



Social distance and trust: Experimental evidence from a slum in Cairo[☆]



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ABSTRACT

While strong social ties help individuals cope with missing institutions, trade is essentially limited to those who are part of the social network. We examine what makes the decision to trust a stranger different from the decision to trust a member of a given social network (a friend), by comparing the determinants of these two decisions for the same individual. We implement a binary trust game with hidden action in a lab-in-the-field experiment with residents of an informal housing area in Cairo. Our results show that trust is higher among friends than among strangers and that higher trust among friends is related to the principal's belief of trustworthiness. However, on average a principal underestimates her friend's trustworthiness leading to inefficient outcomes. Our findings suggest that even within a social network, trade may often be limited to exchanges with few information asymmetries.

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1. Introduction

In developing countries formal institutions are often weak or non-existent. As a means of coping with such an insecure environment, individuals often establish strong social ties with other members of their

immediate community and beyond. Social networks increase people's access to goods and services through reciprocal exchange (Kranton, 1996), mutual insurance (Fafchamps, 1992; Foster and Rosenzweig, 2001) and informal contract enforcement as exercised, for instance, in rotating savings and credit associations and in group banking (Cox and Fafchamps, 2008; Karlan, 2007; Karlan et al., 2009). However, one important inefficiency exhibited by social networks is that trade is essentially limited to members of a given network (Munshi, 2006). For individuals to overcome this limitation and to enter market exchanges, trust in strangers plays an important role. More generally, trust can help achieve efficient outcomes in economic exchanges when information asymmetries are present (Karlan, 2005; Karlan et al., 2009).

We examine the determinants of trust in an environment in which social networks play a crucial role. We are interested in both trust in strangers and trust within a given social network and ask what makes an individual's decision to trust a stranger different from her decision to trust a member of her own social network (henceforth, a “friend”). This question is important as data from surveys and from trust games suggest that trust in strangers – generalized trust – is low in developing countries, which is seen by many as an impediment to economic growth and development (e.g., Bohnet et al., 2010; Cardenas and Carpenter, 2008; Knack and Keefer, 1997; Sobel, 2002).

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To study this question, we implemented a binary trust game in a lab-in-the-field experiment with residents of Manshiet Nasser, an informal housing area in Cairo.¹ Our experimental design allows us to analyze the effect of a change in social distance between the trustor (principal) and trustee (agent) on trust behavior in a within-subject design. Variation in social distance was created by requiring residents to participate in the experiment together with a friend and to play the trust game both with their friend and with a randomly chosen, ex-ante unknown participant (i.e., a “stranger”).² In order to ensure that the reduction in social distance between players does not affect trust through increased availability of informal enforcement mechanisms, we use a binary trust game design in which the agent can hide her behavior (for details see Section 2.1). We focus on two factors that have been shown to affect trust in strangers and that are likely to vary with social distance: expectations of trustworthiness and other-regarding preferences. That is, we are particularly interested in whether higher trust in friends results from stronger solidarity – as measured by dictator games in which the social distance between players is varied – or whether beliefs play a greater role.³

Our results show that, as expected, trust is higher among socially close persons than among strangers. Based on our binary belief measure, this can be explained by the fact that on average a principal is more likely to trust when she expects her friend to be trustworthy while this is not the case when the agent is a stranger. Principals thus appear to be more confident about their stated belief when interacting with a socially close person. Surprisingly, however, principals' expectations about agents' trustworthiness are not more accurate in the friend than in the stranger pairing. In particular, a principal underestimates on average the trustworthiness of her friend, leading to a substantial fraction of inefficient outcomes. We try to explain this finding by contrasting the determinants of principals' expectations about agents' trustworthiness with the determinants of agents' actual trustworthiness. While solidarity is a main determinant of an agent's trustworthiness, it does not on average correlate with a principal's expectation. This may suggest that in environments with strong norms of solidarity, agents' ability to successfully communicate their trustworthiness within their social network is limited.

Other recent studies have made use of individuals' real-world social networks in experiments both in developed and in developing countries, including Brañas-Garza et al. (2010), D'Exelle and Riedl (2010), Goeree et al. (2010), Leider et al. (2009), and Ligon and Schechter (2012). All five of these studies, however, were interested in how social distance between players affects prosocial giving in dictator games.⁴ Amongst others, they find that a decrease in social distance leads to an increase in the amount given by the dictator. The approach taken in this study resembles the trust experiment conducted by Glaeser et al. (2000), who allowed college students to self-select into pairs upon arrival at the lab, thereby raising the likelihood that students

knew each other. They find significantly higher levels of trust and trustworthiness for pairs that are closer socially, which may, however, in part be due to the observability of choices and, hence, the possibility of informal enforcement. Our design, in contrast, rules out this possibility and, by using a within-subject design, we are able to examine what drives changes in trust in response to an increase or a decrease in the social distance between players.

