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Who can be trusted after the financial crisis?

CEPS Working Document No. 322 / November 2009

Felix Roth

Abstract

The financial crisis has severely damaged citizens' trust in public institutions, especially the confidence that European citizens invest in the European institutions. Eurobarometer surveys show, for example, that confidence in the European Central Bank reached an historical low at the peak of the crisis during the first months of 2009. Since then one can observe a partial recovery, but it is not clear whether the previous level can be restored. A variety of other surveys also show that confidence levels in the free market economy have decreased in most of the largest economies and demand for stronger state regulation has increased on both sides of the Atlantic. The key question now is whether this loss of confidence is a temporary or permanent phenomenon, which would have important consequences for the economy and for the proper working of the European institutions.

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WHO CAN BE TRUSTED AFTER THE FINANCIAL CRISIS?

CEPS WORKING DOCUMENT NO. 322/NOVEMBER 2009

FELIX ROTH*

The global financial and economic crisis has done a lot of harm to the public trust in the institutions, the principles and the concept itself of the market economy.

Gurria, 2009

Introduction

Research has shown that a *certain* level of trust in and approval of the market economy is an important ingredient in ensuring the smooth running of the economic, political and social system. A key question is thus now to what extent has the financial crisis undermined trust in both markets and institutions and with what consequences? The purpose of the following analysis is to address these crucial issues for Europe. Based on a different data sources, this analysis attempts to show first evidence to the question whether the financial crisis has negatively affected citizens' trust in institutions and their approval for market economy. Furthermore, it investigates whether this decrease in confidence is accompanied by an increasing demand for more redistributive policies and state intervention.

Due to the exceptional severity of the financial crisis, this analysis draws on a wide range of indicators reflecting the multi-faceted forms of trust that are most likely to have been affected by the crisis. The overall statistical tools used are mostly descriptive in nature.[1] It is acknowledged that this basic methodology does not allow us to trace the precise channels that triggered citizens' fall in confidence. However, based on the rich body of data brought together in this study, extensive econometric studies should follow in the coming years permitting us to analyse the precise channels between the crisis and trust and the long-run consequences of lower trust equilibria within OECD countries. The damage inflicted by the financial crisis on citizens' trust towards their institutions and the ensuing declining rates of approval of the free market economy might represent one of the most costly consequences of the crisis.

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Moreover I gratefully acknowledge the help of the Institut für Demoskopie Allensbach for providing essential data from their archives and that of Corinne Fontaine for excellent collaboration on the GlobeScan data. Finally, I want to thank the Eurobarometer team for important comments concerning the use of the Eurobarometer data.

[1] The strong use of descriptive statistics is due to the fact that the study draws on an extensive collection of data from the different data sources. Concerning trust research, the financial crisis has acted as a natural experiment, with 15 September 2008 representing the shock to trust equilibria in capitalist societies around the world. Thus it can be argued that it is scientifically sound to link a negative fall in trust after 15 September 2008 to the incidence of the financial crisis without immediate control for other explanatory variables.

This report is divided into five sections. Section 1 gives a brief overview of the magnitude of the financial crisis and its consequences for the real economy. Section 2 focuses on the impact of the financial crisis on systemic trust and discusses the concept and the possible consequences of decreasing levels of systemic trust. Section 3 shows empirical evidence on how the financial crisis affected levels of systemic trust. The section starts with a general overview of how levels of systemic trust are distributed across the EU27 and OECD countries (3.1) and continues to discuss levels of trust in the European Central Bank (3.2), other central banks (3.3), the European Commission (3.4), the European Parliament (3.5) and finally, trust in national government and parliaments (3.6). Section 4 stresses business confidence (4.1), trust in the stability of banks (4.2) and citizens' confidence in stock markets (4.3). The fifth section focuses on the evolution of confidence levels in the free market economy and empirically explores whether a decrease of net confidence in the free market economy is associated with an increase of citizens' demand for stronger state regulation. Section 6 concludes.

1. An overview of the financial crisis and its consequences for the economy

Although economic crises are somehow 'naturally' connected to capitalist systems, as can be inferred from historical case studies reaching as far back as the 'tulip mania' in the 17th century (see Kindleberger & Aliber 2005), the current financial crisis has to be considered as especially grave, due to the new dimension of global connectedness of world economies. Most recent evidence shows that industrial output has fallen more sharply in some OECD economies, particularly in France, Italy and Sweden, after the most recent financial crisis than it did following the Great Depression in 1930 (Eichengreen & O'Rourke 2009).

But when did the current financial crisis fully start? Most observers agree that early signs could be detected in 2007, but the character of the crisis changed completely on 15 September 2008 with the bankruptcy of Lehmann Brothers.[2]

Since then, immediately starting from October 2008 onwards, around €2.9 trillion (European Commission 2009a) in guarantees have been given by national governments in order to restore citizens' confidence in the financial markets and more concretely in the safety of their own savings. Moreover, EU governments have spent €200 billion (European Commission 2008) on stimulus packages to prevent the further deterioration of their economies and world economic activity in general. Nevertheless, all these measures still did not prevent the severest economic crisis since the 1930s. The first estimations of the damage of the financial crisis on the real economy have recently been published. For example, a study by the Commerzbank (Zeitpunkt

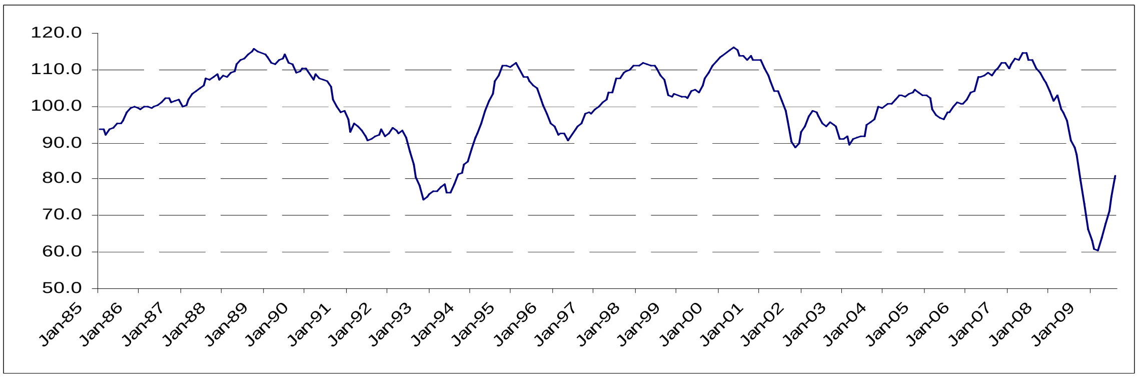
[2] Like other financial institutions, Lehmann Brothers needed more credit to back up its business, but due to the ongoing trust crisis, the financial markets simply stopped lending money and Lehmann was not able to get sufficient credit. However, unlike before, in the case of Lehmann Brothers the Federal Reserve Bank ceased to act as the lender of last resort, presumably to prevent future moral hazard problems, and did not continue its strategy of backing up institutions from the financial industry as it had done for instance in the cases of Fannie Mae and Freddie Mac and other investment banks. With the lender of last resort gone, the panic spread from the US stock markets to other stock markets around the world, resulting in a major crash of global stock markets, with clear impacts on public confidence in the economy and trust in business. As soon as the Federal Reserve and the US Department of Commerce became aware of the disastrous consequences of the bankruptcy of Lehmann Brothers on investors' trust around the globe, they bailed-out the insurance company American International Group (AIG) on September 16th in order to prevent a global breakdown of financial markets and hence also the real economy. By that time, however, the trust crisis had spread round the world.

2009) estimates that the worldwide losses amounted to €7.3 trillion, which equals three-quarters of the yearly GDP of the US and three times the GDP of Germany.[3]

But the key question is really how strongly did the financial crisis affect the real economy? So far (as of late 2009), it is clear only that there has been an unprecedented downturn in economic activity almost everywhere. According to the latest IMF (2009) projections (published in October), Germany's GDP is forecasted to shrink by 5.3% in 2009 with a predicted increase in 2010 of 0.3%. The Italian economy will shrink by 5.1%, the US economy by 2.7%, the French economy by 2.4%, the UK economy by 4.4% and Japan's by 5.4%. However, as Gros (2009) points out, GDP might not be the appropriate measure for a comparison between countries, but rather consumption, which directly affects citizens' confidence. Hence, depending on the level of consumption that has been maintained, the economic crisis feels different. Thus the crisis might have a less severe impact on German citizens who still enjoy a higher level of consumption than US citizens, although Germany's GDP has fallen more dramatically than US GDP.

How will this decrease in GDP affect labour markets? According to the Economic Forecast of European Commission (DG ECFIN) (2009b), the number of unemployed is expected to increase by 9.5 million between 2008 and 2010. Furthermore, the number of workers employed between 2008 and 2010 will decrease by 8.5 million, diminishing the overall EU employment ratio from 66% in 2007 to 63.5% in 2010. Thus the Lisbon goal of reaching an employment rate of 70% will obviously be missed.

Figure 1.1 Economic sentiment indicator (1985-2009)



Source: European Commission (2009c).

To illustrate the severity of the past financial crisis, Figure 1.1 plots the European Commission's (2009c) economic sentiment indicator (ESI), which measures consumer and business confidence in the EU27. The figure shows that since the indicator was first devised in 1985, the ESI reached its lowest value after the financial crisis. With a constant decrease starting from May 2007 and a value of 64.6 in March 2009, it clearly surpassed the threshold of 74.1 in July1993. Moreover, the steepest drop in the economic sentiment indicator happened in 2008-09, as the index dropped by 35.9 points in a one-year period (March 2008-09). Approximately the same amount of ESI decline, reaching its minimum level in July 1993, was recorded over the three-year period of August 1989 to July 1993. Fortunately, as can be seen, economic sentiment has recovered from March 2009 onwards to a value of 80 in August 2009.

[3] However, the study warns that the results should be handled with caution. Estimated losses include for instance insolvencies of banks and value losses in the US housing market.

2. The financial crisis and its impact on systemic trust

2.1 Systemic trust

According to a number of social scientists (Putnam 2000, Levi 1998, Newton 2001 and Luhmann 2000), the concept of trust should be split into three forms: i) thick trust, ii) interpersonal trust and iii) systemic or institutional trust. This study is concerned with the third form of trust: citizens' confidence in their institutions, particularly citizens' trust in the government and parliament, on both European and national levels, citizens' confidence in financial institutions as well as citizens' confidence in the overall mode of production.

