Trust and Institutional Compliance[1]

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Abstract

Scholars in different literatures in political science suggest that both institutions and trust are key to economic and political success. However, even though it is plausible that the two are inter-related, we lack good theories of how institutions may affect trust, or vice-versa. In this article, we provide a theoretical framework that (a) allows us to understand how institutions affect trust, while (b) distinguishing clearly between simple institutional compliance and the effects of institutions on inter-personal trust. We examine how power relations and the degree of formality/informality of institutions shape the ways in which they are likely or unlikely to affect the levels of trust among a given community of actors. We sketch out how our findings are likely to have consequences for empirical research across a variety of settings.

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I. Introduction

What is the relationship between institutions, compliance and trust? This is a key question for the social sciences. Although scholars suggest that both institutions (North 1990, Greif 1994, Easterly, 2001) and trust (Almond and Verba, Pye 1965, Inglehart 1990, Putnam, 1993) are necessary preconditions for political and economic success, we know very little about how – or whether – institutions and trust are related to each other.[2] Do certain kinds of institutions have appreciable and consistent effects on trust among social actors? On the basis of the existing literature, it is difficult to say. Scholars who have studied institutions have little to say about trust (which they frequently conflate with institutional compliance insofar as they study it at all), while scholars who study trust have yet to develop a proper account of the relationship between trust and institutions.

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[2] In this article, we examine how it is that institutions affect trust, rather than, for example, examining how pre-existing patterns of trust affect the creation and/or successful operation of institutions. There is some *ex-ante* theoretical reason to believe that the arrows of causation are most likely to point in this direction in most reasonably advanced societies, where actors are likely to refer to institutions for guidance as to how to deal with others who are not personally known to them on a regular basis. We note that there is a literature that examines the consequences of trust for the operation of institutions, the opposite causal relationship to the one that we examine in this article. See, for example, Putnam (1993). However, this literature has its own conceptual problems; see further Farrell and Knight (2003).

In this article, we set out the core propositions of an account of the relationship between institutions and trust. We elaborate the distinction between trust and institutional compliance, showing how different institutional configurations may be more likely to produce the one or the other. In particular, we show how variation in two aspects of institutions – their level of formality and the degree to which they instantiate power relations – may have substantial implications for trust among those actors who are subject to the relevant institutions. While our primary contribution is theoretical, we also demonstrate that our account has clear consequences for empirical research and may indeed help clear up some of the more vexing problems of the existing literature on trust, compliance and institutions.

Current debates on institutions and on trust have largely emerged in isolation from each other, with adverse consequences for the understanding of how institutions and trust are related to each other (Knight 1998). First, various scholars of institutions have examined how appropriate institutions may produce cooperation among actors. Much of the work in this vein invokes formal theory. For example, there is an important literature that uses sub-game perfect equilibria to model the role that certain historical institutions (the rules governing Champagne fairs, merchant guilds and long distance trade) have played in preventing cheating among traders (Milgrom, North and Weingast 1990, Greif 1994, Greif, Milgrom and Weingast 1995). While this body of work sometimes invokes the term trust, it in fact conflates trust with simple institutional compliance, or more precisely, with the lack of incentive that actors have to deviate from an established equilibrium. We contend that this is an impoverished concept of trust, not least because it fails to incorporate the uncertainty about others' future behavior that political theorists see as a critical feature of social situations where trust may be required.[3]

Second, there is a literature that draws a strong distinction between trust and interests, arguing that to the extent that trust draws upon our rational knowledge regarding others' motives and likely behavior, it cannot properly be considered to be trust (Becker 1996, Mansbridge 1999, Williamson 1993). Arguments of this sort draw upon an intuition that we share – that trust cannot be reduced to mere determinate calculations of others' interests. However, insofar as they deny any systematic connection between our trust in others and our perception of those others' interests, they risk turning trust into a residual category, applicable only in a relatively small set of emotionally "thick" relationships. They certainly offer few possible insights into the relationship between institutions and trust.

Finally, there is a promising body of recent work on trust and encapsulated interests.[4] This argues that trust best applies in contexts where individuals have an interest in continued interaction, and thus may have good reason to behave trustworthily towards each other in specific issue-areas. However, precisely because this work

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[3] See further Gambetta, 1988, Hardin, 2003. To say that these sub game perfect equilibrium models provide an impoverished notion of trust is not to deny the theoretical contribution of these arguments; rather it is to say that they provide insights into institutional compliance rather than trust.

[4] See especially Hardin, 2003. For a version of the encapsulated interest account that seeks to apply the concept of trust to more general social phenomena such as trust in government, see Levi, 1998.

concentrates on personal relations among individuals it has some difficulty in incorporating the effects of institutions, which work at a higher level of social aggregation. While institutions may surely alleviate distrust in this account (Hardin 2002, Farrell, forthcoming), it is difficult to see how they can have positive and systematic effects on the level and kinds of trust that prevail among those social actors that are subject to them.

In short, scholars have paid little sustained attention to possible interaction effects between institutions and trust. Furthermore, this gap is not accidental; it flows directly from the basic ontological and methodological presuppositions that guide research in the existing approaches. However, it seems highly unlikely that the prevailing institutions in a given society do not affect trust relations in important ways.

We believe that an alternative account, which would provide a more nuanced understanding of the relationship between institutions and trust, should fulfill three criteria. First, it should directly and clearly distinguish between simple institutional compliance and trust. That is, we want an account that distinguishes (a) cooperative behaviour on the basis of straightforward institutional incentives from (b) cooperative behaviour on the basis of actors' trust in other actors. However, it should not start from the premise that the effects of institutions on interests are completely unconnected to (and perhaps even incompatible with) trust, properly conceived. Finally, it should provide a proper account of the *causal* relationship between institutions and trust.

In the remainder of this article, we advance just such an account of how institutions may have clear and important consequences for trust among individuals. We begin by delineating more precisely what we mean by institutions and trust. Next, we examine the differences between formal and informal institutions. We argue that insofar as informal institutions provide a greater penumbra of uncertainty *ex post* in resolving unanticipated problems, they offer greater scope for supporting trust than formal institutions. However, as we note in the subsequent section, trust will also be affected by the degree to which a given institution or set of institutions instantiate asymmetries of power. *Ceteris paribus*, institutions which instantiate gross power asymmetries will be more likely to lead to distrust than institutions which do not instantiate such asymmetries. In the final section, we offer preliminary examples of how our theoretical account can enhance our understanding of a number of common empirical issues.

