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Political Economy of EMU: Rebuilding Systemic Trust in the Euro Area in Times of Crisis

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Political Economy of EMU

Rebuilding Systemic Trust in the Euro Area in Times of Crisis

Felix Roth

Abstract

This paper revisits the existent empirical evidence of a decline in citizens' systemic trust in times of crisis for a 12-country sample of the euro area (EA12) from 1999 to 2014. They affirm a pronounced decline in trust in the periphery countries of the EA12, leading to particular low levels in the national government and parliament in Spain and Greece. They discuss the consequences of this decline for the political economy of Economic and Monetary Union and corroborate the strong and negative association between unemployment and trust. They provide evidence of the increase in unemployment in Spain and examine policy measures at the national and EU level to tackle unemployment. They revisit the evidence of the enduring support for the euro and discuss its relevance to crisis management. They elaborate upon the question of how to restore systemic trust without and with treaty change.

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Keywords: financial crisis, euro area crisis, systemic trust, unemployment, political economy, Economic and Monetary Union, support for the euro.

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Introduction

Empirical analyses that focus on the impact of the financial and sovereign debt crisis on citizens' systemic trust (see Appendix A1 for a definition of systemic trust) at the national and European Union level within the original member countries of the Euro Area (EA12)[1] detect a significant and pronounced decline within its periphery, namely in Spain, Greece, Ireland and Portugal (Roth, Nowak-Lehmann and Otter 2013; Roth, Gros and Nowak-Lehmann 2014. For similar findings, but including Italy within the periphery country sample, see also Alonso 2015).[2] In those four countries, trends[3] in citizens' systemic trust have departed from their long-term trajectory and started to steadily decline since the start of the crisis in September 2008. In this respect, the econometric estimations within this literature find that the pronounced increases in unemployment rates in Spain, Greece, Ireland and Portugal throughout the crisis have been a key driver behind the steady and significant decline in systemic trust. In comparing the magnitude of decline among all trust trends analysed, the literature concludes that it is the steady decline in citizens' trust in the Spanish and Greek national parliaments that is the most pronounced. Interestingly, in contrast to the significant decline in systemic trust, an empirical study analysing the impact of the crisis on popular support for the euro from 1990 to 2012 (Roth, Jonung and Nowak-Lehmann 2012a) finds that within an EA-12 country sample, levels of support for the European economic and monetary union with one single currency, namely the euro, have only marginally declined and remained at high levels throughout the crisis, even within its periphery countries.[4]

In light of these overall empirical results reported in the above-mentioned literature, four sets of questions emerge. First, what are the consequences of the significant decline in systemic trust for the political economy of EMU? Why should national and European policy-makers worry about this decline and the low levels of systemic trust revealed in times of crisis? Second, how can citizens' systemic trust in the countries of the Euro Area periphery be restored? What is the role for member states? What is the role for collective action within the Euro Area? Third, to what extent is a substantial and enduring popular support for European economic and monetary union (EMU) and the euro, a prerequisite to overcome the systemic trust crisis in the periphery of the Euro Area? Finally, how can systemic trust be restored in a scenario without treaty change and in one with treaty change?

To answer this set of related questions, the Lecture Notes are structured in the following manner. The first section revisits the empirical evidence concerning a pronounced decline in systemic trust in the institutions of democratic governance at the national and EU level in the periphery countries of the EA12 in times of crisis. Section 2 provides further empirical evidence of a decline in systemic trust in European institutions, as well as satisfaction in democracy at the national and European level and discusses the validity of Eurobarometer data in comparison to other international datasets. Section 3 discusses the consequences of this significant decline in systemic trust in the case of institutions of democratic governance at the national level. Two theoretical arguments are developed and applied to the most recent Eurozone crisis. Section 4 elaborates on how to restore citizens' systemic trust in times of crisis. It identifies the significant increase in unemployment rates as one key driver of the decline in systemic trust and discusses the evolution of unemployment in the case of Spain. Section 5 revisits the empirical evidence concerning citizens' support for EMU and the euro in times of crisis. The section clarifies that in contrast to the pronounced decline in systemic trust, public support for the euro persisted in times of crisis. Section 6 discusses the question of how to restore citizens' systemic trust without treaty change and with treaty change.

[1] The EA12 includes the 12 original member states that formed the Euro Area from 1999 (for Greece from 2001) onwards, namely Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain.

[2] For analyses on trust in the national parliament and trust in the EU for a wider EU27 country sample see Armingeon and Guthmann (2014), Armingeon and Ceka (2014) and Gomez (2015).

[3] The author is aware of the fact that the term trend normally denotes long-run patterns covering at least two to three business cycles. The time series on net trust however are restricted to a 15-year time span per country due to data restriction from the Eurobarometer surveys. Given this limitation in extending the time coverage in order to analyze longer time series, for pragmatic reasons, the term trend will still be applied to the given time series.

[4] For a range of analyses which found similar results than those of the original finding by Roth et al. 2012 (a), see amongst others Debomy 2013; Guiso et al. 2014; Hobolt and Le Blond 2014; Hobolt and Wratil 2015; Clements et al. 2014 for the Greek case.

1. The empirical evidence revisited – Citizens' declining systemic trust in the EA12

Before-After Analysis of Aggregated Country Trends of the EU27

This section of the lecture will once more review the basic empirical findings, which point towards a pronounced decline in systemic trust in the peripheral countries of the EA12,[5] especially Spain and Greece. The analysis will start by comparing selected country samples within the EU27.[6] Table 1 depicts an updated version (until 11/2014) of a before and after comparison of net trust[7] in institutions of democratic government at the national and EU level for an EU27, EU15, NMS12 and EA12 country sample.[8] [9]

Table 1
Net trust levels and changes in net trust in the EA12, EU15, NMS12 and EU27, 2008-14

Sample	Trust	Level: 3-5/2008	Level: 11/2014	Changes: 11/2014 - 3-5/2008
EA12	*NG/NP*	-25/-16	-39/-33	-14/-17
EU15	*NG/NP*	-28/-17	-36/-29	-8/-12
EU27	*NG/NP*	-31/-25	-36/-33	-5/-8
NMS12	*NG/NP*	-44/-55	-37/-51	7/4
EA12	*EC/EP*	21/27	-11/-6	-32/-33
EU15	*EC/EP*	14/19	-11/-8	-25/-27
EU27	*EC/EP*	19/23	-5/-2	-24/-25
NMS12	*EC/EP*	34/38	20/22	-14/-16

Notes: EA = Euro Area, EU = European Union, NMS = New Members States, NG = National Government, NP = National Parliament, EC = European Commission, EP = European Parliament. Values are population-weighted trust trends. Net trust values below 0 show a lack of trust by the majority of citizens. Values reflecting the lowest levels and strongest decline in trust in the NP and EP are shaded in light grey.

Source: Table 1 is an updated version of Table 1 until 11/2014 (by EB's 79 to 82), in Roth, Nowak-Lehmann and Otter (2013).

The four institutions of democratic government displayed in Table 1 include the National Government (NG), National Parliament (NP), European Commission (EC) and European Parliament (EP).[10] [11] Whereas the third column in Table 1 shows the net trust level in 3-5/2008, before the actual start of the financial and economic

[5] The EA12 includes the twelve original member states, which formed the Euro Area from 1999 (for Greece from 2001) onwards, namely Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain.

[6] The EU-27 contains all EU member countries except Croatia. The designation encompasses the EA12 countries plus the three non-EA countries Denmark, Sweden and the UK and the 12 new member states (NMS12), as defined below. The EA12 and the three non-EA countries Denmark, Sweden and the UK form the old member states – the EU15.

[7] Net trust is a concept as proposed by Gärtner (1997: 488-489). A net trust measure is obtained by subtracting the percentage of those who trust from those who do not trust the institution according to the following equation:

$$\text{Net trust} = \frac{\text{Trust}}{\text{Trust+Mistrust+Don't Know}} - \frac{\text{Mistrust}}{\text{Trust+Mistrust+Don't Know}}.$$

[8] The NMS12 country sample consists of the 12 New Member States that acceded to the EU from 2004 onwards and include Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia and Slovenia.

[9] All 27 individual time series, as well as the six aggregated time series are displayed in Figure A1 in the Appendix 2.

[10] Measures for trust in the NG, NP, the EC and the EP were based upon the biannual Standard Eurobarometer (EB) surveys from spring 3-5/1999 (EB51) to 11/2014 (EB82) by asking respondents the following question: "*I would like to ask you a question about how much trust you have in certain institutions. For each of the following institutions, please tell me if you tend to trust it or tend not to trust it*". The respondent is then presented a range of institutions. With respect to the answers "*Tend to trust it*" and "*Tend not to trust it*", a third category, "*Don't know*", can be selected by the respondents..

[11] Although, the author is aware that the European Commission is not directly elected by European citizens, it still seems adequate to include the European Commission together with national governments, national parliaments and the European Parliament under the term "institutions of democratic government at the national and European level". The European Commission is seen to the best-fit counterpart of the national government at the European level.

crisis,[12] the fourth column shows the net trust level in the 6th year of the crisis in 11/2014. The fifth column shows the changes in net trust levels (11/2014 - 3-5/2008).

Focusing our analysis on the EA12 countries, three observations from Table 1 are of particular importance. First, the most pronounced declines in trust throughout the crisis, with declines in the NG/NP of 14/17 and in the EC/EP with 32/33 percentage points, can be detected among the EA12 country sample. Second, within the EA12, the decline in the NG/NP of 14/17 percentage points is less pronounced than the decline in the EC/EP of 32/33 percentage points. Third, within the EA12, the actual net levels of trust in EC/EP in 11/2014 with values of -11/-6 are significantly higher than those in the NG/NP with values of -39/-33. Thus although the decline in net trust in the EC/EP has been more pronounced, the EC/EP still enjoy a significantly higher level of net trust in the sixth year of the crisis in 11/2014 than the NG/NP.

Before-After Analysis of Single country trends within the EA12

Given the fact that the EA12 faces the most pronounced decline in systemic trust among the four country samples, Table 2 disaggregates the EA12. The disaggregated data exposes a large variance of the changes in net trust throughout the crisis among the individual member countries. In the peripheral countries of the EA12, in the EA4 (Greece, Ireland, Portugal and Spain), one detects a large decline in trust in the NG/NP of 76/79 percentage points throughout the crisis.

In contrast, in the core countries of the EA12, in the EA8 (Austria, Belgium, Finland, France, Germany, Italy, the Netherlands and Luxembourg) one actually detects an increase in net trust in the NG/NP of 4/1 percentage points. Thus, whereas we find a pronounced decline of trust within the EA4, we actually detect an increase in trust in the EA8. [13] [14] Among the EA12 the evolution of net trust in the national parliament in Spain and Greece seems to be particularly noteworthy. The two most pronounced declines in net trust in the national parliament among the EA12 countries (94 and 69 percentage points) have led to the lowest values of net trust (-74 and -71) across the EA12 members in the sixth year of the crisis (11/2014) in those two countries.[15]

[12] Note here that the bankruptcy of Lehmann Brothers in September 2008 is considered to act as the start of the financial and economic crisis (c.f. Stiglitz 2012: 1). Empirical evidence from the literature on international finance (Xin et al. 2009) highlights the significant impact of the bankruptcy of Lehmann Brothers on financial stress, unleashing the full potential of the financial and economic crisis.

[13] Two countries within the EA12 are in particular driving these diverging results for the EA4 and EA8: whereas in the peripheral country Spain an overall decline in net trust in the NG/NP of 96/94 percentage points can be detected, in the core country Germany an increase of 29/23 percentage points can be observed.

[14] It should be noted here that although France's decline in net trust in the NP is only moderate (25 percentage points) and Italy's non-existing (0 percentage points), net trust levels of -46 and -57 indicate that large majorities of citizens mistrust their national parliament in the second and third largest economies of the EA. The low net trust levels in France and Italy are in contrast to higher net trust levels in Germany with a value of 8 in 11/2014. This indicates that a majority of German citizens trust their national parliament in the sixth year of the crisis. Similar and even higher net trust levels in the national parliament of 27 percent can be found in Finland. Empirical evidence suggest that governance indicators play an important role in explaining the cross-sectional variance in systemic trust (Arnold et al. 2012; Guiso et al. 2014; Munoz et al. 2011; Roth 2009a). As we are primarily interested in analyzing changes in trust (within-variance) the cross-sectional variance will not discussed further.

[15] The analysis of the mean levels in Table A1 in Appendix 2 confirms our results from the before-and-after analysis. Greece and Spain display the most pronounced drop in net trust, as well as the lowest levels of net trust when comparing the evolution of the means in the before-crisis-sample with those of the crisis-sample.

