Chapter 5
Political Economy of EMU: Rebuilding Systemic Trust in the Euro Area in Times of Crisis

Felix Roth

Abstract This contribution revisits the 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. The findings affirm a pronounced decline in trust in the periphery countries of the EA12, leading to particularly low levels in the national government and parliament in Spain and Greece. The consequences of this decline for the political economy of Economic and Monetary Union are examined, corroborating the strong and negative association between unemployment and trust. The author provides evidence of the increase in unemployment in Spain and examines policy measures at the national and EU level to tackle unemployment. Finally, he revisits the evidence of the enduring support for the euro and discusses its relevance to crisis management, elaborating upon the question of how to restore systemic trust both without and with treaty change.

Keywords Financial crisis · euro area crisis · Systemic trust · Unemployment · political economy · Economic, and Monetary Union · Support for the euro

JEL Classification C23 · D72 · E24 · E42 · E65 · F50 · G01 · J0 · O4 · O52 · Z13

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Felix Roth (✉)
Department of Economics, University of Hamburg, Hamburg, Germany
e-mail: felix.roth@uni-hamburg.de

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1 Introduction

Empirical analyses that focus on the impact of the financial and sovereign debt crisis on citizens' systemic trust (see Appendix 1 for a definition of systemic trust) at the national and EU 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 D. and Otter, 2013; Roth, Gros and Nowak-Lehmann D., 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 departed from their long-term trajectory and began to steadily decline starting from the crisis in September 2008. In this respect, the econometric estimations in 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 et al., 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 in its periphery countries.[4]

In light of these overall empirical results, 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 policymakers 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 substantial and enduring popular support for European Economic and Monetary Union (EMU) and the euro a

[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, is restricted to a 15-year time span per country due to data restrictions from the Eurobarometer surveys. Given this limitation in extending the time coverage in order to analyse longer time series, for pragmatic reasons, the term trend will still be applied to the given time series.

[4] For a range of analyses whose results differ from those of Roth et al. 2012 (a), see among others, Debomy, 2013; Guiso et al., 2014; Hobolt & Le Blond, 2014; Hobolt & Wratil, 2015; and Clements et al., 2014 for the Greek case.

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, this contribution is structured in the following manner. The next section revisits the empirical evidence of 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 3 provides further empirical evidence of declining systemic trust in European institutions as well as satisfaction in democracy at the national and European level. It also discusses the validity of Eurobarometer data compared to other international datasets. Section 4 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 5 elaborates on how to restore citizens' systemic trust in times of crisis. It identifies the significant increase in unemployment rates as a key driver of the decline in systemic trust and discusses the evolution of unemployment in the case of Spain. Section 6 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 has persisted in times of crisis. Section 7 discusses the question of how to restore citizens' systemic trust without resorting to treaty change and with treaty change.

2 The Empirical Evidence Revisited: Citizens' Declining Systemic Trust in the EA12

2.1 Before–After Analysis of Aggregated Country Trends of the EU27

This section reviews the basic empirical findings, which point towards a pronounced decline in systemic trust in the peripheral countries of the EA12,[5] especially in Spain and Greece. The analysis starts by comparing selected country samples within the EU27.[6] Table 5.1 depicts an updated version (until 11/2014) of a before and after

[5] 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.

[6] The EU-27 contains all EU member states 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.

Table 5.1 Net trust levels and changes in net trust in the EA12, EU15, NMS12 and EU27, 2008–2014

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 5.1 is an updated version of Table 1 until 11/2014 (by EB's 79 to 82), in Roth et al. (2013).

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]

The four institutions of democratic government displayed in Table 5.1 include the National Government (NG), National Parliament (NP), European Commission (EC) and European Parliament (EP).[10,11] While the third column in Table 5.1 shows the net trust level in 3–5/2008, before the actual start of the financial and economic

[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: 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 NMS 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 Fig. 5.A1 in 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 European Commission is not directly elected by European citizens, it still seems appropriate 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 be the best-fit counterpart to the national government at the European level.

crisis,[12] the fourth column shows the net trust level in the sixth 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 5.1 are of particular importance. First, the most pronounced declines in trust throughout the crisis, with declines in the NG/NP of 14/17% points and in the EC/EP with 32/33% points, can be detected among the EA12 country sample. Second, within the EA12, the decline in the NG/NP of 14/17% points is less pronounced than the decline in the EC/EP of 32/33% points. Third, within the EA12, the actual net levels of trust in the 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.

2.2 *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 5.2 disaggregates the EA12. The disaggregated data expose a large variance of the changes in net trust throughout the crisis among the individual member countries. In the peripheral countries of the EA12, that is the EA4 (Greece, Ireland, Portugal, and Spain), one detects a large decline in trust in the NG/NP of 76/79% points throughout the crisis.

In contrast, in the core countries of the EA12, that is 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% points. Thus, whereas we find a pronounced decline in 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

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

[13] Two countries within the EA12 in particular are driving these diverging results for the EA4 and EA8: whereas an overall decline in net trust in the NG/NP of 96/94% points can be detected in the peripheral country Spain, in the core country Germany an increase of 29/23% 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% points) and Italy's non-existent (0% points), net trust levels of −46 and −57 indicate that large majorities of citizens mistrust their national parliaments 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% can be found in Finland. Empirical evidence suggests 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 analysing changes in trust (within-variance), the cross-sectional variance will not discussed further.

Table 5.2 Net trust levels and changes in net trust in the EA8 and EA4 and across EA12 countries, 2008–2014

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 et al. (2013).

declines in net trust in the national parliament among the EA12 countries (94 and 69% 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]

[15]The analysis of the mean levels in Table 5.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.

A similar but distinct picture appears in 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% points. In contrast, in the EA8, one detects only a moderate decline by 22% 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, although Spain and Greece again faced the most pronounced decline in net trust in the EC/EP (74/77 and 62/54% points) leading to the lowest net values in 11/2014 (−32/−31 and −49/−33%), they are still significantly higher than those in the NG/NP with (−76/−74 and −78/−71%). Whereas in 11/2014, only 10% and 14% still trusted their national parliament, 28% and 32% 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.