II. Institutions and Trust

"Institutions" and "trust" are among the most ill-defined terms in the social sciences. Both have a plethora of competing (and sometimes conflicting) definitions. In this article, we define an institution as a set of rules that provides information about how people are supposed to act in particular situations and can be recognized by those who are members of the relevant group as the rules that others conform to in these situations (Knight 1992). Treating social institutions as rules helps to highlight the important relationship between institutions and social beliefs and expectations. If a rule is to have the status of a social institution, the members of the community must share the knowledge that the rule defines the relevant community standard of behavior in a particular social situation. If this common knowledge requirement holds, then such rules can affect expectations and behavior in future interactions. As **Searle (1969:42) get cite** points out in his discussion of the differences between rule-governed behavior and simple behavioral regularities:

> Two of the marks of rule-governed as opposed to merely regular behavior are that we generally recognize deviations from the pattern as somehow wrong and defective and that the rule unlike past regularity automatically covers new cases. Confronted with a case he has never seen before, the agent knows what to do.[5]

In defining trust, we want to capture the underlying idea of the many alternative formulations in the social science literature. Mistzal (1996: 9)provides a good start: “to trust is to believe that the results of somebody’s intended action will be appropriate for our point of view.” Here the emphasis is on the fact that trust involves beliefs about the actions of others and that such beliefs must relate in some “appropriate” way to our own interests, values or perspective. To formulate this more precisely, we turn to Hardin’s argument that trust consists of a reasoned expectation on the part of actor *a* that actor *b* will take her interests into account with regard to a particular matter or situation, *x*. Hardin uses this definition to develop a theory that sees personal relationships among individuals as the key source of trustworthiness and thus of trust.[6] We think that Hardin’s account is highly valuable, but we wish to explore how a different – and broader - set of social phenomena than personal relationships may affect trustworthiness and thus trust. In contrast to Hardin’s ‘relational’ account, we contend that an individual actor *a* may possibly trust not only other individual actors such as *b*, with whom she has a personal

[5] However, as we discuss below, there may be complications in identifying whether or not ambiguous cases are covered by the relevant institutional rules.

[6] We follow Hardin in seeing trust as crucially involving grounded expectations over trustworthiness.

relationship, but also actors whom she has no personal relationship with, if they fall into *type* B. In other words, we wish to examine how individuals may trust other actors, not because of a shared thick relationship, but rather because these others belong to a specific category of actor with which they are familiar.

Our account allows actors to trust each other in situations that are to some extent unanticipated, and stresses the degree to which trust is based on suppositions rather than certain knowledge about the trustworthiness of others (Gambetta 1988, Hardin 2002). Highlighting the significance of uncertainty allows us to examine trust in that very important intermediary set of social relationships where we deal with others who are not personally known to us in any deep sense, but who nonetheless fall into categories that (a) we recognize and (b) provide us with some information about how these others are likely to behave in specific social situations. Furthermore, it allows us to examine how trust may apply in contexts where the actors do not know precisely what the situation *x* is in advance.

This is what we think social scientists usually have in mind when they invoke trust in their explanations of social cooperation. That is, they see trust as part of an explanation for why people cooperate in situations characterized by uncertainty about the future. Coleman (1990: 91) conceived of trust as a factor in certain types of social interactions characterized by risk: "They are situations in which the risk one takes depends on the performance of the other actor." Misztal (1996:18) elaborates on this conception by emphasizing the importance of a time lag in the nature of the interaction: "The main common characteristic of trust ... is its 'dependence on something future or contingent; confident anticipation'. The trust features are thus derived from the contingency of social reality and they require a time lapse between one's expectations and the other's action. ... Trust always involves an element of risk resulting from our inability to monitor others' behavior, from our inability to have a complete knowledge about other people's motivations and, generally, from the contingency of social reality."

Under these definitions, how will institutions affect trust among actors who are subject to them? We argue that institutions will affect our trust in others through affecting our beliefs about how these actors are likely to behave in concrete social contexts. Institutions instantiate commonly held beliefs about how others are likely to behave in given social situations. The information which they provide is of a quite specific sort. As we note, institutions take the form of sets of rules at a certain level of abstraction; usually, they do not tell us how individual actors are likely to behave, but rather how classes or *types* of actors are likely to behave. Thus, the information that they provide is quite distinct from the information about more intimate relational incentives that Hardin and others focus on.

Institutions provide information about the range of types to be found in a given society and how they will interact with each other, in part because they instantiate beliefs about the ways in which different actors are likely to behave. Indeed, institutions will arguably be the most important source of such beliefs in most moderately complex social contexts, where actors are dealing with others who are personally unknown to them. In the absence of intimate acquaintance and the forms of knowledge that flow from it, the beliefs instantiated within institutions provide crucial information about how different types of actor are likely to behave across a variety of situations.

Consider, for example, the following mechanism. An actor *a* is aware of the existence of social rules applying to a specific type of actor, *B*, which suggest that type *B* actors will be trustworthy in interactions with *a* (or more broadly, actors of type *A*) in situation *X*. It is reasonable to expect that *a* will trust actors of type *B* in situations that resemble *X*; she will expect that when she encounters actors of type *B* in such situations, they will take her interests into account. For example, in the US people, of certain social categories (upper middle and upper class members of dominant ethnic groups), may have good reason to believe that members of the police will behave in a trustworthy fashion in a wide variety of interactions. These beliefs are intimately associated with informal yet pervasive institutions that dictate how members of the police interact with different types of citizens (e.g. in the US, well dressed Caucasians driving expensive cars are usually not stopped for questioning without good cause).[7] Members of this social category may reasonably trust the police, reasoning on the basis of existing institutions that they belong to a type that the police has good reason to treat in a trustworthy fashion.

