Does Inequality Affect Trust in Social, Economic, and Political Institutions?

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March 15, 2022

IBER Seminar

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Outline

1. Motivation
2. Inequality in Indonesia
3. Trust in Indonesian Society
4. Data and Method
5. Estimation Results
6. Conclusion and Implication

Motivation: Trust is necessary for a well-functioning economy

- Overcomes market failure due to imperfect information, costly enforcement, or coordination failures (Barone & Mocetti, 2016; Zak & Knack, 2001).
- Societies with higher trust have lower corruption and more effective bureaucracies (La Porta et al., 1997). Hence, a higher level of trust increases economic growth (Knack & Keefer, 1997) and financial development (Guiso et al., 2004), and is indispensable in an increasingly knowledge-based economy (Adler, 2001).

Motivation: Trust is affected by many conditions and experiences

- The degree of social connection between two parties predicts the level of trust between them (Glaeser et al., 1999).
- Some experiences reduce trust: traumatic experiences, belonging to a group that suffers from discrimination, economically unsuccessful in terms of income and education, and living in a community with a high degree of income disparity (Alesina and La Ferrara, 2000).
- Living in areas that feature political contestation and encourage voter participation results in higher beliefs that leaders are trustworthy (Manion, 2006).

Research question

Does inequality affect trust in social, economic, and political and state institutions?

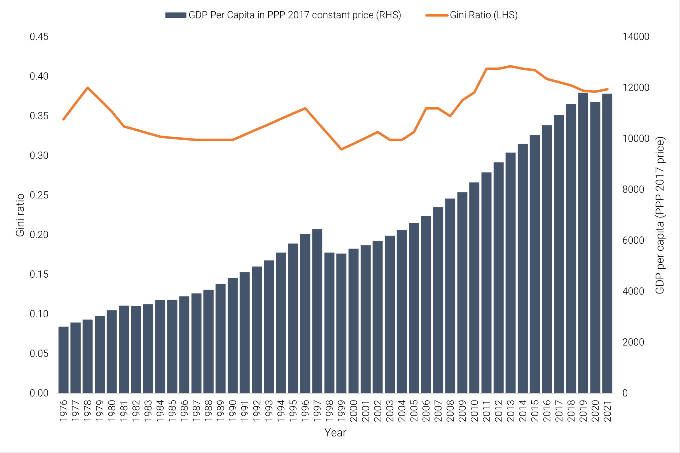
Only a handful of studies adress this question:

- Zmerli and Castillo (2015) finds that higher inequality in Latin America reduces political trust.
- Similar to Alesina and La Ferrara (2000), Yang and Xin (2020) find that Chinese citizens in provinces with higher inequality perceive the local government to be less trustworthy.
- Barone and Mocetti (2016) find a similar finding using cross-country data.
- Gustavsson and Jordahl (2008) find a similar finding using individual panel data from Sweden.
- Leigh (2006) finds no such relationship in Australia.

Contributions to the Literature

- We use a large set of indicators to measure trust in the three types of institutions. For most outcomes, we can establish trends over time, measured using a similar methodology.
- In the impact estimation, we distinguish the impact of village-level inequality and district-level inequality (since individuals are directly exposed to the former but gain information on the latter indirectly, for example through the media, these different kinds of exposure may affect trust differently).

