productivity, than rewards or fellowship/ownership relations to his/her work. The primary concern is closely related to the overall economic situation of the country and the unemployment rate. In Uruguay the unemployment rate has been rather high the last 8 years due to the financial crisis in 2001/2002, although decreasing during the last few years, before the new financial crisis hit in 2008. In the Americas Barometer 2007 from LaPop, as much as 62 percent of Uruguayans state the economy as their main concern among 20 choices of concern grouped in categories as security, politics, basic services and others (Boidi and Queirolo 2008) [26]. In second place comes security, with 15.5 percent.

The perception of a somewhat low socioeconomic security in Uruguay is also underlined by data from International Country Risk Guide (ICRG). ICRG is an in-depth researched analysis based on elite opinions of the potential risks to international business operations. The system enables various types of risk to be measured and compared between countries. Incorporated economic risk factors are loan default, delayed payment of suppliers' credits, political leadership, inflation and international liquidity ratios. The socioeconomic measure is an assessment of the socioeconomic pressures at work in society that might constrain government action or fuel social dissatisfaction ("International country risk guide" 2006).

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[26] Latin American Public Opinion Project (LaPop) is an extensive study of democratic values in America. The Americas Barometer is one of their activities in this work. The 2008 round for Uruguay is included.

Unemployment, consumer confidence and poverty are the components here [27]. On a twelve point scale where 12 is the best, Uruguay is rated with a five in 2006, which is the newest data freely available to the author. The mean for the latest ten years is 4.7. This shows that there is a considerable risk perception around the socioeconomic situation of Uruguay, which affects the labour market. And as mentioned, high risk perception indicated that trust is low. For comparison, Argentina scores 5.2, and also has the same mean value for the last ten years. The risk perception in the two countries is thus almost identical.

The difficulty in obtaining a secure position in the labour market thus seems to be the biggest risk-perception given the socioeconomic conditions. Consequently, the initiatives needed from an employer in order to increase productivity as such centres around the feeling of security, rather than on material benefits. This does not reduce the importance of trust in the mechanism. On the contrary, it makes trust the core to a greater extent because it is not a bonus or other benefits that is necessary for the worker to increase the effort, it is trust in the employer.

Fuscaldo in Pelsa supports the idea that trust in his capacity to offer secure employment is of great importance to the workers in order to keep up their production and stay on in the firm. He actually states that he prefers employees with lower education or few other possibilities of employment, because they tend to have lower expectations to return of their efforts (Fuscaldo 2009). Thus, less is required in order to increase their production.

> "If I have to choose between an unemployed person and a person with a job, I stick to the unemployed. If I have to choose between a person with high or low skills, I try to hire the one with low skills so that he can have time to grow and develop within the firm. The person I surely would not choose is the one with a job and with perfect skills, since he will be quickly bored and quit" (Fuscaldo 2009).

He believes that these two factors contribute to a higher trust relation between the employee and him. Or in other words, the employee to a greater extent is dependent on Fuscaldo and does not have much background for comparison. A crucial reason for Fuscaldo stating this, is the structure of Fuscaldo`s factory. He is the owner of a family business, similar in structure

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[27] ICRD is an acknowledged database and according to the ICRG, its risk ratings have been cited by experts at the IMF, World Bank, United Nations, and other international institutions (Hoti 2004: 556)

to of many other Uruguayan businesses. There is thus a limit to how far an employee can reach in professional terms. He can never reach further than the son or daughter of the owner, independently of effort and contribution.

> "No one gets above the boss, and there is no one that can make themselves the son of the boss in order reach the top. The hierarchy is well established" (Fuscaldo 2009).

Fuscaldo's reasoning is that a very qualified employee will be bored since he has few opportunities of advancement in the business. A bored worker will furthermore produce less, and will probably sooner or later quit. The worker no longer believes in some kind of reward. It is an employer's task to retain the employee's trust in that he/she will receive something back in order to increase effort.

Fuscaldo's thinking goes somewhat against the second theoretical expectations behind hypothesis 2 concerning trust and production: Zak and Knack stress that one function of trust in relation to labour is time that agents do not spend in verifying the labourers' actions. The boss does not need to supervise his workers, because he trusts that they do a good job (Zak and Knack 2001: 303). When Fuscaldo thus prefers an unskilled labour force which he has to train and supervise, he loses time which he could have spent on other activities. Although this only concerns one respondent in my data material, the aspect is somewhat omitted in the theoretical reasoning on trust's role in receiving rewards: The reward does not necessarily need to be something material, it could be promotion within the business. As there is no possibility of this in Fuscaldo's family business, he compensates by hiring employees with sufficiently low expectations.

