Trust and economic wealth in regional communities: Evidence from Latvia

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Abstract

This work aims at analysing, in the light of new insights from economic development theories, the microeconomic relationship between social capital and economic wealth. In this preliminary study, we conduct a quantitative analysis through the use of structural equation modelling, to investigate a multidisciplinary framework across social and cognitive sciences. Results suggest the existence of a causal path linking wealth, institutional trust, social engagement and trust towards people.

Keywords

Social capital, networking, trust, identity theory, structural equation modelling.

Introduction

The concept of *social capital* plays a central role in territorial development theories. It comprises a network of durable relationships across a myriad of agents such as individuals and/or groups, organizations and institutions (Bourdieu, 1986).

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Over the last twenty years, the use of this concept has spread across different branches of social sciences. In particular, in community development studies, social capital is used either as conceptual or analytic tool to examine the strengths and weaknesses of the structure of a society (Woolcock, 1998) and the ways how socio-economic well-being changes due to changes of its tangible and intangible assets over time (Putnam, 1993).

At microeconomic level, the link between social capital and economic wealth has received little attention, whereas most of the literature has concentrated on macroeconomic effects and variables. As a result, under a microeconomic perspective, the relations occurring between social capital and personal wealth show different causality directions according to the frameworks adopted under various scientific branches. Contrasting results emerge from these studies. The statistical significance of the relationship between wealth, social engagement, and trust varies across different geographical contexts. As a consequence, there is little or no evidence of a shared theoretical framework to explain such findings. This would, in fact, reflect an almost absent degree of cross-fertilization, due to the use of different methodological approaches, between social and cognitive sciences. Moreover, most social capital studies have neglected the concept of social identity and the role of social identity in the structure of social capital.

In this preliminary work, we fill in the gap of a theoretical and applied multidisciplinary approach at micro-level for the case of the Republic of Latvia. The theoretical approach integrates social capital theory with social categorization theory in order to take into account the role of social identity dynamics with regard to the research issue under exam. The applied approach investigates the correlation between wealth (household income), network capital and social (trust) capital and the effect on social identity through the use of personal wealth as a predictor variable. We test a theoretical semi-recursive model through the use of a structural equation modelling.

An overview of social capital and economic wealth in community studies

Over the past century, the relationship between social capital and economic wealth becomes a central issue in capital-based community studies. The pioneering work of Putnam (1993) at the University of Princeton investigates the effects of community cohesion on socio-economic development in the regions of Central Italy in the 1960s and 1970s. The novelty of Putnam's work is the adoption of a theoretical and applied framework characterised by two dimensions of social capital: structural capital and trust, where he finds evidence in support of the positive impact of social capital on the economic growth of Central Italy regions.

The criticisms to Putnam's work were not late to arrive, mainly focusing on his overtly positive view of the role of social capital, and his lack of attention to regional socio-economic differences and specificities. In particular, doubts arise in terms of the effectiveness of the contextualization of the analyses when seen under different perspectives. Knack and Keefer (1997) find evidence of the effects of social capital on economic growth only in the presence of high transaction costs: in such a case, the existence of informal networking and trust capital helps reducing such costs. Sabatini (2007) finds different effects of different dimensions of social capital on economic growth, some of the causal effects being even negative. Whereas Putnam has focused on community level dynamics, studies dealing with social capital and community development in developing countries have been often focused on the relations between social capital and economic wealth at the *micro* (individual or household) level, where social capital is seen as a predictor of household income. In some studies (Grootaert, 1998; Narayan, Pritchett, 1997) these assumptions are supported by empirical analysis; in other cases (e.g. Krishna, Uphoff, 1999) no significant effects are found. Inconsistencies are usually explained by the fact that societies are built on different socio-economic structures in the paths of their economic development.

