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A tale of an unwanted outcome: Transfers and local endowments of trust and cooperation☆

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ABSTRACT

Transfers can do good; however, they can also result in massive failures. This paper presents a model that highlights the ambiguous nature of the impact of transfers on local endowments of social capital. It then describes an empirical investigation that illustrates that the receipt of EU structural funds causes a deterioration of the endowments of trust and cooperation in the subsidized regions.

1. Introduction

What happens when a lagging area receives transfers from a centralized authority? Would these transfers be beneficial for the local economy? Would there be any adverse effect?

Answers to these questions are diverse. Advocates of public intervention (see, for instance, OECD, 2009a,b) claim that public funds for economically backward areas are necessary to compensate for a location disadvantage. Opponents of subsidization (see, for example, World Bank, 2009 and Glaeser and Gottlieb, 2009) argue that the rationale for "location-based" policies is theoretically weak, and cite numerous studies showing that aids to local communities are generally ineffective (see, for instance, the review of the literature in Accetturo and de Blasio, 2012).

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Among the arguments to refrain from transferring resources to disadvantaged areas, a prominent role is given to political economy mechanisms (see Besley, 2004). Transfers could be harmful because they enhance rent-seeking, increase payoffs for deviant behaviors (such as corruption) and worsen the degree to which citizens are willing to cooperate with each other. By affecting people's perception of the working of economic exchanges, transfers might lead to societies characterized by a poor sense of community and lower interest in the common good (Krueger, 1974).

This paper studies the effect of transfers on local endowments of social capital.[1] It first provides a simple theoretical model that highlights the ambiguous nature of transfers: they might do good and increase local economic activity; they might also be harmful and tempt people to behave selfishly, thus reducing cooperation. Transfers received from a central authority can be used for the provision of a public good that improves the economic conditions of an area; however, mismanagement and fund diversions are possible and local politicians can allow these frauds upon receiving bribes. Individuals face the choice of either behaving in a civic way or becoming uncivic and grabbing (part of) the transfers received by the local government. Results show that transfers may reduce the relative number of cooperative individuals if local governments are characterized by low efficiency in the provision of public goods. Regions with a higher efficiency may observe, instead, an increase in the share of civic individuals.

Empirically, we estimate the impact of the receipt of EU *Structural Funds* (Objective 1) on proxies for the pervasiveness of cooperative behavior at the local level, taken from the *European Social Survey*. These measures refer to trust and cooperative behaviors that are shared across the members of the regional community. Our identification strategy exploits a discontinuity envisaged under the framework for assigning the EU funds: only the European regions below the threshold of 75% of the EU average per capita GDP are allowed to receive the transfers. As the compliance to the assigned funding mechanism is only partial, we adopt a fuzzy *Regression Discontinuity Design* (RDD), which makes use of eligibility as an instrument for participation in the program (Battistin and Rettore, 2008).

Our results show that transfers from the EU generate a sizable reduction of various measures of cooperation and trust at the local level. Evaluated at the eligibility threshold, the receipt of EU funds lowers by half standard deviation all the indicators of social capital. The results are robust to a number of sensitivity checks. Consistently with the theoretical model, we also find that high quality of local governments attenuates the negative effects of transfers.

This paper contributes to two distinct strands of literature.

The first studies the interactions between social capital and public interventions. According to this literature, individuals' willingness to behave civically is determined by economic, institutional conditions and by the values transmitted by their parents. Bisin and Verdier (2001), Tabellini (2008) and Guiso et al. (2008) present models of intergenerational transmission of values that are, in turn, shaped by economic or institutional incentives (e.g. law enforcement). Glaeser et al. (2007) analyze the impact of schooling on the endowment of social capital. Aghion et al. (2010) and Pinotti (2012) focus instead on the interactions between trust and public regulation; this issue is investigated also by Carlin et al. (2009) in financial markets. In this respect, our contribution is the investigation of the role of the financial transfers to the accumulation/de-cumulation of social capital.

Second, our findings may inform the long-standing debate on the desirability of the EU Cohesion Policy. Indeed, the effectiveness of EU regional financing for regional GDP growth has been questioned by many (Boldrin and Canova, 2001; Sala-i-Martin, 1996). Recently, however, by using an identification strategy similar to the one used here, Busillo et al. (2013) and Becker et al. (2010) have provided new and more encouraging evidence. In these two papers, the receipt of EU Structural Funds is associated with an annual per capita GDP increase of about 1–1.5 percentage points over a programming period of 7 years. Our findings add to this literature by showing the relevance of unwanted outcomes.

The remainder of the paper is structured as follows. Section 2 presents a simple model to assess the impact of transfers on cooperation. Section 3 describes the empirics: it introduces the EU Structural Funds, discusses the datasets, explains the identification strategy, and corroborates them with an extensive number of robustness checks. Section 4 concludes.

2. A simple theoretical model

This section presents a simple model that shows the relationship between transfers (such as the EU Structural Funds) and citizens' endowment of social capital. Like Aghion et al. (2010), we assume that an individual behaves in a civic way when she cooperates with tolerance and mutual respect toward everybody, while she is uncivic if she behaves selfishly outside family (or clan) members. This definition captures the distinction between limited and generalized morality. Limited morality (Banfield, 1958) is applied to a narrow circle of friends and relatives, while norms of generalized morality apply to everyone and induce civic behavior with a larger range of anonymous persons.

Individuals' attitudes toward the general public are usually influenced by a number of factors such as schooling (Glaeser et al., 2007), law enforcement and social fragmentation (Tabellini, 2008) and regulation (Aghion et al., 2010). In this theoretical model, we show that uncivic attitudes can also emerge when a windfall or a transfer from an authority outside the region can be grabbed.

[1] In the paper the word social capital is used to mean the local endowments of trust and cooperation, as captured by the responses at the European Social Survey. In the literature (not only in economics, but also in political science and sociology) the term social capital is used with an impressive number of meanings (from networks to civicness, from trust to generalized morality). Guiso et al. (2008) provides for a thorough discussion on the topic.