



FEATURE

The link between trust and economic prosperity

Repairing the global erosion of trust has economic advantages

Ira Kalish, Michael Wolf, and Jonathan Holdowsky

A bit more trust could make a big difference in achieving greater overall economic prosperity. Don't forget to invest in repairing and rebuilding it.

THE WORLD HAS become a less trusting place. The share of the global population that believes “most people can be trusted” fell by roughly 20% over the last 15 years.¹ Rising inequality, political polarization, and a higher frequency of what were previously considered once-in-a-lifetime disruptions, such as the pandemic, have exacerbated this downward trend. The erosion in trust has serious implications for the economy as trust is foundational to business. In fact, in 1972, Nobel Laureate Kenneth Arrow famously wrote, “Virtually every commercial transaction has within itself an element of trust, certainly any transaction conducted over a period of time.”² A business thrives on the cumulative trust each of its stakeholders place in it. This applies to governments as well. In this sense, trust is like an interdependent web that connects all actors in an economy and influences how they work together to drive growth.

But it's not all gloom and doom. The good news is that the **positive relationship** between trust and the macroeconomy is well-known. Countries where businesses, governments, and other institutions have engendered more trust experience stronger per capita real GDP growth, a standard measure of economic prosperity. Using trust among individuals as a proxy for the level of trust built within a country, macroeconomists have shown

that as trust improves, economic prosperity grows. For example, one meta-analysis of the economic literature shows that a 10-percentage point increase in the share of trusting people within a country should raise annual per capita real GDP growth by about 0.5 percentage point.³ That is a substantial gain given that annual global per capita real GDP growth averaged about 2.2% between 2015 and 2019.⁴ For a country such as Brazil, raising trust to attainable levels seen in other countries would ensure that its per capita real GDP growth rate was at least that of the global average, adding more than US\$40 billion to its 2019 output (figure 1).

WHAT IS “TRUST”?

Across macroeconomics—including business contexts, countries, business leaders, employees, and other market participants—we build and maintain trust by acting with **competence and intent**. *Competence* is foundational to trust and refers to the ability to execute, to follow through on what you say you will do and live up to your brand promise. *Intent* refers to the reason behind your actions, including fairness, transparency, and impact. One without the other cannot build or rebuild trust—both are needed.

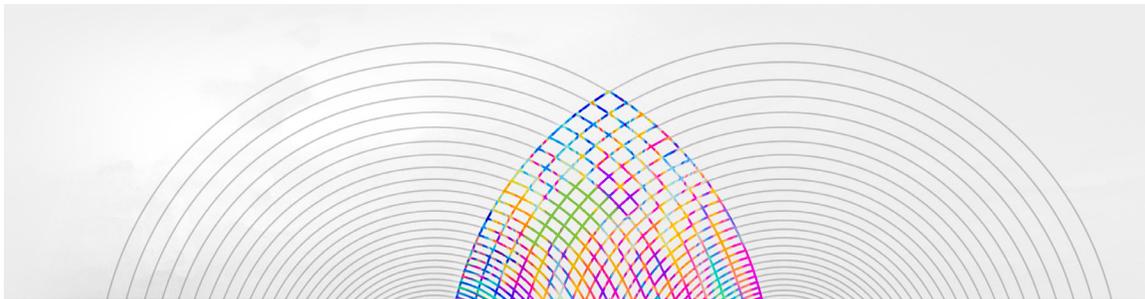


FIGURE 1

Quantifying changes in trust on growth

Changes to economic growth if 50% of the population “trusts most people”

	Country		Change in per capita real GDP growth (percentage points)		Dollar change in 2019 real GDP (in millions of 2015 US dollars)
	INDONESIA	2.3	24,127		
	BRAZIL	2.2	40,021		
	EGYPT	2.1	8,053		
	MEXICO	2.0	25,056		
	NIGERIA	1.9	8,365		
	TURKEY	1.8	17,950		
	RUSSIA	1.4	20,237		
	FRANCE	1.2	31,295		
	ITALY	1.2	22,975		
	SOUTH KOREA	0.9	14,714		
	JAPAN	0.8	36,721		
	UNITED STATES	0.7	139,822		
	UNITED KINGDOM	0.5	15,594		
	AUSTRALIA	0.1	1,359		

Notes: Values represent the change in economic growth if the share of the country’s population that trusts most people increases to 50%. Countries that exceeded this threshold were excluded from the table. All amounts are given in US dollars. Sources: Conal Smith, “Trust and total factor productivity,” International Productivity Monitor 38, (2020): pp. 3–28; World Values Survey Wave 7; Oxford Economics; author calculations.

