* Column title, "Equilibrium"
* Suggested story title: In Education We Trust
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In Education We Trust

Economic growth moves in cycles around a long-run trend. Generally speaking, this trend is determined by the amount of physical and human capital, land and labor used as well as how efficiently these factors of productions are employed. Since there are diminishing returns to labor, capital, and land accumulation, the efficiency of their deployment is what ultimately drives long-term per capita GDP growth. Delving deeper, the latter is determined by the rate of technological progress, which is itself a function of research and development activities and the diffusion of technology.

But what determines how factors of production are combined and employed and how much innovation takes place in an economy and how knowledge and ideas are diffused? Underneath it all, geography, trade integration, and the institutional framework have been identified as potential determinants of economic growth and therefore as possible explanations for the huge differences we see around the world in living standards. Institutions in particular have emerged as the leading candidate and are sometimes referred to as the "deep determinants of economic growth". Institutions take many forms, they are the "rules of the game", and include both formal legal rules and the informal social norms that govern individual behavior and give structure to our social interactions.

Among the institutional variables, the level of trust between citizens is a critical one. How does trust affect economic growth? Using the terminology of the prominent economist Dani Rodrik, trust affects the extent to which property rights are protected and contracts are enforced. As such, trust is an integral part of a *market-creating* institution since, in its absence, markets either do not exist or perform very poorly. After all, not all contingencies can be specified up front in contracts and implicitly many transactions rely on some form of trust between the parties involved ("my word is my bond"). Social trust may reduce risk perception and transaction costs and thereby stimulate capital formation.

As noted by Rodrik, institutions generally (including trust), are also key to sustain the growth momentum, build resilience to shocks, and facilitate socially acceptable burden sharing in response to such shocks. The level of trust and other institutions shape (i) *market regulation*—namely, to deal with externalities, economies of scale, and imperfect information. Examples include regulatory agencies in telecommunications, transport, and financial services; (ii) *market stabilization*—namely, to ensure low inflation, minimize macroeconomic volatility, and avert financial crises. Examples include central banks, exchange rate regimes, budgetary and fiscal rules, and intra and intergovernmental revenue sharing; and (iii) *market legitimization*—namely, the extent to which citizens are provided with social protection and insurance, redistribution, and conflict management.

Apart from affecting the above, trust could increase human capital by improving cooperation

among students and fostering social cohesion leading to higher government spending on education. Trust between employers and their workers would increase on-the-job training and thereby productivity. In addition, greater trust could lead to improved governance, one of the institutional pillars, by creating greater accountability and less political polarization and stimulating reform momentum by reducing catering to vested interests. Indeed, many studies have found that higher trust is associated with less corruption. Trust is not only important for trade within, but also between nations, affecting trade integration and thereby economic growth as well. Countries with high degrees of generalized trust also have stronger and fairer legal systems.

In light of the above, it is not surprising that trust is a key component of the institutional fabric of a country and studies tend to find that countries with high levels of trust have grown faster in recent decades than other comparable countries.

How to measure trust? The standard trust indicator that is used is the proportion of a population that answers yes to the question: “In general, do you think that most people can be trusted, or can’t you be too careful?” This question has been asked in a number of countries by the World Values Survey (WVS) since 1981. WVS results suggest that in the Philippines the vast majority suggests that one “can’t be too careful” (93 percent) compared to the average of the 84 advanced, emerging, and developing countries surveyed of 70 percent being less trustworthy.

These scores suggest that enhancing social trust could help strengthen growth. However, it should be noted that the trust score of countries tends to be very stable over time, even over decades. Hence, trust appears to be difficult to gain. Nevertheless, it has been argued that more equal societies have greater social trust and that these are mutually reinforcing. As noted by Professor Uslaner from the University of Maryland, equality promotes the vision of a shared fate, where others are part of your “moral community.” In contrast, in an unequal world, people will be reluctant to take risks in dealing with people who might be different from themselves. They will press for closed markets and work within their own sub cultures—and will tolerate corruption.

Prioritizing spending on education and designing an effective social safety net would contribute to economic growth by supporting human capital formation and by laying the foundation for greater trust by reducing inequality. In turn, this reduces transactions costs, opens markets, improves the rule of law, strengthen governance and enhance living standards further. Thankfully, reducing inequality and strengthening education are key pillars of President Aquino’s social contract with the Filipino people, which augers well for rebuilding social trust and economic growth in the period ahead.

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