Table 2
Net trust levels and changes in net trust in the EA8 and EA4 and across EA12 countries, 2008-14

Country	Trust	Levels: 3-5/2008	Levels: 11/2014	Changes: 11/2014 - 3-5/2008
EA-4	*NG/NP*	3/10	-73/-69	-76/-79
EA-8	*NG/NP*	-33/-23	-29/-22	4/1
Spain	*NG/NP*	20/20	-76/-74	-96/-94
Greece	*NG/NP*	-31/-2	-78/-71	-47/-69
Ireland	*NG/NP*	-14/-3	-49/-47	-35/-44
Portugal	*NG/NP*	-29/-15	-63/-56	-34/-41
France	*NG/NP*	-38/-21	-61/-46	-23/-25
Belgium	*NG/NP*	-21/-4	-30/-22	-9/-18
Luxembourg	*NG/NP*	22/24	12/9	-10/-15
Finland	*NG/NP*	19/32	0/27	-19/-5
Italy	*NG/NP*	-59/-57	-57/-57	2/0
Netherlands	*NG/NP*	1/10	8/14	7/4
Austria	*NG/NP*	-6/6	5/14	1/20
Germany	*NG/NP*	-25/-15	4/8	29/23
EA-4	*EC/EP*	38/37	-29/-24	-67/-61
EA-8	*EC/EP*	16/22	-6/0	-22/-22
Spain	*EC/EP*	42/46	-32/-31	-74/-77
Greece	*EC/EP*	13/21	-49/-33	-62/-54
Ireland	*EC/EP*	43/51	-3/2	-46/-49
Portugal	*EC/EP*	42/46	-3/-3	-45/-49
Belgium	*EC/EP*	41/42	4/6	-37/-36
Italy	*EC/EP*	29/29	-11/-5	-40/-34
France	*EC/EP*	11/19	-11/-6	-22/-25
Germany	*EC/EP*	6/18	-8/1	-14/-17
Netherlands	*EC/EP*	36/30	22/14	-14/-16
Luxembourg	*EC/EP*	35/40	29/29	-6/-11
Austria	*EC/EP*	-3/6	12/12	15/6
Finland	*EC/EP*	16/17	26/32	10/15

Notes: EA = Euro Area, NG = National Government, NP = National Parliament, EC = European Commission, EP = European Parliament. EA4 and EA8 Values are population-weighted trust trends. All values below 0 show a lack of trust by a majority of citizens. The most pronounced declines and levels of net trust are shaded in light grey. Countries are ranked according to their magnitude in the decline in changes in net trust in the NP and EP.

Source: Updated and slightly modified version of Table 2 until 11/2014 (by EB's 79 to 82) in Roth, Nowak-Lehmann and Otter (2013).

A similar but distinct picture appears when analysing the changes in net trust in the EC/EP. In the EA4, net trust in the EC/EP declined by a pronounced 67/61 percentage points. In contrast, in the EA8 one detects only a moderate decline by 22 percentage points.[16] [17] Two points are noteworthy. First, although net trust in the EC/EP in the EA8 declined more dramatically than in the NG/NP throughout the crisis, in six out of eight countries of the EA8 (except for Germany and Austria), net trust levels in the EC/EP in 11/2014 are still significantly higher than those in the NG/NP. Second, whereas Spain and Greece again faced the most pronounced decline in net trust in the EC/EP (74/77 and 62/54 percentage points) leading to the lowest net values in 11/2014 (-32/-31 and -49/-33 percent), they are still significantly higher than those in the NG/NP with (-76/-74 and -78/-71 percent). Whereas in 11/2014, only 10 and 14 percent still trusted their national parliament, 28 and 32 percent still trusted the European parliament.[18] This indicates that the pronounced declines in trust in Spain and Greece are particularly worrying for trust in the NG/NP.

[16] This slight decline of 22 percentage points in the EC/EP is in contrast to the increase in net trust in NG/NP of 4/1 percentage points and is driven by the pronounced differences in Italy and Germany in which net trust in the NG/NP remained stable and even increased (ranging from 0 percentage points in Italy to 29 percentage points in Germany) but net trust in the EC and EP declined (ranging from -40 percentage points in Italy to -14 percentage points in Germany). Indeed if one compares a change in mean values of the pre-crisis sample (from 3-4/1999 to 3-5/2008) with those of the crisis-sample (from 10-11/2008 to 11/2012) for the national and European institutions (as displayed in Table A1 in Appendix 2) the most pronounced difference in the evolution of trends can be detected in Germany (14/28), in which one detects a steady increase towards net trust in the national institutions but a steady decline towards the European institutions (see here also Alonso 2015).

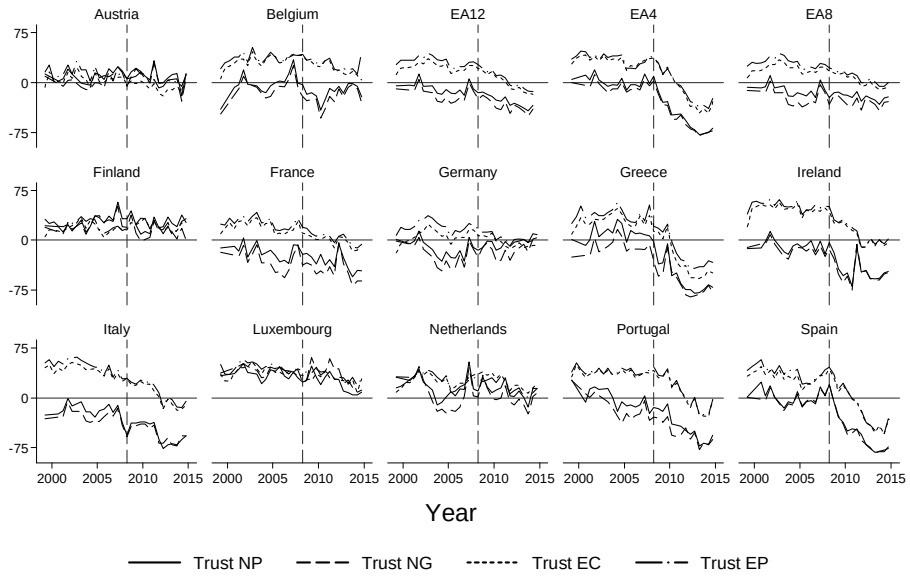
[17] This already indicates that those authors who claim to have found a universal trust crisis in the European institutions (Torreblanca and Leonard 2013a, b) across the continent among the "northern creditors" and southern "debtors" seem to have misinterpreted their data. Our results indicate quite the opposite.

[18] This result actually questions all those authors who claim the crisis is per se a trust crisis in the European institutions (Pew Research Center 2013; Torreblanca and Leonard 2013a, b; Traynor 2013) and fail to recognise the trust crisis in the national democratic institutions, which is far more worrying.

Analysing the net trust trends of the EA12 in the long run

Whereas the before-after comparison in Table 2 only focused on two single points in time, Figure 1 displays the four long-term net trust trends (NG, NP, EC and EP) for the EA12, EA4, EA8 and the 12 individual country time series from 3-4/1999 to 11/2014.

Figure 1
Net trust trends in the EA12, EA4, EA8 and individual countries, 1999-2014



Notes: EA = Euro Area, NG = National Government, NP = National Parliament, EC = European Commission, EP = European Parliament
The dashed line represents the start of the crisis in September 2008. Values are population-weighted trust trends. As the figure presents data on net trust, all values below 0 show a lack of trust by the majority of citizens.
Source: Updated and merged versions of Figures A1-4 until 11/2014 (by EB's 79 to 82) in Roth, Nowak-Lehmann and Otter (2013).

Figure 1 clarifies that all four net trust trends in the EA8 follow their long-term trends, with moderate declines in mean values in net trust in the NG/NP and EC/EP of 8/11 and 19/24, but almost no change in the standard deviations in the before-crisis and crisis sample (all mean values and standard deviations of pre-crisis and crisis trends, as well as the respective changes can be found in Tables A1 and A2 in the Appendix). In contrast, all four trust trends of the EA4 country sample have left their long-term trends with mean levels in the NG/NP and EC/EP, declining by 53/57 and 49/47 percentage points and standard deviations almost tripling for the NG, NP and EP and even quadrupling in the case of the EC.

Within the EA4 country sample, the most noteworthy trends can be detected in Spain and Greece. In Spain all four pre-crisis trust trends tended to be very stable with mean levels of 0/2 percent in the NG/NP and 32/39 percent in the EC/EP and average standard deviations of around 11 percent. Since the start of the crisis in September 2008, all four forms of trust have steadily and significantly declined (with a decline in mean levels in the NG/NP of 58/59 percent and in the EC/EP of 49/55 percent among the EA12), with the standard deviation doubling for the NG/NP and tripling for the EC/EP. Interestingly, when analysing the time trends from 5/2013 onwards, one is able to observe the first slight increases in all four trust trends since the start of the crisis. Similar patterns compared to Spain can be detected in Greece. Pre-crisis trends for all four institutions tended to be stable (average standard deviations of 11) with mean levels for the NG/NP of -8/10 and for the EC/EP of 29/38 percent. Since the start of the crisis in September 2008, mean levels of net trust have declined by 56 to 68 percent among the four institutions and standard deviations have doubled and tripled. Similar to Spain, trust levels slightly recovered from 5/2013 in Greece.

Trust trends in Ireland and Portugal declined markedly but more moderately compared to Spain and Greece, with a decline in average mean levels of 40 percentage points and overall higher mean net values throughout the crisis. Similar to Spain and Greece, in Ireland all four trust trends were very stable in pre-crisis times and declined markedly since the start of the crisis in 2008. Interestingly, in Portugal standard deviations in net trust in the EC/EP quintupled from 5 to 24 but remained stable in trust trends in the NG/NP. This indicates that whereas the net trust decline in the NG/NP had been ongoing in the pre-crisis period, trust in the EC/EP declined sharply since the start of the crisis.

Within the EA8 countries, a similar although less pronounced trend than in Portugal can be detected in Italy, in which a deterioration of net trust trends in the NG and NP already started before September 2008 with standard deviations remaining stable in times of crisis, but in which the crisis had a more pronounced impact on the EC/EP with standard deviation doubling. France's net levels of trust declined moderately among all four trust trends and all four crisis trends follow their pre-crisis trends with standard deviations remaining very stable. Thus, Italy and France both encounter moderate losses of net trust in all four institutions, with almost all trust trends following their pre-crisis trends. It should be noted however, that the (moderate) declines of trust in NG/NP in Italy and France, starting at significantly lower levels than Spain and Greece, have still led to mean values as low as -54/-53 in the case of Italy and -45/-33 percent in the case of France. Thus, in Italy these net levels in times of crisis are closely located at net values of Spain and Greece.

In contrast to Italy and France, in Germany, one detects the very exceptional pattern of diametric trends. Whereas net trust in the NG/NP actually increased throughout the crisis with an increase in the mean levels by 4/10 percentage points, net trust in the EC/EP declined by 10/18 percentage points (with a difference in changes between the NP and EP of +28 percentage points). In 11/2014, Germany has become the only country within the EA12 in which net trust levels in both the NG/NP have become higher than in the EC/EP. The five remaining countries of the EA8 – Austria, Belgium, Finland, Luxembourg and the Netherlands – face moderate declines or actual slight increases in trust with very stable crisis trends.

2. Further Empirical Evidence of a Decline in Systemic Trust

Net trust in the ECB

The above-analysed trust crisis in the EA4, however, has not been exclusive to institutions of democratic governance. Amongst others, the financial and sovereign debt crisis has also affected citizens' trust in the European Central Bank (see, amongst others, Albinowski et al. 2014; Bursian and Faia 2015; Bursian and Fuerth 2011; Ehrmann et al. 2013; Guiso et al. 2014; Gros and Roth 2009; Farfaque et al. 2012; Roth 2009a, b; Roth et al. 2014; Wälti 2012 for empirical evidence). As can be detected in Table 3 with a decline of 49, 76 and respectively 40 percentage points net trust in the ECB actually declined the most dramatically among the three analysed European institutions in the EA12, EA4 and EA8 (see here comparative results in Tables 1 and 2). However, similar to the pattern in Table 2, the decline in the EA4 of 76 percentage points has been more pronounced than the one in the EA8 with 40 percentage points. In Spain, Ireland, Greece and Portugal, net trust in the ECB declined by 88, 67, 55 and 53 percentage points respectively from 3-5/2008 to 11/2014.