Inequality in Indonesia is trending up, slowed by shocks

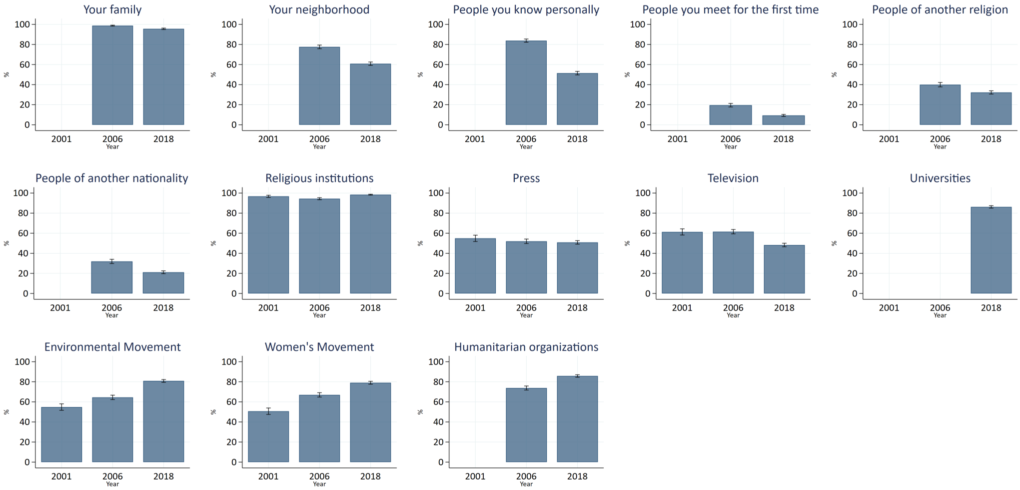


- During 1976-2021, GDP per capita continuously increased, except in 1998-99 due to Asian financial crisis (AFC) and in 2020 due to Covid-19 pandemic, resulting in an increase by around four-fold in real terms.
- Post-AFC recovery, inequality steadily increased and reached the highest record of 0.413 in 2013. Since then, inequality decreased again slowly, reaching 0.381 in early 2020. The pandemic caused inequality to increase again, reaching 0.384 in 2021.

Increase in inequality is caused by many factors

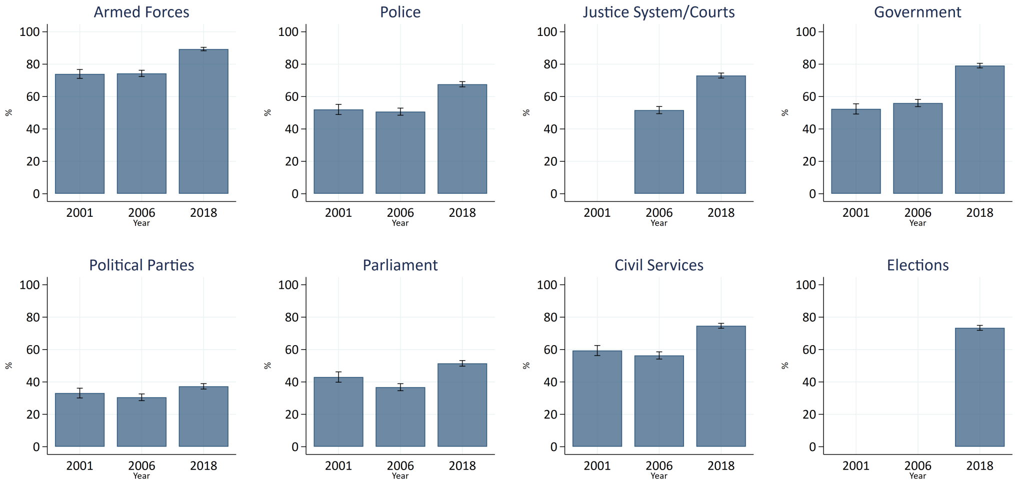
- Labor saving technological change that increases skill premium (Suryahadi et al., 2003).
- Education expansion, especially in urban areas (Silva & Sumarto, 2014; Akita, 2017).
- Financial market liberalization, which mostly benefits those of the upper class (Hill, 2018).
- Commodity boom, i.e. price hikes of primary commodities, whose benefit is only enjoyed by a small group of people (Yusuf et al., 2014).
- Rising wage gap between permanent (regular) and casual or self-employment workers (Manning & Pratomo, 2018).
- Increasing urbanization. Using provincial panel data from 2000 to 2009, Sagala et al. (2013) find that when the urbanization rate is still below 50 percent, an increase in urbanization increases inequality.