More abstractly, in such situations *a* knows that she is a member of the class *A*, and is dealing with a member of the class *B*; the social beliefs instantiated in institutions give her good reason to anticipate that members of class *B* will behave in a trustworthy fashion towards members of class *A* across a variety of situations. Here, the logic is similar to Hardin's personalized trust, but on a broader scale of social abstraction. For Hardin, *a* trusts *b*, with regard to matter *x*, because she knows that *b*'s interests

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[7] Obviously, such institutions are deeply rooted in inequitable power relations; members of other categories (the poor; ethnic minorities) will often have good reason to distrust the police in similar circumstances (Feagin 1991). See further, below.

encapsulate her own in this matter. Under the mechanism that we describe, *a* trusts *b* with regard to situations resembling *X*, because *a* is a member of type *A*, while *b* is a member of type *B*, and *a* knows from existing institutions that type *B* actors have good reason to be trustworthy when interacting with type *A* actors in situations that resemble *X*.[8]

This said, we stress again that the concept of trust has a limited application – it only obtains in conditions of uncertainty (Gambetta 1998, Hardin 2002). Trust has little independent explanatory power in situations where actors possess definitive and complete knowledge of how others will behave. Institutions are likely to affect trustworthiness and thus trust, not in circumstances where institutions have direct and unambiguous consequences for behavior, but rather where there is some ambiguity in how or whether institutions should be applied.

Two kinds of ambiguity are especially important for the relationship between institutions and trust. First, there is ambiguity over whether the situation which actors find themselves in is covered by the relevant institutional rule. Here, Hardin's vocabulary

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[8] Of course, mechanisms of this sort may lead to distrust rather than trust. If *a* knows that she is dealing with an actor of type *B**, and social institutions instantiate beliefs regarding type *B**'s untrustworthiness across various matters, she is unlikely to trust the actor with respect to these matters. Such beliefs can be self-reinforcing. If actors perceive that they belong to a specific type which is regarded as untrustworthy, and consequently are unlikely to enjoy the benefits of social cooperation, they may quite reasonably decide to behave in an untrustworthy fashion on those rare occasions when others trust them, since the longer term benefits of a reputation for trustworthiness are unlikely to accrue to them. See, more generally, Knight (2001).

may be adapted to provide a clearer understanding of the issues involved and of the difference between institution-induced expectations and trust. First, consider the case where *a* and *b* find themselves in a situation *x*, which is clearly covered by an existing institutional rule setting out how agents of type *A* and *B* should behave under circumstances *X*. Under this set of conditions, it is difficult to describe *a*'s expectations regarding *b*, or *b*'s expectations regarding *a*, as involving trust. Their mutual expectations are directly induced by the institution in question. Thus, when institutional rules apply directly and unambiguously, we should speak of institution-induced expectations and of institutional compliance, not of trust.

However, consider an alternative case in which *a* and *b* find themselves in a situation *x**, which resembles *X* in important respects, but is not precisely and unambiguously covered by it. Such situations are endemic in social life; the application of abstract institutional rules to concrete situations is rife with ambiguity. In such contexts, the relevant institutional rule does not compel or induce compliance directly, as it is not entirely clear whether the rule should or should not apply under the given circumstances. Here, institutions may still play a very important role in affecting actors' expectations and behaviour, but not a determinative one. Existing institutions may provide actors *ex post* with a means of interpreting situations that were not specifically anticipated *ex ante*, but that in some important way resemble the situations covered by existing institutional rules. Rather than inducing behaviour directly, these institutions work in the same way as the corporate cultures described by David Kreps and Gary Miller among others; they provide a focal point on which actors' expectations regarding appropriate behaviour may converge (Kreps 1990, Miller 1992).

If actors *a* and *b* find themselves in situation *x**, and are uncertain of how to behave, we may reasonably expect that they will draw upon their knowledge of how type *A* actors and type *B* actors interact in *X* in determining the appropriate actions. Where the situations are analogous, actor *a* will be more likely to behave in accordance with the behaviour prescribed for *A* in the relevant institutional rule, and actor *b* will be more likely to act in accordance with the behaviour ascribed to *B*. If the institution in question prescribes that actor *B* be trustworthy to actor *A* (or vice versa), actor *a* will have some grounded reasons for trusting *b* in situations that are not precisely *X*, but are analogous to *C*. While the rule does not determine actors' behaviour, it does give them initial guidelines about how to behave in unexpected circumstances. To the extent that there are few other reliable sources of information regarding types of actors and how they will behave, the beliefs instantiated in institutions will be compelling focal points – in a situation of uncertainty, they allow actors to interpret situations and act accordingly.

The second form of institutional ambiguity is uncertainty over whether or not the enforcement mechanism associated with an institution is likely to be invoked. We note that this is intimately associated with the first. Ambiguity over whether an institution covers the situation in question will lead to ambiguity over whether or not the institution will or should be enforced under unexpected circumstances. Thus, we may expect that the likelihood of enforcement will vary with the degree of similarity between *x** and *X*. This will have the effect of making the relevant institutional rule more attractive as a focal point – if actors reasonably fear that others may enforce the institutional rule as if *x** fell under *X*, they will be more likely to behave as if *x** indeed falls under *X*. We acknowledge that there is relatively little role for trust in circumstances where *x** is very closely similar to *X*, and the institutional rules and enforcement mechanisms applying to *X* are almost certain to apply. However, we note that there will be very many possible situations in which x^* is only somewhat analogous to *X*, and which will give rise to uncertainty as to whether or not the enforcement mechanism will be invoked. Under these circumstances, we may expect that the possibility of enforcement will increase the focal power of the institution, without at the same time involving that certainty of application which is implied in the notion of institution-induced compliance.

Thus, in summary, we suggest that there is a clear difference between institution-induced compliance and the effects of institutions on trust and distrust between actors. The notion of institution-induced compliance applies in circumstances that are clearly covered by a relevant institutional rule with associated enforcement mechanisms, thus directly structuring actors' interests, their actions, and their knowledge of how others are going to act. The notion of trust is entirely superfluous under these circumstances. The actors can achieve cooperation without trusting each other in any significant sense as long as they each follow the behavior dictated by the institutional rule.

