

Introduction: The Political Economy of Trust: Interests,  
Institutions and Inter-Firm Cooperation in Italy and Germany

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# Chapter 1

## Introduction

### 1.1 A Political Economy of Trust

What are the sources of trust and cooperation in political and economic life?<sup>1</sup> This question lies at the heart of key debates within political science. However, it remains unresolved, in large part because of serious weaknesses in our understanding of the relationship between social structure, trust, and cooperation.

These weaknesses are not the result of neglect by political scientists. The two dominant approaches to the explanation of comparative politics, political culture and rational choice, both place trust and cooperation at the core of their research agenda. Yet there is something unsatisfying about the arguments that they offer. Scholars of political culture have almost uniformly concerned themselves with macrolevel arguments based on aggregate survey data. Their arguments have scanty microfoundations, a rather serious problem if one wishes to explain how individuals may come to trust each other and thus cooperate. Rational choice scholars have constructed models with clearly specified microfoundations, but they have had great difficulty to date in building mid-level theories that can capture the consequences of institutions and other such broader phenomena for trust. All too often, rational choice scholars implicitly or explicitly equate trust with simple institution-induced expectations, a move which nonrational choice scholars (correctly) view as reductionist.

In this book, I try to set out the beginnings of an alternative approach to the understanding of the “political economy” of trust; that is, of the relationship between institutions, trust, and cooperation in economic interactions. My account builds upon the basic foundations of rational choice theory. The above stated caveats aside, I argue that rational choice provides excellent building blocks for a coherent and persuasive theory of what motivates actors to trust each other in economic situations, and thus to cooperate. On the one hand,

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scholars such as Douglass North and Jack Knight provide us with the means to analyze institutions as sets of rules that can shape individual behavior. On the other hand, recent work by Russell Hardin (2002) and others, most particularly Margaret Levi (1998) and Cook, Hardin, and Levi (2005), on the “encapsulated interest” account of trust and related ideas, allows us to see how individuals may draw inferences about the trustworthiness of others from the interests that those others have in behaving trustworthily. In other words, rational choice has the two basic components for the kind of theory that I seek to construct: it provides arguments about (1) the origins and nature of institutions and (2) the bases of trust and social cooperation.

Even so, it is difficult to draw these two literatures within rational choice together into a coherent whole without falling into the trap of reductionism. How may institutions affect the possibility for relations based on trust without, at the same time, entirely determining them? If everything is explained by institutional incentives, then it is difficult to talk about trust in any meaningful way. We have a powerful (and, I believe, valid) intuition that trust encompasses something rather richer than the mechanical sets of incentives and relationships that formal models depict. In two important contributions, David Kreps (1990a) and Gary Miller (1992) provide the beginnings of a more fruitful line of inquiry, which builds on game theory to understand trust in a less mechanistic fashion. In this book, I seek to build on their insights, to integrate them with recent advances in institutional theory, and then to apply them to the comparative political economy of inter-firm relations. The relationship between institutions, trust, and cooperation is an important one for many avenues of inquiry in the social sciences. I argue that it has a particular relevance for comparative political economy. A recent landmark essay by Peter Hall and David Soskice (2001) endeavours to set out the beginnings of a general comparative approach to political economy, building on both historic institutionalism and rational choice theory. I hope to contribute to the “varieties of capitalism” literature that Hall and Soskice wish to systematize, albeit with a different understanding of the forces that guide institutional change and the likely consequences of institutions for individual behavior.

In order to develop this contribution properly, I make use of two rich bodies of empirical evidence. First, I turn to two case studies of trust and cooperation within the political economy: the packaging machinery industry in Emilia-Romagna in Italy, and the machine-tool industry in Baden-Württemberg in Germany. These cases are important examples of “industrial districts,” areas of small firm concentration, which, according to the existing scholarly literature, are characterized by extraordinarily high levels of cooperation among firms. In the classic industrial districts, intensive inter-firm cooperation appears to serve as a substitute for hierarchical production within the firm, a pattern of production that is both extraordinarily rare in advanced industrial economies (Miller 1992) and difficult to explain using standard approaches to the relationship between hierarchy and market (Williamson 1975; 1985). Furthermore, some scholars have claimed that this cooperation involves a kind of trust that cannot be explained using rational choice theory (Brusco 1990; Sabel 1993). In short, industrial districts present important puzzles for both political science and rational

choice theory. Emilia-Romagna and Baden-Württemberg are among the “classic cases” of the industrial district phenomenon (Brusco 1982; 1990; Burroni and Trigilia 2001), and thus provide especially important test cases, while also providing a high degree of variation on institutions. Thus, they allow one to study the effects of institutions on trust and cooperation among actors with a reasonable degree of clarity and precision.