Table 3

Net trust levels and changes in net trust in the ECB in the EA12, 2008-14

Country	Levels ECB/Euro: 3-5/2008	Levels ECB/Euro: 11/2014	Changes ECB: 11/2014 - 3-5/2008
EA-12	29	-20	-49
EA-4	34	-42	-76
EA-8	27	-13	-40
Spain	40	-48	-88
Ireland	47	-20	-67
Greece	1	-54	-55
Portugal	39	-14	-53
Germany	35	-18	-53
Belgium	42	-5	-47
Italy	21	-22	-43
Netherlands	70	28	-42
France	10	-18	-28
Luxembourg	42	18	-24
Finland	49	37	-12
Austria	20	9	-11

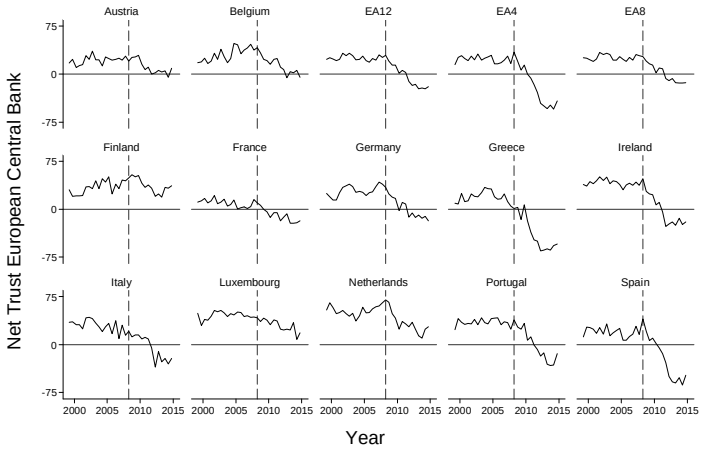
Notes: EA = Euro Area; ECB = European Central Bank. Values for EA12, EA4 and EA8 are population-weighted. As the table presents data on net trust, all values below 0 show a lack of trust by the majority of citizens. The two most pronounced declines and levels of net trust in the ECB are highlighted in light grey.

Source: Updated version of Table 1 until 11/2014 (by EB's 79 to 82) in Roth, Gros and Nowak-Lehmann (2014).

Whereas the before and after comparison in Table 3 already highlights a distinct decline in net trust in the ECB in the four periphery countries of the EA12, this pattern becomes even more pronounced when analysing the time trends in net trust in the ECB in Figure 2 and the mean values and standard deviations and the respective changes for pre-crisis and crisis trends in Table A3 in Appendix 2. Figure 2 and Table A3 clarify that mean values of net trust in the ECB declined the most in Greece, Ireland, Spain and Portugal. In addition, in these four countries, standard deviation tripled and quadrupled. Even though one also finds empirical evidence for a significant decline in EA8 countries such as Italy and Germany, this decline is less pronounced and standard deviation only doubled. It should be noted however, that only Greece and Spain have pronounced negative mean levels of net trust of -40 and -26 in times of crisis.

Figure 2

Net trust trends in the ECB in the EA12, EA4, EA8 and individual countries, 1999-2014



Notes: The dashed line represents the start of the crisis in September 2008. Values are population-weighted trust trends. As the figure presents data on net trust; all values below 0 show a lack of trust by the majority of citizens.

Source: Updated and slightly modified version of Figure A1 until 11/2014 (by EB's 79 to 82) in Roth, Gros and Nowak-Lehmann (2014).

Net trust in the EU

To further corroborate the empirical evidence of a distinct trust crisis in the periphery countries of the EA12, particularly in Spain and Greece we will compare the above results with a before and after analysis for net trust in the EU. Concerning the evolution of trust in the EU, it has been widely claimed that trust in the EU has declined in a universal manner across the 'continent', including 'southern debtors' and 'northern creditors' of the EA12 (Pew Research Center 2013; Torreblanca and Leonard 2013a, b; Traynor 2013). The existing empirical literature has already challenged such claims by showing that the largest losses of trust in the EU have indeed been taking place in the periphery area of the EA12, here in particular in Greece and Spain (see here Table 1 in Armingeon and Ceka 2014: 93; Zalc 2013: 3).

However, in order to further corroborate our claim that a decline in systemic trust has been more pronounced in the periphery area of the EA12 than in the core countries of the EA12, Table 4 shows a before and after comparison between net trust in the EU from 3-5/2008 to 11/2014. Table 4 clarifies that when analysing net trust trends in the EU, one detects a similar although slightly distinct picture as compared to net trust in the EC/EP, as well as ECB. Similar to the results by Armingeon and Ceka (2014: 93), who analysed the differences from 2007 to 2011, and Zalc (2013), who analysed the differences from 2007 to 2012, when analysing the differences between 2008 and 2014, the largest decline in trust is found in Spain and Greece with net trust declines of 77 and 71 percentage points, respectively. Within our EA12 country sample, Spain and Greece are then followed by Ireland, Belgium and Portugal. Core countries such as Germany and Luxembourg have faced only moderate losses or even increased their net trust levels in the case of Austria and Finland. Table 4 once more clarifies that the claim that periphery and core countries from the EA12 face the same universal trust crisis in the EU is unsubstantiated. In addition, Table 4 clarifies that there are primarily two distinct cases with very large losses of trust in the EU, namely Spain and Greece.

Table 4

Changes in net trust in the EU in the EA12, 2008-2014

Country	Trust	Levels: 3-5/2008	Levels: 11/2014	Changes: 11/2014 - 3-5/2008
EA12	*EU*	14	-20	-34
EA4	*EU*	39	-30	-69
EA8	*EU*	7	-16	-23
Spain	*EU*	46	-31	-77
Greece	*EU*	18	-53	-71
Ireland	*EU*	43	-10	-53
Belgium	*EU*	39	-6	-45
Portugal	*EU*	29	-12	-41
Italy	*EU*	4	-25	-29
Netherlands	*EU*	28	1	-27
France	*EU*	10	-16	-26
Germany	*EU*	-1	-19	-18
Luxembourg	*EU*	19	15	-4
Austria	*EU*	-10	-7	3
Finland	*EU*	9	20	11

Notes: EU = European Union. Values for EA12, EA4 and EA8 are population-weighted. As the table presents data on net trust, all values below 0 show a lack of trust by the majority of citizens. The two most pronounced declines and levels of net trust in the ECB are highlighted in light grey.

Validity of the Eurobarometer data

When analysing time series data on trust trends in the national and European Union institutions among a sample of European countries, the best data available are those published in the Eurobarometer (EB) surveys. Conducted since 1973, the Eurobarometer surveys offer consistent data on trust in national and European Union institutions from 1999 onwards.[19] The advantage of the Eurobarometer data is that they offer bi-annual data with an overall number of time series observations per EA12 country of 32 (19 pre-crisis observation and 13 crisis observations – until 11/2014) within the standard EB's. In addition, EB data measure systemic trust for the relevant European institutions such as EC, EP and ECB. Other datasets utilised for measuring trust (confidence) in institutions are produced by the Gallup World Poll (Gallup 2014). The disadvantage of the Gallup data is first that they only measure confidence in the national government, but have no available information for the European institutions, nor national parliament. The second disadvantage of the Gallup data concerning confidence in the national government is that they start from 2006 onwards and only offer yearly data. Thus, by utilising Gallup data it is not possible to adequately compare a long-enough pre-crisis trend with sufficient information (1999-2008) with those of a crisis trend.

On the other hand, the advantage of the Gallup data is that one is able to compare European data with those of other international and OECD economies such as the US and Japan. In general, it should be noted that Gallup utilises a *confidence* question in comparison to a *trust* question. In the standard academic literature, the confidence question is normally utilised to measure systemic or institutional trust (see e.g. Newton 2008; Tonkiss 2009). However, even if using a different questionnaire (trust vs. confidence), it should be expected that the main trends over time behave in a similar manner in both datasets. The Gallup data would thus offer a basic test to corroborate the findings on the pronounced decline in trust trends in the periphery countries of the EA12, as displayed above, within the Eurobarometer data. And indeed, when comparing both datasets, similar trends

[19] Guiso et al. (2014: 42) actually detected one more point in time for trust in the national institutions as early as 1997 (EB 48). As the two observations from EB's 49-50 would be missing, it seems adequate to start analysing the trust data from 1999 (EB51) onwards. In addition, the trust time series for the EC and EP only start from 1999 onwards.

occur. According to Gallup data (Manchin 2013), confidence in the Spanish government dropped from 58 percent in 2008 to 18 percent in 2013 (decline of ~80% of net confidence) and Greek citizens' confidence dropped from 38 percent to 14 percent (decline of ~48% of net confidence).[20] [21] Portuguese citizens' confidence dropped less pronounced than in the EB trust data, from 24 percent to 15 percent.

Interestingly, in contrast to the Eurobarometer data, which already shows a pronounced decline in trust in the Spanish government as early as 2012, Gallup data are only able to depict this decline in 2013. Amongst others, this has led to the fact that the OECD's Government at a Glance report from the year 2013 (OECD 2013), which amongst others focused on the changes in confidence levels in OECD countries throughout the crisis from 2007 to 2012 (OECD 2013: 25), had not been able to identify the pronounced decline in confidence in the national government in Spain. The OECD report already correctly identified pronounced declines in confidence in Ireland, Greece and Portugal but was not yet able to identify the pronounced decline in Spain. If the OECD report had utilised the 2013 Gallup data, the pronounced decline in Spain as displayed within the EB data would have been detected. Overall, when comparing the two data sources, one can conclude that the trust crisis in the periphery is valid and is not based on measurement error due to a lack of quality in the Eurobarometer data. There exists indeed a pronounced decline in systemic trust in the periphery countries of the EA12. Similar results of a pronounced decrease in trust in the periphery countries of the EA12 are found when analysing the European Social Survey (ESS). Researchers find a pronounced decline in trust in the national parliament from 2008 to 2012 for Spain, Greece and Portugal (Torcal 2014), but also for Ireland (O'Sullivan et al. 2014; c.f. Torcal 2014).

Satisfaction with democracy at the national and European level

We will argue below that a pronounced decline in systemic trust might lead to a loss of legitimacy concerning the respective (policy-making) institution. Another indicator for the legitimacy of democratic governance is the degree to which citizens are satisfied with the democratic structures (see here Armingeon and Guthmann 2014, who use trust in the national parliament and satisfaction with democracy for the construction of an index entitled "Support for Democracy" for an EU27 country sample from 2007 to 2011). A comparison between net trust trends and trends in the satisfaction at the national and European level will thus be helpful to add robustness to the empirical results concerning the pronounced decline in net trust in the periphery countries of the Euro Area.

Table 5 compares the levels of satisfaction with democracy at the national level and those at European level before the crisis in 9-11/2007 with those in 11/2014 and displays the changes in between. The empirical findings are similar but distinct to those when analysing changes in net trust trends.[22] Three findings are particularly noteworthy. First, similar to the existing empirical results (Armingeon and Guthmann 2014: 432) and to the changes in net trust in the NP in Table 2, one detects the largest decline in satisfaction with democracy at the national level in Spain and in Greece with declines of 55 and 44 percentage points (~110 and 88 percentage point decline in net satisfaction). Whereas three out four citizens (77 percent) were still satisfied with democracy at the national level in 9-11/2007 in Spain, in 11/2014 only one-fifth (22 percent) was still satisfied. In Greece, the situation changed from 2/3 of citizens (63 percent) being satisfied with democracy at the national level to one-fifth (19 percent) of citizens. In addition, in Greece the situation partially recovered in 11/2014, as in 11/2012 only 11 percent were still satisfied. Spain and Greece also display the largest decline in satisfaction with democracy at the European level (with a decline of 41 and 33 percentage points or ~82 and 66 percentage points decline in net satisfaction). These patterns in Spain and Greece are in contrast to those in Ireland and Portugal where satisfaction with democracy at the national and European level have only declined moderately. Second, similar to the increase in net trust in the NP in the core countries of the EA12, countries such as Germany were

[20] Gallup includes Italy in a "southern" Europe country sample. According to Gallup data, Italian citizens' confidence in the national government declined from 36 to 15 percentage points.
[21] Declines/Increases in net trust (confidence) values are approximately twice the size as those in simple trust (confidence).
[22] Note that the results for changes in the national and European democracy in Table 5 cannot directly be compared with those of net trust. Whereas Table 5 displays absolute values in satisfaction, Table 2 displays net trust levels. Net levels are approximately twice the size as absolute values. Thus, a decline in satisfaction in democracy at the country level in Spain of 48 percentage points relates to a decline of approximately 96 percentage points in net satisfaction.

actually able to increase citizens' satisfaction with democracy at the national level by 4 percentage points. Similar to the trends in trust in the EC and EP, Finland managed to increase satisfaction with democracy at the European level (+11 percentage points). Third, satisfaction levels with democracy at the national level in 11/2014 in Spain is still higher than trust levels in the national parliament (22 vs. 10 percent).