2.3 *Analysing the Net Trust Trends of the EA12 in the Long Run*

While the before–after comparison in Table 5.2 focused only on two single points in time, Figure 5.1 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 5.1 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

[16]This slight decline of 22% points in the EC/EP is in contrast to the increase in net trust in NG/NP of 4/1% 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% points in Italy to 29% points in Germany) but net trust in the EC and EP declined (ranging from −40% points in Italy to −14% 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 5.A1 in Appendix 2), the most pronounced difference in the evolution of trends can be detected in Germany (14/28), where 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 & Leonard, 2013a, 2013b) 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 & Leonard, 2013a, 2013b; Traynor, 2013) and fail to recognise the trust crisis in the national democratic institutions, which is far more worrying.

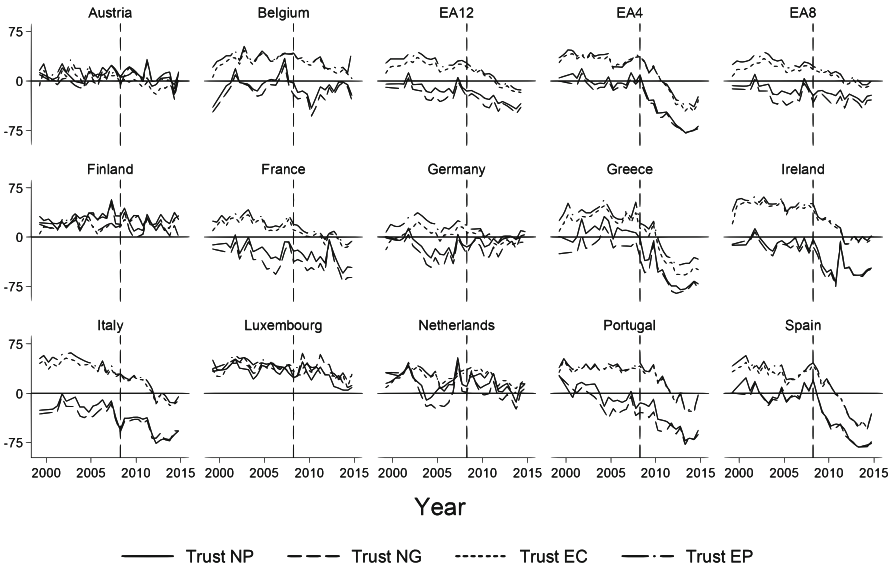

Fig. 5.1 Net trust trends in the EA12, EA4, EA8 and individual countries, 1999–2014
Notes: EA = euro area; NG = national government; NP = national parliament; EC = European Commission; EP = European Parliament. The dashed line represents the start of the crisis in September 2008. Values are population-weighted 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, A2, A3, and A4 until 11/2014 (by EB's 79 to 82) in Roth et al. (2013).

crisis and crisis samples (all mean values and standard deviations of pre-crisis and crisis trends, as well as the respective changes can be found in Tables 5.A1 and 5.A2 in the Appendix). In contrast, all four trust trends of the EA4 country sample have departed from their long-term trends with mean levels in the NG/NP and EC/EP, declining by 53/57 and 49/47% 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% in the NG/NP and 32/39% in the EC/EP and average standard deviations of around 11%. 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% and in the EC/EP of 49/55% 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 to those found in 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%. Since the start of the crisis in September 2008, mean levels of net trust have declined by 56 to

68% across 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% 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 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% 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, one detects in Germany 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% points, net trust in the EC/EP declined by 10/18% points (with a difference in changes between the NP and EP of +28% points). In 11/2014, Germany became the only country within the EA12 in which net trust levels in both the NG/NP were higher than in the EC/EP. The five remaining countries of the EA8—Austria, Belgium, Finland, Luxembourg, and the Netherlands—faced moderate declines or actual slight increases in trust with very stable crisis trends.

3 Further Empirical Evidence of a Decline in Systemic Trust

3.1 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

Table 5.3 Net trust levels and changes in net trust in the ECB in the EA12, 2008–2014

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 et al. (2014).

debt crisis has also affected citizens' trust in the European Central Bank (see, amongst others, Albinowski et al., 2014; Bursian & Faia, 2015; Bursian & Fuerth, 2011; Ehrmann et al., 2013; Guiso et al., 2014; Gros & Roth, 2009; Farfaque et al., 2012; Roth, 2009a, 2009b; Roth et al., 2014; Wälti, 2012 for empirical evidence). As can be detected in Table 5.3 with a decline of 49, 76 and, respectively, 40% 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 5.1 and 5.2). However, similar to the pattern in Table 5.2, the decline in the EA4 of 76% points has been more pronounced than the one in the EA8 with 40% points. In Spain, Ireland, Greece and Portugal, net trust in the ECB declined by 88, 67, 55 and 53% points, respectively, from 3–5/2008 to 11/2014.

While the before and after comparison in Table 5.3 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 5.2 and the mean values and standard deviations and the respective changes for pre-crisis and crisis trends in Table 5.A3 in Appendix 2. Figure 5.2 and Table 5.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