However, institutional rules may also have important consequences in circumstances where there is ambiguity or uncertainty over whether an institutional rule should be applied. In circumstances that are not directly covered by an existing institution, but that are analogous to those circumstances covered by an institution, we may still expect actors to use relevant institutional rules as guidelines that help them anticipate how others are likely to act, and thus how they should act themselves. The power of institutions to serve as focal points of this sort is likely to be enhanced by the possibility that the institution may be enforced, even where it is not entirely clear that it applies.

This allows us to distinguish clearly between institution-induced expectations, and the less determinate kinds of institutional effects that are likely to affect perceptions of trustworthiness, and thus of trust. It also suggests that institutions have two clear effects on human behavior. First, they may directly structure expectations and behaviour, in circumstances where they unambiguously apply. This is the ‘core’ function of institutions, and is the focus of most existing institutional theory in the rational choice tradition. Second, they may provide guidelines of interpretation for actors in situations where they do not unambiguously apply. This second realm of institutional effects can be usefully described as the ‘penumbra’ of institutions: the shadow that institutions cast over expectations in circumstances that are not clearly covered by institutional rules.[9] It is in this latter context that institutions may lead to trust among actors, by providing them with means to interpret situations in ways that conduct towards trustworthiness and reasonably grounded expectations about trustworthiness, or alternatively in ways that conduct towards untrustworthy behavior and distrust, depending on the institutions in question. Insofar as the precision of institutions varies, so too will the relative importance of the core and penumbra. Relatively precise institutions (that is, institutions for which *X* is tightly delimited) will tend to have well-defined cores, but relatively narrow penumbrae (they are difficult to apply to circumstances other than those for which they were defined). Relatively diffuse institutions, in contrast, will not have well defined cores, but will have relatively wide penumbrae with important effects for behavior. Thus, if trust is

[9] For quite similar applications of the terms ‘core’ and ‘penumbra,’ see Hart 1997.

a phenomenon of uncertainty rather than unambiguous and externally induced expectations, we may expect it to be more readily created under diffuse rather than narrowly defined institutions. We develop this argument in the next section.

III. Formality in Social Institutions

In the previous section, we have argued that as institutions' precision varies, so too will the relative importance of their core (where they directly induce expectations), and their penumbra (where they merely influence them). How best may we capture this variation? In this section, we argue that there are important differences between formal and informal institutions.

Here we use the distinction to try to capture the differences in the degree to which the various types of institutional rules effectively induce clear and precise behavior. In doing so we note that formal and informal institutions differ in their form (and in their standard means of interpretation) as well as in the commonly highlighted difference in the enforcement mechanisms that underlie them. Thus, we are adopting a somewhat broader and non-standard way of conceptualizing the array of possible social institutions than much of the existing literature, but we think that there are important analytical benefits in doing so.

Formal institutions consist of written rules. They include laws, constitutions, regulations, contracts, written agreements and similar forms. Usually, although not always, they are enforced by a third party. Typically, this third party is the state; in some situations it may be specialized private actors. Even where formal institutions are not accompanied by a third party enforcement mechanism, they may serve to coordinate expectations, providing “parchment equilibria (Carey 2000). Formal institutions typically emerge through formal bargaining processes, in which actors seek consciously to create institutions that may bind them (or others) in the future. They may evolve through various forms of interstitial change and reinterpretation and/or through further processes of bargaining.

Informal institutions are unwritten rules that structure social behaviour (Knight 1992). They include community norms, unwritten understandings and the like. Typically, such institutions are not enforced by a specialized third party, but rather rest on the threat of enforcement by members of the relevant community of actors. Thus, they are likely to emerge through a series of bargaining interactions, which come over time to create institutions that instantiate expectations about the relevant bargaining strengths of actors involved, and thus structure future interactions. In the long run, they are likely to change in response either to changes in the interests or the relative bargaining strength of powerful actors.

In relative terms, formal institutions will tend to have well defined cores, and relatively narrow penumbrae. Thus, they will be primarily relevant to the explanation of social outcomes insofar as they directly induce expectations. Informal institutions, in contrast, will tend to have relatively inchoate cores, and relatively broad penumbrae. Such institutions will often be more important because they provide actors with guidelines that help form expectations than because they directly induce expectations. *Ceteris paribus*, formal institutions will be more likely directly to induce expectations than informal ones, while informal institutions will be more likely to foster trust under appropriate circumstances than formal ones.

Why should formal institutions be characterized by a better structured core, and a narrower penumbra than informal ones? As we have already noted, a key feature of institutional rules is their precision. Formal institutions usually consist of written texts that are intended to increase *ex ante* predictability.[10] Their scope therefore tends to be more tightly defined than the scope of informal institutions. Thus, formal institutions usually have a clearer scope of application than informal ones – the situations which they apply to, and which they do not apply to, are relatively clearly defined and distinct from one another.

Furthermore, formal institutions, to the extent that they are associated with effective enforcement mechanisms, are likely to involve less ambiguities of enforcement than informal institutions. The actions of third party enforcers are typically more predictable than the actions of a congeries of agents within a community, especially when the mechanisms of institutional interpretation are transparent.[11]

This is not to deny that there is substantial variation among formal institutions. Some such institutions (legal regulations, comprehensive contracts) are extremely

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[10] This is not to say that their content is defined by functional needs; see next section.

[11] We note that this argument is less plausible in political systems where formal institutions are only selectively and patchily enforced by the state. See further Hay (1975). Such systems involve theoretical difficulties that we wish to bracket for the purposes of our argument. However, we note that to the extent that the enforcement (or lack of same) of these formal rules depends on informal understandings about what is, or is not 'permitted,' that these systems are better characterized as dominated by informal rather than formal institutions.

detailed in their scope, and correspondingly precisely delimited. Because of this precision, it is difficult to apply them in contexts other than those for which they were originally drafted. Other formal institutions (prominent examples include constitutional texts and business contracts that have the relational quality analyzed by MacNeil (1978) among others) tend to be more diffuse, and thus to have a broader penumbra. They state general principles without providing much direct guidance as to how those principles should be applied. However, even more diffuse formal institutions of this sort tend to have a limited range of ambiguity. Typically, they are interpreted in the final analysis by specialized entities (such as courts) that have an organizational interest in maintaining standards of transparency and consistency in order to maintain their more general legitimacy (Knight and Epstein 1996). While such formal institutions may be indeterminate in themselves, they are usually accompanied by dependent quasi-formal institutions (traditions of precedent and judicial interpretation, bureaucratic codes) that substantially reduce their indeterminacy