In most of these studies, social capital is meant as a determinant of personal / household wealth. A minority of regional scientists agree, instead, on the existence of an *inverse causality* where it is the economic wealth to affect trust (capital) among people. As a consequence, the key argument becomes that where 'members of households that are richer will have more leisure time to devote to associational membership. Higher levels of associational activity are associated, in turn, with higher levels of social capital' (Krishna, Uphoff, 1999).
The study of the effect of personal wealth on social capital is more common in social and organisational psychology studies, in particularly in the context of class analysis. Results are, once again, contrasting. Di Ciaccio (2005) states that social capital is found to be higher among high income people in several studies. Piff et al. (2010), on the contrary, find evidence of higher levels of social engagement in lower classes, and explain it by the existence of stronger egalitarian values and higher trust levels among poorer people. The differences are likely to be partly explained by the different meanings of social capital, whether weaker, temporary ties, of a mainly utilitarian nature, or stronger, trust-based linkages, are taken into account.

Limits of current literature

From the above mentioned observations, it is clear that the linkages between social capital and wealth do exist due to the use of a multitude of approaches and hypotheses. Less clear appear the results to these hypotheses, which do not show to have common grounds, leaving scientists with insufficient debate and explanations to discuss. The existing differences in the structure of the economy of the considered societies, which are acknowledged in most works, provide with a partial explanation of inconsistent results.
Inconsistencies can be also explained by arguing on the somehow overlooked nature of trust. Trust, a concept which has gradually entered the mainstream sociological debate largely due to the work of Luhmann (1979, 2000), is widely recognised as

one of the key components of 'cognitive' social capital (Putnam, 1993; Storper, 1997; Nahapiet, Ghoshal, 1997) which is also seen to be relevant for the enhancement of economic development (Granovetter, 1995; Sabatini, 2007). The real problem when we consider trust in social capital studies lies in the context, type and level of analysis employed. This is because trust assumes a generalised meaning towards, for example, citizenship and institutions; whereas some other times it is investigated in more concrete contexts, such as that towards surrounding people (Seligman, 1997). It is therefore essential to correctly define the concept of trust given that ambiguities and misinterpretations may arise (Alesina, La Ferrara, 2002).

A further issue to consider is the almost total absence of different components of trust in the same analytic models. Few studies find evidence of a complex interplay between different components of trust and socio-economic features (Skiott-Larsen, Henriksen, 2009).

Theoretical framework. Social capital and social categorization theories: An attempt at a multidisciplinary view

The relevance of socio-cognitive dynamics is well known in organisational science (Nonaka, 1991; Nahapiet, Ghoshal, 1997) whereas it is almost non-existent in regional studies. Territorial innovation studies can be seen as an exception to this 'trend', in particular the thread which is based on the innovative *milieu* theory (Aydalot, 1986; Camagni, 1991) and on the concept of innovation in territories as a complex non-linear process based on collective learning paths (Lundvall, Johnson 1994). This process has been notably investigated over the last decade through empirical approaches (Capello, 2002). Another example is that of creativity theory (Florida, 2002) which hypothesizes a positive correlation between the existence of a creative class, dynamism of the urban environment, and economic development. In all of these cases, however, the study of cognitive processes under a theoretical or applied view appears rare, and a multidisciplinary approach with cognitive science theories is virtually absent.

The criticisms to Putnam's work indirectly underline the overlooking of cognitive issues and dynamics in territorial community studies. The debate on the distinction between *bonding* and *bridging* social capital which, in a territorial context, implies the necessity to find access to external forms of knowledge and to the openness to other cultures, is an example which has cognitive implications.

In our work, we study the link between social capital and economic wealth at *micro* level. The novelty of our analysis is to consider a multidisciplinary view alongside social psychology through social identity theory. The main argument of such a theory is that significant others, both important people and close, direct social communities, are included in the representation of self (Saribay, Andersen, 2007). The main assumption is that social identity is a relational structure nested across three levels: (1) self-categorization expressed in terms of feelings of personal differentiation and belongingness (Brewer, Gardner, 1996); (2) categorization of immediate social groups (e.g., family members, teams and collectives in respect to one's occupation); and (3) categorization of large-scale social groups (e.g., political, ethnic, national communities). The relation between the first and the second level is characterized by the process of inclusion of close others and immediate social groups in the conception of self (Saribay, Andersen, 2007). The first level is the most inclusive and also psychologically most significant and real one.