Second, I examine an empirical context characterized by widespread distrust and opportunism – relations within the Sicilian Mafia. For obvious reasons, this case is not directly comparable to mechanical engineering – the problems of trust are rather starker for a mafioso seeking to determine whether his apparent friend wishes to lure him to a secluded spot so as to strangle him, than for a producer of packaging machines trying to determine which subcontractor is trustworthy. Even so, it provides a parallel demonstration of how the mechanisms of expectation formation and information transmission that serve to underpin trust in one set of circumstances can help lead to pervasive distrust in another.

I use empirical evidence drawn from these cases to assay my broader theoretical claims. These case studies, even if they exemplify quite important phenomena, provide only an imperfect means of testing generalizable arguments. Yet there are some very real intellectual advantages to proceeding in this fashion. Robert Bates, Avner Greif, Margaret Levi, Jean-Laurent Rosenthal, and Barry Weingast (1998a) recommend the use of analytic narratives, a combination of abstract theoretical argument, and detailed exegesis of empirical facts, to disentangle the causal relationships in complex strategic situations. Analytic narratives, as described by these scholars, are problem driven rather than theory driven; they seek to account for particular outcomes rather than to establish general causal relationships. Yet, as Peter Hall (2003) notes, studies of this sort may also serve wider theoretical goals beyond the specific explication of the particular cases under examination. Indeed, such studies may be quite essential to the mapping of certain kinds of causal relationships. Hall suggests that the methodologies used by comparative social scientists have increasingly fallen out of step with the underlying ontologies that they assume. Cross-national multiple n multivariate analysis rests on assumptions about the underlying data such as the independence and noncollinearity of relevant variables. However, these assumptions do not sit well with the accounts of politics that have increasingly come to the fore in comparative analysis, which stress path dependence (Pierson 2000), or, as in this case, strategic interdependence among actors. Hall suggests that process tracing” – the careful examination of paths of causation to see if outcomes are congruent with those predicted by theory – is a more appropriate way to test the validity of complex causal models.

I seek to build on insights from both the analytic narratives approach of Bates and his co-authors, and the historical institutionalist approach to process tracing advocated by Hall. On the one hand, I draw inspiration from the kinds of formal models emphasized in the analytic narratives approach. On the other, I seek to use theory and evidence not only to provide an account of the relationships in a specific setting but also to draw conclusions that may potentially have wider applicability.

Before so doing, however, it is appropriate to situate this book more precisely within ex-

isting debates in the field. In the remainder of this introductory chapter, I will set out in turn the main benefits and shortcomings of the political culture approach and current rational choice approaches to trust and cooperation. I will then go on to examine issues of trust and cooperation in the field of comparative political economy, with particular reference to the literature on industrial districts and other regionally based forms of economic cooperation. I then conclude by stating more precisely how this book contributes both to broader arguments about trust and cooperation and more specific debates about how these concepts explain outcomes in the political economy.

## 1.2 Approaches to Trust – Political Culture

Trust has been a central concept in comparative politics at least since the first wave of the behavioral revolution. This may in large part be traced back to the research agenda set out in Gabriel Almond and Sidney Verba's *The Civic Culture*. Almond and Verba sought to locate the sources of political success in the political culture of a country: those beliefs, norms, and values held by the country's citizens. Specifically, they argued that countries with "parochial" cultures, in which individuals failed to identify properly with their fellow citizens, instead relying on local or familial ties (Banfield 1958), were likely to do less well than countries with "subject" cultures, or (the ideal) "participant" cultures. In Almond and Verba's (1963, 284) view, this could in large part be traced back to social values stressing cooperation: "The degree to which cooperative interpersonal behavior is valued is directly related to the propensity to create political structures." Trust rapidly became a key explanatory variable, if not the key variable for scholars of political culture. They argued that it explained the relative levels of development of different countries. Countries with a high level of diffuse interpersonal trust were likely to be politically and economically successful; those that did not were likely to do poorly. As described by Lucian Pye (1965, 22), "political cultures are built either upon the fundamental faith that it is possible to trust and work with fellowmen or upon the expectation that most people are to be distrusted and that strangers in particular are likely to be dangerous." This emphasis on trust as "one of the most basic . . . attitudes" supporting mass democracy persists in contemporary work on political culture (Inglehart 1988,1204). Ronald Inglehart, in a series of articles and monographs (1981,1988,1990,1997,1999), has sought to show that diffuse interpersonal trust remains a key explanatory variable for political science, and Robert Putnam's work, which is deeply influenced by the political culture tradition, also stresses trust as a vital explanatory factor.