On the other hand, the family structures as such can contribute to an attitude that keeps down an environment of ambitions, which in the long run is negative for economic development of the firm. I will come back to this point when discussing *Hypothesis 3, trust is good for investment.*

Some of the respondents seem afraid of giving a cynical impression when it comes to motivating the workers. Taking care of the employees is good, but admitting that this is a conscious strategy from the firm because happy and trusty employees produce more, is not

pronounced – or it is not conscious. On a follow-up question concerning programs to motivate employees at work, Gualberto Muñoz from the large tannery factory Zenda responded:

> "We do not think like that. For us, the life quality of the worker is most important, not their motivation to work or not" (Muñoz 2009).

However, motivation and well-being are not contradictory factors as it seems from his answer, but rather closely connected. The whole mechanism rests on the latter leading to the former. Muñoz´ answer, and somewhat defensive attitude, highlights what Fernandez in the Chamber of Commerce and Service initially claimed that the human resource consciousness is not very developed in Uruguay.

Social responsibility does not necessarily mean motivational programs or creating environments where the workers will thrive. Social responsibility can refer to the company's fulfilment of the *societal* responsibility of society. Muñoz emphasizes Zendas contribution to the education of the employee's children, Lombardi underlines the various contributions such as food tickets on birthdays, or pencil boxes for the children when school starts, which go to the families of his employees (Lombardi 2009; Muñoz 2009). This is in accordance with the point underlined by Hodara, the worker needs to feel that he contributes to an important firm, or a good firm or a big firm (Hodara 2009). The firm needs to have some positive characteristics. Thus, the environment within the workplace is not the only tool for motivation; the pride in the company is also motivational.

5.2.3 Section summary

For the ordinary Uruguayan worker, a substantial economic risk will be the loss of employment and consequently the loss of a stable income, or in the words of Bartesaghi (2009): "The Uruguayan is satisfied by little". Trust as a risk-moderator is thus important with respect to the employer's ability to offer a safe working place. All the respondents, except for two, mentioned non-work activities within their companies; although it did not seem like an institutionalised mentality among them. The directors working in the international free trade zone differed from the others by showing greater awareness of this topic. Whether trust in a safe employment contributes to increased productivity proved difficult to map out. However, the companies investigated in this thesis are all doing rather well economically, and as such, their strategy of offering something safe and predictable seems to have pay-offs. Accordingly,

the hypothesis has gained support. However, in order to produce a more robust analysis, this mechanism could have been further investigated by interviewing workers. Due to the time restrictions of this master thesis, this was not done. The theoretical mechanism is, as is the nature of theoretical explanations, strictly simplified, but it seems to function, though apparently different, in a developing country such as Uruguay.

5.3 Trust promotes investment

"Uruguay has a good environment for trade, but not for investment" (Bartesaghi 2009).

Connected to the hypothesis of trust reducing transaction costs is the hypothesis that claims investments will increase with trust. The core of both is trust as a risk-reducing factor (Luhmann 2000). You are more likely to invest if you trust your investment partner. You are also more likely to find an investment partner if you trust your surroundings. Although Uruguay has the highest level of trust in Latin America, I find that the average Uruguayan does neither seem like a risk-managing person nor as an innovative one. The tendencies among the answers from the interview subjects show that their perception of Uruguayans is that they like to play safe. Hence, trust does not seem to function as a risk reducing factor for the Uruguayan to create new businesses and being innovative, or, trust does not have an effect. On the other hand, the respondents think Uruguay is considered as a safe and trustworthy partner for international investment, and thus an attractive trading partner for the international market.

5.3.1 Attracting foreign investment

I start with the latter point, Uruguay as safe and trustworthy for foreign investment first. According to Ignacio Bartesaghi, Uruguay has a well-functioning rule of law which people can rely on, and the country is also quite politically stable. Following the theoretical expectations, such functional institutions constitute a trust-promoting sanction mechanism and a source of trust (Rothstein and Stolle 2008), because people can believe that bad behaviour will be punished. In this respect, sanctions and trust are additives, since sanctions limit the risk involved in trust. Institutions are an example of risk-limiting sanctions at macro level, while networks, which function along the same logic, as they can constitute *informal social* sanction mechanisms, work on micro level (Humphrey 1998: 33). The core in both is, as mentioned, that trust in others is promoted by the environment around you because this

environment notice if you act untrusting, whether comprised of people (networks) or institutions (police etc) (Becker 1974).