Table 5

Changes in Satisfaction with democracy in the EA12, 2007-2014

Country	Satisfaction	Levels: 9-11/2007	Levels: 11/2014	Changes: 11/2014 - 9-11/2007
Spain	SDN/SDE	77/66	22/25	-55/-41
Greece	SDN/SDE	63/58	19/25	-44/-33
France	SDN/SDE	65/50	49/41	-16/-9
Austria	SDN/SDE	80/47	64/47	-16/0
Portugal	SDN/SDE	36/46	25/27	-11/-19
Italy	SDN/SDE	40/48	30/32	-10/-16
Ireland	SDN/SDE	69/58	59/54	-10/-4
Netherlands	SDN/SDE	80/44	74/44	-6/0
Belgium	SDN/SDE	66/66	63/59	-3/-7
Finland	SDN/SDE	77/40	75/51	-2/11
Luxembourg	SDN/SDE	73/55	76/62	3/7
Germany	SDN/SDE	66/52	70/47	4/-5

Notes: EB 68 & EB82. SDN = Satisfaction with Democracy at the National level; SDE = Satisfaction with Democracy at the European level. Vales that are displayed in light grey reflect two pronounced declines and levels. Values from 9-11/2007 (EB68) are displayed as no data were available for 3-5/2008 (EB69).

Overall Table 5 shows that within EA12, the crisis has only moderately dented satisfaction with democracy at the national and European level. In 11/2014, a significant share of citizens is still satisfied with democracy at the national and European level. However, there are two clear outliers to this trend in the EA12. In the two countries Spain and Greece satisfaction with democracy at the national and European level has declined comparably to the one in trust. The losses in those countries are pronounced and the low net levels in 11/2014 should be considered a source of worry for national and European policy-makers.

3. Consequences of declining systemic trust for the political economy of EMU

3.1 Theoretical Arguments

From the above descriptive results, it can be observed that the decline in systemic trust in the national and European Union institutions in the periphery countries of the Euro Area has been pronounced. However, whereas there is still a significant share of trust left concerning the EU institutions, the steady decline in net trust in the national parliament has already reached levels as low as -74 (or 10 percent who still trusted the NP) in Spain and -71 (or 14 percent who still trusted the NP) in Greece in 11/2014.[23] But what are the consequences of a significant decline in systemic trust in the periphery countries of the EA12 for the political economy of EMU? Why should national and Europe policy-makers worry about this decline in trust? Below we will follow two sets of arguments of why these declining trends in trust and low levels of trust deserve adequate attention. Both arguments are then applied to the most recent Eurozone crisis.

i) The loss of legitimacy

Scholars from the various academic disciplines, including sociology, political science and economics within the social sciences, agree on the fact that citizens' systemic trust is crucial for the legitimacy of (policy-making) institutions (Kaltenthaler et al. 2010: 1262; Kosfeld et al. 2005: 673; Luhmann 2000: 69; Newton 2008: 243; Scharpf 2003: 3, Stiglitz 2012). In the absence of systemic trust, this legitimacy might be endangered (Kaltenthaler et al. 2010: 1262; Kosfeld et al. 2005: 673; Newton 2008, Scharpf 2003) which might ultimately lead to the break-up of a (policy-making) institution (Giddens 1996: 166). In this respect, Newton (2008) differentiates between the trust in mere persons, e.g. politicians, and the trust (or confidence) in the institutions and system of government (243). Whereas a decline in trust in politicians is of less concern, according to Newton a "deep-seated lack" of trust "in the institutions and system of government" should be worrisome as it endangers its very foundations. Similar arguments are put forward by the author in other publications in which he claims that trust in institutions are the basic foundation of society and "if they begin to crumble there is indeed cause for concern" (Newton 2001: 205; Newton and Norris 2000: 53).

Within the literature two scenarios have been identified as a source of concern for the legitimacy of (policy-making) institutions. First, taking arguments by Kaltenthaler et al. (2010: 1262) into consideration, who develop their argument in an application concerning trust in the ECB, it would be worrying for the legitimacy of a (policy-making) institution if a large majority of citizens would start to mistrust it. Second, according to Newton (2001: 205), who develops his application concerning trust in the national parliament, "a sudden or consistent decline in confidence (…) is a serious matter". As we are dealing primarily with the changes in net trust throughout the crisis for our discussion, Newton's approach seems more adequate for analysing whether the legitimacy of the above-discussed (policy-making) institutions at the national and European level might be endangered in times of crisis. However, in order to also assess the argument by Kaltenthaler et al. (2010: 1262), a combination of both scenarios might seem appropriate. Combining both scenarios one could then state that it would be worrying for the legitimacy of a (policy-making) institution if a sudden or consistent decline in trust leads to very low levels of trust with a large majority of citizens distrusting the (policy-making) institutions.

In practice, however, how would a loss of the legitimacy of a (policy-making) institution lead to its potential break-up and what would be the consequences for the political economy of EMU? Given that the trust crisis in the national institutions of democratic governance in the EA4, here in particular in Spain and Greece, is more pronounced than the one vis-á-vis European institutions, we will try to answer this question by focusing on the net trust decline in the NG and NP.

[23] After less pronounced declines in net trust, levels have reached -46 and -57 percent in France and Italy. Although these levels should also be considered problematic, there are not as acute as those in Spain and Greece.

The less problematic case exists once trust in the NG declines but trust in the NP remains constant. Should trust in the NG steadily decline but trust in the NP would remain stable, citizens could easily punish the NG by electing historically well-established democratic opposition parties within the NP. This would then lead to a break-up of the NG (a potential scenario as highlighted by Giddens 1996: 166) but would not yet affect the NP. According to Newton (2001: 205), distrust in the NP is a different issue, as distrust includes both the ruling parties as well as the opposition parties. In a scenario of a steady decline in trust in the NP, the parliamentary system as such might be in danger of losing its legitimacy. Given the steady decline in trust in the NP to very low levels, it seems realistic that the historically well-established democratic parties within the NP will lose ground to newly established populist parties from the right or the left, which might be able to secure a majority of votes among citizens and form the new government.[24]

But how would the establishment of a government formed by the newly established populist parties affect the political economy of EMU? In order to maintain high rates of approval, such newly established populist parties might tend to be inward-looking and give priority to national over European Union objectives (Lachmann 2010: 356). Moreover, the policies of such populist parties will most likely be short-term fixes (Györffy 2013). If such a populist party, for example, would be confronted with an acute unemployment crisis within the country, associated with a large amount of debt per GDP, most likely it might consider ways to circumvent the established processes and treaties within EMU. If such a party forms the government within a country that is in a debtor position, realistic measures might then include confronting member partners of EMU with a potential default on its debt, which might lead a disorderly exit from EMU (and would most likely damage EMU as a whole). Most importantly, the mere intention of taking such measures would endanger the political unity among the political elites within the member countries of EMU. As has been frequently pointed out, however, the political unity of the political elites in EMU is the glue that holds EMU together (Jonung 2002: 420-421; Bordo and Jonung 2003). Absent the glue, the long-term success of a currency union, such as EMU, will likely be threatened (Bordo and Jonung 2003; Jonung 2002: 420-421).

ii) Trust as a prerequisite for an economy's long-term fiscal sustainability

Following the arguments by Jonung (2013a, 2013b: 114) and Györffy (2007, 2013), it can be argued that a loss of trust in the institutions of democratic governance at the national level endangers an economy's long-term fiscal sustainability. The argument is made explicit by Györffy (2013: 47-50), who discusses two potential cycles: the virtuous and vicious cycle between systemic trust and growth. The virtuous cycle works in the following manner. If citizens' trust in public administration is high, citizens' will obey the law and pay their taxes (see here also Nye 1997 and Scholz 1999). These resources can then be used by the public administration to implement long-term planning and policies based upon a stable budget. These conditions moderate uncertainty and create a positive business environment providing predictability and reliability for entrepreneurs, which will trigger higher business investments, leading to higher growth and lower unemployment levels. This sequence of developments again generates systemic trust in the public administration. The complete opposite scenario, the vicious cycle, can materialise if citizens' trust in the public administration is low. In this scenario, compliance with the law and willingness to pay taxes will be low. This will lead to short-term planning and political business cycles. This situation hampers entrepreneurial activity and leads to lower growth and higher unemployment, which again leads to a decline of systemic trust on behalf of citizens.

In this respect, another important point, as highlighted by Jonung (2013a, b) and Györffy (2007, 2013), is the relationship between low levels of systemic trust and the effective implementation of structural reforms within an economy to regain competiveness. Both authors conclude that in countries in which citizens' systemic trust is low, governments will find it more difficult to be able to implement structural reforms in order to regain competitiveness. Györffy and Jonung illustrate this fact by comparing the country case of Sweden with that of Portugal (Györffy 2013: 82-91; Jonung 2013b: 114) and Hungary (Györffy 2007: 10-20). Sweden, which had a financial crisis in the 1990s, was able to successfully implement structural reforms to regain competiveness already after several years. The key to these structural reforms was the fact that citizens' trusted the government and did not boycott the reforms. The structural reforms were implemented with citizens' support and not in

[24] In an extreme scenario, such parties, once having seized power, might try to erode the parliamentary process from the inside (for two detailed analyses of the German case during the Weimar Republic, see Berman 1997; Frey and Weck 1983).

opposition to them. In contrast, Portugal and Hungary, two low-trust countries, when facing economic crisis were not able to regain competitiveness but were exposed to political cycles that lead to the installation of populist parties, political instability and short-term policy fixes. Whereas this field of research is still largely underdeveloped and needs more basic empirical research, first econometric results between systemic trust and fiscal adjustments point towards a positive relationship (Weichenrieder et al. 2014).

3.2 Application of theoretical arguments to the most recent Euro Area crisis

Given the theoretical arguments, we will now apply these arguments to the most recent Eurozone crisis. The question guiding the discussion is how far can a significant decline in systemic trust affect the political economy of EMU.

i) Loss of legitimacy

Applying the combined scenario by Kaltenthaler et al. (2010: 1262) and Newton (2001: 205) described above with the rich empirical evidence as presented in sections 1 and 2 clarifies that in particular the Spanish and Greek trends in net trust in the national government and parliament in times of crisis should be considered worrisome for the legitimacy of these two institutions. As elaborated above, the Spanish and Greek trust trends in the NG/NP have faced the most pronounced decline in net trust among the EA12 since 2008 and have reached the very low net levels of trust of -74 and -71 in 11/2014 (significantly lower than in EC/EP). In addition, in both countries, this pronounced decline in trust in the NP is associated with a pronounced decline in satisfaction with democracy, an incidence exclusively detected in those two countries within the EA12 (see Table 5). Having established that the legitimacy of the Spanish and Greek national government and parliament has been endangered in times of crisis, how will this affect the political economy of EMU? We will first discuss the Greek case and will then continue with the Spanish case.

The Greek case has strongly evolved as laid-out within our theoretical arguments. The pronounced and steady decline in Greek citizens' net trust in the national parliament throughout the crisis to very low levels in 11/2014 has led as a consequence to the new establishment of a populist party from the left (Syriza), as well as the strengthening of a party from the radical right (Golden Dawn) within the Greek national parliament and crowded out the historically well-established social democratic party from the moderate left (Pasok). This trend had already manifested itself in the national elections in June 2012 in which Syriza managed to win a 16.8 percent share and Golden Dawn a 7 percent share. It continued in the European Parliament election in May 2014, which Syriza managed to gain the largest share with 26.6 percent, ahead of the then ruling New Democracy Party with 22.8 percent. In addition, parties from the radical right, Golden Dawn, achieved 9.4 percent. Thus since June 2012, the historically well-established democratic parties at the centre of the parliamentary democratic process were pressured from the populist left and radical right party spectrum. After the Greek national parliament failed to elect a new president in December 2014, new elections were scheduled for January 2015. In the seventh year of the crisis, at a time at which net trust in the national parliament already declined by 69 percentage points and stood at a net level of -71 percent, a newly established party from the populist left (Syriza) managed to form the government with an almost absolute majority.

And now that a newly established party from the populist left formed the government in January 2015, let us examine how this has affected the political economy of EMU. Being a debtor country within the EMU and being confronted with 26 percent unemployment and a debt load of 174 percent per GDP, the newly established government from the populist left repeatedly stressed its willingness to default on its debt, if necessary. More importantly than the fact that the Greek government has not yet defaulted on its debt, the ongoing discussions on a potential default has already created strong political tensions among the member countries of EMU. If these political tensions not ease off in the short to medium run, they will most likely affect the political unity among the political elites of the member countries and will thus weaken the glue that holds currency unions such as EMU together (Bordo and Jonung 2003; Jonung 2002).