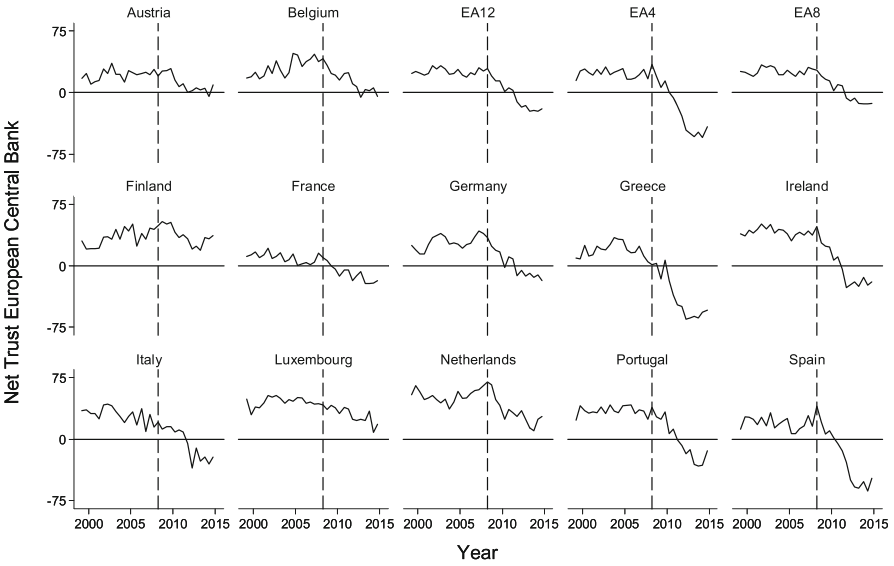

Fig. 5.2 Net trust trends in the ECB in the EA12, EA4, EA8 and individual countries, 1999–2014
Notes: The dashed line represents the start of the crisis in September 2008. Values are population-weighted trust trends. As the figure presents data on net trust, all values below 0 show a lack of trust by the majority of citizens.
Source: Updated and slightly modified version of Fig. A1 until 11/2014 (by EBs 79–82) in Roth et al. (2014).

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.

3.2 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 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 & Leonard, 2013a, 2013b; 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, particularly in Greece and Spain (see Table 1 in Armingeon & Ceka, 2014, p. 93; Zalc, 2013, p. 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 5.4 shows a before and after comparison between net

Table 5.4 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 a majority of citizens. The two most pronounced declines and levels of net trust in the ECB are highlighted in light grey.

trust in the EU from 3–5/2008 to 11/2014. Table 5.4 clarifies that when analysing net trust trends in the EU, one detects a similar although slightly different picture compared with net trust in the EC/EP, as well as the ECB. Similar to the results by Armingeon and Ceka (2014, p. 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% 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, as in the case of Austria and Finland. Table 5.4 once more clarifies that the claim that periphery and core countries from the EA12 face the same universal trust crisis in the EU is not substantiated. In addition, Table 5.4 clarifies that there are primarily two distinct cases with very large losses of trust in the EU, namely Spain and Greece.

3.3 Validity of the Eurobarometer Data

In analysing time series data on trust trends in the national and EU institutions among a sample of European countries, the best data available are those published in the Eurobarometer (EB) surveys. Conducted since 1973, the EB surveys offer

consistent data on trust in national and EU 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 observations and 13 crisis observations—until 11/2014) within the standard EBs. In addition, EB data measure systemic trust for the relevant European institutions such as the 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 provide no information on the European institutions, nor national parliaments. Another disadvantage of using Gallup data on 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 United States and Japan. In general, it should be noted that Gallup utilizes a confidence question in comparison to a trust question. In the standard academic literature, the confidence question is normally used 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 emerge. According to Gallup data (Manchin, 2013), confidence in the Spanish government dropped from 58% in 2008 to 18% in 2013 (decline of ~80% of net confidence) and Greek citizens' confidence dropped from 38% to 14% (a ~48% decline in net confidence).[20,21] The drop in Portuguese citizens' confidence was less pronounced than shown in the EB trust data, from 24% to 15%.

Interestingly, in contrast to the Eurobarometer data, which show a pronounced decline in trust in the Spanish government as early as 2012, Gallup data are only able to depict this decline in 2013. This led to the fact that the OECD's Government at a Glance report from the year 2013 (OECD, 2013), which among others focused on the changes in confidence levels in OECD countries throughout the crisis from 2007 to 2012 (OECD, 2013, p. 25), was not been able to identify the pronounced decline

[19] Guiso et al. (2014, p. 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 49–50 would be missing, it seems appropriate 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.

[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% points.

[21] Declines/increases in net trust (confidence) values are approximately twice the size as those in simple trust (confidence).

in confidence in the national government in Spain. The OECD report correctly identified the 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 shown in 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 marked 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).

3.4 Satisfaction with Democracy at the National and European Level

We argue below that a pronounced decline in systemic trust might lead to a loss of legitimacy on the part of the respective (policymaking) institution. Another indicator for the legitimacy of democratic governance is the degree to which citizens are satisfied with the democratic structures (see here Armingeon & Guthmann, 2014, who use trust in the national parliament and satisfaction with democracy for constructing 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 on the pronounced decline in net trust in the periphery countries of the euro area.

Table 5.5 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 different from those obtained when analysing changes in net trust trends.[22] Three findings are particularly noteworthy. First, similar to the existing empirical results (Armingeon & Guthmann, 2014, p. 432) and to the changes in net trust in the NP in Table 5.2, one detects the largest decline in satisfaction with democracy at the national level in Spain and in Greece, with declines of 55% and 44% points (~110% and 88% point decline in net satisfaction), respectively. Whereas three out of every four citizens

[22]Note that the results for changes in the national and European democracy in Table 5.5 cannot directly be compared with those of net trust. Whereas Table 5.5 displays absolute values in satisfaction, Table 5.2 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% points relates to a decline of approximately 96% points in net satisfaction.

Table 5.5 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. Values that are displayed in light grey reflect two pronounced declines and levels. Values from 9 to 11/2007 (EB68) are displayed as no data were available for 3–5/2008 (EB69).

(77%) were still satisfied with democracy at the national level in 9–11/2007 in Spain, only one-fifth (22%) was still satisfied in 11/2014. In Greece, the situation changed from 2/3 of citizens (63%) being satisfied with democracy at the national level to one-fifth (19%) of citizens. In addition, in Greece, the situation partially recovered in 11/2014, as in 11/2012, only 11% 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% points, respectively, or ~82% and 66% 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 has declined only moderately. Second, similar to the increase in net trust in the NP in the core countries of the EA12, some countries such as Germany were actually able to increase citizens' satisfaction with democracy at the national level by 4% points. Similar to the trends in trust in the EC and EP, Finland managed to increase satisfaction with democracy at the European level (+11% points). Third, satisfaction levels with democracy at the national level in 11/2014 in Spain are still higher than trust levels in the national parliament (22% vs. 10%).

Overall, Table 5.5 shows that within the EA12, the crisis has only moderately dented satisfaction with democracy at the national and European level. In 11/2014, a significant share of citizens were still satisfied with democracy at the national and European level. But there are two clear outliers to this trend in the EA12: in 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 policymakers.