Informal institutions, in contrast tend to have a less well-defined core of application, and a much broader penumbra. In contrast to formal institutions, they are usually unwritten, and do not provide tightly defined *ex ante* expectations regarding their scope of application. Even while informal institutions may inform the expectations of all members of a community, they are unlikely to be as tightly specified, or as delimited to specific contingencies as formal ones. Thus, while informal institutions typically have some core (an area of application where everyone in the relevant community agrees that the institution applies), the perceived boundaries of this core are fuzzy, and may indeed vary from individual to individual within the community. This lack of hard edges means that their penumbrae are wider – precisely because they are fuzzier, they may more easily provide guidance in unanticipated *ex post* contingencies. By the same token, it is more difficult for any one agent to be sure that other agents in the community will not seek to enforce the institution, even in situations that are at best ambiguously covered by the informal institution in question. The process through which the institution is re-interpreted *ex post* is relatively unbounded and unpredictable – there is little role for the kinds of tradition of precedent and interpretation that characterize most formal institutions. Again, this serves to extend the penumbra of the informal institution considerably.

What does this mean for institutional compliance, trust and trustworthiness? *Ceteris paribus*, it implies that formal institutional settings will be more likely to lead to institution-induced expectations and simple institutional compliance than trust and trust-induced cooperation. Because formal institutions have a relatively narrow penumbra, institution-induced expectations will predominate, and there will be little scope for institutions to produce trust or trustworthiness. We note that this does not imply that trust and trustworthiness will not exist, and perhaps even play an important role in formal institutional settings. However, trust will not have its source in these institutions, or even be very much influenced by them; instead it will have its source in the kinds of personal relations discussed by Hardin and others.

In contrast, there will be much greater scope for informal institutions to affect trust and trustworthiness. Because such institutions have a greater penumbra, they may more easily influence trust among actors. Both the ambiguity of scope and of application of these institutions will make them more salient than formal institutions when dealing with situations that are not anticipated *ex ante.* But here it is important to note that what our argument implies is that informal institutions are *more likely to affect levels of trust* than formal institutions, not that they necessarily will produce greater levels of trust. The actual extent to which these informal rules will produce trust is greatly influenced by the degree to which they instantiate existing power relations in a society. It is to this second point that we now turn.

IV. Power relations and trust

In the preceding section, we have argued that informal institutions will potentially affect trustworthiness and trust over a considerably greater range of situations than formal ones. However, this claim only concerns the scope or range of institutional effects on trust; it tells us little about their actual consequences. When will institutions lead to increased trust among actors? When will they lead to increased distrust?

We suggest that the actual consequences of institutions for trust and distrust will depend upon the precise expectations that they involve. In particular, we wish to point to the consequences of one aspect of institutions – the power relations that they instantiate – for trust and distrust among actors.

There is good reason to believe that trust is much more easily achieved in circumstances where actors have relatively equal bargaining power (and thus, the ability to ensure that distributional outcomes do not systematically disadvantage them). Furthermore, severe asymmetries of power are likely to produce distrust among actors.[12] The reasons are straightforward. In Hardin's account and in ours, trust is the expectation

[12] For an extended version of this argument, see Farrell (2004).

on the part of one actor that another actor will take her interests into account with regard to the matter at hand. This expectation is problematic in situations where there are substantial asymmetries of bargaining power and is increasingly less likely to obtain as these asymmetries increase.

Why is this so? Bargaining power depends on the alternative options that are available to an actor. If I am considering a transaction with you, but have many other attractive options (other ways to achieve my goals), then my bargaining power will be relatively high in this transaction. I will be able credibly to threaten to take up another option in order to persuade you to accept an outcome that is less favourable to you and more favourable to me in terms of final distributional outcomes. In other words, to the extent that I have greater bargaining power than you have in a particular transaction, I have less need to take your interests into account. Thus, I am less likely to be trustworthy in your eyes; you have less reason to trust me. In situations involving extreme asymmetries of power, where I have no reason at all to take your interests into account, you will have very good reasons actively to distrust me because I have no reason whatsoever to pay attention to your needs and concerns.

Furthermore, asymmetries of this sort are likely to be instantiated in both formal and informal institutions, insofar as both kinds of institutions result from bargaining processes. This is evident for formal institutions, which typically arise through formal bargaining processes. But as Knight (1992) shows, the relative bargaining strength of actors may be instantiated in informal institutions too, even when these institutions emerge in an entirely decentralized way. In a very important sense, informal institutions may be said to instantiate the history of social relations among types over time – they are the by-product of successive instances of bargaining among actors and the expectations to which these instances give rise. Where power relations are asymmetrical, and where powerful actors may expect to secure distributional outcomes that favour them, expectations about these power relations and their consequences will become instantiated in informal institutions. Institutions crystallize expectations about the ways in which different categories of actors interact with each other, including most particularly expectations about the relative bargaining power of actors.

Thus, we can reasonably make two claims. First, asymmetries in bargaining power may be expected to have important consequences for trust and trustworthiness. To the extent that power asymmetries apply in a given situation, powerful actors will have less reason to take the interests of less powerful actors into account, and thus will be less trustworthy. Second, these asymmetries are likely to become instantiated in both formal and informal institutions.

These claims, in combination with the claims about institutional effects made in the previous section, allow us to make the following argument: the power asymmetries (or lack of same) that are instantiated in formal and informal institutions will determine how the application of institutions generates trust or distrust in situations where uncertainty arises. In settings where the relevant institutions instantiate a rough equality of power relations, we may expect that these institutions will (to the extent that they affect trust at all) help foster trust and trustworthiness among actors. In settings where the relevant institutions instantiate substantial inequalities in power relations, we may expect that institutions will foster distrust and lack of trustworthiness.