Fernandez, along with Bartesaghi, claims that there is an overall trust in the government institutions in the population of Uruguay (Fernandez 2009). Nonetheless, the view of trust in having your rights preserved by public institutions and legal framework can diverge between the employer and the employee. Fernandez draws an example:

> "On one hand, the renovation of the law concerning collective negotiation for labourers is seen as a step backwards from the point of view of a firm owner. It makes him loose control over the possibilities of regulating strikes, as a tool for bargaining salaries etc which should be his, according to the right of property. From the employee's point of view, the law of collective negotiation increases the trust in institutions because the law secures him the right to influence the conditions of his work" (Fernandez 2009).

In spite of such sources of variation, a consensus in the data material seems to exist, that trust in the government and legal institutions is common. This is supported by survey data from Latinobarómetro which shows that 52 % of the population in Uruguay has a lot of trust or some trust in the government and 56% has a lot or some trust in the judiciary on a four point scale (Latinobarómetro 2007). This is rather high compared to the neighbouring countries. In Argentina 23.6 % have some or a lot of confidence in the judiciary and 34.8 %in the government, while in Brazil the corresponding percentages are 41.6 % and 34.7 %[28]. Does this pay off as expected theoretically? Bartesaghi thinks this lays the ground for attracting international investors. He specifies that:

> "People in the international business where I work trust each other" (Bartesaghi 2009).

Lombardi points at the Uruguayan businessmen as "serious" within the Latin American context, and Rial from Conaprole compares Uruguay with the neighbouring countries:

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[28] In the survey the data are based on subjective understandings of words and concepts. The word confidence can easily be mixed with agreement, impression, evaluation etc. It is therefore difficult to reveal the difference between those perceptions among the respondents in an accurate way. However, it still reflects the opinion of the people concerning private firms.

"The Uruguayan is a quite serious person in comparative terms, along with the Chilean. The Argentinean is not […]. The fact that Uruguay is so small makes people be careful in their way of doing business" (Lombardi 2009).

"Uruguay has a good reputation of trusting and honest people in general" (Rial 2009).

The size, as mentioned earlier, causes transparency which creates an honest culture, according to Lombardi. The mechanisms of control and punishment as such function and contribute to an environment of trust. Hodara agrees:

"Uruguay has the name of a serious trading partner; reliable, responsible, delivering quality products. Uruguay was the biggest export country of Mercosur just a few years ago. Why is this? Because the market is so small, the competition so hard, that you need to take good care of the customers you get in order not to lose them" (Hodara 2009).

It should be mentioned, as Ostrom highlights, that the attractiveness of Uruguay for foreign investors is probably due to many elements (Ostrom 2000), e.g. educated citizens as highlighted by the human capital measure in the quantitative analysis. Next to Brazil, Uruguay has the highest mean level of human capital among the 19 countries in the sample between 1996 and 2007. The education level in Uruguay contributes to the quality of the labour force, which is important for the international market. Compared to the level of education in the region, Uruguay has a highly skilled labour force. Illiteracy is almost non-existent, and the public, free primary education is at a quite elevated level. Data from LaPop 2008 shows that only 1.3 percent of the population have no education. As much as 48 percent of the sample had secondary education, and 16.6 had superior level education (Boidi and Queirolo 2008). Furthermore, the Universidad de la República, which is the public university, is free and well recognized (Hodara 2009)[29].

However, how the Uruguayans are viewed by the international market should intuitively not be determined by the level of trust inside Uruguay. Rather, it rests on the trust of the actors. If Brazilians trust Uruguayans and invest in Uruguayan products, it is the level of trust in Brazil that determines the Brazilians behaviour. Nonetheless, as trust and trustworthiness are highly

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[29] High levels of social capital followed by high levels of human capital are not very surprising since they according to the theory are expected to correlate (Coleman 1988).

correlated (Glaeser 1999; Knack 2001), there *is* a relationship between how the Uruguayans are judged by the outside world and the level of trust inside Uruguay. The level of trust can thus contribute to economic gains in this respect: It contributes to Uruguay's good reputation as being reliable.