Under such theoretical framework, we hypothesize that social capital, at least in part, reflects the structure of social identity. Therefore, two different trust capital dimensions are included in our micro-level model investigating the effect of wealth (household income) on social capital. We do so to integrate the commonly hypothesized wealth-engagement-trust causal chain.

Theoretical model

Given the considerations in the previous section, we use a recursive model with four variables (one exogenous and three endogenous) and three hypotheses. With regard to social capital, the model broadly relies on Putnam's taxonomy (1993), which, as mentioned above, identifies two main dimensions: structural capital (consisting of roles, networks and norms) and cognitive (or relational) capital (consisting of trust and other 'affective', intangible linkages). However, in the present context, such dimensions are accounted for in a way which takes into account the specific scope of the analysis.
The considered variables are:

- *Household income (economic wealth)*;
- *Structural social capital* (meant as *social engagement*);
- *Relational social capital (trust)*. Trust is distinguished into *trust towards individuals* and *trust towards institutions*. Following Seligman (1997), this distinction becomes necessary in social capital quantitative studies. We assume that trust towards institutions is seen in a large scale level of categorization, while trust towards individuals is observed in a smaller scale (e.g immediate groups).

We assume the following hypotheses:
Hypothesis 1. Household income positively affects trust towards institutions. This is somewhat intuitive given that personal well-being leads to a better attitude towards institutions.
Hypothesis 2. Trust towards institutions positively affects social engagement. This represents a reasonable assumption in our context (it is a novelty given that this pattern is usually not considered in social capital studies), where structural capital assumes the non-instrumental meaning of social engagement. The hypothesis considers a positive effect of a good institutional climate on the social behaviour of individuals.
Hypothesis 3. Social engagement positively affects trust towards people. This is a common assumption, generally confirmed by empirical analyses, in both organisational and regional social

capital studies (Tsai, Ghoshal, 1998; Grootaert, Van Bastelaar, 2002).

From the point of view of social capital studies, the main novelty of the proposed theoretical model consists of two assumptions: a) the positive effect of wealth on (non-utilitarian) networking is mediated by trust towards institutions; b) different trust dimensions appear in different stages of the causal chain. The resulting model (Figure 1) is therefore a *recursive* one, since a hierarchical cause-effect sequence of variables is hypothesized, according to the *path analysis* model (Bollen, 1989).

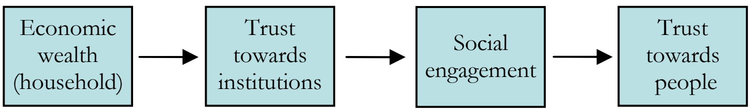

Figure 1: Theoretical model

Case study: Social context

The Republic of Latvia is an interesting context for the study of intra-community dynamics because of several peculiar factors. First, the Latvian society is characterised by the presence of a multi-ethnic framework in which consistent minorities co-exist. The multi-ethnic structure experienced a massive immigration from other Soviet republics in the years between 1944 and 1991. Second, over the last twenty years the Latvian economic, social and political context has been subject to numerous structural changes, a feature being common to almost all ex-Eastern Bloc countries. The consequences of such changes reflect, on one hand, the relevant cultural generational gap existing by Soviet-trained older generations and more Westernized youth, and, on the other hand, the economic polarization of society, due to a predominance of *laissez faire*, neoliberal economic policies in the first years after independence. The Latvian context is therefore characterized, in line with a general trend in European post-communist countries (Heineck, Sussmuth, 2010), by low levels of social capital. According to Eurobarometer (http://ec.europa.eu/public_opinion/index_en.htm), the level of trust and cooperation attitude among Latvian people is considerably lower than the EU average, and the engagement in socially conscious activities is low as well.

We can describe the Latvian society as being characterized by a problematic relationship between *integration* and *linkage*, a situation in which trust and goodwill are limited to family members, friends and close acquaintances (Woolcock, 1998). In this society there is also an insufficient exploitation of potential civic linkages creating, in effect, a missing link between community and institutions (Laboratory of Analytic and Strategic Studies, 2007; Zobena, 2007). A partial explanation to this argument can be found in a perceived distance between nation and state, resulting in generalized distrust towards state governance and public institutions. Ethnic fragmentation and interethnic tension is another possible cause (Laboratory of Analytic and Strategic Studies, 2007). The above mentioned features are among the problems which affect the diffusion of sustainability oriented and long term-conscious attitudes among citizens.