Even if scholars of political culture see trust as a core concept, their account of its origins and effects has problematic microfoundations. Three problems stand out. First, the political culture account of diffuse interpersonal trust (and other cultural factors) rests on an insufficiently specified causal model. This has been a criticism of political culture accounts since Almond and Verba's original research. The concept of political culture had its begin-

nings in Parsonian sociology (Almond 1956), which notoriously employed a conceptually muddied and functionalist approach to the explanation of social institutions and practices. Almond and Verba were robustly criticized for assuming that culture caused structure, rather than vice versa (Pateman 1971; see also Barry 1978). More recent versions of political culture theory have argued that the causal arrows run both ways, so that culture may affect structure/and or politics, and vice versa (Inglehart 1990). In broad terms, this claim is inarguable, but without more specific – and testable – arguments as to how each relates to each, it is also rather unhelpful (Johnson 2003). Further, generalistic arguments of this sort may in practice shade into functionalist accounts of the origins of trust, as in Robert Putnam’s *Making Democracy Work* (1993). For Putnam, civic values, networks, and norms (informal institutions) go together to make up social capital. He states that the norms of diffuse reciprocity that underpin cooperation and trust in society evolve “because they lower transaction costs and facilitate cooperation.” Arguments that seek to explain a social practice in terms of its broad social benefits, without providing clear causal mechanisms connecting the two, have little intellectual merit (Farrell and Knight 2003). In short, even while scholars of political culture have provided intriguing – and important – empirical evidence on topics such as the relationship between certain sets of values and material well-being in a society (Inglehart 1990), they have failed to provide a satisfactory account of where culture comes from and how it is related to other important factors, which in turn leads to implausibilities in their account of trust.

Second, the notion that trust is an “attitude” (Inglehart 1988), or that certain cultures have “dominant values [that] stress cooperative behavior” (Almond and Verba 1963, 284) rests on a deterministic, and conceptually flawed, account of what attitudes and values are (Johnson 2003). It is important to note that there are controversies among scholars of political culture about how best to conceptualize cultural variables. Scholars such as the late Harry Eckstein follow Parsons in suggesting that culture largely consists of learned patterns of orientation (Eckstein 1996; 1997). Under this account, culture is the product of socialization, and it plays a strong role in determining individuals’ behavior. The general problems with accounts of this sort are well known (Granovetter 1985; Johnson 2003). However, they also have specific consequences for the understanding of trust. They suggest that diffuse interpersonal trust is something that is learned rather than considered, so that there is limited (if any) scope for individual agency or decision making in explaining it.

But there are scholars who view political culture as playing a less overwhelmingly determinative role. Both Elkins and Simeon (1979) and Barnes (1988) argue that culture does not define the individual so much as it provides her with an understanding of the assumptions that are shared in her society; she need not agree with a belief or orientation in order to recognize it as an important facet of her culture. This second account of culture provides much greater scope for human agency and is at least partly compatible with a broadly rational choice perspective on cultural factors. Unfortunately, however, it is Eckstein’s rather less supple account of political culture that has predominated in empirical work. Ronald Inglehart, for example, applies Eckstein’s concepts in his cross-national work on

culture (Inglehart 1990), with direct consequences for his understanding of interpersonal trust, which he sees as resulting from very broad social forces (such as national history) rather than from the interplay between individual actors.