Although the concept of systemic trust has featured strongly in the literature of sociologists (Luhmann 2000) and political scientists (Zucker 1986, Newton 1997 and Putnam 2000) for some time, economists have only recently started to explore the concept in their research (Guiso et al. 2004 and Roth 2009). Whereas Luhmann differentiates three forms of systemic trust: i) trust in the parliament (trust in the legitimate power), ii) trust in money[4] and iii) trust in informative authority, most political scientists focus solely on confidence in the government (Mishler & Rose 2001, Blind 2006 and Chanley et al. 2000). Although this report agrees that institutional trust is a crucial component of systemic trust, it also incorporates the more economic dimension of 'confidence in the mode of production' in its definition. (a short theoretical elaboration of the subject is given in Annex 1). The importance of confidence in free market economies and state institutions has also been stressed extensively by policy-makers throughout the financial crisis (see here Tonkiss 2009). Thus this report uses systemic trust as a concept to describe citizens' confidence in i) institutions and ii) confidence in the mode of production.

2.2 How did the financial crisis affect citizens' systemic trust?

The fact that financial markets could come so close to collapse has given citizens a glimpse of the fragility of modern finance. They have witnessed the near collapse of the financial industry (and consequently also the real economy), which could only be rescued by the immense efforts of the state as described above. More precisely, citizens have been confronted with the fragility of their economic systems and their strong dependence on mutual trust. If the production system enjoys *sufficient* trust, the production process works smoothly, but if this trust is undercut, it can have dramatic consequences for the production process. Thus one might conclude that in free market economies, trust is an essential input in the production process. Without a sufficient level of trust, free market economies can not function, at least not efficiently. Trust here functions as a kind of 'grease', facilitating production and minimising transaction costs (see here Hardin 1982, North 1990, Ostrom 1990 and Fukuyama 1996). From a firm's perspective, if the employer can trust his employees *sufficiently*, contracts do not need to cover all contingencies. Furthermore, if management trusts its employees, it can spend less resources on

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[4] The importance of the relationship between money and trust cannot be elaborated upon in this report as it would give rise to another extensive discussion. That money and trust are identical has been stressed by economic sociologists such as Perelmann (1998) who stresses that credit is trust and that a crisis of trust would evidently lead to a credit crisis within the financial system. Similarly, Helmut Schieber (2000) points out that money should be considered as trust. In an interview with the western media, the Chinese Premier Wen Jiabo told the Financial Times that "confidence is the most important thing, more important than gold or currency" (Merk 2009). Former US Labor Secretary Robert Reich argues that "the fundamental problem isn't a lack of capital. It's a lack of trust and without trust, Wall Street might as well fold up its fancy tents" (in Tonkiss 2009: 196).

monitoring their performance and more on research and development that enhance innovation.[5] The chain of events triggered by the collapse of Lehmann Brothers has shattered citizens' confidence in the long-run, resulting in lower levels of systemic trust.

2.3 What is the potential impact of low systemic trust? Will it lead to more public interventionism?

According to the literature on systemic trust, there are three broad sets of consequences associated with increases or decreases in levels of systemic trust. First, accepting the positive empirical results on the relationship between interpersonal trust and economic growth (Knack & Keefer 1997, Zak & Knack 2001, Whiteley 2000, Beugelsdijk et al. 2004 and Akcomak & Ter Weel 2009), one can assume that systemic trust has a positive effect on economic growth. However, as most recent empirical results on the macro- and micro-level demonstrate a curvilinear relationship between interpersonal trust and economic growth (Roth 2009, Bidault & Castello 2009 and Butler et al. 2009), one can conclude that systemic trust is also curvilinear related to economic growth.

Whereas Roth (2009), in his analysis of an EU15 and OECD country sample, finds a negative relationship between confidence in the government and confidence in major companies and economic growth, Haerpfer et al. (2005: 263) find a positive relationship between a confidence index and economic growth in a sample of post-communist countries. Thus, whether systemic trust is also related to economic growth in a curvilinear manner is an open question and more research has to be conducted in order to test the question whether systemic trust matters for economic growth. Common sense clearly suggests that the financial crisis has eroded too much trust, meaning that the sufficient levels of systemic trust for economic growth have been undercut. Moreover, to the author's knowledge, no empirical studies have investigated the crucial relationship between confidence in the mode of production and economic growth.

Second, systemic trust should be considered crucial for the stability of democracy. Various empirical studies have shown that interpersonal trust is positively related to democracy (Paxton 1999, 2002 and Gabriel et al. 2002). Trust in the government is a basic prerequisite for the legitimacy of those who have been entrusted with political power by their citizens (Levi 1998 and Hardin 1998). Levi (1998) claims that citizens are more likely to comply with norms if they perceive that: i) the government is trustworthy and ii) other citizens are cooperative as well. In particular, Scholz (1998) finds evidence that political as well as social trust increases tax law compliance. Blind (2006) asserts instead that the relationship between trust and governance should be considered as circular: confidence towards institutions enhances efficiency in governance, which in turn fosters political trust.

A third consequence found in the literature on systemic trust, especially trusts towards the production regime of free market economies, is its effect on citizens' demand for redistributive policies (Alesina & La Ferrara 2005 and Aghion et al. 2009). Should citizens not consider the production system as fair and just they will start to pressure their national governments for redistributive policy measures and more state intervention. In this instance, Alesina and Angeletos (2005) argue that the belief in the fair operations of the economic system is associated with a lower incidence of citizens demanding redistributive measures. Alesina et al. (2001) stresses this kind of argument when assuming that if citizens should feel strongly dissatisfied with the market economy they may respond by pressuring governments to move towards more communitarian/socialist modes of production.

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[5] Nevertheless the importance of the fear factor in worker-manager relations should also not be underestimated.

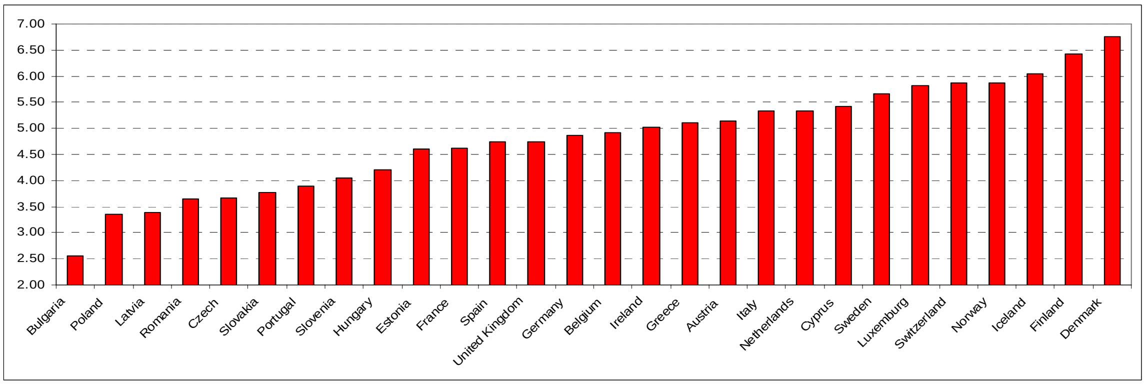
3. How has the financial crisis affected citizens' systemic trust? First empirical evidence

3.1 Systemic trust in the EU vs OECD – A general empirical overview

3.1.1 The variability of trust – Levels of systemic trust in the EU27

To provide a first overview of the levels of systemic trust in the EU27, we analysed data provided by the European Social Survey (ESS).[6] If one analyses the first three rounds of the ESS,[7] it is possible to retrieve information on 25 out of 27 EU countries.[8] Figure 3.1 shows the distribution for a systemic trust index in the EU27. The index consists of the five systemic trust items: confidence in i) national parliament, ii) politicians, iii) the legal system and iv) the police.[9] On the right hand side of the distribution are five Scandinavian countries: Denmark, Finland, Iceland, Norway and Sweden.

Figure 3.1 Comparison of levels of systemic trust in the EU27



Source: European Social Survey 2002-2006.

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6 An academically-driven social survey designed to chart and explain the interaction between Europe's changing institutions and the attitudes, beliefs and behaviour patterns of its diverse populations. For more information, see http://www.europeansocialsurvey.org/.

7 The 4th round of the ESS has just recently been published in September 2009, based on field work conducted in the immediate aftermath of the financial crisis from September 2008 to January 2009. A comparison of the 4th round results with those from the 3rd round (conducted in 2006) shows that the only item of trust that increased significantly is trust in national parliaments. In Germany, for instance, the confidence level increased by more than 10% from 4.1 to 4.6. On average, interpersonal trust levels stayed constant. The index of the above-mentioned four institutes and increased marginally by around 2%. Interestingly, however, in the direct aftermath of the crisis, the average confidence level in the European Parliament increased only marginally by 2%. When splitting up the sample in those countries that were surveyed from August to January, one detects an increase in confidence in the European Parliament, in those countries surveyed until March 2009 one detects a decrease. Thus one might conclude that the apparent failure of the European institutions to tackle the financial crisis on a consolidated European level (see here Alesina et al. 2008) has caused the sharp decline in the net confidence levels in January-February 2009, as will be shown later. More detailed results on the before and after comparison between the 3rd and 4th wave of the ESS can be obtained from the author upon request.

8 Data for Lithuania and Malta are missing. For purposes of comparison, Iceland and Switzerland were included.

9 A factor analysis shows that all four items load on the same scale. The results for the Cronbach Alpha Measure can be obtained from the author on request.

On a scale from 0-10, all five countries score higher than 5.5, with Denmark achieving a value of 6.75. The ranking is then followed by the 'coordinated' countries (see Hall & Soskice 2001) of Luxembourg, the Netherlands and Austria. Interestingly, the liberal country Ireland and the two Mediterranean countries Italy and Greece are also located in the upper half of the distribution. The transition countries are clearly located at the end of the distribution with Bulgaria falling in last place with a score of 2.55. With the exception of Portugal, which has the lowest level of systemic trust from the EU15 countries, all transition countries in the sample are located on the right hand side of the distribution. Figure 3.2 shows the levels of systemic trust in accordance with the five country regime typologies.

Figure 3.2 Levels of trust by regime typologies, EU27

Source: European Social Survey 2002-2006.

Figure 3.2 illustrates that the Scandinavian countries rank higher than Coordinated and the Mediterranean countries. The transition countries perform poorly when it comes to levels of systemic trust. Figure 3.4 in the Annex shows the very close association between government effectiveness and systemic trust. With a R-squared value of nearly 0.7, the relationship has to be considered quite strong.