Whereas in Greece, the new establishment of parties from the populist left and the strengthening of parties from the radical right was a steady process throughout the crisis, in Spain an opposition to the well-established

democratic parties (Peoples Party and Spanish Socialist Workers Party) in the national parliament emerged from outside the Spanish party system within the 15-M social movement. In January 2014, this social movement established itself as a new party from the populist left under the name Podemos. This party has won a 5 percent share of the vote in the European Parliament elections in May 2014 and a 15 percent share of the vote in the regional election in Andalusia in March 2015. Whereas polls by El Mundo in November 2014 predicted that Podemos would be able to win the largest share of votes (28.3 percent) in the upcoming national parliamentary elections (Buck 2014), polls by Metroscopia in March 2015 indicate that Podemos has already lost a significant share of votes (22.5 percent), although still securing the largest share of votes (Kennedy 2015). The Spanish national elections will be hold at the end of 2015. If a populist left party such as Podemos manages to become the strongest political force in Spain, and if it potentially manages to form the new government within a coalition government, this would increase the existing political tensions between the member countries of the EMU. With Spain being the 4th largest economy in EMU, such tensions would more significantly affect the political unity of the member countries of EMU, than those currently witnessed in the Greek case.

ii) Trust as a prerequisite for an economy's long-term fiscal sustainability.

Applying the above theoretical arguments to the most recent empirical evidence within the periphery countries of the Euro Area indicates that low levels of systemic trust are indeed an important obstacle to the long-term fiscal sustainability of a country. We will try to illustrate this reasoning in the case of Greece. The Troika (EC, ECB and the International Monetary Fund) bailed-out Greece in 2010 under the conditionality of implementing deep structural reforms within the Greek economy. A crucial point that all three institutions did not take into consideration was the fact that Greek citizens' trust in the national parliament already declined markedly in the aftermath of the financial crisis and more importantly during the first months of the Papandreou government – from -5 percent in 10-11/2009 to -53 percent in 5/2010 (see here also Roth 2011). Thus at the time the structural reforms should have been implemented by the Papandreou government from May 2010 onwards, a large majority of Greek citizens already mistrusted their parliament. Taking these low levels of systemic trust into consideration, it was clear that implementation of the structural reforms as envisaged by the Troika had a high probability of failing as they were implemented in opposition to citizens and not with the mutual consent of the citizens (such as occurred in Sweden in the 1990s). Indeed, in line with the theoretical arguments, the opposition of Greek citizens provoked a boycott of the implemented austerity measures and led to a political business cycle. Similar problems occurred in Spain, Ireland and Portugal, in which austerity measures were implemented at a time when citizens net trust in their national parliament's had already declined significantly in the aftermath of the financial crisis and stood at -50, -49 and -39 percent in May 2010.

In general, it should be noted that the low levels of trust in the national parliaments in the EA12 countries, including those of two large economies France and Italy, pose an obstacle to implementing structural reforms in these economies in times of crisis. It seems common sense that deep structural reforms should not be initiated, given such low levels of systemic trust in order to back the political stability/legitimacy of their respective national parliaments. A destabilisation of these respective national parliaments in times of crisis would only add fuel to the fire of parties from the radical right in France (Front National) and the populist left in Italy (Five-Star Movement). As will discussed in more detail below, given these condition of political uncertainty in France and Italy, the widening competitiveness gap vis-à-vis Germany needs to be largely closed via a German revaluation.

4. Restoring citizens' systemic trust in the Euro Area periphery

4.1 Empirical findings between unemployment rates and systemic trust in times of crisis

In sections 1 and 2 we have identified a pronounced decline of systemic trust in the EA4, here in particularly in Spain and Greece, in times of crisis. How can this loss in systemic trust be restored? What are the key drivers of this decline in systemic trust in the EA4, especially in Spain and Greece?

Econometric findings for the US and for an EA12 country sample suggest that amongst others an increase in unemployment rates throughout the crisis is significantly negatively related to a decline in systemic trust (Stevenson and Wolfers 2011; Roth et al. 2013, 2014; cf. Wälti 2012).[25] Table 6 displays updated econometric findings of a fixed-effects DFGLS estimation between unemployment and net systemic trust for the six-year crisis period (10-11/2008 to 11/2014) for an EA12 country sample utilising a model specification and a research design as developed within the existing literature.[26] Table 6 clarifies that within the EA12 in times of crisis, a 1 percent increase of the unemployment rate is associated with a decrease of 7.5 and 7.3 percentage points of net trust in the NG and NP, and a decrease of 4.1 and 4.2 percentage points in the EC and EP. With an unemployment coefficient of -6.5, the association between unemployment and net trust in the ECB in times of crisis is significantly higher compared to those in the EC and EP. Within the EA12 in times of crisis, a 1-percent increase of the unemployment rate is associated with a decrease of 6.5 percentage points of net trust in the ECB.

Table 6

Unemployment and net systemic trust, fixed-effects DFGLS estimation, 2008-2014, EA12

	1	2	3	4	5
Dependent Variable	NG	NP	EC	EP±	ECB±
Source	EUI	EUI	EUI	EUI	JEI
Unemployment	-7.5***	-7.3***	-4.1***	-4.2***	-6.5***
	(1.81)	(1.36)	(1.11)	(0.95)	(1.25)
Growth	-3.1	-2.8	0.69	0.01	0.6
	(2.59)	(2.07)	(1.41)	(1.28)	(1.63)
Inflation	-1.9	-3.1	-4.8	-6.9***	-11.8***
	(5.32)	(4.15)	(3.00)	(2.71)	(3.52)
Government Debt	0.44	0.2	-0.66***	-0.51***	-
	0.32	(0.24)	(0.20)	(0.17)	-
Election Dummy	Yes	Yes	-	Yes	-
Durbin-Watson statistic	2.02	1.95	2.14	2.15	2.38
Adjusted R-Squared	0.87	0.89	0.89	0.89	0.89
Country fixed effects	Yes	Yes	Yes	Yes	Yes
Control for endogeneity	Yes	Yes	Yes	Yes	Yes
Elimination of first order autocorrelation	Yes	Yes	Yes	Yes	Yes
Observations	119	119	119	119	119‡
Number of countries	12	12	12	12	12

Notes: NG=Net Trust in National Government, NP=Net Trust in National Parliament, EC=Net Trust in European Commission, EP=Net Trust in European Parliament, ECB=Net Trust in European Central Bank. ‡ In order to estimate net trust in the ECB with 119 observation the country case of the Netherlands in 5/2011 was dropped. This does not alter the results in any significant manner.

Sources: Updated and merged econometric results until 5/2011 (by EB's 79-81) in Roth, Nowak-Lehmann and Otter (2013); Roth, Gros and Nowak-Lehmann (2014).

[25] The importance of the unemployment coefficient is line with Gomez (2015) who finds a significant effect of unemployment on an index for support for the EU for an EU27 country sample (c.f. Armingeon and Ceka 2014; Armingeon and Guthmann 2014). In addition to the unemployment rate as published by the European statistical office Eurostat, citizens' perceptions of the personal unemployment situation (Guiso et al. 2014; Polavieja 2013; c.f. Torcal 2014) has also been found to be a significant determinant of the decline in trust.

[26] For a detailed description of the research design, model specification and econometric estimation strategy, see Roth et al. (2012a, 2013, 2014).

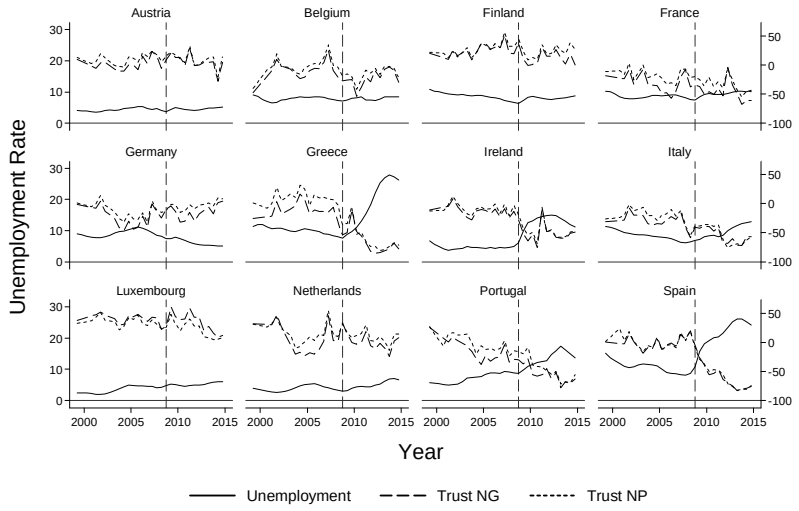
Whereas the unemployment rate is the sole significant variable that is able to explain the decline in trust in the national institutions in the EA12, in the case of the EC and EP there exists a second significant variable contributing to a decline in trust in times of crisis. Indeed, as can be detected in Table 6, an increase of 10 percentage points of government debt in times of crisis is associated with a decline of 6.6 and 5.1 percentage points in trust in the EC and EP. Thus, in contrast to trust in the national institutions, trust in the EC and EP in times of crisis seems to be driven by both an increase in unemployment and an increase in debt over GDP. The negative and significant coefficients of -6.9 and -11.8 respectively for inflation and trust in the European Parliament and European Central Bank lack robustness. Excluding the two time periods (EB 70 and 71) in the direct aftermath of the financial crisis renders insignificant coefficients. In particular, in the case of the ECB, an insignificant relationship between inflation and trust is in line with theoretical considerations as the ECB successfully muted inflation in times of crisis. The econometric results in Table 6 thus seem to suggest that among the four depicted macroeconomic variables (unemployment, growth of GDP per capita, inflation and debt per GDP) it is in particular the unemployment rate in times of crisis that is highly significantly and strongly negatively associated with systemic trust at the national and European level.

Graphical analysis

The econometric findings in Table 6 clarified the important role of unemployment rates in explaining the pronounced decline in trust in the periphery countries of the EA12. In order to assess whether this relationship is driven universally across all 12 countries, Figure 3 plots the unemployment trends from 3-4/1999 to 11/2014 against the net trust trends in the NG/NP.

Figure 3

Unemployment and net trust in the national government and parliament in the EA12, 1999 to 2014



Notes: The left hand x-axis displays the percentage of unemployment rate, ranging from 0 to +30. The right-hand side displays the levels of net trust ranging from -100 to + 50.

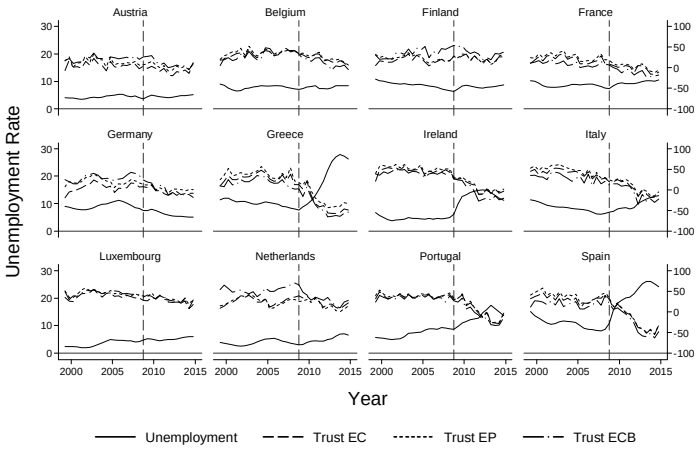
Figure 3 together with the table of correlation coefficients in Table A4 in Appendix 2 clarifies that whereas trust trends in the NG/NP are almost all negatively related to unemployment trends (with Belgium being the only exception), the strength of this association varies across the 12 countries. The negative relationship is particularly strong with the three EA4 countries Spain, Portugal and Greece. The case of the former country is of particular interest. In Spain, the correlation coefficients for both relationships, the one between unemployment and net trust in the NG/NP, are as high as -0.99, and thus resemble almost a perfect negative correlation in times of crisis. It is most noteworthy, as can be identified in Figure 3, that this perfect negative relationship not only holds during the

steady increase in unemployment rates since the start of the crisis in 10-11/2008, in which net trust steadily declined, but also once unemployment rates started falling from 5/2013 onwards, in which net trust started to slightly recover. Similarly perfect, although slightly less pronounced patterns can be identified in the cases of Greece and Portugal (with correlation coefficients ranging from-0.90 to -0.75). In both cases, the steady increase of unemployment rates from 10-112008 to 5/2013 was associated with a steady decline in trust. The decrease of unemployment rates from 5/2013 onwards is then associated with a slight recovery in net trust. The same patterns with lower magnitude can be detected in Ireland and all EA8 countries, with the exception of Austria and Belgium. For Germany, it is noteworthy, that the negative correlation coefficient is actually driven by a reverse effect – an actual reduction of unemployment rates throughout the crisis – has led to an increase in net trust.