Exploring the relationship between trust and macroeconomic growth

From a supply-side perspective, there are just two ways to raise per capita GDP growth—increase business investment or raise productivity—and trust affects both (figure 2). A rise in trust not only increases the quantity of business fixed investment, but it also boosts productivity growth through higher-quality investments, human capital accumulation, organizational improvements, and internationalization (see sidebar, “The link between per capita real GDP, business investment, and productivity”).

Raising business investment through trust

MORE TRUSTING ENVIRONMENTS CAN REDUCE COSTS, FREEING UP FUNDS FOR MORE INVESTMENT

Trust can raise per capita real GDP growth by increasing the quantity of business investment that is possible. One way more investment is made possible is through cost reductions for everyday transactions.⁵ Simply put, lacking trust can be expensive. Writing and enforcing contracts, monitoring worker and subcontractor behavior, and implementing security protocols cost money. Building greater trust with stakeholders, such as employees and supply chain partners, enables an organization to reallocate investment in oversight and monitoring toward other parts of the business. Consider the increase in remote working as a result of the pandemic. The trust between employers and their employees to work remotely has grown and, as a result, many organizations are planning to

THE LINK BETWEEN PER CAPITA REAL GDP, BUSINESS INVESTMENT, AND PRODUCTIVITY

Per capita real GDP is a standard measure of economic prosperity for a country. It is theoretically equal to output per person and income per person. Aggregate GDP can increase as a population gets larger, but unless GDP per capita also rises, the population is no better off than it was before. Per capita GDP growth is a function of level of business investment and total factor productivity (TFP). A rise in either raises per capita GDP growth.

Increasing business investment is relatively straightforward. Buying more equipment or software raises the productive capacity of an economy. However, it comes with diminishing returns. For example, investing in a second laptop for 10 workers will have a larger effect on output than buying the 100th laptop for 10 workers.

TFP growth is the additional output you can get with the same inputs. You can think of it as the recipe for business while physical capital and labor are the ingredients. TFP growth can come from a few sources. In some cases, TFP grows because of organizational changes. One example is the assembly line where rearranging the same workers and equipment yields more output per hour. The quality of inputs can also boost TFP. A more highly skilled worker will produce more per hour worked, which means human capital improvements and skill building raise productivity growth. Similarly, higher-quality business investments will yield more output. A faster computer can process more data per hour than a slower model. For the latter two examples, one can think of TFP more as technological innovation rather than the recipe.

allow their employees to work remotely going forward.⁶ That trust allows the business to rent less office space and save on real estate costs while improving employee satisfaction and productivity. To be sure, some costs will be unavoidable, but more trusting environments have the positive side effect of making some costs unnecessary and driving investment higher.

STRONGER TRUST IN THE FINANCIAL SECTOR MAKES CAPITAL MORE READILY AVAILABLE

Banks lacking trust face quicker savings withdrawals during times of distress.⁷ Evidence suggests that the first people to withdraw their deposits following the collapse of Lehman Brothers were those who had the least trust in their bank.⁸ If the banking sector had earned more trust from its customers prior to the Great Recession, it would have experienced fewer runs and therefore would have more capital available to support the rest of the economy. Trust in the financial sector is also

important outside of crises. More trusting households have historically kept a smaller share of their savings under the mattress and used credit-granting institutions more frequently.⁹ This creates better outcomes for financial service providers and boosts the level of capital that can be used for business investment.¹⁰



FIGURE 2

How trust improves economic prosperity



Source: Deloitte analysis.

Boosting productivity through trust

TRUST AFFECTS THE QUALITY AND TYPE OF INVESTMENTS BUSINESSES MAKE

A lack of trust can make some investments appear too risky, which can lead to suboptimal investment allocations. For example, countries with low levels of trust tend to invest in projects with shorter time horizons.¹¹ Investments with longer time horizons require more trust in workers to complete the project, in suppliers to get the necessary equipment, and in customers to continue to be there through the useful life of the investment. Of the three major types of business investment, structures, such as office buildings and warehouses, have the longest time horizon, followed by equipment, and then intellectual property products, such as software. In the absence of trust, businesses may make only incremental gains to capacity through investments with short time horizons, such as software, rather than expanding capacity more substantially through investments with longer time horizons, such as structures.