Finally, most work in the political culture tradition applies a particular set of tools to the understanding of culture: the statistical analysis of survey data. Even if one is not so profound a skeptic of the ability of survey methods to uncover cultural patterns as James Johnson (2003), one may still note that broadly framed questions, such as those in the World Values Survey, provide a doubtful proxy for how trust and cooperation actually work in a society (Hardin 2002). Surveys typically ask respondents whether or not they believe that others in their society can or cannot be trusted as a general rule. When patterns of trust or distrust involve specific individuals and specific matters (as they usually do), questions that seek to ascertain levels of generalized, impersonal trust are unlikely to provide helpful insights into actual motivations or behavior. Thus, it is at best unclear whether the survey data used to study trust is a good proxy for how individuals trust (or do not trust) each other.

All of these problems suggest that political culture approaches to trust, at least as they are commonly construed, have problematic microfoundations. They rest on imprecise or functionalist causal models, apply a Parsonian theory of culture that provides little scope for individual agency, and use survey data that provides a poor proxy for actual trust and cooperation. A more successful account of trust and cooperation should rest on secure microfoundations, such as those provided by rational choice theory. However, as discussed in the following section, rational choice theory faces its own theoretical problems in describing trust.

### 1.3 Trust and Rational Choice Theory

Rational choice approaches to politics, like political culture, take the problem of cooperation as a central concern. Noncooperative game theory, despite its name, provides a powerful set of tools for understanding the circumstances under which individuals will or will not cooperate with each other. What is less clear, though, is how well rational choice approaches can explain trust, which typically involves complex and personal relationships that are difficult to model using a game-tree or similar methodology. Three approaches to the understanding of cooperation predominate in rational choice theory. First, scholars such as Oliver Williamson treat the decision of whether to cooperate or not with others as being for the most part an exercise in parametric decision making (Williamson 1975; 1985). Williamson suggests that the decision of a firm to produce internally or to outsource (cooperate with another firm) in a given instance, depends on the cost of the transaction at hand, which in large part is a function of the potential for opportunism. The risks of opportunism, however, primarily adhere to the type of transaction, rather than the type of partner. Unsurprisingly, Williamson has little patience for theories of trust, arguing that

they have little purchase in the realm of economic decision making, where interests are unambiguous (Williamson 1993). Thus, Williamson argues that trust is unnecessary to the explanation of economic cooperation; instead, cooperation flows more or less directly from the interests of economic actors.

Second, there is a burgeoning literature that treats trust and cooperation as features of games. Work in this vein ranges from relatively simple treatments such as Partha Dasgupta's "Dishonest Salesman" game (1988) to the sophisticated use of game theory to model bilateral cooperation within a large group of agents. In the latter body of work, infinitely repeated games are used to model institutions that "promote the trust necessary for efficient exchange" (Milgrom, North and Weingast 1990, 1). Institutions are usually represented as subgame perfect equilibria, in which no actor has an incentive to deviate from her strategy. Given appropriate parameter conditions, and the existence of a specific institution, actors will have no incentive to behave in an untrustworthy fashion, so that trust and cooperation can be maintained among quite large groups of actors. Institutions, under this approach, may involve quite complex sets of social relationships and information exchange, in which, for example, one actor may serve as a central clearinghouse for information.

Less formal accounts of institutions and trust may be found in that branch of the New Institutional Economics (North 1990; North and Weingast 1995) that emphasizes how institutions may underpin credible commitments. In this argument, institutions may serve as an important technology of commitment. Actors may subject themselves to institutions when they seek to demonstrate to others that they may be trusted to behave honestly in situations where those others might reasonably suspect that these individuals would otherwise behave opportunistically. In both this literature and in the game theoretic literature discussed previously, trustworthiness flows more or less ineluctably from certain institutional arrangements. Institutions both serve to underpin trustworthiness (by giving actors the incentive to behave in a trustworthy fashion) and to communicate information about the trustworthiness or untrustworthiness of others.