Similar but distinct patterns can be found when analysing trust in the EC, EP in Figure 4 and Table A4. In the three periphery countries Spain, Portugal and Greece as well as in Italy and France, one detects large negative correlation coefficients between an increase in unemployment and a decline in net trust. In particular, in Spain, with correlation coefficients of -0.94 and -0.95, an almost perfect negative correlation between unemployment and net trust in the EC/EP can again be found. In contrast to the patterns in the NG/NP within the three core countries Germany, Austria and Finland, one actually finds a positive correlation between unemployment and net trust in the EC/EP, with a particularly strong correlation in Germany with 0.84 and 0.71.

Figure 4

Unemployment and net trust in the EU institutions in the EA12 – 1999 to 2014



Notes: The left hand x-axis displays the percentage of unemployment rate, ranging from 0 to +30. The right hand side displays the levels of net trust ranging from -100 to + 100.

Thus, Germany is the real exception among the EA12 countries (see here also Alonso 2015). In Germany a reduction in unemployment rates throughout the crisis is associated with a decline in net trust in the EC/EP. This exceptional status of Germany becomes even more apparent concerning net trust in the ECB (also shown in Figure 4 and Table A4). Whereas in Spain, Portugal, Greece, Italy and France, with negative correlation coefficients ranging between -0.93 to -0.80, an increase in unemployment rates is negatively associated with declines in net trust, Germany's situation is nearly the exact opposite. With an appositive correlation coefficient of 0.88, a reduction in unemployment rates is positively associated with a decline in net trust in the ECB.

Fairness as an intermediating effect between unemployment and systemic trust in times of crisis

As highlighted by Stiglitz (2012), the pronounced increases in unemployment might lead to the significant decline in systemic trust via the intermediating factor of fairness. The role of fairness might be one of the reasons why the unemployment coefficient on trust is lower and only weakly significant in pre-crisis times but becomes highly significant and negative in times of crisis and here in particular from the second year onwards of the

sovereign debt crisis (Roth et al. 2013: 15-16). Given that the financial crisis has been largely responsible for the emergence of the sovereign debt crisis within the EA and given that a significant amount of *public* resources at the national level has been spent on aiding/bailing out the *private* financial sector (De Grauwe 2010: 344), the implemented austerity measures in Spain, Greece, Portugal and Ireland aimed at building *confidence* (see e.g. the debate in Corsetti 2012 and De Grauwe and Yi 2013), with their pronounced increase in unemployment rates have most likely created perceptions of significant unfairness among the citizens in those countries.

This fairness problem also concerns the growing income inequality in those countries caused amongst others by the pronounced increase in unemployment rates (see European Commission 2014a: 40 for the case of Spain). It is most likely this parallel action by policy-makers of aiding/bailing out the financial sector and implementing significant austerity measures, which have led to an increase of unemployment, has led to a strong sense of unfairness amongst citizens. In the Spanish case for example the (very) long-term unemployment rates (> 2 years) have increased significantly throughout the crisis (European Commission 2014a: 40). Given the fact that unemployment benefits are paid for a duration of two years, poverty rates increased significantly (European Commission 2014a: 40). Connected to the concept of fairness might also be an increase in the perception of corruption in the periphery countries of the EA12 (Torcal 2014), which has led to the large and significant unemployment coefficient in times of crisis. Thus a needed reduction in unemployment rates should be associated with enhancing the governance structures by enhancing government effectiveness and the rule of law and effectively controlling corruption. In this respect, the OECD has set up a whole trust strategy, identifying amongst others, the two dimensions of integrity (control of corruption) and fairness (OECD 2014).

4.2 Increasing unemployment throughout the crisis – factual evidence in the case of Spain

The econometric findings as displayed in Table 6 and the clear pattern between an increase of the unemployment rates and trust in the NP in Figures 3 and 4 indicate that for most EA12 countries to regain citizens' systemic trust, amongst others, it would be important to reduce unemployment rates in times of crisis. Given that we have identified two worrisome countries in particular, namely Spain and Greece (both of are confronted with a large increase in unemployment rates), and given the fact that Spain from the sheer size of its economy is a more pivotal case for the EA12 than Greece, the following discussion will be centred on the case of Spain. Given the fact that Spain is struggling with one of the largest increases in unemployment rates throughout the crisis, what are the specific reasons for such a pronounced increase in the Spanish economy in the first place? It is hoped that the following set of arguments will shed light on this question.

The initiation of the Euro Area in 1999 has led to large capital inflows into the peripheral countries of the EA12, here in particular in Spain (Hale and Obstfeld 2014; Sinn 2014: 39-40). These large capital inflows have led to unsustainable housing investment (construction bubble) and household consumption in the run-up to the crisis (Hale and Obstfeld 2014; Sinn 2014: 39-40, 67-68). The Spanish economy has been severely hit in the aftermath of the financial and economic crisis once this lending stopped from September 2008 onwards (Sinn 2014: 111). Although government debt had been relatively low when the crisis erupted, household debt and the debt of the financial industry were significant (De Grauwe 2010: 344; Sinn 2014: 68-69).

Similar to other European/Euro Area countries, the Spanish government had to devote substantial resources in order to stabilise its banking sector (De Grauwe 2010: 344). Together with the automatic stabilisers set in motion this led to a fast increase of Spanish government debt in the first years of the crisis (De Grauwe 2010: 344). From May 2011 onwards, significant amounts of capital investments have been withdrawn from the Spanish economy (Merler and Pisani-Ferry 2012; Sinn 2014: 226). In addition, the competitive position vis-à-vis other economies within the Euro Area has deteriorated in the early years of EMU, here in particular the relative labour unit costs vis-à-vis Germany (De Grauwe 2014a: 130-131). With Spain being a member of a currency union and having given up its possibility to conduct an individual national monetary policy, the economy could not regain competiveness via a large currency depreciation such as was seen within the UK (Krugmann 2009; De Grauwe 2014b). Instead it had to go through a process of internal devaluation (cutting budgets + lowering

wages) which has led to a deepening of the depression and a further increase in unemployment rates (De Grauwe 2014a: 132).

Given this overall economic situation, the financial markets were less willing to purchase Spanish government bonds and Spanish bond prices subsequently started to increase in the beginning of 2011 (De Grauwe 2014a: 121). In order to calm the financial markets, austerity measures (further budget cuts) were implemented in the midst of an economic crisis to restore confidence (Corsetti 2012; De Grauwe and Yi 2013). This has led to an intensification of the crisis and even higher unemployment rates (De Grauwe 2014a: 132). In order to calm the markets, the European Central Bank has decided to act as lender of last resort within the Spanish government bond market (De Grauwe 2013a) and has thereby achieved the subsequent decline in spreads vis-à-vis the Bund (De Grauwe and Yi 2013). In the seventh year of the crisis, the Spanish unemployment rate increased by around 15 percentage points, from 8 percent in 3-5/2008 to 24 percent in 11/2014. Even if the structural unemployment rate in Spain is sizeable (van Ark 2014) due to the existence of a pronounced skill gap (European Commission 2014a) and rigid employment-protection legislation (European Commission 2014a), a cyclical component of the Spanish unemployment increase is recognised by the central European institutional actors in the seventh year of the crisis (Draghi 2014; European Commission 2014b).

4.3 Tackling unemployment in times of crisis

Given that this pronounced increase in unemployment rates in times of crisis endangers the legitimacy of the Spanish national parliament, it would be crucial for Spain and the long-term success of EMU to reduce a significant share of the cyclical unemployment rate over the coming years.

The structural unemployment in Spain would need to be tackled at the national level (Baldwin and Wyplosz 2012: Chapter 8) through the implementation of structural labor market reforms, and adequate policies fostering the re- and upskilling of the labor force (Draghi 2014; European Commission 2014a, b). It has been suggested that the cyclical component of unemployment in the Euro Area should be tackled by stimulating aggregate demand with a mix of monetary policy (Draghi 2014) and expansive fiscal policy via an investment plan for Europe (European Commission 2014c, d; Fichtner et al. 2014). The importance of stimulating aggregate demand to kick-start growth and reduce cyclical unemployment in times of crisis has been advocated by Nobel laureates throughout the crisis (Krugman 2014; Stiglitz 2012). Most likely, this policy mix will successfully stimulate the aggregate economy of the Euro Area and tackle a part of the cyclical unemployment in Spain.[27]

However, such a policy mix is not able to solve problems of structural unemployment, nor tackle the underlying competitiveness gap indicated by the large spread in unit-labour-costs vis-à-vis Germany within the 12 Euro Area member states.

In the medium-term in order to enhance growth in Spain and reduce unemployment, this gap in unit-labour-costs vis-à-vis Germany would need to be closed (De Grauwe 2015). With Spain having joined the Euro Area in 1999 and having lost the possibility to regain competiveness via a large devaluation of its currency (as in the case of the UK – see Krugman 2009; De Grauwe 2014a: 9-10, 2014b) two realistic options are given in order to close the competitiveness gap vis-à-vis Germany. Either Spain continues its ongoing process of internal devaluation or Germany revaluates more strongly. Given the empirical evidence of an already pronounced trust decline in the Spanish national parliament with very low levels of trust in times of crisis a continuation of its ongoing process of internal devaluation would further endanger the legitimacy of the national parliament, and thus political stability. The view that the continuation of the ongoing internal devaluation is politically unsustainable for the periphery countries within the EA12 is supported by most recent literature (De Grauwe 2013b: 39-40; O. Rourke and Taylor 2013) and the important historical analogy of the fall of the Weimar Republic and the rise of German fascism (Sinn 2014: 138-139).

[27] The recommended policy mix, however, is not without criticism. For some commentators this policy mix violates the subsidiary principle and leads to large market distortions endangering the unity of Europe (Sinn 2014). For other commentators, this policy mix is not far-reaching enough. They propose a targeted investment plan for the euro-area periphery that would be directly financed by the ECB (Varoufakis and Holland 2012).

Given Spain's already unstable political situation, what is thus needed to close the competitiveness gap is a significant revaluation within the core countries of the EA12, here in particular in Germany (see De Grauwe 2013b: 39-40; De Grauwe 2015; Fratzscher 2014).

5. Public support for the euro in times of crisis

As has been elaborated upon above, European policy-makers have announced their intention to stimulate aggregate demand within the EA via a mix of monetary policy (Draghi 2014) and expansive fiscal policy via an investment plan for Europe (European Commission 2014 a, b) in order to stimulate aggregate demand and tackle cyclical unemployment at the Euro Area level. Given the empirical fact that systemic trust in the European institutions has declined throughout the crisis, one might argue that such collective action on behalf of the European institutions in the sixth year of the crisis lacks (political) legitimacy (see the general discussion of declining systemic trust and loss of legitimacy in section 3). Although, this argument certainly has its merits, from an EA12 perspective the empirical reality is more nuanced. In this respect, one important indicator that has not yet been elaborated upon in the above discussion is citizen support for Economic and Monetary Union, with one single currency, the euro.[28] Following Roth, Jonung and Nowak-Lehmann (2012a), three strands of arguments in this field of research can be highlighted. First, according to Banducci et al. (2003: 686) and Kaltenthaler and Anderson (2001: 140-141), the evolution of public support for the euro is a crucial test to determine the future process of EU integration and the accessibility to move towards supranational governance. Second, according to Bordo and Jonung (2003) and Jonung (2002), public support for the euro is crucial for the political legitimacy of EMU and the euro and thus functions as an important prerequisite for the long-term success of EMU. Third, public support of the euro can be interpreted as a communality of destiny (Baldwin and Wyplosz 2012: 425), solidarity (De Grauwe 2014a: 133) or political glue (Bordo and Jonung 2003) among the member countries of EMU. According to Jonung (2002) it is rather the socio-political concept of commonality of destiny or solidarity or political glue that holds a currency union together rather than standard economic arguments as developed with the literature on Optimal Currency Unions.