Trust in social institutions vary, both in levels and trends



Trust in economic institutions is relatively stable

Trust in political and state institutions has different starting points, but has improved



Data & Method

Data sources:

- The World Value Survey (WVS) 7th survey for Indonesia, conducted by SurveyMeter and University of Melbourne in June to August 2018, with a sample of 3,200 individuals over the age of 18, collected in 20 out of 34 provinces and spread in 320 villages in 168 districts.
- Inequality at the village level of 2010 & 2015 from SMERUs PovertyMap (povertymap.smeru.or.id).
- Susenas (National Socioeconomic Survey) March 2015 from BPS for Gini ratio at district level and migration inflow at district level.
- PODES (Village Census) 2014 for village characteristics (infrastructure, disaster, access, agricultural and mining activity, pollution, and geographical location). Because some variables have similar information (for example availability of primary and secondary schools), they are combined into economic index, education index, health index, and access index using Principal Component Analysis (PCA).

Data & Method

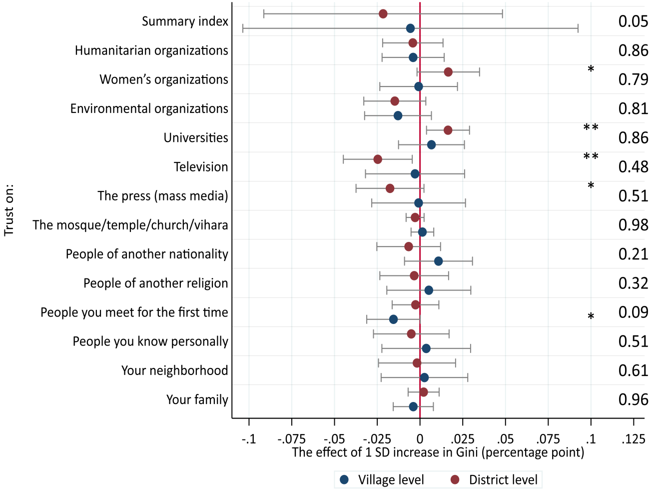
$$trust_{ijd} = \beta_1 Gini_j + \beta_2 Gini_d + X_{ijd} + V_{jd} + \varepsilon_{ijd}$$

where $trust_{ijd}$ is the trust of an individual i living in village j in district d in 2018 regressed on the Gini ratio at village j ($Gini_j$) and district d ($Gini_d$) in 2015. Meanwhile, X_{ijd} is a vector of individual characteristics from WVS and V_{jd} is vector of village and district characteristics.

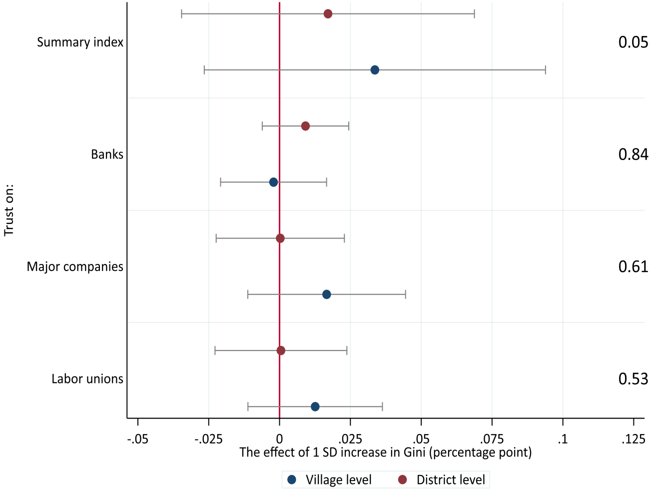
Potential sources of bias:

- Reverse causality: High trust people behave in a way that reduces inequality $\rightarrow$ Inequality measures from 2015, trust measures from 2018.
- Endogenous placement (choice of residence): High trust people move to low inequality areas $\rightarrow$ Migration between districts is relatively small and we control for district migration rates.
- Omitted variable bias $\rightarrow$ To control for this as much as possible, we include individual, village, and district characteristics.