4 Consequences of Declining Systemic Trust for the Political Economy of EMU

4.1 Theoretical Arguments

One can observe from the descriptive results presented in the previous section 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 remains a significant level of trust towards the EU institutions, the steady decline in net trust in the national parliament has already reached levels as low as −74 (or 10% who still trusted the NP) in Spain and −71 (or 14% 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 European policymakers worry about this decline? Below, we follow two sets of arguments why these declining trends in trust and low levels of trust deserve attention. Both arguments are then applied to the most recent crisis in the Eurozone.

4.1.1 The Loss of Legitimacy

Scholars from academic disciplines, including sociology, political science and economics, agree on the fact that citizens' systemic trust is crucial for the legitimacy of (policymaking) institutions (Kaltenthaler et al., 2010, p. 1262; Kosfeld et al., 2005, p. 673; Luhmann, 2000, p. 69; Newton, 2008, p. 243; Scharpf, 2003, p. 3, Stiglitz, 2012). In the absence of systemic trust, this legitimacy might be threated (Kaltenthaler et al., 2010, p. 1262; Kosfeld et al., 2005, p. 673; Newton, 2008, Scharpf, 2003), leading ultimately to the break-up of one of these (policymaking) institutions (Giddens, 1996, p. 166). In this respect, Newton (2008) differentiates between trust in mere persons, for example, politicians, and trust (or confidence) in the institutions and system of government (p. 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 worrying 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 is the basic foundation of society and 'if they begin to crumble there is indeed cause for concern' (Newton, 2001, p. 205; Newton & Norris, 2000, p. 53).

The literature has identified two scenarios as a source of concern for the legitimacy of (policymaking) institutions. First, taking the arguments into consideration advanced by Kaltenthaler et al. (2010, p. 1262), who develop their argument in an

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

application concerning trust in the ECB, it would be worrying for the legitimacy of a (policymaking) institution if a large majority of citizens would start to mistrust it. Second, according to Newton (2001, p. 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 appropriate for analysing whether the legitimacy of the above-discussed (policymaking) 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, p. 1262), a combination of both scenarios might be called for. Combining both scenarios, one could then state that it would be worrying for the legitimacy of a (policymaking) institution if a sudden or consistent decline in trust leads to very low levels of trust on the part of a large majority of citizens.

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

A less-problematic case would arise if trust in the NG declines but trust in the NP remains constant. If trust in the NG steadily declines but trust in the NP remains 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, p. 166) but would not yet affect the NP. According to Newton (2001, p. 205), distrust in the NP is a different issue, as such distrust would include both the ruling and the opposition parties. In a scenario of 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 well-established democratic parties would lose ground to newly established populist parties from the right or the left, which might be able to secure a majority of votes from citizens and form a new government.[24]

But how would the establishment of a government formed by the newly elected populist parties affect the political economy of EMU? To maintain high rates of approval, such parties might tend to be inward-looking and give priority to national over EU objectives (Lachmann, 2010, p. 356). Moreover, the policies of such populist parties would most likely be short-term fixes (Györffy, 2013). If such a populist party, for example, would be confronted with an acute unemployment crisis in the country, involving a large amount of debt as a share of GDP, most likely it would consider ways to circumvent the established processes and treaties within

[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 & Weck, 1983).

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 to 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 frequently pointed out, however, the political unity of the political elites in EMU is the glue that holds EMU together (Jonung, 2002, pp. 420–421; Bordo & Jonung, 2003). In the absence of such glue, the long-term success of a currency union, such as EMU, would likely be threatened (Bordo & Jonung, 2003; Jonung, 2002, pp. 420–421).

4.1.2 Trust as a Prerequisite for an Economy's Long-Term Fiscal Sustainability

Following the arguments by Jonung (2013a, 2013b, p. 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, pp. 47–50), who discusses two potential cycles: the virtuous and vicious cycles 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 encourage higher business investments, leading to higher growth and lower unemployment levels. This sequence of developments again generates systemic trust in the public administration. The completely 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, leading 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 the part of citizens.

In this respect, another important point, as highlighted by Jonung (2013a, 2013b) 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 competitiveness. 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 case of Sweden with that of Portugal (Györffy, 2013, pp. 82–91; Jonung, 2013b, p. 114) and Hungary (Györffy, 2007, pp. 10–20). Sweden, which had a financial crisis in the 1990s, was able to successfully implement structural reforms to regain competitiveness after only 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 their opposition to them. In contrast, Portugal and Hungary, two low-trust countries, when faced with economic crisis, were not able to regain competitiveness and were exposed to political cycles that led to the installation of populist parties, political instability, and short-term policy fixes. Although this field of research is still largely underdeveloped and needs more basic empirical work, the first econometric results between systemic trust and fiscal adjustments point towards a positive relationship (Weichenrieder et al., 2014).

4.2 Application of Theoretical Arguments to the Most Recent Euro Area Crisis

Given the theoretical arguments, we 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?

4.2.1 Loss of Legitimacy

Applying the combined scenario by Kaltenthaler et al. (2010, p. 1262) and Newton (2001, p. 205) described above with the rich empirical evidence as presented in sections 2 and 3 clarifies that the Spanish and Greek trends in net trust in the national government and parliament in times of crisis should be considered particularly worrisome for the legitimacy of these two institutions. As elaborated above, the trends in Spanish and Greek trust 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 5.5). 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 first discuss the Greek case and 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% share and Golden Dawn a 7% share. It continued in the European Parliament elections in

May 2014, in which Syriza managed to gain the largest share with 26.6%, ahead of the then ruling New Democracy Party with 22.8%. In addition, parties from the radical right, Golden Dawn, achieved 9.4%. Thus, since June 2012, the historically well-established democratic parties at the center 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 when net trust in the national parliament had already declined by 69% points and stood at a net level of −71%, 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 EMU and confronted with 26% unemployment and a debt load of 174% of 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 have already created strong political tensions among the member countries of EMU. If these political tensions do not ease in the short-to-medium run, they will most likely affect the unity among the political elites of the member countries and will thus weaken the glue that holds currency unions such as EMU together (Bordo & 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 constituted 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. The party has won a 5% share of the vote in the European Parliament elections in May 2014 and a 15% 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%) 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%), although still securing the largest share of votes (Kennedy, 2015). The Spanish national elections will be held at the end of 2015. If a populist leftist party such as Podemos manages to become the strongest political force in Spain, and if it manages to form the new government within a coalition government, this would increase the existing political tensions between the member countries of EMU. With Spain being the fourth-largest economy in EMU, such tensions would more significantly affect the political unity of the member countries of EMU than was experienced in the Greek case.