Finally, a recent and important literature seeks to build a theory of personal trust on the basis of considered interests. Russell Hardin's "encapsulated interest" account provides a three-part account of trust in which one actor trusts another when she knows that the latter actor's interests encapsulate her own with regard to the relevant matter. As Hardin emphasizes, this is a relational account of trust – actor interests will most likely encapsulate each other when the actors are engaged in a long-term relationship, which might deteriorate or be lost if one of them behaves in an untrustworthy fashion. Hardin also claims that broader social institutions may affect trust between actors, although his argument about the relationship between social institutions and individual relationships that involve trust is not fully spelled out. In Hardin's view, it is unlikely that one will trust others whom one does not know directly, such as government officials. Margaret Levi (1998), who has also sought to develop the encapsulated interest account, disagrees (although see Cook, Hardin, and Levi 2005). She suggests that individuals may trust government officials and others

when the latter embed themselves in institutions that give them the right incentives. The argument that I develop is a rational choice one: I construct an argument about trust, cooperation, and institutions on the basis of arguments about actors who pursue goals that reflect their individual economic interests. However, there are important gaps in the rational choice literature as it now stands. First, much of the literature on institutions, trust, and cooperation is implicitly or explicitly functionalist. The argument that institutions may support cooperation is all too frequently conflated with the argument that institutions come into being “in order to” support cooperation. Functionalism is especially endemic in the game theoretic literature on institutions. Although game theorists have enjoyed remarkable success in modeling quite complex social institutions as equilibria in infinitely repeated games, they face the problem of the “folk theorem,” which suggests that there are vast amounts of potential equilibria in such games, each of which is equally plausible from a theoretic point of view. Thus, game theorists may use game theory to say that an equilibrium is possible under certain parameters, but they very often have to turn to external mechanisms in order to explain why one equilibrium rather than another has prevailed. All too often, however, they merely show that an equilibrium is possible and would further a broad social goal without further discussing the specific mechanisms through which this equilibrium rather than another was arrived at. Many articles on trust and cooperation thus model an institution that supports cooperation among a group of actors and assume that the institution came into being in order to support cooperation, rather than investigating the various causal mechanisms that may be implicated in institutional creation or change. Furthermore, there is a disjuncture between institutionalist approaches, which are overly determinist, and relational accounts of trust, which have difficulty in explaining how institutions affect trust. Despite some important initial contributions (Kreps 1990; Miller 1992; Levi 1997; 1998; Ensminger 2000), we still do not have a fully developed theory of how institutions may affect trust and cooperation among actors without fully determining their interests.

The institutionalist literature provides an overly simplistic and deterministic account of trust and cooperation. For example, Milgrom, North, and Weingast (1990) demonstrate the existence of an institutional equilibrium under which dishonest behavior lies off the path of play. It is not in any player’s interests to cheat, given certain parameters and expectations about how other players will respond. This captures an important effect of institutions. However, it is unhelpful to conflate this effect with trust. Trust is usually seen as involving social relationships that are personal, at least in part, and matters in which there is a real (if unquantifiable) risk of default. Game theoretic models of institutions have extreme difficulty in modeling such relationships and the kinds of expectation generated by these relationships. To the extent that cooperative relations are a simple function of the incentives created by institutions, Williamson’s criticism stands. It is a misnomer to describe expectations over straightforward institutional compliance as trust.

But the encapsulated interest account of trust provides a nuanced account of trust among actors that is sensitive both to the uncertainties involved in trust and to its specifically

relational nature. However, precisely because it treats trust as a relational concept, it has difficulties in delineating how institutions may affect it. Insofar as trust involves personalized relationships among specific individuals, it is at least at one remove from the effects of institutions.

Therefore, rational choice approaches to trust offer both a useful theory of how institutions may induce cooperation and a helpful microlevel account of trust in personal relations. However, it still has difficulty in creating bridges between these accounts, that is, in showing how institutions may affect trust in relationships among individuals, as opposed to merely inducing determinate expectations over cooperation.

## 1.4 Trust and Political Economy

Controversies about trust and cooperation have become increasingly important in the field of comparative political economy as that field has broadened in scope and ambition. Increasingly, comparative political economy is concerned not only with the sources and consequences of government economic policy across nations but also with the broader patterns of cooperation and competition that characterize different models of capitalism (Crouch and Streeck 1995; Hollingsworth and Boyer 1997; Hall and Soskice 2001). Comparative political economy has also seen an increasing degree of agreement on basic principles, as historical institutionalists and rational choice institutionalists have begun to use models and arguments that rest on similar microfoundations. Historical institutionalists and rational choice scholars now not only agree that institutions are important but they also increasingly agree on why they are important, and what they are. Peter Hall and David Soskice, for example, argue on behalf of an approach to “comparative capitalism [that] emphasizes the presence of institutions providing capacities for the exchange of information, monitoring, and the sanctioning of defections relevant to cooperative behavior among firms and other actors.” Few rational choice scholars, if any, would disagree with this set of priorities. Thus, for Hall and Soskice, as for other comparative political economists, the relationship between institutions and cooperation is vital to how economies work.