This reputation is supported by risk- indicators from the International Country Risk Guide. Uruguay scores 9.5 on investment profile in 2006, which is an assessment of factors affecting risk to invest within the political component ("International country risk guide" 2006). The subcomponents of investment profile are contract viability, profit repatriation and payment delays. 70-80 percent of the total ranking should be defined as low risk according to ICRG. Uruguay is at 79 percent, and has thus a low risk investment profile, in agreement with the opinion of the interviewed business leaders.

5.3.2   Repelling internal investment

The quantitative analysis shows that investment has a positive significant effect on growth in Latin America. However, in Uruguay, the investment share of the GDP is one of the lowest on the continent. Is this reflected in the interview data?

As my sample of interview subjects largely consisted of representatives from big and well-known firms, the focus is biased towards these actors. However, I got information concerning how the respondents perceived the internal investment market and this perception indeed reflects the findings in the quantitative analysis. The overall answers do not directly support the impression of an environment of trust in Uruguay, or trust does not have the theoretically expected effect on investment.

> "The concept *businessman* is not a very valued one here in Uruguay" (Muñoz 2009).

Muñoz states that there are few real "emprededores" or enterprising people in Uruguay, which he thinks contributes to the low image of a businessman. He stated that if there had been a survey investigating this topic, "businessman" would have been evaluated as a negative word. He does not have any figures to support his claim when stating this, just his own impression. I have used Latinobarómetro data from 2007 to investigate if there is support for his perception. The data in table 5.1 show that 11.3 percent of the Uruguayan population have no confidence in private enterprises, while 36.4 have a little on a 4 point scale. Only 6.1 percent have a lot of

confidence. When the respondents were asked to *evaluate* the businessmen of their country on a four point scale, the results were a bit more positive. Just 6.6 percent evaluate them as "very bad", while 21.8 answered they are "bad". Almost 50 percent answers "good". In comparison with the Argentinean population, the picture of businessmen in Uruguay is not so negative after all. In Argentina 15.3 percent evaluate businessmen as "very bad" and 33.1 as "bad". Nevertheless, the numbers give some support to Muñoz' statement. Over 20 percent of the population thinks businessmen are "bad". I assume that the "businessmen" within this category do not only conduct business with each other, hence this perception influences the trust of the whole investment culture.

Table 5.1 Evaluation of Businessmen

	Uruguay			Argentina		
	Frequency	Percent	Cumulative percent	Frequency	Percent	Cumulative percent
Very good	38	3.2	5.7	9	.8	4.3
Good	570	7.5	53.5	395	32.9	37.2
Bad	262	21.8	75	397	33.1	70.3
Very bad	79	6.6	81.6	183	15.3	85.5

Source: Latinobarómetro 2007

Table 5.1 shows businessmen from Uruguay and Argentina evaluated by the population in theses two countries.

Bartesaghi is also worried about the culture of innovation and business.

> "There is not an appropriate environment for creating business-people in Uruguay. The Uruguayan is culturally conservative, not taking risks or playing anything. This fact is of major concern for the Chamber" (Bartesaghi 2009).

Bartesaghi actually repeats this points several times during the interview. He believes this culture of some kind of tall puppy syndrome[30] influences the internal business climate extensively. The negative association of the success of others in economic terms contributes to the lack of ambition and willingness to take risks among Uruguayans. According to Bartesaghi it is viewed as positive to be satisfied with little (Bartesaghi 2009): "The Uruguayan is pleased with little…which causes an unhealthy environment for innovation" (Bartesaghi 2009).

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[30] Tall poppy syndrome, or the Law of Jante, is a perceived tendency to discredit those who achieve notable wealth or prominence (*The oxford dictionary of phrase and fable* 2006).

Lombardi also points to the fact that the Uruguayan likes to play safe. This is somewhat unexpected given the functional institutions highlighted by the respondents. Theoretically, high levels of trust, along with functioning institutions, are risk-reducing which then in turn should give incentives for investment (Bjørnskov 2003: 6). Lombardi states that the lack of risk results in a "grey" investment environment where people tend to repeat the same procedures, and not doing something new (Lombardi 2009). Jodal sees a paradox in the view of entrepreneurs and business people in Uruguay:

> "I think this is quite interesting because in the media the businessman is associated with problems, corruption and none-concrete things. For example for a few weeks ago there was a bank crisis and some of the most important bank directors where arrested. On one hand these scandals tarnish the reputation of the business people. But on the other hand, I think that if you ask people what they want their children to be, the majority would have liked them to become a business person" (Jodal 2009).