4.2.2 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, we find that low levels of systemic trust are indeed an important obstacle to the long-term fiscal sustainability of a country. We 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 in 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 had already declined markedly in the aftermath of the financial crisis and more importantly during the first months of the Papandreou government—from −5% in 10–11/2009 to −53% 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' wishes and not with their mutual consent (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 parliaments had already declined significantly in the aftermath of the financial crisis and stood at −50%, −49%, and −39%, respectively, 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 discussed in more detail below, given these conditions of political uncertainty in France and Italy, the widening competitiveness gap vis-à-vis Germany needs to be largely closed via a German revaluation.

5 Restoring Citizens' Systemic Trust in the Euro Area Periphery

5.1 Empirical Findings of the Relationship between Unemployment Rates and Systemic Trust in Times of Crisis

In sections 2 and 3, we have identified a pronounced decline of systemic trust in the EA4, here in particular 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 United States and for an EA12 country sample suggest that among others an increase in unemployment rates throughout the crisis is significantly and negatively related to a decline in systemic trust (Stevenson & Wolfers, 2011; Roth et al., 2013, 2014; cf. Wälti, 2012).[25] Table 5.6 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 5.6 clarifies that within the EA12 in times of crisis, a 1% increase of the unemployment rate is associated with a decrease of 7.5% and 7.3% points of net trust in the NG and NP, and a decrease of 4.1% and 4.2% 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% increase of the unemployment rate is associated with a decrease of 6.5% points of net trust in the ECB.

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 seen in Table 5.6, an increase of 10% points of government debt in times of crisis is associated with a decline of 6.6% and 5.1% 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

[25] The importance of the unemployment coefficient is in 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 & Ceka, 2014; Armingeon & 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) have 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).

Table 5.6 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[a]
Number of countries	12	12	12	12	12

[a]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.
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.
Sources: Updated and merged econometric results until 5/2011 (by EBs 79–81) in Roth, Nowak-Lehmann and Otter (2013); Roth, Gros and Nowak-Lehmann (2014).

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 5.6 thus seem to suggest that among the four depicted macroeconomic variables (unemployment, growth of GDP per capita, inflation, and debt as a share of 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.

5.1.1 Graphical Analysis

The econometric findings in Table 5.6 clarify the important role of unemployment rates in explaining the pronounced decline in trust in the periphery countries of the EA12. To assess whether this relationship is driven universally across all

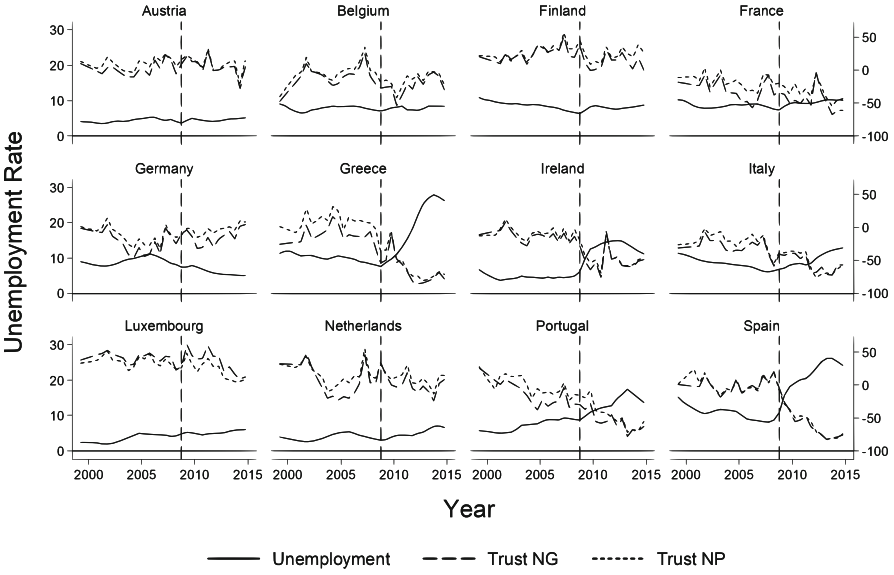

Fig. 5.3 Unemployment and net trust in the national government and parliament in the EA12, 1999 to 2014
Notes: The left hand x-axis displays the percentage of unemployment rate, ranging from 0 to +30. The right-hand side displays the levels of net trust ranging from −100 to +50.

12 countries, Fig. 5.3 plots the unemployment trends from 3–4/1999 to 11/2014 against the net trust trends in the NG/NP.

Figure 5.3 together with the table of correlation coefficients in Table 5.A4 in Appendix 2 clarify 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 in 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 noteworthy, as can be identified in Fig. 5.3, 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 in unemployment rates from 10–11/2008 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