Investment in research and development suffers from a similar problem. Because the quality of research is nearly impossible to monitor while it is being conducted, low trust between employer and researcher leads to lower rates of such investment.¹² A lack of trust can therefore skew investment toward projects that are more easily monitored and less ambitious, forcing companies to give up on investments that have the potential to push past the current frontier of innovation. In other words, a higher trust environment between employer and researcher leads to the kinds of R&D investments that could yield higher value-added innovations that ultimately drive productivity. If higher trusting environments have more ambitious R&D initiatives, they should have increased demand for well-educated and productive workers as a result.¹³ Greater demand for such workers can

improve the average level of human capital in each firm and throughout the broader economy, thereby boosting productivity.

TRUST ENHANCES HUMAN CAPITAL INVESTMENT, WHICH RAISES PRODUCTIVITY GROWTH

Trust between employer and employee and among employees enhances human capital investment. Trust influences the behaviors of both employers and employees. For example, employers are more willing to invest in their workers if they can trust that those workers will not switch to another firm. Unfortunately, trust between employer and employee is fractured. Recent Deloitte research revealed that about 40% of employees in the United States do not highly trust their employer.¹⁴ This lack of trust discourages investment behaviors of both employers and employees. Alternatively, improving trust enables human capital to deliver greater value. Deloitte research suggests that employees who highly trust their employer are about half as likely to seek new job opportunities as those who don't.¹⁵ At the same time, workers are more likely to invest in *their own* skill building if they trust that their employer will reward them for their efforts. This is especially true regarding nontransferable or firm-specific skills, which suggests that trust can raise the level of institutional knowledge that can lead to more productive work.¹⁶ Trust among employees on a *peer to peer* basis is also crucial for human capital building. Employees who trust each other are more collaborative and more likely to share ideas and information, which enables organizations to foster greater innovation and ultimately drive productivity.¹⁷

TRUST AFFECTS HOW BUSINESSES ORGANIZE THEMSELVES

Trust can also boost productivity through means unrelated to additional investments. One way this occurs is through decentralized decision-making.¹⁸ Decentralization empowers those closest to the problem to solve it, making the firm faster to adapt

in a rapidly changing business environment.¹⁹ Such decentralized decision-making can't occur without the trust of those working together. Decentralization is often associated with firms that are more productive and that specialize in innovation and information technology.²⁰ Consider a software company that reaped tangible benefits thanks to the new kinds of decentralized, more autonomous working arrangements that the pandemic made necessary. More autonomous, self-driven work arrangements unleashed in its workers new kinds of creativity, individuality, and productivity that helped drive a jump in the amount of code they wrote and that enabled them to deliver two major, high-quality product releases on time.²¹

Trusting vendors and subcontractors can lead to improved outcomes as well. Research studies across a number of industries demonstrate this connection. For example, one study shows “investors who have more trust in financial institutions delegate more decisions to them and thus obtain better diversified and more efficient [productive] portfolios.”²² Another study shows that greater trust between construction companies and subcontractors leads to greater collaboration, more flexibility, and better communication.²³ All of these examples have the potential to raise productivity growth.

TRUST IS KEY TO IMPROVING EXPORT SALES

At the country level, greater trust is associated with more international trade. For example, a recent European study suggests that fostering greater trust at the organizational level could lead to more international sales.²⁴ Greater integration in the global economy, for example, importing and exporting a larger share of goods, can itself boost productivity growth. For one, it can allow businesses to focus on their comparative advantage and invest in the parts of the business that yield the

greatest results. Second, internationalization is associated with technology and knowledge transfers that can also boost productivity and therefore real per capita GDP.²⁵ The success of Brazil's aircraft manufacturing sector, a great feat given the highly technical nature of the industry, was in part due to knowledge transfers from foreign suppliers and contractors.²⁶ And that would not have happened in the absence of trust.

The role of leaders influencing trust: A call to action

Trust has clear implications for the macroeconomy, but that trust is built from the actions taken by businesses and the leaders that guide them. Greater levels of trust can raise the quantity and quality of investments in physical and human capital. It can also boost productivity growth through more effective organizational adjustments. Trust is in a constant state of being built, destroyed, and rebuilt. As leaders reflect on how to increase organizational trust with stakeholders and society, the following considerations may be helpful:

- Make trust a strategic priority.
- Develop an understanding of trust within and outside the enterprise.
- Identify the stakeholders with whom you have or want to have trusted relationships.
- Measure and quantify levels of trust.
- Invest proactively in repairing, rebuilding, and enhancing trust.
- Reassess where you are as managing trust is not a one-time event.

Trust directly influences the actions and outcomes of business every day. By embedding trust in a company's business, leaders generate value for their stakeholders and society more broadly now and in the future.

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