Following the methodology within Roth et al. (2012a), Table 7 compares the changes in net support in the euro before the crisis and in the sixth year of the crisis (11/2014 - 3-5/2008), with those of net trust in the EC, EP and ECB for an EA12, EA8 and EA4 country sample. Three findings are particularly noteworthy. First, in line with the original findings (Jonung, Nowak-Lehmann and Roth 2012; Roth, Jonung and Nowak-Lehmann 2011, 2012 a, b) and similar findings (Debomi 2013; Guiso et al. 2014; Hobolt and Le Blond 2014; Hobolt and Wratil 2015), Table 7 highlights that within all three country samples public support for the euro remained stable throughout the crisis. Second, as already elaborated above and once more shown in Table 7, this is in sharp contrast to net trust in the ECB, which has suffered the greatest decline in trust among the three European institutions. In addition, the difference in net support and net trust is the most pronounced within the peripheral countries of the EA4 with an overall difference of a net value of 76 percentage points. Third, with a value of +40 the levels of net support are surprisingly high in the sixth year of the crisis. Whereas in the sixth year of the crisis already a slim majority distrusted the European institutions within the EA12 (with net trust levels ranging from -20 to -6) a large majority supported the EMU and the euro.

[28] To measure public support for the euro, the survey participants were asked their opinion on several proposals: *"Please tell me for each proposal, whether you are for it or against it."* One proposal was: "*A European Monetary Union with one single currency, the Euro"*. The interviewed person could then choose from the following set of answers: *"For", "Against"* or *"Don't Know"*.

Table 7

Comparison of changes between net support and net trust in the EA12, EA4 and EA8, 2008-2014

Sample	Trust/Support	Level: 3-5/2008	Level: 11/2014	Changes: 11/2014 - 3-5/2008
EA12	*Euro*	40	40	0
EA12	*EC*	21	-11	-32
EA12	*EP*	27	-6	-33
EA12	*ECB*	29	-20	-49
EA4	*Euro*	34	34	0
EA4	*EC*	38	-29	-67
EA4	*EP*	37	-24	-61
EA4	*ECB*	34	-42	-76
EA8	*Euro*	42	42	0
EA8	*EC*	16	-6	-22
EA8	*EP*	22	0	-22
EA8	*ECB*	27	-13	-40

Notes: EA = Euro Area, EC = European Commission, EP = European Parliament, ECB = European Central Bank. EA12, EA4 and EA8 values are population-weighted trust trends. All values below 0 show a lack of trust by the majority of citizens. Minimum values are shaded in dark grey. Maximum values are shaded in light grey. Table ranked according to decline in changes.

Source: Updated and slightly modified version of Table 1 until 11/2014 (by EB's 79 to 82) in Roth, Jonung and Nowak-Lehmann (2012a).

Since Table 7 only depicts a before-and-after comparison, it seems of interest to also analyse the time trends of net support in comparison to net trust in the EC, EP and ECB from 1999 to 2014. Figure 5 compares the net support trend in EMU and the euro with the net trust trends in the ECB, EC and EP. With a decline in mean levels of only 4 and 2 percentage points, net support trends have remained almost stable in the EA12 and EA8 country sample (see Table A5 in Appendix 2 for the mean values and standard deviations, as well as the respective changes of the before the crisis and crisis periods). In the EA8 these stable trends are driven by opposing trends, with Italy on the one hand facing a decline of 15 percentage points, and the Netherlands, Germany and Finland on the other hand facing increases of 9, 10 and 21 percentage points. In contrast with a decline in mean values of 13 percentage points, net support has slightly declined in the EA4 country sample. This decline in mean levels of the EA4 has been driven by the decline in Spain of 16 percentage points and of Portugal of 18 percentage points.

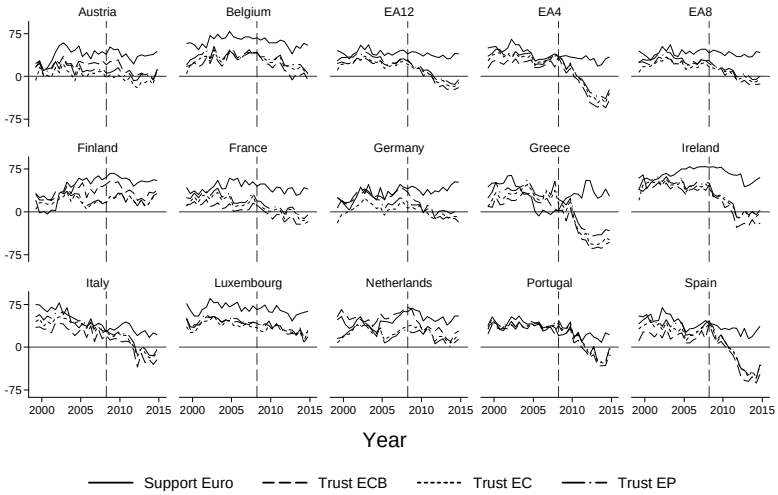
Closely analysing Figure 5, one detects that the decline in mean levels in Italy, Spain and Portugal and the increase in mean levels in Finland, the Netherlands and Germany are largely due to a significant decline/increase from relatively large/low levels of net support within the first years since the actual establishment of the euro area in 1999. As can be identified by the low standard deviations, with a crisis/pre-crisis ratio of below 0 in the respective countries, net support trends stabilized in times of crisis. Throughout the crisis only Germany managed to further increase net support for the euro, while Spain faced a moderate decline. The most pronounced decline throughout the crisis can be witnessed in Ireland. Remarkably, Greece has actually enjoyed a significant increase in net support throughout the crisis (see here also Clements et al. 2014).

The net support trends are in stark contrast to trends in net trust in the EA4. Whereas net support only declined slightly in the EA4, we detect large pronounced declines in mean levels and sharp increases in standard deviations in all three European institutions in the EA4, particularly in the ECB. Among the EA8 we only detect a significant contrast between net support for the euro and net trust in the ECB among the four stability-centred countries Austria, Finland, Germany and the Netherlands. In those four countries net trust trends in the ECB have started to decline from significantly higher levels in 3-5/2008 since the start of the crisis and are now located at lower levels compared to net trust in the EC and EP. Whereas net trust in the ECB has already turned negative in eight of the EA12 countries (EA4, Belgium, France, Germany and Italy – see also Table 3), Figure 5

clarifies that in each individual country of the EA12 a majority of citizens always supported the euro during the crisis (with a minimum level of 8 in Portugal in 11/2013).

Figure 5

Public support for the euro and trust in the ECB, EC and EP in the EA12, EA4, EA8 and individual countries for the euro in the EA-12, 1999-2014



Notes: EMU = Economic and Monetary Union, ECB = European Central Bank, EC = European Commission, EP = European Parliament. The dashed line represents the start of the crisis in September 2008. Values for the EA12, EA8 and EA4 are population-weighted trust trends. As the figure presents data on net trust, all values below 0 show a lack of trust by the majority of citizens.

Sources: Updated and merged versions of figures until 11/2014 (by EB's 79 to 82) in Roth, Jonung and Nowak-Lehmann (2012a); Roth, Nowak-Lehmann and Otter (2013); Roth, Gros and Nowak-Lehmann (2014).

Given the empirical evidence in Figure 5 that in times of crisis in each individual member country of the EA12 a majority of citizens has supported the euro, including a large majority in Germany, it becomes apparent that it is not the euro itself that has been criticised by Euro Area 12 citizens. Rather it is the management of the crisis by the European institutions, which has been criticised. Given the significant decline in net trust, the enduring popularity of the euro within the EA12 should be considered an important prerequisite for collective action at the EA level to stimulate aggregate demand and tackle cyclical unemployment as announced and currently undertaken by the European institutions (Draghi 2014; European Commission 2014c, d).

6. Restoring Systemic Trust without treaty change and with treaty change

From the above line of argument we have learned that the periphery countries of the EA12, here in particular Spain and Greece, face an acute crisis of systemic trust in times economic crisis. Levels of systemic trust in the national parliament have fallen in a such a pronounced manner that its legitimacy might be endangered in time of crisis. Econometric results indicate that amongst others it is the pronounced increase in unemployment rates which has been responsible for the pronounced decline in systemic trust. Under the given conditions, how could systemic trust be restored in a scenario without treaty change and in one with treaty change?

6.1 Restoring systemic trust in the short run without treaty change

The policy mix initiated by the European institutions to stimulate aggregate demand in order to tackle cyclical unemployment within the EA via a mix of monetary policy (Draghi 2014) and expansive fiscal policy via an investment plan for Europe (European Commission 2014 c, d; Fichtner et al. 2014) will most likely help to restore citizens' systemic trust. Given the empirical findings presented above, however, this will depend strongly whether the policy mix will be successful in generating the envisaged volume of jobs.

Such action however will most likely only help to restore citizens' systemic trust in the short-run. The ongoing discussion highlights that in order to reduce unemployment in the medium to long-run, the competitiveness gap between the Euro Area periphery vis-a-vis Germany needs to be closed (De Grauwe 2013b, 2015). Given the already political unstable situation in the periphery countries of the EA12 (but also problematic situation in France and Italy) a continuation of the asymmetric ongoing internal devaluation by the peripheral countries will be politically unsustainable and thus does not represent a viable option (De Grauwe 2013b: 39, 2014: 132; O'Rourke and Taylor 2013; Sinn 2014: 138-139). The ongoing discussion indicates that what is needed instead is a moderate internal devaluation within the periphery countries and a strong revaluation within core countries, particular the German economy (De Grauwe 2015; Fratzscher 2014). Such a revaluation in Germany might lead to a temporary and moderate strengthening of German anti-euro parties from the populist-right, but given the overall large support for the euro by German citizens, those parties will not benefit significantly in the medium to long run and pose no threat to the political stability of the German parliament (see also Heinen and Kreutzmann 2015). Indeed, as has been shown, trust in the national parliament and support for EMU and the euro among German citizens is at all times high in the sixth year of the crisis in 11/2014.

6.2 Restoring systemic trust in the long run with treaty change

In the medium run, the financial and sovereign debt crisis has underlined that first steps towards deeper fiscal integration are essential in order to sustain the long-term success of EMU (Bordo et al. 2013; De Grauwe 2014). Given that EMU currently lacks a) sufficient labour mobility, b) a flexible wage setting and c) sufficient financial market integration, the development of a fiscal union would be needed in order to mitigate the social and political costs of large asymmetric shocks among the individual economies of the euro area (as witnessed in the current ongoing crisis) (De Grauwe 2014).

Different proposals have been brought forward in how to design the next steps of this fiscal union. The discussion is still going on. One proposal to mitigate the social and political costs of asymmetric shocks within the EA is the implementation of fiscal capacity (van Rompuy 2012) in the form of a European unemployment insurance scheme (Andor 2013, 2014; European Commission 2014b). This proposal has been criticised for being inefficient and the creation of a banking union has been proposed instead (Asatryan et al. 2015; Feld and Osterloh 2013). Another proposal is the issue of common euro bonds (De Grauwe 2014: 125). The proposal has been criticised on moral hazard grounds (Sinn 2014: 317). Bordo et al. (2013) have propose the issuing of common euro bonds but stress the necessity of a non-bailout clause. Another part of the literature highlights the necessity to coordinate the wage costs within the EA via the creation of a European Competitiveness Council and Euro System of Fiscal Policy to prevent the build-up of competitive gaps (Sapir and Wolff 2015).

Regardless of which proposal will ultimately be implemented in the coming years, in order to build systemic trust these proposals should manage to close the large heterogeneity in unemployment rates among the member countries of the Euro Area.

In addition, given the fact that a large proportion of the political legitimacy within the fiscal realms still lies with the national institutions of democratic government a further integration towards fiscal union would most likely need a reform of democratic governance within the euro area. One possibility is the establishment of a euro area parliament (potentially within the framework of the European parliament) to be held accountable by citizens. Such a step would realistically entail a treaty change.

Another prerequisite of the establishment of the above-mentioned proposals towards a fiscal union would be to maintain the high public support for the EMU and the euro. Without a high public support for EMU and the euro implementing these next steps towards a deeper fiscal integration would most likely endanger the long-term success of EA integration (Jonung 2002).