3.1.2 Levels of systemic and interpersonal trust in the OECD

With the help of data from the World Values Survey,[10] one can compare levels of systemic trust, here specifically levels of confidence in the government, between OECD countries. As demonstrated by Figure 3.3, Turkey demonstrates the highest level of government confidence ever recorded.[11] It is followed by Switzerland and the Scandinavian countries Norway and Finland. The lowest confidence levels are found in Poland, France and Germany. It is worth noting that Sweden, Spain and Finland are the only EU member states where the level of government confidence is above the OECD average. If we take into consideration the whole European Economic Area (EEA), then Norway and Switzerland are the absolute forerunners, well beyond both the EEA and the OECD average. The world's largest economies, such as the US or Canada, are slightly above the OECD average, whereas Japan scored only moderately below the average.

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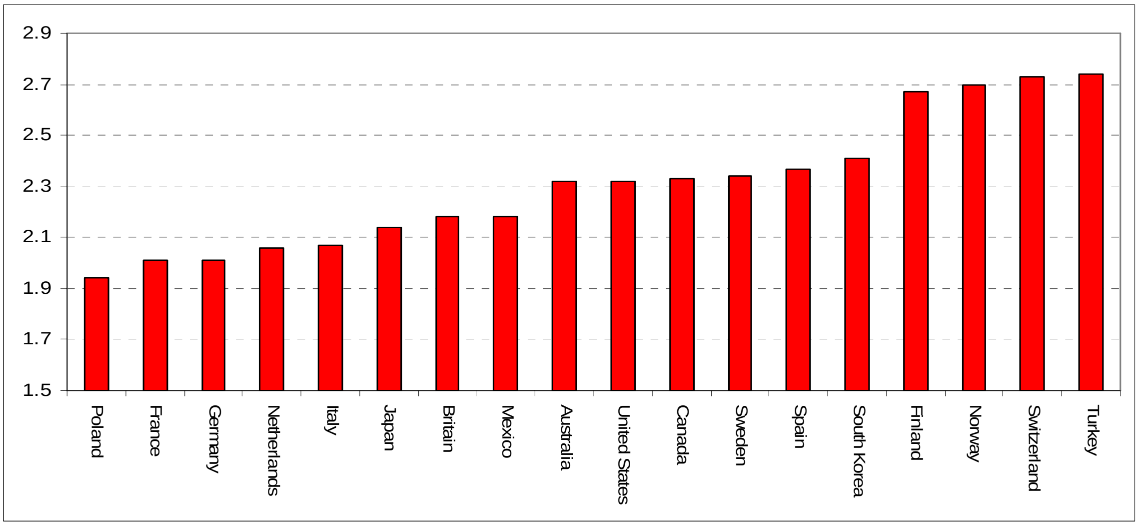
[10] The World Values Survey (WVS) is a global network of social scientists who have surveyed the basic values and beliefs of the publics of more than 80 societies, on all six inhabited continents. For more information, see http://www.worldvaluessurvey.org/.

[11] One has to note here that Turkey has one of the lowest levels of interpersonal trust. Thus the case of Turkey clearly underlines that various forms of trust should be kept distinct from each other.

Figure 3.3 Comparison of levels of confidence in the government among selected OECD countries



Source: World Values Survey 2005.

3.1.3 Government effectiveness and systemic trust

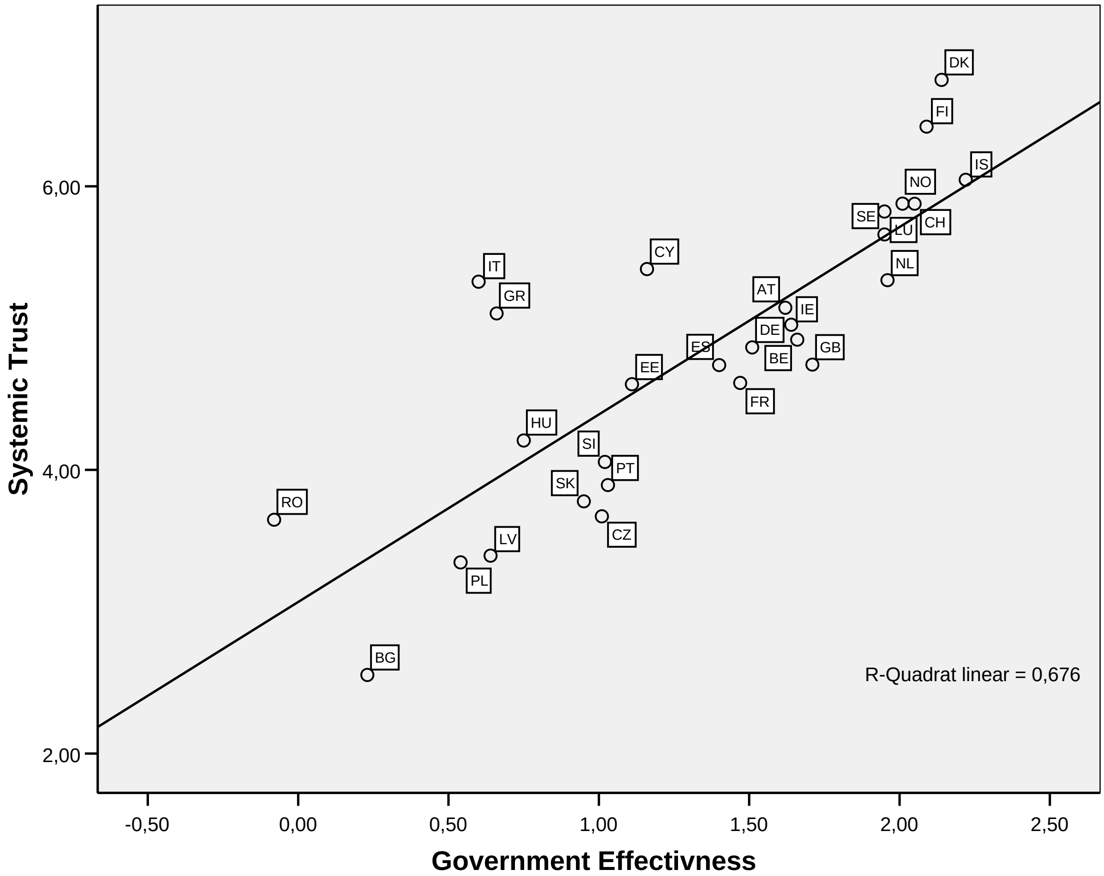
Researchers believe that the effectiveness of governments is one of the most crucial elements for interpersonal trust (Rothstein & Stolle 2008, Hardin 1998 and Levi 1998). A range of empirical studies has also shown the significant impact of government effectiveness on interpersonal trust (Kumlin & Rothtein 2005, Delhey & Newton 2005). Figure 3.4 shows a scatterplot between government effectiveness[12] and the levels of systemic trust in a cross section of European countries. One can observe the direct and very strong association between the effectiveness of a country's government and its level of systemic trust. The amount of social expenditure and the level of systemic trust are only weakly associated.[13] Various control variables do not seem to alter the strong and positive association between government effectiveness and systemic trust.[14]

[12] Government effectiveness is measured by using the Kaufmann index, see WGI (2009) http://info.worldbank.org/governance/wgi/index.asp.

[13] Results can be obtained from the author upon request.

[14] Results can be obtained from the author upon request.

Figure 3.4. Scatterplot between government effectiveness and systemic trust



Source: Author's own estimations with Kaufmann Indicators and European Social Survey.

3.2 Trust towards the European Central Bank (ECB)

3.2.1 Levels and increase of distrust in the ECB in the aftermath of the financial crisis

In order to investigate citizens' confidence levels in the EU27, it was necessary to find a source of internationally comparable data that exhibit a time trend. One survey that covers all countries from the EU27 and permits an evaluation of time trends is the Eurobarometer (EB) launched by the European Commission.[15] The fieldwork of Standard EB70 was launched soon after the start of the financial crisis in October-November 2008. Then in January-February 2009, Eurobarometer launched the second EB survey after the crisis, the Special EB71.1 (2009b). The

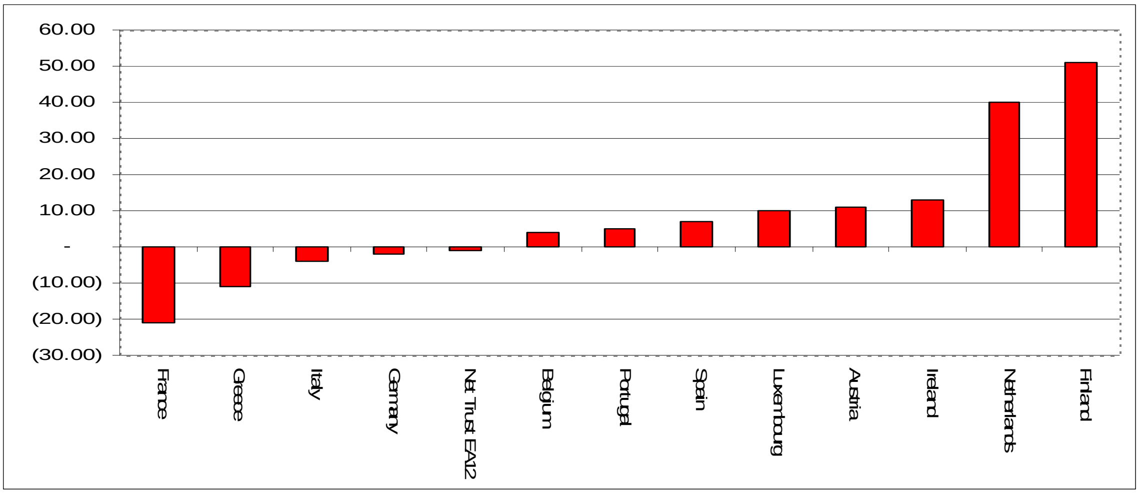
[15] Raw data available on CD-ROM from Gesis ZA Data Service for Standard Eurobarometers 51-62 (Gesis 2005a, 2005b) and received on request from Gesis ZA Data Service for Standard Eurobarometers 63-69 (http://www.gesis.org/en/services/data/survey-data/eurobarometer-data-service/data-access/). Data for the Standard Eurobarometer 70 were taken from Eurobarometer (2008, 2009a). Data for the Special Eurobarometer 71.1 were taken from Eurobarometer (2009b). Data from the Eurobarometer 71 were taken from Eurobarometer (2009c).

third observation in the aftermath of the financial crisis was obtained from the Standard EB71 (2009c), which was launched in June 2009.