To show why this is likely to be so, we set out two possible cases. In both of these cases, actors *a* and *b* find themselves in a situation *x** that resembles, but is not identical to, a situation *X* specified in an institutional rule covering how actors of type A and type B ought to behave, so that it falls into the institution's penumbra. If, as we have argued in the previous section, actors seek to use existing institutions as guidelines indicating how others are likely to behave, then actor *a* will reason that actor *b* will behave according to the actions dictated by the institutional rule for actors of type *B* in situation *X*. Similarly, actor *b* will reason that actor *a* will act in accordance with the behaviours dictated by the institutional rule for actors of type *A*.

However, this will have different consequences for trust, depending on the extent to which the institutional rule in question instantiates power asymmetries. First, let us imagine a case in which this institutional rule does not instantiate serious inequalities in bargaining power. Actor *a*, when he looks to the institutional rule in question, will see that actor *b*, insofar as she is a member of type B, will have good reasons to take actor *a*'s interests into account, and thus to be trustworthy. Actor *b* will make the same judgement with regard to actor *a.* Because the institutional rule suggests that there are no major asymmetries of bargaining power, each actor will infer from the institutional rule that the other actor is likely to be trustworthy and that they may thus trust the other actor. Thus, by using the institutional rule as a guide to how others are likely to behave in a new situation, they will be likely to trust each other; the expectations instantiated in the institution will lead them to believe that the other actor is likely to be trustworthy.

In contrast, we may imagine the case where actors *a* and *b* refer to a rule that instantiates gross asymmetries in bargaining power, and thus suggests that actors of type

B are more powerful than actors of type A in situation C. In this case, the institution will give actor *a* little reason to believe that actors of type B have good reason to be trustworthy. Actor *a* will reasonably infer from the institution that *b*, as a member of type B, has little reason to take account of her interests. She will therefore conclude that actor *b* should not be trusted. Not only this: actor *b* will have little reason to trust actor *a*. He will infer from the institution that actor *a*, as a member of type A, has no reason to trust him, which means in turn that actor *b* has no reason to trust actor *a*. Insofar as actor *a* has no reason to trust actor *b*, she also has no reason to behave in a trustworthy fashion towards actor *b*, whom she may reasonably expect not to reward any trustworthiness. Thus, the asymmetries of power that are instantiated in the institutional rule will give weaker actors no reason to trust stronger ones and in consequence will give stronger actors no reason to trust weaker ones.

V. Summary

We may now bring the two skeins of our argument together, by showing how the effects of institutions on trust and trustworthiness varies together with (a) institutional type, and (b) the extent of power asymmetries instantiated within the institution. The chart below sets out the basic relationships generated by the analysis. In this penultimate section we will discuss the four categories and illustrate how the framework applies to empirical cases.

Institutional type/extent of power asymmetries	**No Asymmetries/Minor Asymmetries of Power**	**Major Asymmetries of Power**
Formal Institutions	Institution based confidence/impersonal	Institutionalized inequality

	exchange	
Informal Institutions	Rich trust/trustworthiness	Extensive distrust, lack of trustworthiness

A. Formal Institutions

1. No Major Power Asymmetries. As formal institutions have a strong core, and a relatively narrow penumbra, we may expect that their primary effect will be to instill confidence rather than to create trust. Individuals will be able to transact with each other with a considerable degree of security in circumstances that are covered by the relevant institutions. In these circumstances, trust will be irrelevant. However, because the penumbra of formal institutions is relatively limited, we may expect that these institutions will not predispose individuals to trust each other under many circumstances that are not directly covered by the institution. This does not imply that individuals will distrust each other, but it does suggest that they will need to draw on alternative sources of information (such as the personal relations privileged in Hardin's account) if they are to create the mutual expectations that are necessary for trust and trustworthiness.

2. Major Power Asymmetries. Here too, we may expect that exchange under the relevant institutions will be relatively impersonal, and that individuals will have a high degree of confidence in its outcomes, although the distributional results of these exchanges will be grossly inequitable, favoring certain social groups over others. Such institutions will have negative direct consequences for trust and trustworthiness, but these consequences may be limited in scope. Within the relatively narrow penumbra that formality allows, these institutions will be likely to produce distrust, and lack of trustworthiness.

3. Discussion. As a way of illustrating how this framework helps us to understand the distinct roles of formal institutions and trust in facilitating social cooperation, we will briefly discuss the role of property rights and other economic institutions in coordinating economic exchange. Property rights and the other institutional arrangements that interpret and enforce them are a central focus of many of the scholars of the New Institutional Economics. Most of the claims about the beneficial consequences of impersonal exchange for economic prosperity and political stability are grounded in causal claims about the effects of property rights on economic activity.

Consider, for example, the analyses of the emergence of economic and legal institutions in the Middle Ages offered by Avner Greif, Paul Milgrom, Douglass North and Barry Weingast in several important papers and a monograph authored by Greif. In the first of this set of papers, Greif analyzed relationships among Maghribi merchants and their overseas agents in eleventh century Mediterranean trade relations. [13] Greif argues that these merchants relied on informal institutions in order to enforce honesty, but that these institutions were associated with pervasive inequalities in Maghribi society (Greif 1989). This contrasts with Genoese merchants during the same period, who relied on formal contracts, which provided for a much greater degree of equality and social mobility (Greif 1994). Greif suggests that the contractual forms and cultural beliefs of Genoese society may have provided the seeds for the later economic flowering of the West. In later work, Greif both individually and together with Douglass North, Paul Milgrom and Barry Weingast (Milgrom, North and Weingast 1990; Greif, Milgrom and Weingast 1994, Greif 2006) explicitly seeks to identify how early informal institutions

[13] Greif 1989.

and their associated beliefs gave way to formal rules through a variety of intermediary institutional forms with increasing degrees of formality, and thus to answer one of the major unanswered questions of economic history. These latter analyses share a common explanatory logic. Economic actors needed a means of carrying out economic transactions that could not be guaranteed by purely personal relationships. They had no basis to trust the other actors. In each case the formal judicial and administrative institutions provided clearly defined rules of behavior, a mechanism of interpretation and conflict resolution and mechanisms of enforcement. With these institutions in place economic actors could reasonably expect cooperative behavior from those with whom they interacted. Note here that the causal work of facilitating cooperation is done by the formal institutions. The relevant expectations about the behavior of others are derived from the guarantees established by the institutional framework. There is no reason to invoke the concept of trust to explain social cooperation.