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Appendices

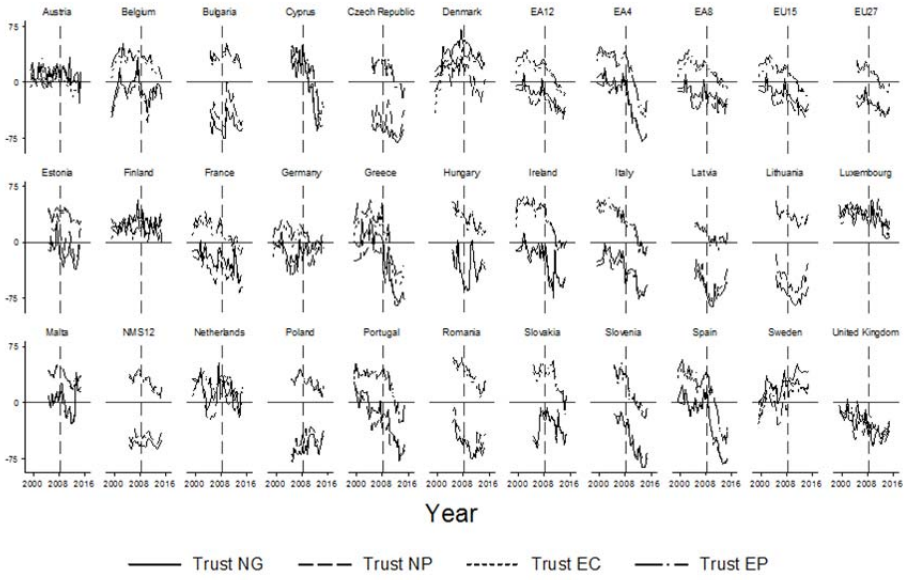
Appendix 1. Conceptualisation of Systemic Trust

Trust can be grouped in three broad dimensions: thick, interpersonal or generalised trust and systemic or institutional trust (Giddens 1990, 1996; Khodyakov 2007; Luhmann 2000; Newton 1997; Putnam 2000). The term systemic trust[29] was specifically introduced within the discipline of sociology within the early work of Niklas Luhmann in the 1960's (Luhmann 2000) and later work by Anthony Giddens (1990, 1996). Both authors stress that in today's modern differentiated societies the key for the smooth functioning and stability of the societal, political and economic system relies on citizens' systemic trust (Luhmann 2000) or trust in abstract systems (Giddens 1990, 1996). The advantage of the term systemic trust in contrast to institutional (Stevenson and Wolfers 2011) or political trust (Hetherington 1998; Mischler and Rose 2001) is that it is able to embed trust in the differentiated subsystems including the political, economic and financial system. Judging from the size of the ongoing financial, economic and sovereign debt crisis and the already gathered empirical evidence within the most economic-crisis hit countries such as the EA4 it seems adequate to conclude that trust in at least three subsystems: namely, the political, economic and financial system has been significantly affected by the ongoing financial and sovereign debt crisis. Thus, although the effects of the crisis on citizens' trust in national parliaments are pronounced (as elaborated within these lecture notes), the crisis cannot be reduced solely to a crisis of political trust. It has also strongly affected citizens' trust in the financial system (Ehrmann et al. 2013, Roth 2009b; Roth et al. 2014; Schatz and Vollbracht 2010; Sonnenschein 2013; Wälti 2012), and the economic system (Roth 2009 a, b; Stevenson and Wolfers 2011). The term systemic trust with its underlying theoretical framework, as developed within the discipline of sociology (Giddens 1990, 1996; Luhmann 2000), is ideal to function as an umbrella term for citizens' trust in the various subsystems (including the financial, economic and political system) having been affected by the ongoing financial, economic and sovereign debt crisis.

[29] Systemic Trust is the author's own translation of the German term *Systemvertrauen* as coined by the sociologist Niklas Luhmann (2000). Within the literature, *Systemvertrauen* has also been translated as "system trust" (see here a.o. Khodyakov 2007: 123; Seligman 1997: 19).

Appendix 2. Ancillary Figures and Tables

Figure A1
Individual time series of net trust in institutions of democratic governance
at the national and EU level in the EU-27, 1999 to 2014



Notes: EU = European Union, NG = National Government, NP = National Parliament, EC = European Commission, EP = European Parliament The dashed line represents the start of the crisis in September 2008. Values are population-weighted trust trends. As the figure presents data on net trust, all values below 0 show a lack of trust by a majority of citizens.

Source: Updated and merged versions of Figures A1-4 until 11/2014 (by EB's 79 to 82) in Roth, Nowak-Lehmann and Otter (2013).

Table A1
Mean levels of net trust in institutions of democratic governance
at the national and EU level, 1999-2014

Country	Mean Level BC		Mean Levels C		Changes Mean Levels (C - BC)		Difference in Changes	
	NG	NP	NG	NP	NG	NP	NG-EC	NP-EP
EA12	-18	-9	-36	-29	-18	-20	8	10
EA4	-5	2	-58	-55	-53	-57	-4	-10
EA8	-22	-11	-30	-22	-8	-11	11	13
Greece	-8	10	-65	-59	-57	-69	3	-11
Spain	0	2	-58	-57	-58	-59	-9	-5
Portugal	-12	-2	-54	-45	-42	-43	-8	-8
Ireland	-10	-8	-50	-47	-40	-39	-1	4
Italy	-23	-21	-54	-53	-31	-32	7	9
France	-24	-17	-45	-33	-21	-16	1	8
Belgium	-7	-2	-23	-15	-16	-13	-4	0
Luxembourg	32	36	34	22	2	-14	13	0
Netherlands	4	17	2	11	-2	-6	1	4
Finland	20	28	13	24	-7	-4	-11	-4
Austria	1	10	6	10	5	0	17	12
Germany	-18	-13	-14	-3	4	10	14	28
Country	Mean Level BC		Mean Levels C		Changes Mean Levels (C - BC)		Difference in Changes	
	EC	EP	EC	EP	EC	EP	EC-NG	EP-NP
EA12	24	32	-2	2	-26	-30	-8	-10
EA4	34	36	-15	-11	-49	-47	4	10
EA8	21	30	2	6	-19	-24	-11	-13
Greece	29	38	-31	-20	-60	-58	-3	11
Spain	32	39	-17	-15	-49	-54	9	5
Ireland	46	52	7	9	-39	-43	1	-4
Italy	41	48	3	7	-38	-41	-7	-9
Portugal	38	41	4	6	-34	-35	8	8
France	20	27	-2	3	-22	-24	-1	-8
Germany	6	21	-4	3	-10	-18	-14	-28
Belgium	33	37	21	24	-12	-13	4	0
Luxembourg	39	46	28	32	-11	-14	-13	0
Netherlands	26	27	23	17	-3	-10	-1	-4
Austria	6	15	-6	3	-12	-12	-17	-12
Finland	18	23	22	23	4	0	11	4

Notes: NG = National Government, NP = National Parliament, EC = European Commission, EP = European Parliament. BC = Before Crisis (3-4/1999 to 3-5/2008); C = Crisis (10-11/2008 to 11/2014). As the table presents data on net trust, all values below 0 show a lack of trust by the majority of citizens. Table ranked according to decline of changes in mean levels in the NP and EP. BC-sample includes 19 observations. C-sample includes 13 observations.

Source: Updated data in Roth, Nowak-Lehmann and Otter (2013).

Table A2
Standard deviations of net trust in institutions of democratic governance at the national and EU level, 1999-2014

Country	Standard Deviation BC		Standard Deviation C		Change Standard Deviation (C : BC)	
	NG	NP	NG	NP	NG	NP
EA12	10	9	9	8	0.9	0.9
EA4	8	8	20	21	2.5	2.6
EA8	12	10	7	6	0.6	0.6
Greece	12	11	21	22	1.8	2.0
Spain	11	12	23	23	2.1	1.9
Portugal	18	15	15	20	0.8	1.3
Ireland	9	9	17	16	1.9	1.8
Italy	12	13	13	16	1.1	1.2
France	16	11	16	14	1.0	1.3
Belgium	16	16	14	11	0.9	0.7
Luxembourg	8	8	17	14	2.1	1.8
Netherlands	25	17	15	12	0.6	0.7
Finland	11	11	13	13	1.2	1.2
Austria	10	9	12	11	1.2	1.2
Germany	17	13	12	7	0.7	0.5
Country	Standard Deviation BC		Standard Deviation C		Changes Standard Deviation (C - BC)	
	EC	EP	EC	EP	EC	EP
EA12	6	6	13	12	2.2	2.0
EA4	6	8	26	24	4.3	3.0
EA8	7	7	9	9	1.3	1.3
Greece	10	10	28	24	2.8	2.4
Spain	9	10	29	30	3.2	3.0
Ireland	8	7	15	16	1.9	2.3
Italy	8	10	17	16	2.1	1.6
Portugal	5	5	24	24	4.8	4.8
France	8	8	9	9	1.1	1.1
Germany	10	8	8	6	0.8	0.8
Belgium	10	8	10	9	1.0	1.1
Luxembourg	7	7	7	7	1.0	1.0
Netherlands	9	10	11	11	1.2	1.1
Austria	7	7	9	7	1.3	1.0
Finland	8	9	7	8	0.9	0.9

Notes: NG = National Government, NP = National Parliament, EC = European Commission, EP = European Parliament. BC = Before crisis (3-4/1999 to 3-5/2008); C = Crisis (10-11/2008 to 11/2014). Table ranked in the same order as Table A1. BC-sample includes 19 observations. C-sample includes 13 observations.

Source: Updated data in Roth, Nowak-Lehmann and Otter (2013).

Table A3
Mean levels and standard deviations in net trust in the ECB, 1999-2014

Country	BC		C		Changes	
	Mean	St. Dev.	Mean	St. Dev.	Mean (C - BC)	St. Dev. (C : BC)
EA12	25	4	-6	16	-31	4.0
EA4	24	6	-24	28	-48	4.7
EA8	26	4	-1	13	-27	3.3
Greece	18	9	-40	26	-58	2.9
Ireland	42	5	-5	21	-47	4.2
Spain	20	9	-26	31	-46	3.4
Portugal	35	6	-4	23	-39	3.8
Italy	29	9	-6	19	-35	2.1
Germany	29	8	0	14	-29	1.8
Netherlands	54	8	32	15	-22	1.9
France	10	6	-11	9	-21	1.5
Belgium	31	11	12	12	-19	1.1
Luxembourg	45	6	29	10	-16	1.7
Austria	22	6	10	11	-12	1.8
Finland	35	10	36	11	1	1.1

Notes: BC = Before crisis (3-4/1999 to 3-5/2008); C = Crisis (10-11/2008 to 11/2014). As the table presents data on net trust, all values below 0 show a lack of trust by the majority of citizens. Table ranked according to decline in the changes of mean value. BC-sample includes 19 observations. C-sample includes 13 observations.

Source: Updated data in Roth, Gros and Nowak-Lehmann (2014).

Table A4
Correlation coefficients between unemployment trends and net trust in national and European institutions in times of crisis, 2008-2014

Country	NG	NP	EC	EP	ECB
Belgium	0.04	-0.08	-0.49	-0.48	-0.47
Austria	-0.24	-0.14	0.23	0.28	-0.17
Ireland	-0.22	-0.41	-0.53	-0.56	-0.61
Finland	-0.71	-0.47	0.14	0.19	-0.26
Netherlands	-0.59	-0.54	-0.77	-0.74	-0.80
France	-0.45	-0.57	-0.67	-0.78	-0.86
Germany	-0.34	-0.60	0.84	0.71	0.88
Luxembourg	-0.69	-0.66	-0.67	-0.60	-0.58
Italy	-0.70	-0.75	-0.88	-0.87	-0.86
Greece	-0.75	-0.82	-0.89	-0.88	-0.90
Portugal	-0.84	-0.90	-0.89	-0.90	-0.92
Spain	-0.99	-0.99	-0.94	-0.95	-0.93

Notes: NG = National Government, NP = National Parliament, EC = European Commission, EP = European Parliament, ECB = European Central Bank. Table ranked according to strength in the correlation coefficients with net trust in the NP. Positive correlation coefficients are depicted in light grey. Minimum levels are depicted in dark grey. Correlations Coefficients between unemployment and systemic trust are based on 13 observations in times of crisis per country.

Source: Updated data in Roth, Nowak-Lehmann and Otter (2013) and Roth, Gros and Nowak-Lehmann (2014).

Table A5
Mean levels and standard deviation – Net support euro

Country	BC		C		Changes	
	Mean	St. Dev.	Mean	St. Dev.	Mean (C - BC)	St. Dev. (C : BC)
EA12	42	6	38	4	-4	0.7
EA4	44	10	31	6	-13	0.6
EA8	42	7	40	4	-2	0.6
Portugal	39	9	21	7	-18	0.8
Spain	46	11	30	8	-16	0.7
Italy	53	17	38	8	-15	0.5
Luxembourg	70	8	62	7	-8	0.9
Belgium	64	8	57	7	-7	0.9
France	45	9	40	6	-5	0.7
Ireland	67	11	63	12	-4	1.1
Austria	38	13	39	8	1	0.6
Greece	28	25	32	12	4	0.5
Netherlands	44	11	53	9	9	0.8
Germany	30	13	40	7	10	0.5
Finland	36	25	57	6	21	0.2

Notes: BC = Before Crisis (3-4/1999 to 3-5/2008); C = Crisis (10-11/2008 to 11/2014). As the table presents data on net support, all values below 0 show a lack of trust by the majority of citizens. Table ranked according to decline in the changes of mean value. BC-sample includes 19 observations. C-sample includes 13 observations.

Source: Updated data in Roth, Jonung and Nowak-Lehmann (2012a).

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