Thus a comparison of Standard EB70, the Special EB71.1 and Standard EB71 on the one hand, with the Standard EB69, which was conducted in spring 2008 on the other hand, constitutes an ideal research design to analyse the impact of the ongoing financial crisis on European systemic confidence levels. Public confidence in three different institutions seems to hold the potential to verify the crucial research question of whether the financial crisis has acted as a shock to confidence levels. "For each of the following European bodies, please tell me if you tend to trust it or not to trust it. European Central Bank? European Parliament? European Commission?"

Since the financial crisis has mostly been driven by severe failures in the banking sector, the question towards confidence in the European Central Bank can be regarded as a very appropriate proxy to measure people's confidence towards the financial institutions per se, and banks in particular. As we will see later, especially when considering several country studies in more detail, the corresponding data show that public confidence in banks has been severely damaged. But before analysing the time trend in the levels of net trust[16] within the EU as an aggregate and in single countries, Figure 3.5 highlights the actual levels of net trust in the euro area 12 (EA12)[17] in the aftermath of the financial crisis in January-February 2009 (Special EB 71.1, 2009b). The variance across the 12 countries is quite apparent. Whereas Finland and the Netherlands still demonstrated sufficient levels of trust (40% and 51%, respectively), in France a massive two-thirds of the population mistrusted the ECB at the beginning of 2009. Moreover, in Italy and Germany, more people mistrusted the ECB than actually trusted it.

Figure 3.5 Levels of net trust in the ECB in the aftermath of the financial crisis



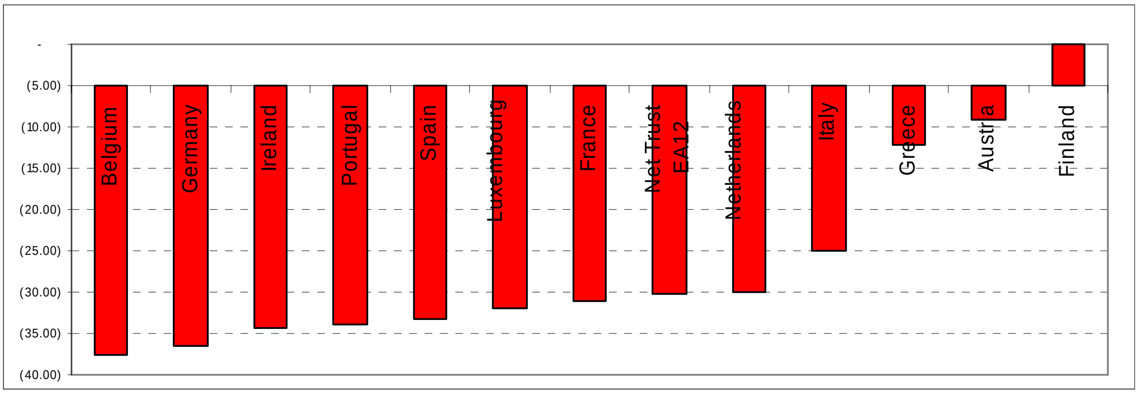
Source: Eurobarometer: Special EB71.1.

[16] In order to control for the significant variations in the "Don't know" answers, net trust values are given in this paper when using EB data. 'Net trust' here looks only at those respondents who have an opinion and subtracts the percentage of those who say they do not have trust from those who say they have trust in the system. Thus a value above zero indicates that there are more people overall who trust than distrust and a value below zero indicates that the majority of people distrusts.

[17] The four new countries Slovenia, Cyprus, Malta and Slovakia that joined the euro area recently have not been included in constructing the average.

In order to evaluate the overall decrease in net trust (with only Finland acting as an exception), Figure 3.6 shows the change in net trust from spring 2008 (before the financial crisis) through January-February 2009 (in the aftermath of the financial crisis). Except in the cases of Finland, Austria and Greece, this financial crisis had a tremendous impact on citizens' confidence towards the central banks, with eight countries experiencing a decrease in net trust by over 30%.

Figure 3.6 Decrease in net confidence levels (EB69 – EB71.1)



Source: Eurobarometer: Standard EB69 and Special EB71.1.

3.2.2 Trend analysis of net trust in the ECB

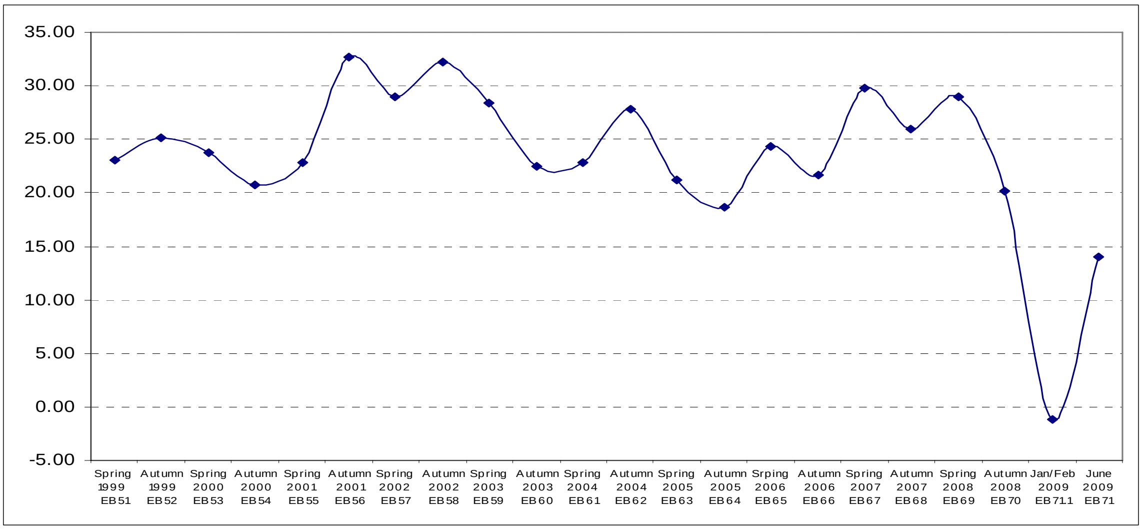
It is therefore evident that the net trust in the European Central Bank has significantly decreased. But how does this decrease in trust relate to the pattern from 1999 onwards? To shed some light on this comparison, the analysis takes into consideration the 10-year time trend from spring 1999 to spring 2009 in Figure 3.7.

From autumn 2006 to spring 2007 the European economies were booming. The average EU15 GDP per capita growth rate in 2006 amounted to 3% (the results of a first empirical assessment of whether GDP and growth of GDP are related to net trust levels in the ECB can be found in Annex 2). In all four big European economies, the confidence levels towards the ECB increased in the indicated period. From spring 2007 to autumn 2007, the financial crisis showed its first signals with financial markets collapsing around mid-September. The time period between spring 2008 and autumn 2008 encompasses the crucial shock of the collapse of Lehmann Brothers on September 15th. Interestingly, immediately in the aftermath of the financial crisis, the overall net trust levels fell by only 8% in the EA12[18]. However, the inclusion of the observation from the Special EB71.1 (2009a), the one of January/February 2009, reveals the starkest drop in citizens' level of trust in the ECB since its very establishment in 1999. In January-February 2009, more people tended to mistrust the ECB than to trust it. Correspondingly, the decline of net trust in the aftermath of the financial crisis in relation to the time period before the crisis amounted to almost 30%. Although clear signs of recovery of the confidence levels were obvious in June 2009, bouncing back by 13%, the spring 2008 confidence level of 28% of net trust could still not be restored. One possible guess is now that

[18] The question of confidence in the ECB is really only relevant in the case of those countries that have implemented the euro. Therefore, only data from the euro area member states (EA12) have been used. However, the results do not differ significantly when using an EU15 or EU27 country sample. As the time trend from 1999-2009 is of primary importance in Figure 3.7, the four new countries Slovenia, Cyprus, Malta and Slovakia that joined the euro area recently have not been included in the average.

the data from autumn 2009 (yet to be released (Standard EB72)) should maintain the same level as of June. In other words, it might be that the financial crisis has established a new equilibrium of trust in the ECB, one that is significantly lower than the level before.

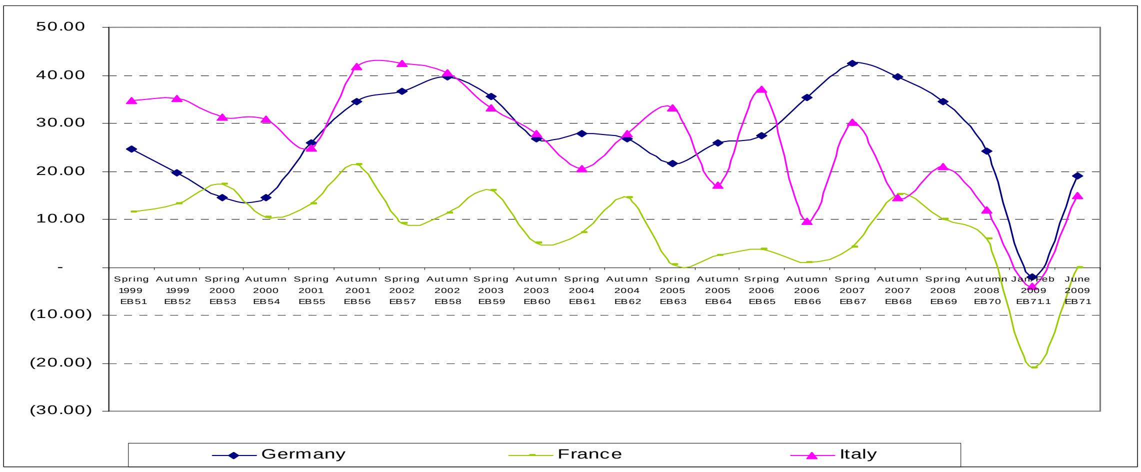
Figure 3.7 Net trust in the ECB EA12, 1999-2009



Source: Eurobarometer: Standard EB Nos. 51-71 and Special EB 71.1.

While Figure 3.7 shows only the aggregated trend data, it is worth taking a look behind the single country cases. This is why Figure 3.8 plots the country graphs for the three big European economies of the eurozone: Germany, France and Italy. As for Germany, a decline in net trust from the level of over 40% in spring 2007 to -2% in January 2009 can be detected. However, the recovery in June 2009 has been quite significant reaching the level of 20%. In the case of France, the already relatively low level of net trust of 13% in autumn 2007 fell to -20% in January-February 2009, implying that in the beginning of 2009, already two-thirds of French citizens mistrusted the ECB. The data from June 2009 indicate that despite the recovery, one-half of French citizens still mistrust the ECB now. Starting with a net trust value of 30% in spring 2007, almost 50% of Italian citizens mistrusted the ECB, with a net trust level of around 17% in June 2009.