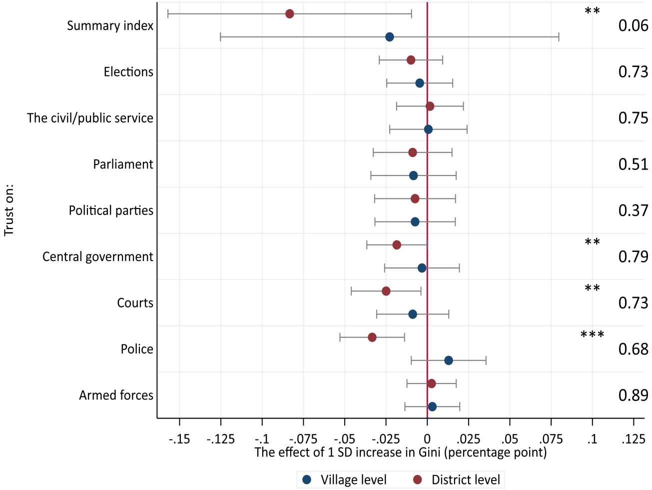
Village-level inequality has little impact on trust in social institutions; district-level inequality has impact on more aspects of trust



There is no evidence that higher inequality, either at the village or district-level, affects trust in economic institutions

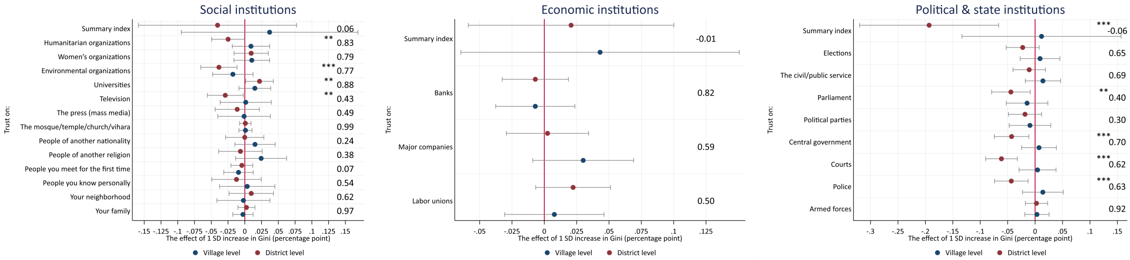


Higher district-level inequality significantly reduces trust in central government, courts, and police



Heterogeneity analysis: High educated respondents

Higher district-level inequality reduces trust in television, environmental and humanitarian organizations, the police, the courts, the central government, and the parliament among high educated respondents.



Heterogeneity analysis

- For the low educated respondents, inequality does not affect trust in social or economic institutions. On trust in political and state institutions, a one standard deviation increase in district-level inequality reduces trust in the police by 3 percentage points, or 4.2 percent proportionally.
- There is no statistically significant effect of higher village or district inequality on any trust outcomes among urban residents.
- In rural areas, there is a positive impact of higher village inequality on trust in foreigners. On trust in political and state institutions, there is a negative impact of higher district inequality on trust in the police and political parties.

Conclusion and implication

- Higher inequality at the village level has a negative effect on trust in strangers. This indicates that localities high inequality have lower social cohesion and, hence, people are more suspicious of strangers.
- Higher inequality at the district level reduces trust in many social and political institutions: environmental organizations, television, the press, religious institutions, the central government, the courts, and the police. However, higher inequality at the district level increases trust in womens organizations and universities.
- These findings mean that the impact of inequality on trust differs according to whether the inequality is at local or aggregate level and differs by the type of trust.
- However, it is clear that for effectiveness of government policies and their implementation, it is inequality at the aggregate level that matters.
- Since inequality at the aggregate level has negative effects on trust in various social, political and state institutions, the government needs to focus on keeping inequality at the aggregate level in check in order to maintain peoples trust in social, political and state institutions.

Thank you!