The overall impression of the mainstream Uruguayan presented by my interviewees is a conservative and security-focused actor. Trust as a risk-moderator does not seem to function very well. According to the first-hand data, the mechanisms behind *hypothesis 3 trust increases investment* thus seem divergent. First, trust does play a role in the relation of Uruguayans with the international market. Uruguay has a trustworthy image abroad according to the respondents. This might, as highlighted by some of the respondents themselves, also be explained by how Uruguay is viewed *comparatively*. It appears as a serious and trustworthy country compared to its neighbours Argentina and Brazil. Secondly, networks and relations within Uruguay are highly present, promoting a trusting environment which functions in a positive way for investment. But thirdly, and contrary to the two first points, the Uruguayans do not seem to carry a general trust or confidence, as few people take risks and innovate in business. This is somewhat in accordance with the results from the quantitative data. Although Uruguay was the most trusting country among the Latin American counties, 72.7 percent of the population did NOT trust in others.

5.3.3 Section summary

Trust as a risk-moderator is not tracked within Uruguay. In my sample of respondents there exists a perception of Uruguayans as poor risk-managers. This is in accordance with the low macro results of Uruguay on investment measures presented in the quantitative analysis.

Although Uruguayans are viewed as trust-worthy and honest trading-partners by the international environment, hypothesis 3 trust promotes investment is not supported. Whether this is due to an insufficient stock of social capital in Uruguay, or because the mechanism does not function according with the theory, is difficult to say. Further analysis is necessary for modifying the theory.

5.4   Concluding the qualitative analysis

The goal of this analysis chapter was to use primary interview data from Uruguay to investigate three hypotheses. Those are:

Hypothesis 1: Trust lowers transaction costs
Hypothesis 2: Trust has a positive effect on productivity.
Hypothesis 3: Trust promotes investment

The analysis finds support for hypothesis 1. Networks which create trust are frequent in Uruguay, and there is an environment where most business people know each other, which in turn facilitates transactions: First by making it easy to find people with whom to transact, secondly by lowering the documentation needed in order to trust the partner. Small environments create a transparency which promotes trust by constituting a sanctioning mechanism people can rely on. Trust also seems to make an informal economy possible, since buying products or services informally requires a trust in the other part. Ultimately, trust also seems to make up for too low transaction costs – corruption. The subjectively perceived corruption level is comparatively low among the respondents.

The results from the analysis on hypothesis 2 are somewhat more divergent. The consciousness of enhancing production through the motivation of workers does not seem to be well developed in Uruguay: "Human resource policy in the companies, or even something corresponding, is non-existent" (Bartesaghi 2009). However, is seems that it is not necessarily needed. Workers in a developing country have other expectations of their bosses, and can be satisfied by the insurance of a secure employment. Trust in a stable and safe income thus constitutes the core risk-moderator and incentive to work hard. However, in order to achieve more robust results one should ask workers concerning the increase in their productivity.

The data material throwing light on Hypothesis 3 is also mixed. Based on the interviews, Uruguayans neither seem to be risk-taking nor innovative. However, indictors from the ICRG coincide with the perception of the respondents in Uruguay that the country is evaluated as attractive from a foreign investment point of view. Due to their functioning institutions, judicial security and democratic stability, sanction mechanisms exist for punishing bad business behaviour. The networks within the business sector have the same function as risk-moderators. Nonetheless, among the average Uruguayan trust does not seem to be risk-reducing and promote investment, hence, hypothesis 3 is not supported.

6   CONCLUSIONS

6.1   How and why to track trust

The aim of this thesis was to investigate *how social capital influences economic development in Latin America.*

In order to answer the research question it was first of all necessary to elaborate on what social capital is. I identified *trust* as a core element in all of the theoretical definitions reviewed in this thesis. I furthermore pointed out theoretical explanations of why trust influences the economy. This formed the basis for the three hypotheses about the mechanisms that link the two. These are H1: Trust lowers transaction costs, H2: Trust increases production and H3: Trust increases investment. In the methods chapter I argued that determining a *general relationship* between trust and growth in the Latin American continent is a necessary foundation for investigating these hypotheses. Proper tools for determining the general relationship, selecting a case, and for tracing the causal mechanisms between trust and economic output were also presented in the methodology chapter.

