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"Summary of article by Partha Dasgupta: Trust as a Commodity"

Trust is usually taken for granted by economists, yet it is central to all transactions. It is essential for the smooth functioning of society and for ensuring individual wellbeing. This article discusses how people pay to acquire trust by enhancing their reputation. An approach is presented which treats reputation as a capital asset in which people are willing to invest. The article shows how both dishonest and honest people invest in their reputations and both may exhibit honest behavior, even though their underlying motivations are different.

TRUST AND REPUTATION

While there is more than one type of trust, this article focuses on the category of trust in which a person does not know the disposition of a potential partner. People must then rely on a person's reputation, which in turn is based on knowledge about the person such as background, motivations, and available options.

A model based on selling cars is used to make several points about the nature of trust. It is assumed that salesmen are either honest or dishonest; each type is assumed to have different payoff structures for selling good cars or faulty cars. The payoff to the dishonest salesman for selling a good car is lower than for selling a faulty car. However, customers will not even enter the showroom if they believe the salesman to be dishonest.

This model shows that both honest and dishonest salesmen would be willing to invest money to increase their reputations so that customers would be willing to enter into a transaction with them. Salesmen would be willing to invest up to the level of payoff they would receive for selling a car to the customer (with differential returns for honest and dishonest salesmen selling good or bad cars).

Since people are willing to invest in their reputations and perceive a benefit for doing so, reputations are a type of capital asset. When people invest in enhancing their reputations they are only willing to spend up to the point that an enhanced reputation benefits themselves. Yet trust is a public good which creates externalities. Increased trust in the seller also benefits the buyer (who benefits from buying the car), but the buyer would not invest to increase trust in other people. This results in market failure, with chronic underinvestment in building trust.

While there may never be enough investment in trust, Albert Hirschman says that trust is like other moral resources "whose supply may well increase rather than decrease through use."[1]

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How does trust increase with use? First, sometimes people have a sense of personal obligation to not betray someone's trust. Second, people who repeatedly transact business with each other develop psychological bonds which will inhibit the tendency to cheat. Third, people form their opinions about someone's trustworthiness based on experiences with others in that group. Thus, if a consumer's first several encounters with people of a particular group show them to be honest, then the consumer infers that the chances are that others in that group are also honest and will continue dealing with them. If the first several encounters are with dishonest people, then the consumer infers that others in the group are also dishonest and may terminate any future transactions with them. The increase in trust through use is reflected in this case as the increase (or decrease) in the perceived proportion of honest people in the particular population.

THE ACQUISITION OF A REPUTATION FOR HONESTY

When it is common knowledge that a seller has the payoff structure of a dishonest person and is in business for a limited time, no one would enter into a transaction with him. However, consider a situation in which a dishonest salesman is known to intend to stay in business forever and also discounts future benefits at a low rate. Because future customers would refuse to enter the showroom if the dealer ever sells a bad product, it is in the dealer's interest to sell only good cars. An equilibrium outcome is then possible in which the salesmen sells a good product and receives a lower short-term payoff. To sell one bad car would mean a greater return for that time period, but would risk losing an infinite flow of future benefits. Customers may know that the salesman is dishonest, but they also know that he acts honestly because the punishment for being dishonest (loss of customers) is high.

This example deals with only one aspect of trust -- customers trust a salesperson to sell them good merchandise, even when they know that his payoff structure is that of a dishonest person. However, it does not deal with another aspect of trust in which the merchant wishes to convince people that he really is an honest person, as opposed to simply acting honest as the only way to remain in business.

Assume another case, in which all customers could be made aware of a salesman's practices and that he is in business for a finite period of time. All salesmen would then sell reliable cars in the initial periods, independently of whether or not they are truly honest. Selling reliable cars at this stage does not indicate the underlying disposition, so the salesman's reputation does not change. During later periods, honest salesmen would continue selling good cars. On the other hand, dishonest salesmen would choose randomly between honest and dishonest strategies after the initial periods. At some point, a bad salesman would choose the strategy of selling a bad car, thus ending future transactions. Finally, a dishonest salesman would have no incentive to be honest in the last period of time if he is still in business. His reputation is only valuable to him if it helps ensure future customers.

This model illustrates how people invest in building a reputation for honesty. Within each time period, the dishonest salesman has a higher payoff if he chooses a dishonest strategy. However, he invests in his reputation by foregoing these short-term gains.

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A serious weakness of this model is that there is no way to distinguish honest from dishonest salesmen (before the later periods). The role of commitments in distinguishing honest from dishonest salesmen could be explored. Another weakness of the model is that it does not include all credible strategies, thus excluding potential outcomes. In the real world, there are many sellers, customers, and transactions, making the model far more complex. Salesmen who behave dishonestly may be able to stay in business because not everyone is aware of their reputation.

This problem of complexity can be simplified by assuming only a limited number of strategies. Sociobiologists argue that each person has only one strategy; no one has any real choice about which strategy they follow. Yet people in the real world are not nearly so restricted in the strategies they choose. Neither are strategies chosen completely randomly. Rather, outcomes can be predicted based on factors such as moral codes, which rule out certain behaviors. The role of moral codes in building analytical models of trust may thus be a valuable avenue for future research.

Notes

1. Albert O. Hirshman, "Against Parsimony: Three Easy Ways of Complicating Some Categories of Economic Discourse," *American Economic Review Proceedings* 74 (1984), 88-96

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