Appendix

Conceptual Framework (1)

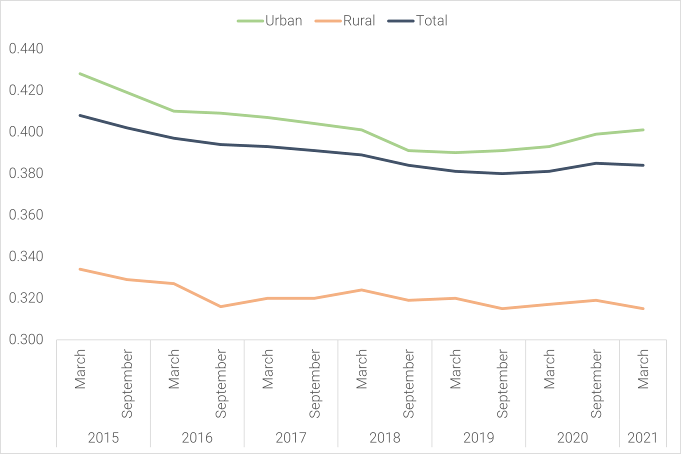
Mechanisms on how higher inequality could reduce trust (Jordahl, 2009; Barone & Mocetti, 2016):

- Social ties: People that belong in the same socio-economic group, hence equal, have social ties to each other that create incentives for trustworthiness and familiarity.
- Inference on social relationships: Inequality is seen as a signal of exploitation that influences people holding this belief to reduce their trust amidst rising inequality.
- Conflicts over resources: Inequality creates economic incentives among poor people for deceitful behavior against the rich.

Conceptual Framework (2)

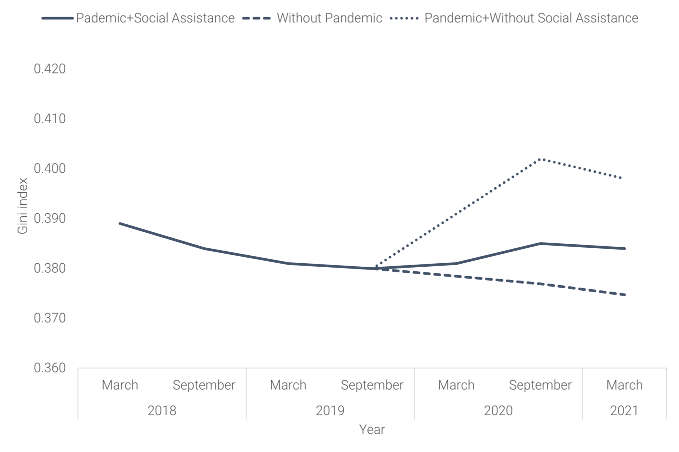
- Opportunity cost of time: If a person's trust is sensitive to changes in income, a change in income inequality will come hand in hand with a change in the level of trust.
- The homophily principle and aversion to heterogeneity: As higher inequality means higher economic gaps across people, individuals feel less connected and, hence, less trust to other people.
- Resource conflict: high inequality may lead people to disagree on how to share public goods and, hence, reduce social ties and cohesion and lower trust.

The impact of COVID-19 on inequality (1)



- Gini Ratio slightly increased from 0.380 in September 2019 to 0.381 in March 2020. From 0.391 to 0.393 in urban areas and from 0.315 to 0.317 in rural areas.
- By September 2020, Gini Ratio further increased to 0.385, to 0.399 in urban areas, and to 0.319 in rural areas.
- In March 2021, Gini Ratio slightly decreased to 0.384, driven by the decline in inequality in rural areas to 0.315, while in urban areas continued to increase to 0.401.

The impact of COVID-19 on inequality (2)



- The actual Gini Ratio in September 2020 is 0.385.
- If there was no COVID-19, the Gini Ratio would be 0.377.
- If there was a COVID-19 but there were no social protection programs, the Gini Ratio would be 0.402.
- The effect of the COVID-19 is +0.025 points (0.402-0.377).
- The effect of the social protection program is -0.017 points (0.385-0.402).

Trust in institutions categorization

Social Institutions	Economic Institutions	Political and State Institutions
Your family	Labor unions	The armed forces
Your neighborhood	Major companies	The police
People you know personally	Banks	The courts
People you meet for the first time		Government (central)
People of another religion		Political parties
People of another nationality		Parliament (DPR/MPR)
The religious institutions		Civil/public service
The press (mass media industry)		Elections
Television		
Universities		
Environmental organizations		
Womens organizations		
Humanitarian organizations		