The regression analysis supported the main hypothesis; *trust promotes economic development.* It also revealed that Uruguay was a case particularly appropriate for investigating the theory because it had the highest value on the variable of interest, namely social capital. Although Uruguay did not seem like a perfect case according to Liebermann (2005) due to the non-correspondingly low economic growth, it has proved a useful case. I was able to answer the research question based on the interview data from Uruguayan business-people, and the comparatively low economic growth seemed to be explained mainly by influential control variables; low levels of investment share of GDP and population growth.

6.2   Has trust been tracked?

The answer to the research question is that social capital explains economic development in Latin America through lowering of transaction costs and through increasing productivity, though in a slightly different way than theoretically expected. Trust does not seem to explain economic development through investment in the case of Uruguay.

Table 6.1 Results

Expectation	Supported
Hypothesis 1: Trust lowers transaction costs	Yes
Hypothesis 2: Trust has a positive effect on productivity	Yes
Hypothesis 3: Trust promotes investment	No

The qualitative analysis on Uruguay supports hypothesis 1. Trust seems to potentially reduce the costs related to contract making, both in the sense of finding contract partners easily and using little time to secure the transactions. Furthermore, the small size of Uruguay contributes to promotion of trust in transactions. It also appears that trust plays a part in enabling informal economic activity, such as markets, in Uruguay.

The results for hypothesis 2 are supported, but demonstrate that trust seems to play a different role than expected theoretically. The substantial economic risk for an average Uruguayan worker will be the loss of employment and consequently the loss of a stable income. Motivation for increasing productivity does hence not seem to rest on trust in receiving higher wages or a material reward, but rather in maintaining a safe employment. Confidence between the employer and the employee is thus necessary for the worker to enhance the productivity. As Uruguay has relatively low socioeconomic security, the primary concern of Uruguayans is to preserve a monthly income.

The evidence for analysis on hypothesis 3 are not uniform, and shed light on a difference between how Uruguayans invest, and how they are seen as investment partners from abroad. On the one hand, my interviewees think that Uruguay is perceived as a safe, trustworthy and a good country to invest in by foreigners. On the other hand, the argument about the role of trust in investment is not supported; the respondents stress a low investment environment and a high risk-perception among ordinary Uruguayans, which is supported by other data sources. As such, trust does not seem to function as risk-reducing as the theory expects, and hypothesis 3 is not supported.

The overall conclusion is that the theoretical transmission mechanisms in Uruguay to some extent function according to the expectations, but need to be adapted to the context of a developing country. Societal factors such as level of development, education and crime influence the way trust affects the economy. In addition, the analysis revealed the small size

of Uruguay as an important intervening variable on the sources of social capital. This is illustrated by figure 6.1.

Figure 6.1 The argument revised

INTERVENING VARIABLES   ARGUMENT

ECONOMIC

DEVELOPMENT

Socioeconomic   +   +   -
conditions

Security   **H1**   **H2**   **H3**

Size

TRUST
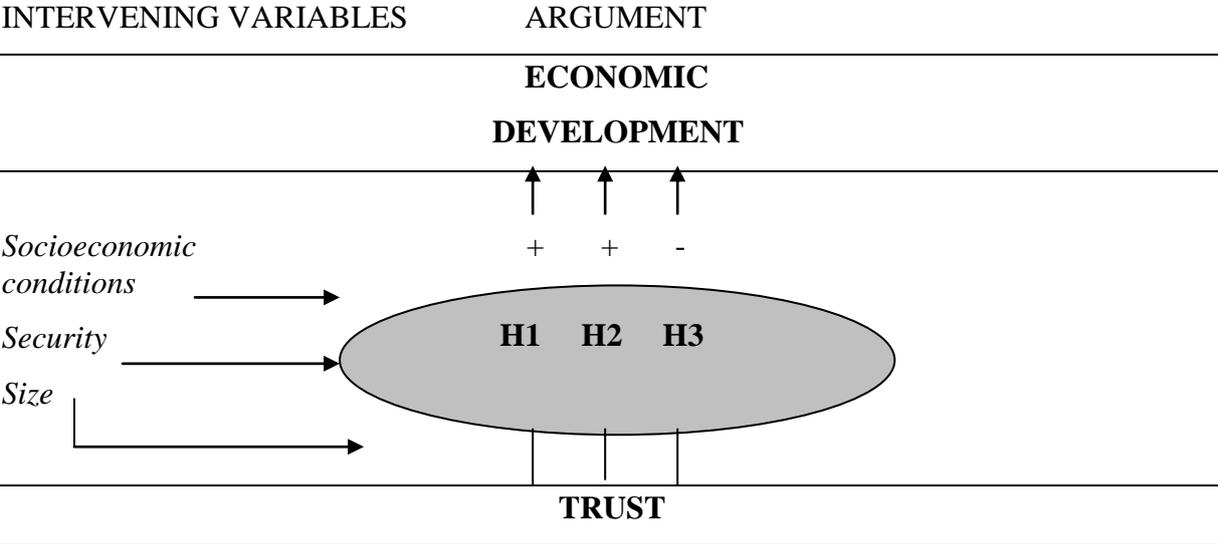
6.3   Implications for future tracks