In each of these analyses the established institutions appear to treat the relevant group of actors equally, suggesting that the institutions do not instantiate any significant power asymmetries among the actors. There are two interesting implications of this fact for our analysis. First, as long as the institutions continue to treat the actors relatively equally, there is good reason to believe that the institutions will continue to be an effective and sufficient mechanism for coordinating activity. The additional costs of enforcement that characterize institutions that create significant distributional asymmetries are missing from this type of case. However, many of the ‘nice’ features of these institutional frameworks depend precisely on the absence of substantial power inequalities, something that is obscured because Greif and his co-authors take this absence for granted. There is no necessary reason why formal institutions will not instantiate power asymmetries, and in those cases where they do, we may expect substantial problems for economic development to result. By paying better attention to the relationship between power inequalities and formal institutions we may better integrate Greif's and his co-authors' insights with the burgeoning literature on inequality and economic growth (Alesina and Rodrik 1994, Sokoloff and Engerman 2000, Acemoglu et al. 2007).

Second, as our analysis here argues, as long as the types of economic exchange in which the actors are engaged are covered by the dictates of the formal institutional framework, there will be little opportunity for trust to emerge from these interactions. Although the equal treatment of the actors introduces the possibility that the right kinds of expectations could emerge through ongoing cooperative behavior, the likelihood that there will be pressure for trust to emerge in analogous circumstances is small. This allows us to help clarify why, as Greif and others in a long line of social scientific inquiry have observed, advanced industrialized countries have increasingly come to rely on impersonal forms of exchange rather than personalized ones. The increasing prominence of formal institutions in most of these countries means that the 'right' form of expectations for trust are not generated by the broader institutional framework, so that individuals will usually rely on formalized arrangements when dealing with others not personally known to them.

When we turn to the case of formal institutions that instantiate major power asymmetries, we can readily see that, although the underlying conditions are quite different, the basic causal mechanism of institutional effect is the same. To put this in the starkest terms, consider the extreme cases of apartheid or slavery. Questions of property rights, the nature of economic organization and activity and the distribution of the benefits of economic exchange are all governed by formal institutional rules and procedures (Thompson 1990; Patterson 1982.) Knowledge of the dictates of the rules, including the extreme disparities in the rewards of cooperation, is wide spread throughout the society. Non-compliance with the relevant rules is commonly met with severe punishment. Economic cooperation, albeit of a seriously discriminatory nature occurs, according to the formal rules that govern commercial activity in the community.

Controlling for the differences in the power relationships in the two cases (admittedly, a difficult thing to do morally, but not so analytically), the explanatory logic of cooperation in the slavery case is the same as that of the previous economic examples. Those members of such a society who are discriminated against do not like it and may want to radically change it, but they lack the resources to effectively do so. And thus they are confronted by the stark and unpleasant reality that compliance with the highly discriminatory dictates of the formal institutions may be better than their other alternatives. In this way the institutions mean that their best available choice to act as their oppressors want them to. There is obviously no causal role for trust under such circumstances.

This is how institutionalized inequality works. And, under such circumstances the likelihood that trust would emerge through ongoing social interactions of this kind is slight indeed. For this to occur it would have to be the case that those members of the community who are disadvantaged by the existing institutional framework draw a counterintuitive inference from the behavior of the powerful, that the latter can be counted on to act in a way that is "appropriate for [their] point of view." The more likely inference, of course, is that the powerful can be counted on to act contrary to the less powerful actors' interests and perspective. If the formal institutions of slavery and apartheid were to have any lasting effect on the more general expectations about cooperative behavior in those societies, it would most likely be to reinforce the distrust between the powerful and the powerless.

B. Informal Institutions.

1. No Major Power Asymmetries. Here, we may expect institutions to lead to quite rich forms of trust and trustworthiness across a variety of possible situations. In addition to their core effects, such institutions will have relatively wide penumbrae. Within those penumbrae, actors will be highly likely to trust each other, and to be trustworthy towards each other – they may reasonably infer from existing institutions that others will be trustworthy, and will reward trust.

2. Major Power Asymmetries. In contrast to the last case, we may expect extensive distrust and lack of trustworthiness across a wide variety of social situations. Within a broad penumbra, individuals will infer from existing informal institutions that other individuals from more powerful and less powerful social categories cannot, and should not be trusted. The result is likely to be pervasive, mutually reinforcing distrust among social groups, with negative consequences for economic and political exchange.

3. Discussion. Consider as an example of the benefits of this framework for the problem of corruption and its consequences for economic and political development, a major topic of inquiry for both political scientists and economists over the last fifteen years. Many scholars argue that there is an important relationship between corruption, inequality, and the propensity of individuals to trust each other (You 2005, Rothstein and

Uslaner 2005). Economists and scholars working within the rational choice tradition have typically seen corruption as involving a failure to develop appropriate formal institutions that would underpin impersonal economic transactions and secure property rights (North 1990, Azfar, Lee and Swamy 2001). In contrast, many political theorists (Warren 2004) and political scientists (Johnston 2006, Rothstein and Uslaner 2005) argue for more extensive definitions of corruption, which would take account of the ways in which it affects people's overall life chances, arguing that its causes may partly be located in the differing access of individuals to political and economic opportunity and its consequences in the propensities of individuals to trust each other.

The theory of institutions and trust that we have presented accommodates the insights of both frameworks, showing how the weakness of formal institutions identified by economists and the inequalities of access identified by political theorists and scientists reinforce each other and lead to endemic mistrust. Adapting arguments made by Helmke and Levitsky (2004), we argue that the corruption that plagues many countries is best considered as a deeply rooted set of informal institutions that instantiate inequalities of power, undercutting the formal institutions that purportedly guarantee equality of treatment so that favored and disfavored classes of actors are treated in a highly differential fashion. Trust may be more difficult, or even impossible to achieve among actors, as less powerful actors have little reason to trust more powerful ones (and vice versa) under a host of situations that fall under the broad penumbra of existing informal rules. In cases of extreme disparities of power such as those found in advanced kleptocracies, informal institutions will serve to ground profound distrust among different groups of actors.