The rest of this paper is organized as follows: in Section 2, we give an overview of the experimental procedures along with a description of the game setups and empirical strategy. Section 3 discusses the main results, while Section 4 examines the determinants of principals' expectations in the trust game. Section 5 concludes.

2. Research design

In the following, we provide a short description of the background and the procedures of our study as well as the game designs (more detailed information can be found in the Web Appendix). The study was conducted in May 2008 in Manshiet Nasser, one of the largest and oldest informal housing areas in Cairo. Similar to other informal housing areas, Manshiet Nasser is characterized by a high population density and a lack of basic infrastructure in many of its neighborhoods.

Three female recruiters were assigned to different districts in order to recruit participants. Recruited participants (invitees) were told that participation in the experiment was only possible together with a friend, excluding direct family members and minors. In total, 144 slum dwellers from the various districts of Manshiet Nasser participated in a total of five experimental sessions. The participants exhibited substantial heterogeneity with respect to their socio-economic status (see Appendix Table 4).⁵ Educational attainment ranged from illiterates (30% of our sample) to university graduates (10%). About 40% of the participants received a regular wage, with an average monthly income of 377 Egyptian pounds (L.E.), equivalent to about 71 US\$ at the time of the experiment.⁶ In contrast, friend pairs exhibited very similar characteristics with regard to age, schooling, employment status, and wealth. All our friend pairs were same-sex pairs, which likely reflects the strong gender norms in Egypt. About 60% of friend pairs saw each other on a daily basis and most had known each other for more than five years.

The experimental sessions were run by a female instructor, who was supported by a large group of assistants, both male and female. The instructions were read aloud and the games and procedures were demonstrated in front of the participants. Participants made their decisions in private and, if necessary, an assistant answered questions and explained the tasks individually. Each session started with the trust game followed by two dictator games, a summing-up and an interview-based questionnaire, which contained questions on socio-economic characteristics, on other-regarding and risk preferences and on characteristics of their relationship to their friend. The trust game was always played first, because it involved the most effort to explain and we wanted the participants' concentrated attention. Participants received the instructions for each game separately and there was no feedback about outcomes between the games. On average, participants earned a total of 34 L.E. (about 6.4 US\$), which was more than twice a worker's daily wage.

2.1. Trust game

We used a binary trust game with hidden action similar to that conducted by Charness and Dufwenberg (2006). The trust game works as follows (see Fig. 1): the principal can choose *Distrust* or *Trust*.⁷ In the former case, both the principal and the agent receive a

¹ Trust is defined as placing something valuable at the disposal of another person, the trustee, without being able to ensure that she will not misuse it. Trust thus creates a situation where the trustor is vulnerable to the trustee (Coleman, 1990). In the binary trust game, placing trust pays off if the trustee is trustworthy, but not if the trustee is untrustworthy.

² In the theoretical literature, social distance is usually defined as the path length between trading partners in social networks (e.g., Jackson, 2008). According to this definition, direct friends are connected by the shortest possible path in a network, whereas the path length to strangers is infinite.

³ Previous experimental studies on trust (in strangers) in developing countries have mostly used a continuous trust game (“investment game”) based on Berg et al. (1995) and have, for instance, related trust behavior to individual characteristics – such as age, gender, and risk preferences – and to beliefs (e.g., Barr, 2003; Schechter, 2007), as well as to real-world behavior (Karlan, 2005).

⁴ In previous experimental studies, the term “social distance” has mainly been used to describe changes in the degree of anonymity either between participants and the experimenter, for instance, by using double-blind procedures (e.g., Hoffman et al., 1996), or between participants, for instance, by providing certain information about the opponent (e.g., gender or last name) or by letting participants meet before taking the decision (e.g., Bohnet and Frey, 1999).

⁵ Note that we do not draw on a representative sample since we are mainly interested in a relative comparison of trust. Representative samples have recently been used in order to compare absolute levels of trust across populations (e.g., Cardenas et al., 2009).

⁶ The exchange rate was about 1 US\$ to 5.3 Egyptian pounds (L.E.).

⁷ The labels in Fig. 1 are only used for illustrative purposes. In the experiment we used neutral labels.

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