However, some important problems remain in Hall and Soskice’s account, as in other work in the literature on comparative capitalism. Specifically, the relationship between micro- and macrolevel phenomena is poorly spelled out. Hall and Soskice argue that their account provides a firm-centered approach of the economy and compare economies according to how firms resolve their coordination problems. They distinguish between “liberal market economies,” in which firms primarily rely on market mechanisms to coordinate, and coordinated market economies, where they rely on nonmarket mechanisms, including incomplete contracting. In this perspective, institutions are important because of “the support they provide for the various types of relationships that firms use to resolve coordination problems” (Hall and Soskice 2001, 9). Hall and Soskice do not seek to explain how nations acquire these institutions in the first place. However, they suggest that nations with certain

institutions in one sphere of the economy will seek to develop “complementary” institutions – institutions that involve complementary forms of coordination – in other spheres. Thus, one may expect that economies will be governed by relatively coherent institutional ensembles at the national level.

Hall and Soskice’s account has some important advantages over much existing work: it demonstrates how institutions can affect cooperation between economic actors without fully determining the form that cooperation takes by providing greater support for some types of relationship than for others. However, it also has some important lacunae. Hall and Soskice state that their account (1) relies on a strategic account of individual interaction, and (2) only seeks to explain how institutional structures affect coordination among firms, and not the origins of the institutions themselves. To the extent that the authors follow their own prescriptions, they fall into an implicit functionalism, in which strategic interaction is only important insofar as it creates problems that need to be “solved” through different institutional structures. In short, their approach assumes that institutions’ role is to improve coordination and has little to say about the strategic problems involved in the process of institutional creation itself. This is most obvious in Hall and Soskice’s account of institutional complementarities, which is a cornerstone of their larger intellectual project. They suggest that certain kinds of institutions tend to be found together in an economy because “the presence (or efficiency) of one increases the returns from (or efficiency of) the other” (Hall and Soskice 2001, 17). In the absence of specific propositions as to how strategic interaction among actors leads them to seek efficiency gains, this is a functionalist claim. More recent work by Hall on his own (2005), and in collaboration with Kathleen Thelen (Hall and Thelen 2007), goes some distance toward articulating an account of institutional change that pays more attention to distributional struggle. However, precisely because of its eschewal of functionalism, it sits uneasily with Hall and Soskice’s macrolevel framework. In short, Hall and Soskice seek to introduce a strategic element to the understanding of cooperation in the comparative political economy, but they do not go far enough. Strategic interaction exists in their model as a problem to be resolved through appropriate institutions, rather than an underlying feature of the processes that create institutions in the first place.

## 1.5 Articulating an Alternative Account of Trust in the Economy

In the previous sections I have discussed existing approaches to the explanation of trust and cooperation in the political economy, and I have suggested that these accounts have some rather important shortcomings. I identify two key problems. First, there is a strong tendency toward functionalism in most current approaches to the understanding of trust. Scholars tend to assume, explicitly or implicitly, that the social structures that support trust between actors come into being because they support trust between actors. This is as

true of much rational choice or “varieties of capitalism” work examining how institutions allow actors to cooperate with each other, as it is of political culture scholarship, which assumes that political culture exists because it fulfils the broader functional needs of a society. In specific instances, it may well be that the origins of social structures are explained by the social needs that they meet, but this should be a subject for empirical investigation, rather than a starting assumption. Not only may functionalist explanations be wrong (as they very often are), but they usually commingle the explanans and the explanandum so as to muddy causal relationships. Thus, a satisfactory account of the relationship between institutions and trust should not rest on functionalist assumptions, unless there is strong independent evidence that functional needs are in fact the main driving force in the relationship at hand. Instead, it should be able to show how social structure may affect trust relations, without necessarily arising from the need to underpin these relations.