The main theoretical purpose of this thesis has been to confront the criticism of social capital theory as lacking elaboration on the transfer mechanisms to economic development. Woolcock and Narayan (2000: 243) explicitly called for " … more work on unbundling the mechanisms through which social capital works".

This thesis has contributed to the understanding of those mechanisms through the use of unique data material gathered in Uruguay. The results highlight the aptness of an in-depth analysis of this research question because interviews with micro level actors in growth-promoting positions in Uruguay worked well for mapping micro level mechanisms. Furthermore, the fieldwork contributed to broaden my contextual understanding of Uruguay. The respondents gave a lot of information, some of it not directly useful in the analysis, but rather as an informative backdrop. Speaking the mother tongue of the respondents was a big advantage both during the interviews and in order to arrange them.

However, I have interviewed a quite homogenous group of Uruguayan business leaders. It is difficult to know whether other respondents would have given other answers and

consequently given other results in the analysis. Nevertheless, by using secondary sources in the analysis, I have strengthened and/or challenged the results.

Still, it would have been relevant to interview a larger heterogeneous group of respondents. Since tendencies reveal that the dynamics between trust and the economy is influenced by such factors as the size of the businesses and since the small family-driven businesses in Uruguay are numerous, an interesting next step would be to interview several representatives from such small firms as well. For investigating Hypothesis 2, trust increases productivity, an interesting sample of respondents would have been workers from different types of labour.

In this thesis, a country with different conditions of living than what the original cases which the theory was induced from has been investigated. As the conclusion has shown, some of the mechanisms seem valid in Uruguay. However, the analysis indicates that other variables are important in the relation between trust and economic output in Uruguay. An amplification of the scope of analysis would therefore be useful, taking these factors into consideration to a higher degree. As such, the social capital theory would adapt better in a developing context. Although this single case-study cannot modify a theory, numerous future analyses might.

Lastly, both institutions and networks have proved important in creating trust according to my interview data. A more thorough analysis on where social capital stems from would therefore be fruitful in order to understand the investigated causality better. Since the creation of trust has proved to be of a multilevel character, a multilevel analysis which is able to include variables on different levels would be appropriate for such an investigation (Luke 2004). A three-level structure analysis of the influence of networks/organizations (meso) and institutions (macro) on trust (micro), would contribute to a further understanding of the trust concept.

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APPENDIX 1

Interview guide

Preguntas particulares sobre la empresa

1. ¿Cuál es su rol dentro de la empresa?

2. ¿Al hacer negocios, siempre utiliza contratos escritos?

   - ¿También en casos de acuerdos de poca importancia?

3. ¿En general, ya conoce las personas con quien hace contratos?

   - ¿Diría que ya conoce a las personas facilita el hacer contratos?

4. ¿Diría Usted que falta de confianza en las posibles partes de negocios es un problema frecuente?

5. ¿Cómo difunde información dentro de tu empresa?

6. ¿Utiliza una red o algún Network para difundir información/ propaganda sobre su empresa?

7. ¿Se encuentra con compañeros de trabajo en su tiempo libre/ fura del trabajo?

8. ¿Existen actividades organizadas por la empresa de carácter no laboral?

   - Por ejemplo futbol, coros, cenas etc.

9. ¿Opina que estas actividades tienen algún efecto en el ambiente laboral y también a la productividad de la empresa?

10. ¿Tiene la impresión de que la taza de rotación es alta o baja?

    - ¿Como afecta el ambiente laboral? ¿Afecta la productividad?