Johnston (2006) provides a recent typology of different varieties of corruption, ranging from the kinds of corruption found in advanced industrialized societies to the extreme forms of kleptocracy found in some developing countries. While Johnston stresses the typological differences between different 'syndromes' of corruption, he also amply illustrates the relationship between corruption and power. The most extreme syndromes of corruption are just those ones in which inequalities of power are most extravagant. As Klitgaard's (1991) famous formulation states, corruption equals monopoly plus discretion minus accountability. That is, corruption is likely to be at its worst when privileged actors have the power to make decisions without any mechanisms of accountability that might force them to consider the welfare of other, less powerful actors. These extreme forms of corruption are associated with pervasive mistrust, just as our arguments would predict.

If we are right, efforts to combat corruption and promote economic development through restraining the 'grabbing hand' of the state (Shleifer and Vishny 1998) are at the very best going to be partially effective. If anti-corruption strategies don't address the problem of political and social inequality (which by no means is limited to the specific asymmetries resulting from state authority), they will fail to address the underlying problems that reproduce corruption and pervasive distrust in these societies.

Finally, as an example of low power asymmetries combined with informal institutions, consider Italy's industrial districts – tightly linked clusters of small firm production, with extraordinarily high levels of cooperation between firms – which have been cited by Robert Putnam (1993) as providing key supporting evidence for his arguments about social capital. These show how informal institutions may support dense forms of trust-based cooperation under the right circumstances. The formal institutions governing the Italian political economy are notoriously dysfunctional (Regini 1995), creating space for an extraordinary variety of local micro-economies (ibid, Locke 1995), operating on the basis of local community rules (Brusco 1992, Bianchi 1993, Bellandi 1996). In industrial districts, these rules support very broad forms of cooperation based on word-of-mouth agreements that allow actors to trust each other under circumstances that could not readily have been anticipated *ex ante* (Farrell 2005).

Up until the recent past, these local systems of informal rules have typically gone together with low degrees of power asymmetry between economic actors. Typically, industrial districts have both final firms, which market and perhaps assemble the finished product, and subcontractors, which provide particular inputs to the final firms. Although the final firms in industrial districts have typically had a somewhat stronger bargaining position vis-à-vis subcontractors than vice-versa (Trigilia 1989), this asymmetry has not been very great (Farrell and Knight 2003). This rough equality of bargaining power has meant in the past that the informal rules governing interaction between final firms and subcontractors have underpinned forms of cooperation to the advantage of both sides.

This is changing in some districts, where power asymmetries have heightened substantially even as informal rules continue to play a key role (Farrell and Knight 2003). As our theory would predict, business actors find it more difficult to trust and cooperate with each other in industrial districts where there has been a substantial increase in hierarchy, such as Prato (dei Ottati 2005) and Bologna (Farrell and Knight 2003). In other districts where power asymmetries have grown less markedly, trust based relationships involving informal reciprocity seem to have fared rather better (Brusco and Bigarelli 2002, Whitford 2001).

Thus, Italian industrial districts offer strong evidence that appropriate informal institutions and low degrees of power asymmetry are highly conducive to producing trust and cooperation among actors. Where major power asymmetries have emerged in these districts, trust has correspondingly become more one-sided and more difficult to maintain. Where, in contrast, these asymmetries are not so marked, actors have been able to maintain some degree of trust among each other.

Conclusions

In this article, we have addressed a major lacuna in our theories of cooperation – the disconnect between our theories of the effects and consequences of institutions, and our theories of the sources of trust. We have shown how these literatures fail to build connections that are necessary to a complete understanding of the origins of cooperation, and how this failure stems from their basic assumptions about what institutions do, and what trust involves. We have then set out an alternative theory of institutions that accommodates both the kind of behavioral effect traditionally considered by rational choice institutionalism (that is, simple institutional compliance), and effects that have received little sustained attention (the ways in which institutions may affect complex forms of trust). This allows us to build a coherent theory that both shows how institutions may result in compliance and trust, and allows us usefully to distinguish between them, thus bridging two previously separate literatures and creating a new framework that not only integrates their insights but allows new causal connections to be drawn.

Our arguments have wider relevance for the literatures on trust, on institutions, and on the relationship between the two. We examine each in turn.

First, by clearly distinguishing between institution-supported trust and simple institutional compliance, we clear the ground for a better understanding of how and when institutions affect trust. This has wide implications for the existing theoretical and empirical literature on trust, which has often relied on vague assertions and functionalist arguments about the sources of trust; e.g. that trusting attitudes stem from the right kind of political culture (Inglehart cite), or that trust is the result of norms that evolve "because they lower transaction costs and facilitate cooperation" (p.172, Putnam 1993). We provide an alternative account which clearly specifies the institutional mechanisms that are likely to produce trust, without any implication that these institutions themselves arise because they support trust (rather, we argue, they are a by-product of struggles over distributional benefits). Our arguments furthermore extend the thriving literature on the relationship between trust and interests in new directions. They complement existing arguments about how trust may stem from purely personal relationships (Hardin 2002, Cook, Levi and Hardin) by showing how intermediate level social structures such as institutions may affect trust too, while maintaining the necessary distinction between trust and compliance.

Second, we make a substantial contribution to the literature on institutional effects, expanding rational choice arguments over institutions in new directions, by detailing the ways in which institutions may affect the expectations of rational actors without simply inducing compliance. This allows rational choice institutionalists better to capture how institutions work in practice. It also builds bridges between rational choice theory and other forms of theoretical inquiry (specifically historical institutionalism and sociological institutionalism) by showing how conventional forms of rational choice institutionalism need to be extended if they are properly to understand institutions. One implication of our arguments is that much of the important action happens precisely where institutions' behavioral consequences are less clearly defined; this suggests that rational choice scholars have much to learn from other forms of institutionalism that have concerned themselves with these interactions.

Finally and most importantly, our arguments suggest that a theory of the *interactions* between institutions, institutional compliance and trust provide us with the appropriate intellectual tools to open up several exciting new empirical research agendas. As noted at the beginning, our contribution in this article is primarily theoretical; we lack the space to provide more than a series of sketches of our arguments' consequences for important controversies in the social sciences. Nonetheless, we believe that the preliminary evidence supports our contention that closer attention to these key relationships will shed light on important empirical questions that have thus far received no satisfactory answer in the literature.

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