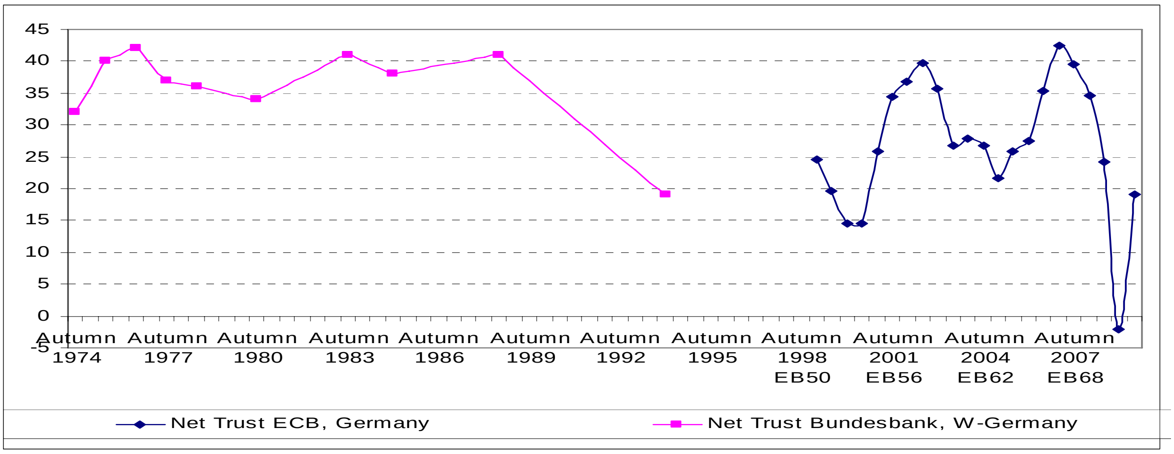
Figure 3.8 Net trust in the ECB for the European G3, 1999-2009



Source: Eurobarometer: Standard EB Nos. 51-71 and Special EB 71.1.

Yet again, one is tempted to suppose that the timeframe of ten years could simply be too short to evaluate whether the financial crisis has caused a historical low level of trust in the central banks. With this in mind, Figure 3.9 shows the trend in net confidence over the 35-year time period from 1974 to 2009[19] in Germany, exploring whether the trust in the former German central bank[20] (the German Bundesbank) has ever encountered such a steep decrease and a level of confidence below 0%. It follows that there has neither been such a steep decline in net trust over such a short time period, nor has the net trust level ever decreased below 0%.

Figure 3.9 Comparison of net trust in the Bundesbank vs. net trust in ECB, 1974-2009



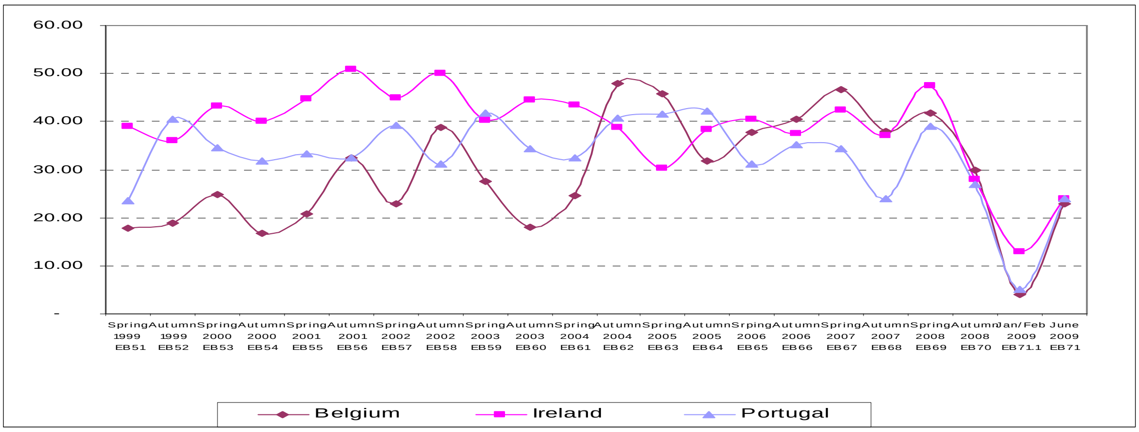
Source: Institut für Demoskopie Allensbach (2009) and Eurobarometer: Standard EB Nos. 51-71.

One further question to be posed is: How did citizens in the small European countries react to the financial crisis? Has there been a slightly different trend? Figure 3.10 shows the trend curves for the three small countries Belgium, Ireland and Portugal. The picture is quite similar to the figure above describing developments in Germany, France and Italy. Related to the period before the financial crisis, a significant drop in net trust was recorded with a slight recovery in June 2009. But do all European countries follow this trend?

[19] With the purpose of covering the last point of observation from Standard Eurobarometer 71, the ECB net trust is considered for the whole of Germany and not only for West Germany., whereas the net trust in the Bundesbank obviously includes only West Germany. Since the ECB net trust curves for the whole of Germany and West Germany are highly correlated, the comparison made in the figure is valid.

[20] Institut für Demoskopie Allensbach (2009).

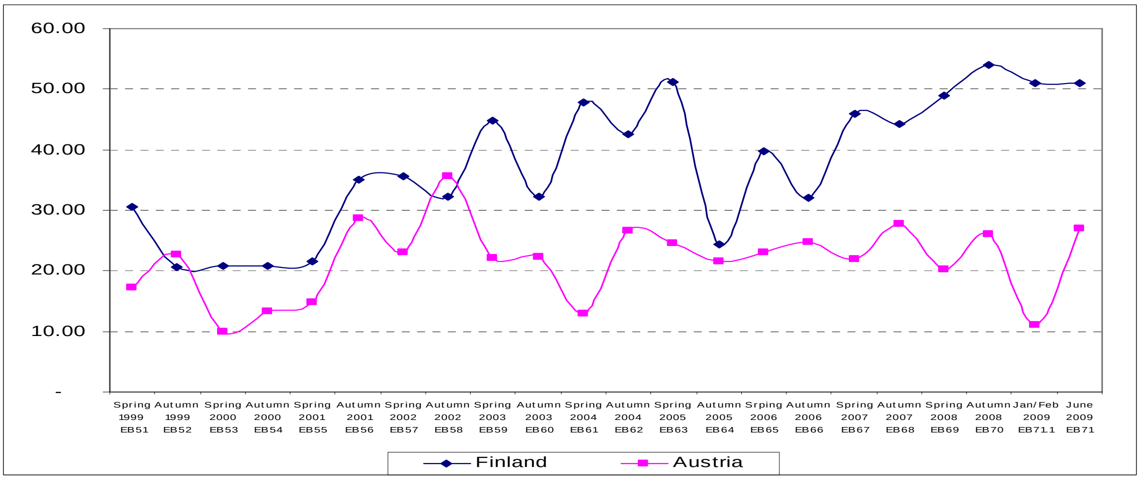
Figure 3.10 Net trust in the ECB for selected small European countries



Source: Eurobarometer: Standard EB Nos. 51-71 and Special EB 71.1.

Figure 3.11 describes the trend in net trust for the ECB in two other countries, Austria and Finland. Whereas in Austria the recovery of net trust has reached levels as high as they were before the financial crisis (for instance the level of autumn 2007), in Finland net trust levels have only marginally been affected, with a current level of net trust amounting to a staggering 50% in the aftermath of the financial crisis, in June 2009.

Figure 3.11 Net trust in the ECB for Austria and Finland



Source: Eurobarometer: Standard EB Nos. 51-71 and Special EB 71.1.

3.3 How does the ECB compare to other central banks?

A recent Financial Times-Harris poll (Table 3.1) from July 2009 (2009d) suggests that the ECB is not alone in having lost the trust of the people. In this poll respondents were asked: “Do you feel the European Central Bank/Bank of England/Federal Reserve has responded appropriately to the challenges of the economic downturn and its consequences?”

In the case of the US 18% more answered no, than answered "yes". In continental Europe the verdict on the ECB was even more negative with a balance of 23% for those answering "no". In this poll the Bank of England scores best with a negative balance of only 6 percentage points.

Table 3.1 Responses to the question: "Was the action taken by central bank appropriate to the challenges of the economic downturn?"

Panel A

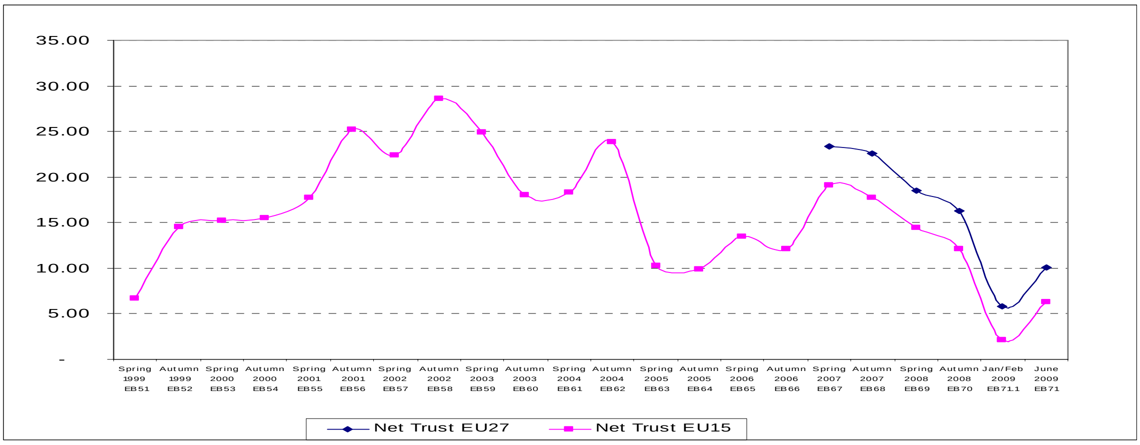
July 2009	Great Britain (BoE)	Europe (ECB)	United States (Fed)
Yes	28	19	23
No	34	43	41
Not sure	38	38	36
Net balance	**-6**	**-23**	**-18**

Source: Own calculations based on FT-Harris Poll (2009d).

3.4 Trust in the European Commission

Up to now we have observed a severe reduction in the levels of citizens' trust in the ECB from spring 2008 to January-February 2009 with a slight recovery in June 2009. Can we observe a similar pattern when analysing the time trends for the other two European institutions, the European Commission and the European Parliament? Figure 3.12 shows the aggregated trend of net trust in the Commission within the EU15 and then subsequently, from the beginning of spring 2007, also within the EU27.