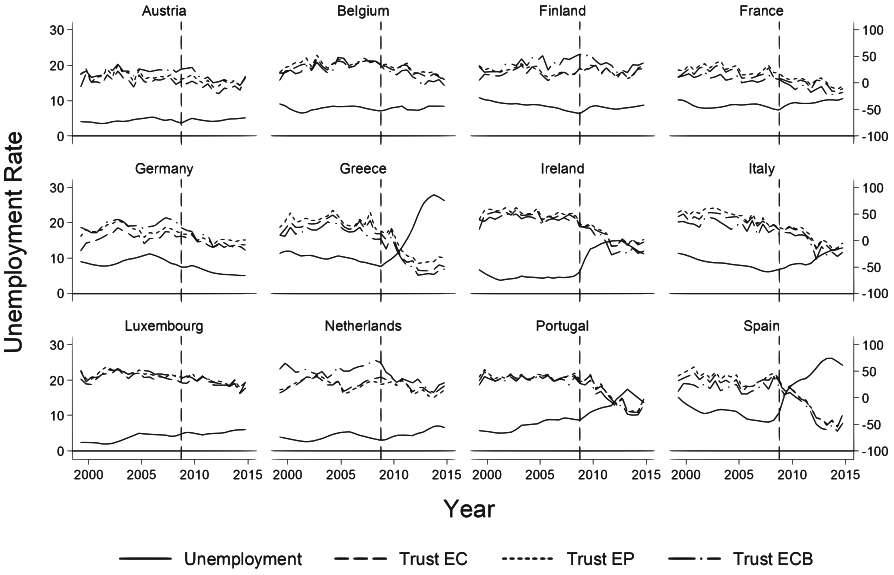

Fig. 5.4 Unemployment and net trust in the EU institutions in the EA12–1999 to 2014
Notes: The left hand x-axis displays the percentage of unemployment rate, ranging from 0 to +30. The right hand side displays the levels of net trust ranging from −100 to +100.

Austria and Belgium. For Germany, it is noteworthy that the negative correlation coefficient is actually driven by a reverse effect—an actual reduction in unemployment rates throughout the crisis—which has led to an increase in net trust.

Similar but distinct patterns can be found when analysing trust in the EC and the EP in Fig. 5.4 and Table 5.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.

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 Fig. 5.4 and Table 5.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.

5.1.2 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 a 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, particularly from the second year onwards of the sovereign debt crisis (Roth et al., 2013, pp. 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, p. 344), the austerity measures implemented in Spain, Greece, Portugal and Ireland aimed at building *confidence* (see e.g., the debate in Corsetti, 2012 and De Grauwe & Ji, 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 among others by the pronounced increase in unemployment rates (see European Commission, 2014a, p. 40 for the case of Spain). It is most likely this parallel action by policymakers of aiding/bailing out the financial sector and implementing significant austerity measures, which have led to an increase in unemployment, that has created a strong sense of unfairness in the minds of citizens. In the Spanish case, for example, the (very) long-term unemployment rates (>2 years) have increased significantly throughout the crisis (European Commission, 2014a, p. 40). Given the fact that unemployment benefits are paid over a period of only two years, poverty rates increased significantly (European Commission, 2014a, p. 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 strengthening the governance structures by enhancing government effectiveness and the rule of law and effectively countering corruption. In this respect, the OECD has set up a broad trust strategy, identifying among others, the two dimensions of integrity (control of corruption) and fairness (OECD, 2014).

5.2 Increasing Unemployment throughout the Crisis: Factual Evidence in the Case of Spain

The econometric findings as displayed in Table 5.6 and the clear pattern between an increase in the unemployment rates and trust in the NP in Figs. 5.3 and 5.4 indicate that for most EA12 countries to regain citizens' systemic trust, among others, it

would be important to reduce unemployment rates in times of crisis. We have identified two problematic countries in particular, namely Spain and Greece (both are confronted with large increases in unemployment), but the sheer size of the former's economy makes it a more pivotal case for the EA12 than Greece. The following discussion will therefore focus on that country's case and the specific reasons for such a pronounced increase in Spanish employment in the first place.

The formation of the euro area in 1999 led to large capital inflows into the peripheral countries of the EA12, particularly Spain (Hale & Obstfeld, 2014; Sinn, 2014, pp. 39–40). These large capital inflows led to unsustainable housing investment (construction bubble) and household consumption in the run-up to the crisis (Hale & Obstfeld, 2014; Sinn, 2014, pp. 39–40, 67–68). The Spanish economy was severely hit in the aftermath of the financial and economic crisis once this lending stopped from September 2008 onwards (Sinn, 2014, p. 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, p. 344; Sinn, 2014, pp. 68–69).

As in other European/euro area countries, the Spanish government had to devote substantial resources in order to stabilise its banking sector (De Grauwe, 2010, p. 344). Together with the automatic stabilisers set in motion, this led to a fast increase in Spanish government debt in the first years of the crisis (De Grauwe, 2010, p. 344). From May 2011 onwards, significant amounts of capital investments were withdrawn from the Spanish economy (Merler & Pisani-Ferry, 2012; Sinn, 2014, p. 226). In addition, its 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, pp. 130–131). With Spain being a member of a currency union and having forfeited the possibility to conduct its own national monetary policy, the economy could not regain competitiveness via a large currency depreciation, as was available to the United Kingdom (Krugman, 2009; De Grauwe, 2014b). Instead, it had to go through a process of internal devaluation (cutting budgets + lowering wages), which led to a deepening of the depression and a further increase in unemployment rates (De Grauwe, 2014a, p. 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 at the beginning of 2011 (De Grauwe, 2014a, p. 121). To calm the financial markets, austerity measures (in the form of further budget cuts) were implemented in the midst of an economic crisis to restore confidence (Corsetti, 2012; De Grauwe & Ji, 2013). This led to an intensification of the crisis and even higher unemployment rates (De Grauwe, 2014a, p. 132). To calm the markets, the European Central Bank decided to act as lender of last resort within the Spanish government bond market (De Grauwe, 2013a) and thereby achieved the subsequent decline in spreads vis-à-vis the Bund (De Grauwe & Ji, 2013). In the seventh year of the crisis, the Spanish unemployment rate increased by around 15% points, from 8% in 3–5/2008 to 24% 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 was recognised by the central European institutional actors in the seventh year of the crisis (Draghi, 2014; European Commission, 2014b).

5.3 *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 & Wyplosz, 2012: Chap. 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, 2014b). It was 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, 2014d; Fichtner et al., 2014). The importance of stimulating aggregate demand to kick-start growth and reduce cyclical unemployment in times of crisis has been underlined 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 can it 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 and reduce unemployment in Spain, this gap in unit-labour-costs vis-à-vis Germany needs to be closed (De Grauwe, 2015). With Spain having joined the euro area in 1999 and having given up the possibility to regain competitiveness via a large devaluation of its currency (as in the case of the United Kingdom—see Krugman, 2009; De Grauwe, 2014a, pp. 9–10, De Grauwe, 2014b), two realistic options are available to the country 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 already of a pronounced decline in trust in the Spanish national parliament with very low levels of trust in times of crisis, a continuation of

[27] This recommended policy mix, however, is not without criticism. For some commentators, it violates the subsidiary principle and leads to large market distortions, endangering the unity of Europe (Sinn, 2014). For others 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).