Second, current accounts have great difficulty in describing the relationship between the macro- and microlevels, that is, between the structures that influence trust relationships and those trust relationships themselves. Political culture accounts have great difficulty in speaking to the microlevel on which individuals trust or do not trust each other with regard to specific matters, while rational choice accounts have problems in linking macro- to micro-level without reducing trust to quite narrow institution-induced expectations. A satisfactory account should thus be able to show how the macro- and microlevels are related, without reducing the one to a mere effect of the other. As I have noted, current work in the literature on “varieties of capitalism” goes some way toward doing this, but on the basis of a causal model that has quite important gaps and ambiguities.

I propose an account of the “political economy of trust,” which, I hope, meets both of these criteria. It does so on the basis of rational choice theory and, more specifically, the rational choice theory of institutions. This means that it has some clear limits. Institutions are not the only form of social structure that is relevant to trust relations. As sociologists have been at pains to illustrate, social networks may have quite important effects on individual relations, which are by no means fully reducible to institutions. However, the converse is also true, and network accounts of politics face enormous difficulties in bridging the micro- and macrolevels without invoking external mechanisms. Furthermore, precisely because my theory of trust is a rationalist one (and one that privileges material interests at that) it can only explain forms of trust that rest on one kind or another of self-interest. Thus, it cannot explain trust beyond interest, that is, the grounded expectation that actors will be trustworthy in circumstances where it is not in their best interest to be so. I do not seek to deny that such trust (and trustworthiness) exist. Indeed, I acknowledge that I cannot explain it using the arguments laid out in this book. Instead, I seek to show how an interest-based account of trust can accommodate institutional effects that go beyond the kinds of determinate effects on expectations provided by game theoretic models and the like.

These caveats aside, there is considerable reason to believe that an institutionalist account of trust may provide important insights into how trust comes about, and how it affects

social relations. As Jack Knight puts it:

the concern with such issues as social capital, trust and civility basically involves an analysis of the types of informal institutions that exist in a society . . . to understand the emergence and maintenance of social capital, trust and community in a society, we must understand the evolution of these informal rules.

By coming to a better understanding of the consequences of institutions, we may better appreciate the sources of trust and cooperation. Furthermore, even if some forms of trust are not based on expectations over self-interest, many are. It is furthermore plausible that self-interest-based forms of trust will play a much more direct role in areas such as economic relations, where material interests are both obvious and important.

I do differ substantially from many other scholars in my account of the relationship between institutions, trust, and cooperation. Rather than positing functional complementarities and feedback loops (Hall and Soskice 2001), I suggest that institutional change is driven by self-centred actors' efforts to reap distributional benefits (Knight 1992; Farrell and Knight 2003). Thus, I seek specifically to distinguish between the sources of institutions – which I argue, following Knight (1992), are struggles over how benefits are distributed – and the consequences of institutions (observable patterns of trust and cooperation at least in some instances). Furthermore, I hope to provide a more complex and nuanced account of the relationship between institutions and trust than provided by the extant literature, showing how trust is related to institutions but cannot simply be reduced to institution-induced expectations.

In the social sciences, perhaps the most important test of a theoretical framework is whether it gives a good explanation of empirical reality. Without seeking to engage directly in ongoing and complex debates about the epistemology of the social sciences, I suggest that any framework should meet two important criteria. First, and most obviously, are its predictions supported by the available empirical evidence? If not, then the theory may still have real intellectual value (it may involve substantial methodological or theoretical advances, or it may provide interesting counterfactuals), but it is likely to be of limited practical relevance to our understanding of politics. Second, does the theory make nonobvious predictions? Does it advance our understanding of empirical phenomena in important and nontrivial ways? If not, its contribution to our scientific knowledge is again likely to be limited: proving the obvious only infrequently provides significant advances in understanding.