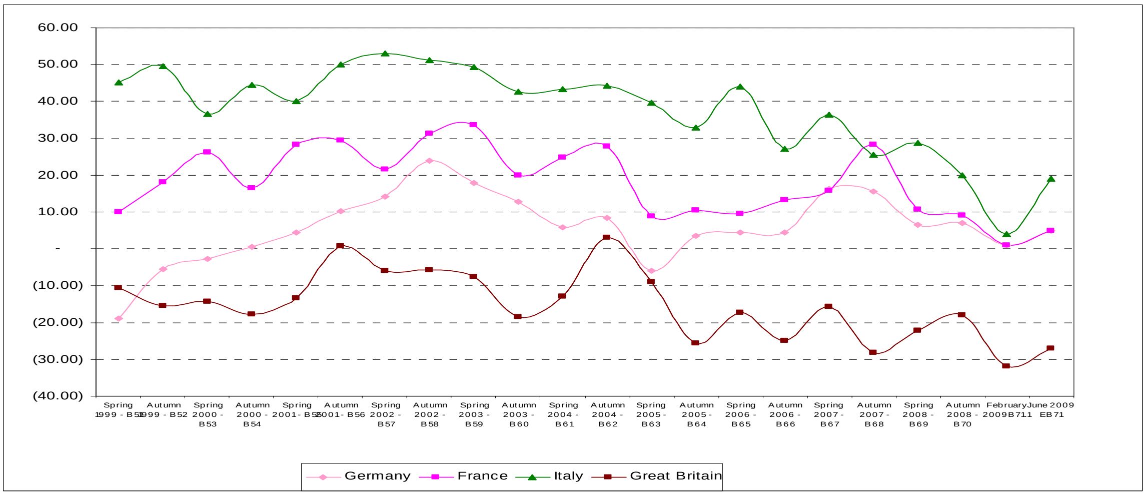
Figure 3.12 Net trust in the European Commission in the EU15 (EU27), 1999-2009



Source: Eurobarometer: Standard EB Nos. 51-71 and Special EB 71.1.

The trend in net trust in the European Commission is clearly comparable to the trend of the data measuring the net trust levels in the ECB. In the EU15 and from spring 2007, there has been a steady decrease in net trust until January-February 2009, reaching its lowest value from 1999 onwards. From January-February 2009, there has been a small recovery with the net trust level of 7%.

Figure 3.13 Net trust in the European Commission in Germany, France, Italy and Great Britain



Source: Eurobarometer: Standard EB Nos. 51-71 and Special EB 71.1.

In order to investigate in more depth the trends in particular country cases, Figure 3.13 shows the trend in net trust for the four big European economies: Germany, France Italy and Great Britain. Italy had one of the most significant decreases by 30% of net trust within the period between spring 2007 and January-February 2009. However, there has been a significant recovery in Italy from January-February 2009 to June-July 2009. France has faced the steepest decline with only a modest recovery. Germany's decrease was not as severe as France's but the recovery was also only moderately. The UK faces a significant decrease with a small recovery. Concerning the UK, one has to denote that the UK's level is significantly lower that one of the other three countries. But how did the net confidence levels in the smaller EU countries evolve?

Figure 3.14 Net trust in the European Commission in Finland, Ireland and Austria

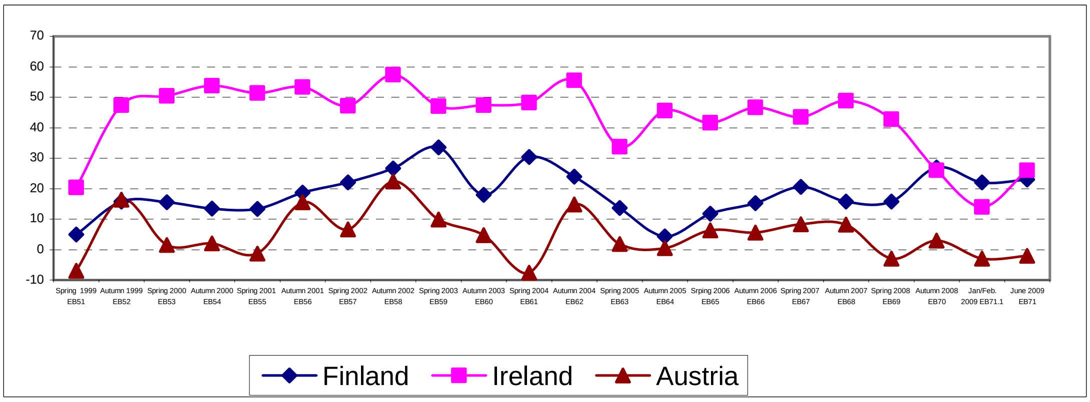
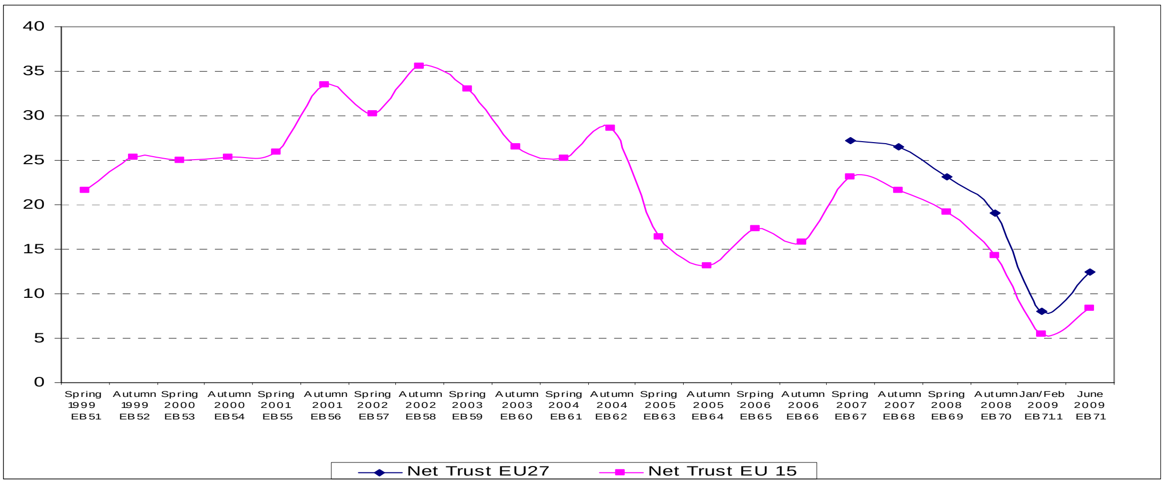


Figure 3.14 shows the trends in net confidence in Finland, Ireland and Austria. Whereas Ireland had a dramatic loss of net confidence in the direct aftermath of the crisis (January-February 2009) with a significant recovery nine months later (June-July 2009), citizens' net confidence levels in Finland and Austria were only marginally affected.

3.5 Trust in the European Parliament

The previous section has shown that the drop in net trust towards the European Commission has been significant, but not as severe as in the case of the ECB. The accent will now be placed on the net trust trend towards the European Parliament. Has it also been affected? Figure 3.15 reveals the aggregated trend data for the net trust in the European Parliament in the EU15 and EU27. Similarly to the Commission and the ECB, the net trust in the European Parliament has reached its historical (1999-2009) low in January-February 2009, in the immediate aftermath of the financial crisis. There has been a steady decrease from spring 2007 to January-February 2009 with a slight recovery in June 2009, reaching net trust levels of around 7%. Similar to the other net trust trends, the question arises in how far the disaggregated single country trends differ from the aggregated trend.

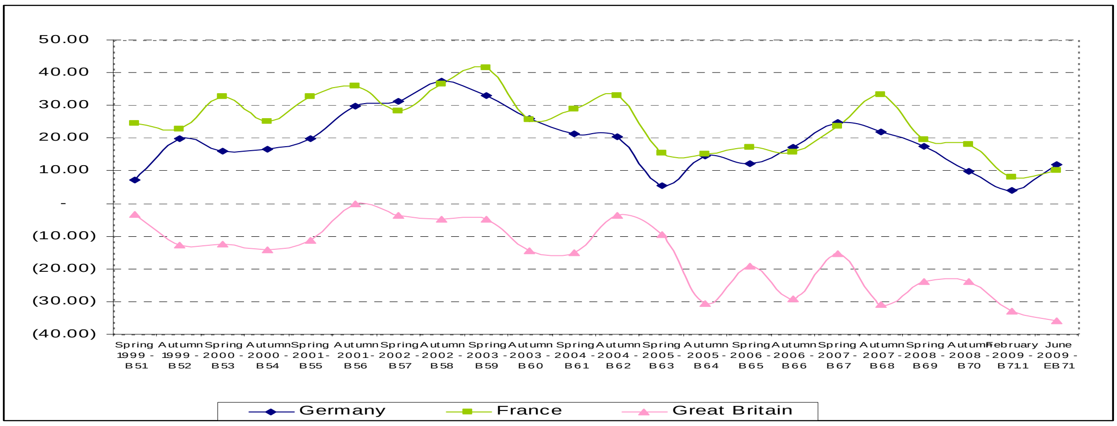
Figure 3.15 Net trust in the European Parliament in the EU15 (EU27), 1999-2009



Source: Eurobarometer: Standard EB Nos. 51-71 and Special EB 71.1.

Figure 3.16 analyses the net trust for the three large European economies: Germany, France and Great Britain. The most interesting case here is Britain with an astonishing net trust level at nearly -40%. The slight recovery which could be observed in the aggregated trend is not replicated in Great Britain. Even in the period between January-February to June-July 2009, there has been a further decrease in net trust. Although there has been a gradual decline starting in the autumn 2007 in Germany and France, the net confidence levels have never fallen below the threshold of 0%. In both countries a slight recovery took place in June 2009. But how did net confidence levels evolve in the smaller EU member states?