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 the most recent literature (De Grauwe, 2013b, pp. 39–40; O'Rourke & Taylor, 2013) and the important historical analogy of the fall of the Weimar Republic and the rise of German fascism (Sinn, 2014, pp. 138–139).

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, particularly in Germany (see De Grauwe, 2013b, pp. 39–40; De Grauwe, 2015; Fratzscher, 2014).

6 Public Support for the Euro in Times of Crisis

As elaborated above, European policymakers 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, 2014a, 2014b) 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 4). 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 discussed above is citizen support for Economic and Monetary Union, with one single currency, the euro.[28]

Following Roth et al. (2012a), three strands of arguments in this field of research can be highlighted. First, according to Banducci et al. (2003, p. 686) and Kaltenthaler and Anderson (2001, pp. 140–141), the evolution of public support for the euro is a crucial test to determine the future process of EU integration and the prospect 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 commonality of destiny (Baldwin & Wyplosz, 2012, p. 425), solidarity (De Grauwe, 2014a, p. 133) or political glue (Bordo & Jonung, 2003) among the member countries of EMU. According to Jonung (2002), it is rather the

[28] To measure public support for the euro, 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 interviewee person could then choose from the following set of answers: '*For*', '*Against*' or '*Don't Know*'.

Table 5.7 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 79–82) in Roth et al. (2012a).

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 in the literature on optimal currency areas.

Following the methodology proposed in Roth et al. (2012a), Table 5.7 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, respectively. Three findings are particularly noteworthy. First, in line with the original findings (Jonung et al., 2012; Roth et al., 2011, 2012a, 2012b) and similar findings (Debomy, 2013; Guiso et al., 2014; Hobolt & Le Blond, 2014; Hobolt & Wratil, 2015), Table 5.7 highlights that public support for the euro in all three country samples remained stable throughout the crisis. Second, as already elaborated above and shown in Table 5.7, this is in sharp contrast to net trust in the ECB, which 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% 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 EMU and the euro.

Since Table 5.7 only depicts a before-and-after comparison, it is interesting 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 5.5 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

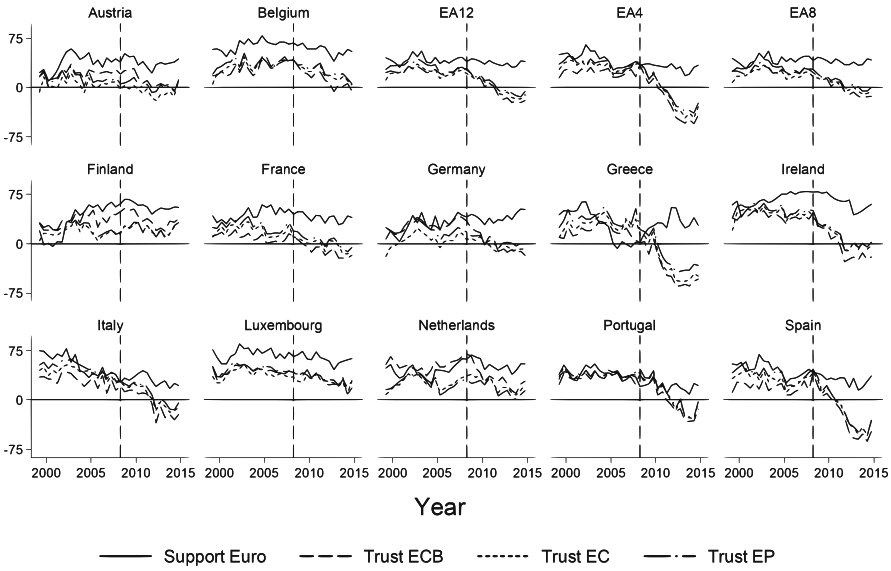

Fig. 5.5 Public support for the euro and trust in the ECB, EC and EP in the EA12, EA4, EA8 and individual countries for the euro in the EA-12, 1999–2014
Notes: EMU = economic and monetary union; ECB = European Central Bank; EC = European Commission; EP =European Parliament. The dashed line represents 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 79–82) in Roth et al. (2012a); Roth et al. (2013); Roth et al. (2014).

levels of only 4% and 2% points, net support trends have remained almost stable in the EA12 and EA8 country sample (see Table 5.A5 in Appendix 2 for the mean values and standard deviations, as well as the respective changes of the before-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% points, and the Netherlands, Germany, and Finland on the other hand facing increases of 9%, 10% and 21% points, respectively. In contrast with a decline in mean values of 13% 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% points and of Portugal of 18% points.

In closely analysing Fig. 5.5, 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 high/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 period, 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 seen in Ireland. Remarkably, Greece 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 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-centered 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 5.3), Fig. 5.5 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 eight in Portugal in 11/2013).

Given the empirical evidence in Fig. 5.5 that in times of crisis in each individual member country of the EA12 a majority of citizens supported the euro, including a large majority in Germany, it becomes apparent that it is not the euro itself that has been criticised by EA12 citizens. Rather, it is the management of the crisis by the European institutions that 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, 2014d).

7 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, particularly Spain and Greece, face an acute crisis of systemic trust in times of economic crisis. Levels of systemic trust in national parliaments have fallen in a such a pronounced manner that their legitimacy might be endangered. Econometric results indicate that among others, it is the sharp increase in unemployment rates that has been responsible for the sharp decline in systemic trust. Under the given conditions, how can systemic trust be restored in a scenario without treaty change and in one with treaty change?

7.1 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, 2014c, 2014d; Fichtner et al., 2014) will most likely help to restore citizens' systemic trust. Given the empirical findings presented above, however, this will depend strongly on whether the policy mix will be successful in generating a sufficient number 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 unstable political 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, p. 39, De Grauwe, 2014a, 2014b, p. 132; O'Rourke & Taylor, 2013; Sinn, 2014, pp. 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, in 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 & Kreutzmann, 2015). Indeed, as has been shown, trust in the national parliament and support for EMU and the euro among German citizens is at an all times high in the sixth year of the crisis in 11/2014.