11. ¿Qué tal el ambiente de inversión en Uruguay?
    - ¿Se puede decir que ambiente de inversión en Uruguay es caracterizado por gente honesta y confiable?
    - Porqué?

12. ¿Hay programas para motivar sus empleados dentro de la empresa?

    - Por ejemplo "premios", bonos, o eventos sociales

    - ¿Cómo afecta eso a la productividad?

13. ¿Cual es la estrategia de desarrollo de la empresa?

14. ¿Cómo mantiene las buenas relaciones de confianza y productividad en la empresa en tiempo de crisis?

15. ¿Su empresa forma parte de algún sindicato?

Preguntas de carácter general

16. ¿Como describiría Usted la cultura/el ambiente empresarial de Uruguay?

- ¿Formal o informal?

- Hay varias formas de informalidad, me refiero a informalidad social y económica.

17. ¿Diría Usted que es una buena cultura/buen ambiente para crear nuevas empresas en Uruguay?

18. ¿Existen incentivos de parte del estado para crear nuevos negocios/empresas?

- ¿Cuáles son?

19. ¿Conoce rutinas para contralar la corrupción en Uruguay?

20. ¿Siente seguridad jurídica en Uruguay?

APPENDIX 2

Countries in the quantitative analysis

1	Argentina	11	PuertoRico
2	Brazil	12	Uruguay
3	Chile	13	Bolivia
4	Colombia	14	Guatemala
5	Costa Rica	15	Honduras
6	DominicanRepublic	16	Nicaragua
7	Ecuador	17	Panama
8	El Salvador	18	Paraguay
9	Mexico	19	Venezuela
10	Peru		

Normal distribution of the dependent variable, growth in GDP

Histogram

Mean =3,77
Std. Dev. =1,002
N =19
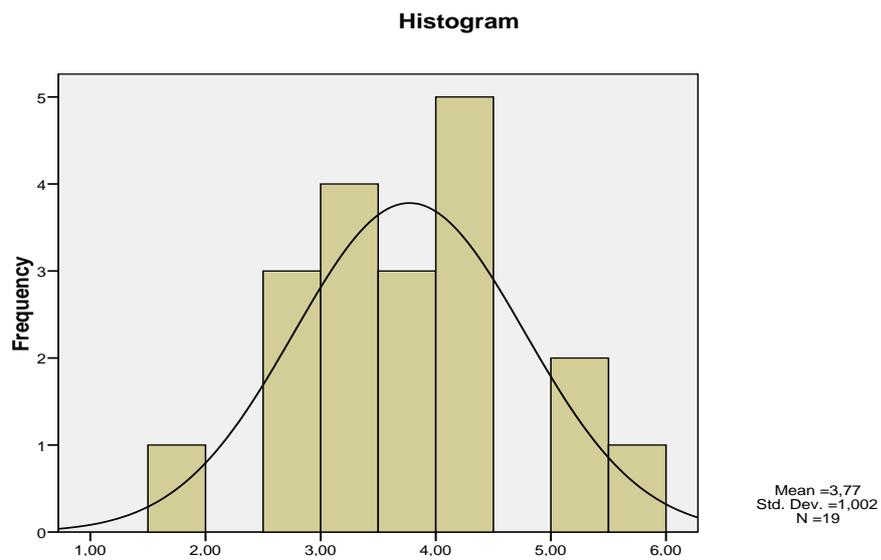
Correlations

		Population growth	GDPLevelPPP	Investment share	Human capital	Growth
Social trust	Pearson Correlation	-0.168	0.112	0.130	-0.145	0.328
	Sig. (2-tailed)	0.491	0.657	0.596	0.566	0.170
	N	19	18	19	18	19
Population growth	Pearson Correlation		-0.515	0.209	-0.688	0.107
	Sig. (2-tailed)		0.029	0.391	0.002	0.662
	N		18	19	18	19
GDPLevelPPP	Pearson Correlation			-0.172	0.539	0.076
	Sig. (2-tailed)			0.494	0.021	0.765
	N			18	18	18
Investment share	Pearson Correlation				-0.422	0.643
	Sig. (2-tailed)				0.081	0.003
	N				18	19
Human capital	Pearson Correlation					-0.106
	Sig. (2-tailed)					0.676
	N					18

*   Correlation is significant at the 0.05 level (2-tailed).
**   Correlation is significant at the 0.01 level (2-tailed).