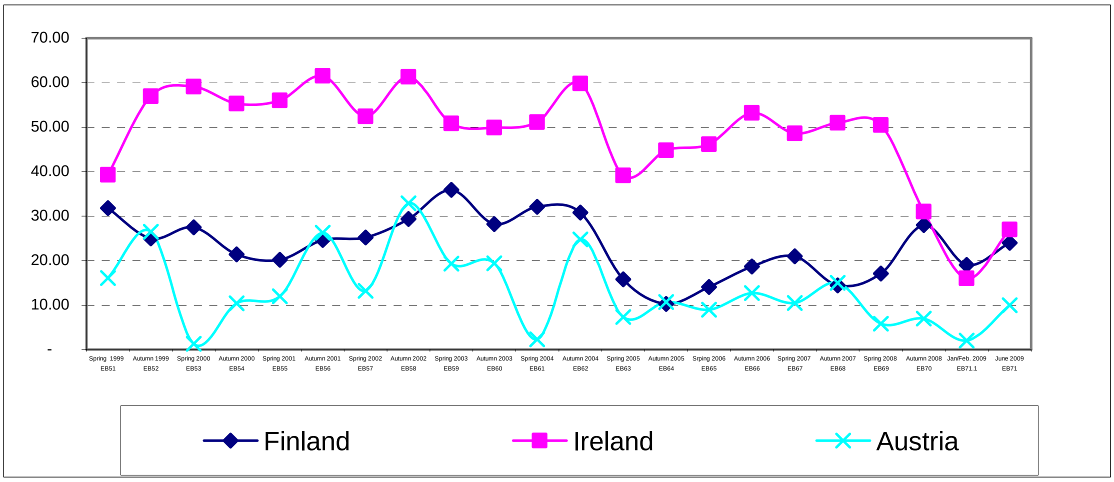
Figure 3.16 Net trust in the European Parliament in Germany, France and Great Britain



Source: Eurobarometer: Standard EB Nos. 51-71 and Special EB 71.1.

Figure 3.17 shows the trend in net confidence for three countries: Finland, Ireland and Austria. Whereas in Ireland, the crisis has had a severe impact on confidence levels with a historical low level of below 20% in the immediate aftermath of the crisis (January-February 2009), the net trust losses in Finland and Austria were only marginal. Interestingly, Austria has already had far steeper declines from autumn 1999 to spring 2000 and from autumn 2003 to spring 2004.

Figure 3.17 Net trust in the European Parliament in Finland, Ireland and Austria

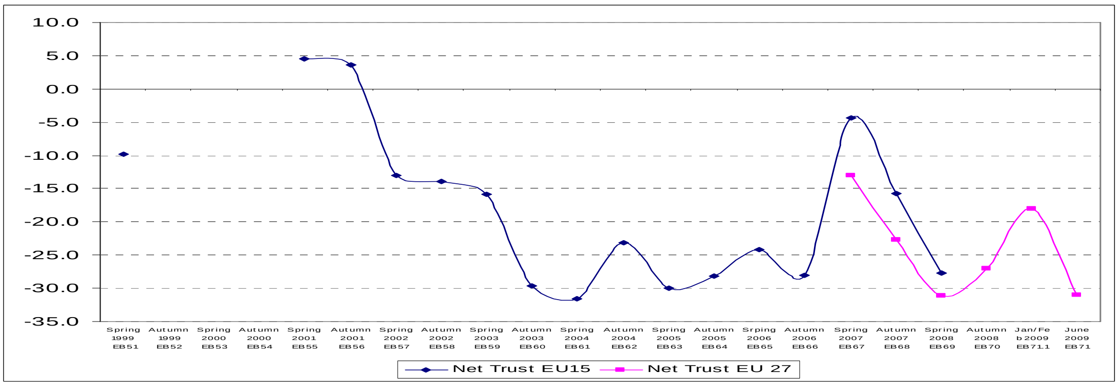


3.6 Trend in the national government and the national parliament

The loss of net trust in the European Parliament and the European Commission should be understood as the failure of the European Commission to effectively coordinate the fiscal stimulus packages and the bail-out of the banking sector at the European level. With Ireland being the first country to bail out its banking sector at the national level, all national governments followed. A similar picture can be drawn when observing the fiscal stimulus packages implemented at the national levels with blatant protectionist and national interests.[21] Thus it seems crucial, besides the trust in the European institutions, to evaluate the levels of confidence in the national government and parliament.

First, the empirical literature on confidence in the government suggests that after times of crisis, citizens' trust in the government actually increases (Chanley 2002).[22] Moreover, the fact that all bail-out plans and stimulus packages have been agreed solely on the national level implies that citizens' level of net trust in their governments and parliaments have correspondingly increased. Respectively, Figure 3.18 evaluates the confidence trend in the national government for the aggregated EU15 and EU27.[23] As suspected and contrary to the pattern to the European institutions, net trust trends have increased in the aftermath of the financial crisis in autumn 2008 and January-February 2009. However, this increase slowed down in the period from January-February 2009 to June 2009. Interestingly enough, the trend in levels of trust in national governments behaves exactly in an opposite manner relative to the corresponding trust levels towards the European Commission.

*Figure 3.18 Trust in national governments**



* The autumn 2002 value was imputed.

Source: Eurobarometer: Standard EB Nos. 51-71 and Special EB 71.1.

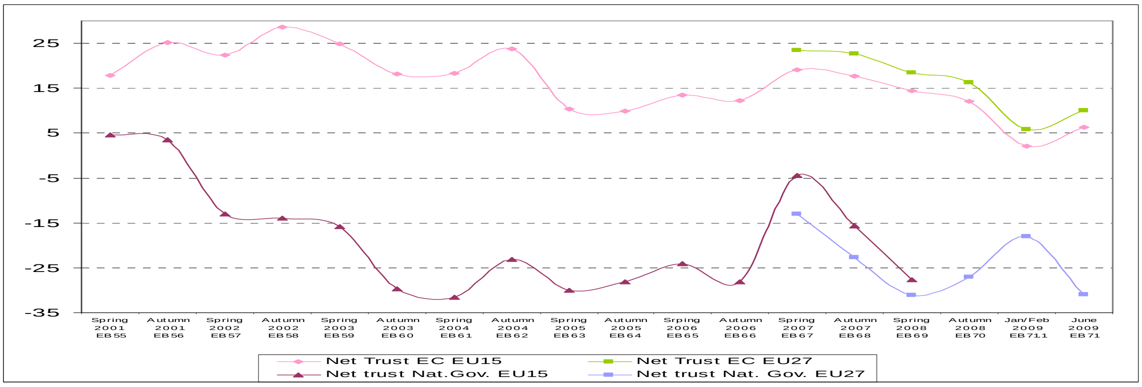
As Figure 3.19 clearly shows for both EU-15 and EU-27 aggregate data, there has been a constant decrease in net trust in the Euro-Commission starting in the spring 2007. On the contrary, net trust levels in national governments have clearly risen since early 2008, which should be attributed to the positive effects of various government stimulus packages aiming to revive national economies. However, the graph also makes clear that the net trust levels towards the Commission are higher than those towards national government.

[21] A good example is here the story of Opel protectionism. See AFP (2009) (http://www.newstin.co.uk/tag/uk/145543810).

[22] Chanley's empirical work shows that after the 9/11 attacks on the US, US citizens' confidence in the government actually increased. Although the September 11 attacks were not of an economic character, but rather were general attacks on the US, these figures might nevertheless give some indication of the trend in government confidence in the aftermath of national crisis.

[23] The data for Standard EB70, Special EB71.1 and Standard EB71 have only been released for the aggregated values for the EU27.

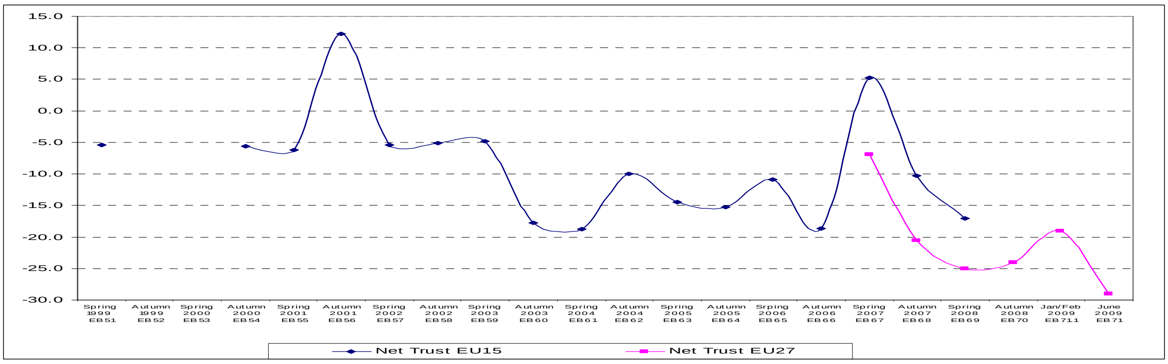
Figure 3.19 Comparison between net trust in the European Commission and national government in the EU15 (EU27), 2001-09



Source: Eurobarometer: Standard EB Nos. 55-71 and Special EB 71.1.

Is the increase in the net trust in national governments replicated when analysing the net trust trend in national parliaments? Indeed, as Figure 3.20 suggests, the same trend emerges. There was a slight recovery in the aftermath of the financial crisis in autumn 2008 and January-February 2009, with a decrease in June-July 2009, leading to an historical low of -30% in June 2009.

*Figure 3.20 Net trust in the national parliament**

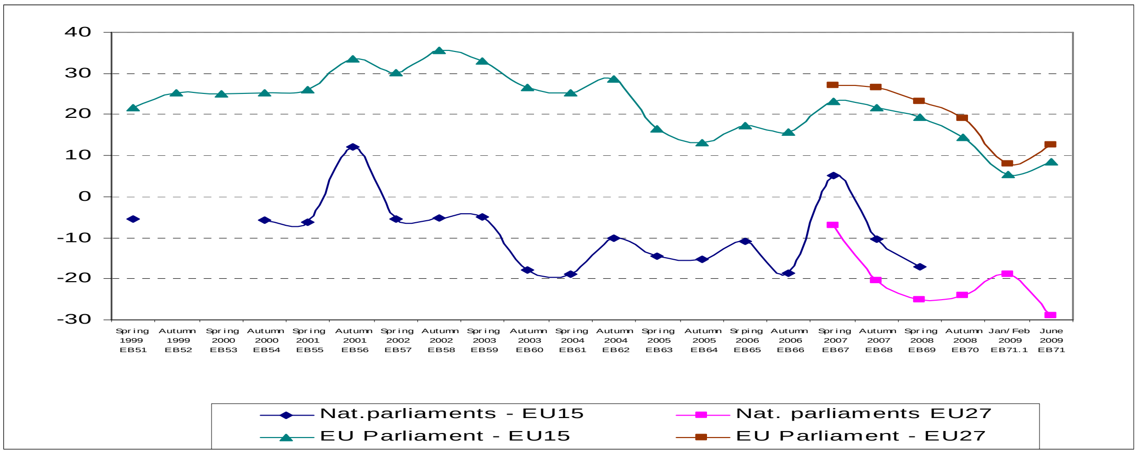


* The autumn 2002 value was imputed.