7.2 Restoring Systemic Trust in the Long Run with Treaty Change

In the medium run, the financial and sovereign debt crisis has underlined that the first steps towards deeper fiscal integration are essential in order to sustain the long-term success of EMU (Bordo et al., 2013; De Grauwe, 2014a, 2014b). Given that EMU currently lacks a) sufficient labour mobility, b) 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, 2014a, 2014b).

Different proposals have been brought forward on how to design the next steps of this fiscal union. The discussion is still going on. One proposal for mitigating 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 as inefficient and the creation of a banking union has been

proposed instead (Asatryan et al., 2015; Feld & Osterloh, 2013). Another proposal is the issuance of common euro bonds (De Grauwe, 2014a, 2014b, p. 125). The proposal has been criticised on moral hazard grounds (Sinn, 2014, p. 317). Bordo et al. (2013) proposed the issuing of common euro bonds but stressed the necessity of a non-bailout clause. Elsewhere the literature highlights the necessity to coordinate the wage costs within the EA via the creation of a European Competitiveness Council and a Euro System of Fiscal Policy to prevent the build-up of competitive gaps (Sapir & 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, 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 for establishing one of the above-mentioned proposals towards a fiscal union would be the maintainance of high public support for EMU and the euro. Without such support, implementing these next steps towards a deeper fiscal integration would most likely endanger the long-term success of EA integration (Jonung, 2002).

Appendix 1: Conceptualisation of Systemic Trust

Trust can be conceptualized in one of 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 into the discipline of sociology in the early work of Niklas Luhmann in the 1960s (Luhmann, 2000) and in the later work of Anthony Giddens (1990, 1996). Both authors stress that in today's modern differentiated societies 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 & Wolfers, 2011) or political trust (Hetherington, 1998; Mishler & Rose, 2001) is that it is able to embed trust in the differentiated subsystems, including the political, economic, and financial systems.

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

Judging from the magnitude of the ongoing financial, economic and sovereign debt crisis and the empirical evidence gathered to date within those countries hardest hit by the economic crisis, such as the EA4, it seems appropriate to conclude that trust in at least three subsystems, namely, the political, economic, and financial systems, has been adversely affected by the ongoing financial and sovereign debt crisis. Thus, although the effect of the crisis on citizens' trust in national parliaments is found (as elaborated in this contribution), 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 & Vollbracht, 2010; Sonnenschein, 2013; Wälti, 2012) and the economic system (Roth 2009 a, b; Stevenson & Wolfers, 2011). The term systemic trust, with its underlying theoretical framework, as developed within the discipline of sociology (Giddens, 1990, 1996; Luhmann, 2000), functions well as an umbrella term for citizens' trust in the various subsystems (including the financial, economic and political systems) having been affected by the ongoing financial, economic, and sovereign debt crises.

Appendix 2: Ancillary Figures and Tables

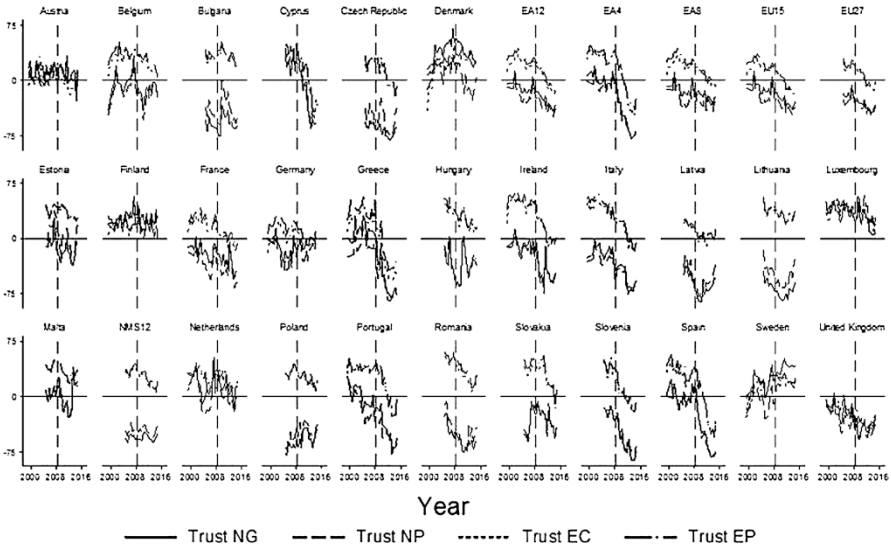

Fig. 5.A1 Individual time series of net trust in institutions of democratic governance at the national and EU level in the EU-27, 1999 to 2014

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. Since 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 Figs. A1, A2, A3, and A4 until 11/2014 (by EB's 79 to 82) in Roth et al. (2013).

Table 5.A1 Mean levels of net trust in institutions of democratic governance at the national and EU level, 1999–2014

	Mean level BC		Mean levels C		Changes mean levels (C - BC)		Difference in changes	
Country	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
	Mean level BC		Mean levels C		Changes mean levels (C - BC)		Difference in changes	
Country	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). Since the table presents data on net trust, all values below 0 show a lack of trust on the part of a majority of citizens. Table ranked according to decline of changes in mean levels in the NP and EP. The BC-sample includes 19 observations. C-sample includes 13 observations.
Source: Updated data in Roth et al. (2013).

Table 5.A2 Standard deviations of net trust in institutions of democratic governance at the national and EU level, 1999–2014

	Standard deviation BC		Standard deviation C		Changes standard deviation (C : BC)	
Country	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
	Standard deviation BC		Standard deviation C		Changes standard deviation (C : BC)	
Country	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 5.A1. BC-sample includes 19 observations. C-sample includes 13 observations.
Source: Updated data in Roth et al. (2013).

Table 5.A3 Mean levels and standard deviations in net trust in the ECB, 1999–2014

	BC		C		Changes	
Country	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). Since 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 et al. (2014).

Table 5.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 et al. (2013) and Roth et al. (2014).

Table 5.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 et al. (2012a).

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