I will show that an institutional account of trust and cooperation does indeed seem to be supported by empirical evidence gathered from important cases privileged by the existing literature. Furthermore, it sheds light on an unsolved empirical puzzle: the sources of inter-firm cooperation within industrial districts. Inter-firm cooperation is one of the most important forms of economic activity within advanced industrial societies – different pat-

terms of cooperation are associated with different “varieties of capitalism” (Hall and Soskice 2001). Industrial districts provide an important test case for theories of trust. Indeed, debates about industrial districts and regional economies have played an important role in the development of modern comparative political economy as a field of study. However, these districts are difficult to explain using the theoretical frameworks that have dominated the field. The “classic” industrial districts involve forms of inter-firm cooperation that do not sit well with typical transaction cost accounts of the circumstances under which actors do or do not cooperate (Trigilia 1998). The political culture perspective faces even greater difficulties in explaining trust and cooperation in industrial districts. The *loci classici* of the phenomenon are located in the center and northeast of Italy, a country that has frequently served as political culture theorists’ prime example of a low-trust country (Almond and Verba 1963, LaPalombara 1965, Inglehart 1990). How is it that such extensive forms of trust are possible in a country where there is scanty “culture of trust” to support it?

Chapter 6 begins from a different yet related question. Members of the Sicilian mafia live within a dense set of mutual understandings and expectations, which are structured by informal institutions. Some of these informal institutions (such as the requirement that mafiosi always speak the truth to each other) seem on the face likely to support trust and cooperation, yet in practice they appear not to do so. Why is this so?

An institutionalist account of trust provides us with important insights as to how economic actors may come to trust each other enough to engage in the extensive forms of cooperation that are found in industrial districts. It shows us how institutions may support cooperative relationships among actors that may enable the radical disintegration of the production process. It also provides a more nuanced and specific account of trust at the microlevel than prevailing theories. While I do not suggest that my account provides a complete theory of trust (humans are neither fully rational nor entirely motivated by self-interest, nor only guided by institutions), it does provide a sufficient account to explain how trust may arise in apparently unpromising circumstances.

In addition, an institutionalist theory of trust provides us with important nonobvious insights. It provides an explanation of key empirical puzzles. Why is it that certain kinds of trust are common in societies that have weak formal institutions and little generalized trust, but they are rare in societies where individuals, at first glance, face much less serious problems of trust and cooperation? Why is it that informal institutions seem to support trust under some circumstances and to perpetuate distrust under others? Through the careful comparison of case studies involving different kinds of institutions, I provide answers to these questions.

I offer an alternative account of the political economy of trust, starting from the bottom up. Chapter 2 sets out an extensive theory of the relationship between institutions, trust, and cooperation. It returns to debates over institutions and debates over trust in greater detail, setting out a theory of how institutions may affect trust without reducing trust to simple expectations over institutional compliance.

Chapter 3 situates the main empirical discussion by providing brief accounts of the indus-

trial district phenomenon and of the two industrial districts that are examined in the bulk of this book. Its intention is to offer readers without previous grounding in this literature an account of what industrial districts are, why they are important, and why the specific industrial districts examined in this book may usefully be employed as proxies for a more general phenomenon. It concludes by arguing for the benefits of a rational choice account of trust, which focuses on relatively stable individual interests, in explaining why actors trust each other or do not trust each other, and why they cooperate or do not cooperate in industrial districts. In the subsequent empirical discussion, I build up an account of trust, institutions and cooperation. In Chapter 4 I examine whether or not institutions affect the ways in which actors trust or do not trust each other, and how best to capture the putative effects of institutions by examining institutions comparatively. If institutions affect the ways in which actors trust or do not trust each other, one may reasonably expect that different institutional settings will be associated with differences in trust, and thus in cooperative outcomes. In particular, I argue that one may expect to see systematic differences between settings where formal institutions predominate and settings where informal institutions are more important.

Chapter 5 considers the sources of institutional creation and change. In order to avoid the rather diffuse functionalism that frequently characterize arguments about trust and trust creation, I specifically eschew an account that explains institutional change in terms of its functional benefits, instead assessing an account in which institutions instantiate social beliefs that reflect power relations (Knight 1992, Farrell and Knight 2003). I use this account to structure an analytic narrative that provides an account of informal institutional changes in one of the two cases (the other, because it involves formal rather than informal institutions, does not provide suitable data for this purpose).

Chapter 6 turns to a quite different context – trust relations among members of the Sicilian Mafia – in order to investigate the circumstances under which informal institutions may perpetuate distrust. It examines how the informal rules governing life within the Mafia set generalized expectations over behavior and distort information flows so as to exacerbate persistent problems of distrust among mafiosi.

The conclusion discusses the applicability of my claims to debates about the relationship between trust and self-interest, between trust and institutions, and also how trust relations may change as a result of institutional change.