Data and methodology

The data are the result of a survey carried out by Latvian SKDS research institute in December 2010 within the Latvian state-endowed project Nacionala Identitate (National Identity), and aimed at measuring citizens' well-being self-assessment and their attitudes towards the community and institutions. The sample covers over 1000 individual observations carried out in the whole territory of the Republic of Latvia and is representative of the whole population. The proposed theoretical model has been tested through the use of *structural equation modelling* for observed variables (Joreskog, Sorbom, 1979), with the support of complementary techniques such as factor analysis, by means of software SPSS 15.0 and its extension AMOS 7.0. Structural equation modelling has been chosen over simple regression analysis because of the complexity of hypothesized cause-effect relations (two of the model variables are at the same time dependent and independent), common in *path analysis* models. The chosen measured variables are listed below. All of these variables are ordinal (e.g. non-metric; Stevens, 1951); social capital variables have been measured according to psychometric Likert scales (Likert, 1932), whereas household income has been measured by identifying income levels:

- Household income ranges measure economic wealth;
- Intensity of support towards neighbours measures structural capital;
- Trust towards neighbours measures trust towards people (immediate group trust);
- Trust towards the state measures trust towards institutions (large-scale trust).

Given the ordinal nature of variables, we use Bayesian estimation. Due to *listwise* criterion restrictions, the effective number of useful observations has been limited to 554 individuals.

Results

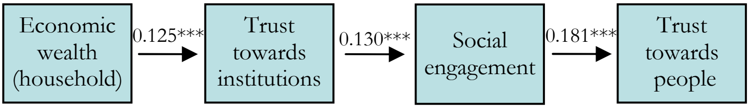

Figure 2: General model results

Results show an acceptable adaptation to data (P=.350). All hypothesized effects are found to be significant at 99% level (Figure 2). Errors associated with the two trust dimensions are positively correlated, which may depend on both variables being extracted from the same group of questions. Because of this, the resulting model is considered being partially recursive (Bollen, 1989). No relevant unexpected effects are found. Squared multiple correlations are low and imply a modest explicative power of the model. In other words, some relevant predictors of the endogenous variables appear to be left out of the model.

Causality direction

Proofs in support of the hypothesized causal chain verse do exist. Results have been tested by substituting causal verses with a-directional correlations and by inverting the causal verse, obtaining in both cases an acceptable but lower goodness of fit (respectively: P=.290; P=.200).

Conclusions

This work considers a theoretical and empirical attempt to employ a multidisciplinary approach to study the relations between social capital and economic wealth at *micro* level. The novelty of our study is to consider, under a theoretical point of view, a multidisciplinary approach which is consistent with the social identity theory in social psychology studies. We construct a model where social capital, at least in part, reflects the structure of social identity, this way closing the gap between social capital theories and social categorization theory.

In our model we include two different trust capital dimensions by investigating the effect of wealth (household income) on social capital. In this way, we join together the commonly hypothesized wealth-engagement-trust causal chain. Our results are in support of the causality direction of this chain. Given that the explicative value of the model is low, we interpret the results with caution. However, our work mainly aims at identifying the statistical relevance of the link between the considered variables rather than defining a predictive model. We can therefore argue in favour of our findings which can be considered worth of interest. The work needs undoubtedly to conduct a robustness exercise against a number of control variables to test the sensitivity of our hypotheses, and policy implications need also to be addressed to strengthen our assertions. This will be the scope of further investigations.

Given the preliminary nature of our study, we can conclude arguing that the analysis of the general sample supports the main model's assumption where trust towards institutions presents a positive effect of well being on social engagement. Also, the existence of the causal path 'social engagement-immediate group' trust is consistent with the social identity theory (Coté's hypotheses, 1996, 1997).

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