Source: Eurobarometer: Standard EB Nos. 51-71 and Special EB 71.1.

On the other hand, there is a clear relationship between the trend in net trust in national parliaments and the trend in net trust in the European Parliament in the aftermath of the financial crisis. Figure 3.21 highlights these simultaneous developments. Similarly to the comparison of the two trust trends in national government vs. the European Commission, the diametric picture in the post-crisis period becomes apparent.

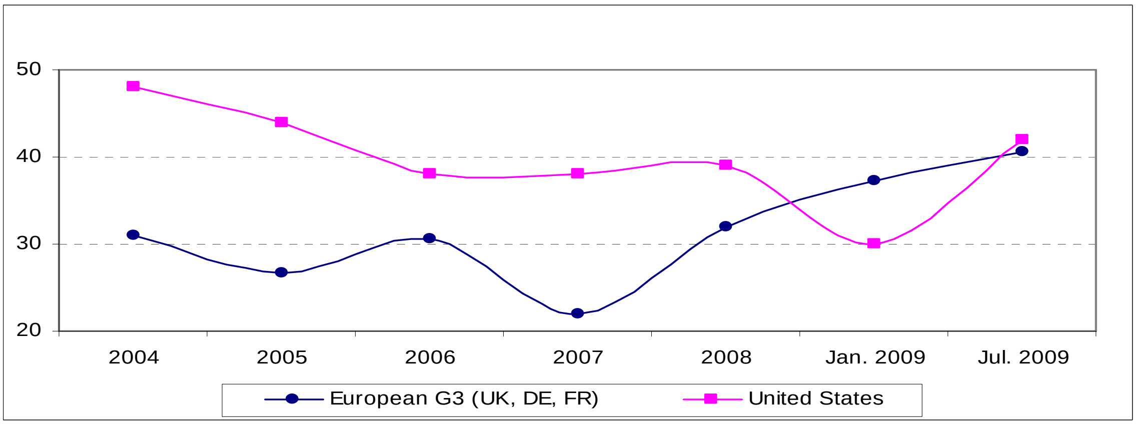
Figure 3.21 Comparison between net trust in national parliament vs. European Parliament



Source: Eurobarometer: Standard EB Nos. 51-71 and Special EB 71.1.

A further question now is whether it would be possible to replicate the analysis of the confidence towards national governments with a different dataset. Luckily there exists the time trend data from the Edelman Trust Barometer,[24] constructed by the Edelmann Corporation. Figure 3.22 shows the net trust trend from 2004 to July 2009. According to the Edelman Trust Barometer, confidence increased from January 2009 to July 2009 in the European G3, as well as in the United States. The difference between the Edelman trust data and Eurobarometer data could either be due to the different populations used or the usage of an EU27 aggregate.

Figure 3.22 Trust in the government, 2004-09



Source: Edelman Trust Barometers 2004-2009.

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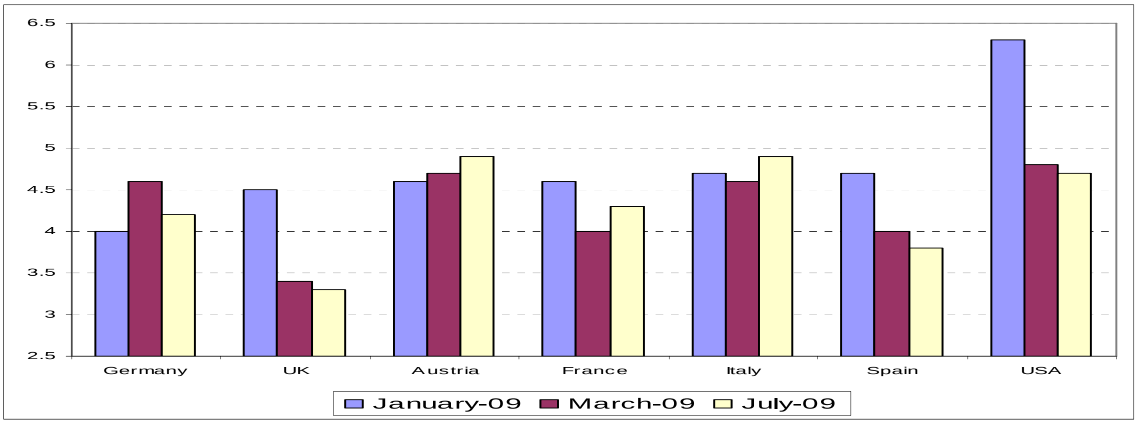
[24] Data from the 2004 to 2009 period are provided by the Edelman Trust Barometer reports which can be downloaded at http://www.edelman.co.uk/trustbarometer. Unlike the Eurobarometer surveys, the Edelman Trust Barometer surveys are not based on a representative sample of the population but are purposely constructed to monitor the opinions of 'elites' (defined as college-educated and reporting a household income in the top quartile of their country).

Another point of our inquiry is to find out how the citizens' perceptions of their governments' ability to successfully cope with the crisis evolved during the financial crisis. Figure 3.23 highlights that citizens' trust in their government to manage the crisis varies strongly among the countries. Whereas US citizens still showed strong confidence in their government's ability to manage the crisis in January 2009, there was a significant decline in April 2009 and again a slight decrease in June 2009. In Germany, citizens' confidence increased from January to March 2009 but fell again from March to June 2009. In Spain and the UK, on the other hand, one can detect a steady decrease of citizens' confidence since January 2009. The Austrian case seems to be the only instance in which there has been a steady increase in citizens' confidence.

Figure 3.23 Trust in government to manage the crisis (January-April 2009)



Source: WIN CRISIS INDEX - 1st, 2nd, and 3rd Waves of the Worldwide Barometer of the Financial Crisis, Worldwide Independent Network of Market Research (http://www.winmr.com).

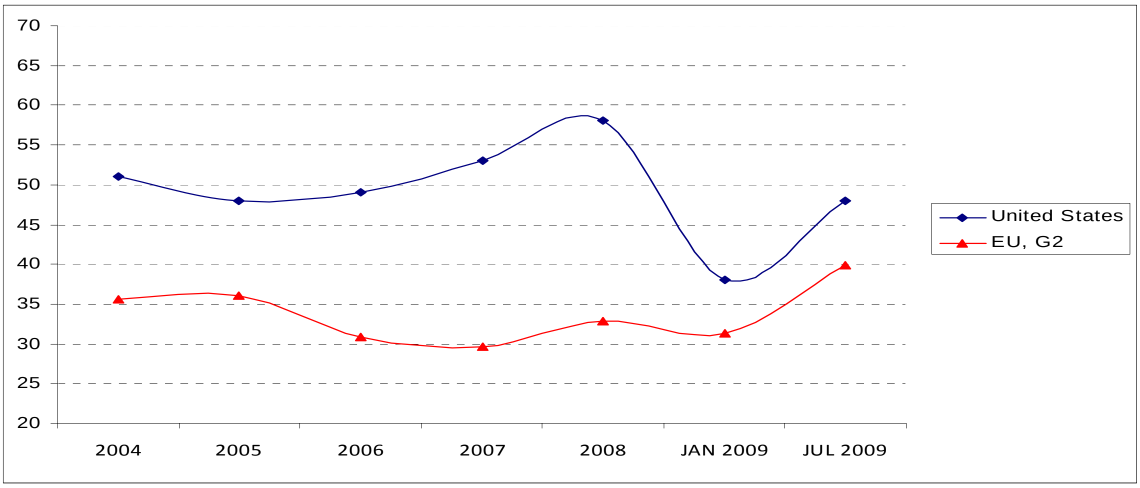
4. How has the financial crisis affected business confidence and citizens' confidence in banks and stock markets?

4.1 Confidence in businesses

Next to citizens' confidence in the government, another crucial issue is public confidence in business in the aftermath of the financial crisis. Once more, using Edelman Trust Barometer, it is possible to analyse trends in the confidence in business. In general, according to this source, 62% of the 25-to-64-years-olds surveyed in 20 countries said that they trust corporations less in the direct aftermath of the financial crisis in January-February 2009. A breakdown country shows a 77% decrease in trust, 67% in the UK, 67% in France, 73% in Germany and 56% in China in the immediate aftermath of the financial crisis. Figure 4.1 illustrates the time trend from 2004 to July 2009 in the US, Germany and France (representing the G2).

In January 2009, in the US the financial crisis acted as a clear shock to elite's confidence in business, dropping from over 55% to 38% in January-February 2009. However between January and July 2009, the situation improved, reaching the level of 2005. In Germany and France, the financial crisis triggered a small decrease in confidence followed by a strong recovery, reaching the highest trust levels since 2004. As also shown by to the data from the ESI, a recovery in business trust could be detected from January to June 2009, most likely due to national bail-out plans and stimulus packages.

Figure 4.1 Trust in business – comparison between the US and the EU (G2)

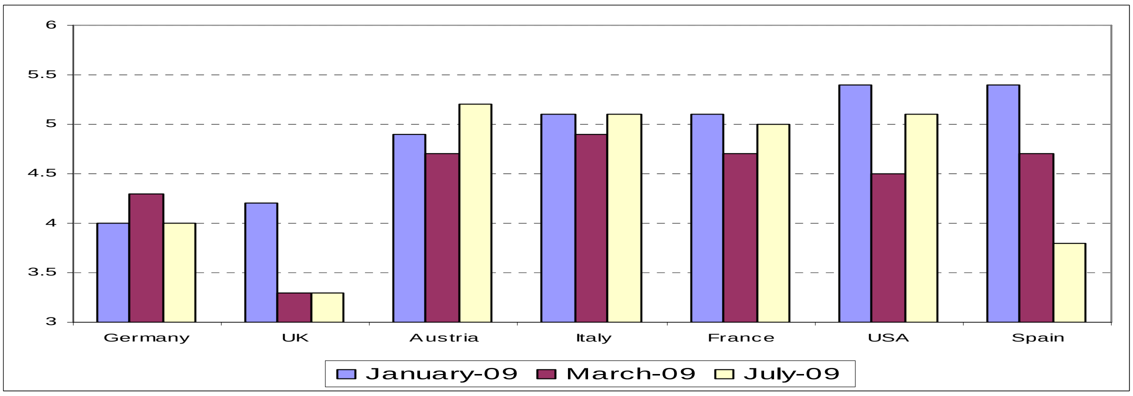


Source: Edelman Trust Barometer 2004-June 2009.

4.2 Trust in the stability of banks

As argued above, the financial crisis has lowered citizens' confidence in banks. If citizens lose their trust in banks, the architecture of the banking system is quickly endangered as banks obviously retain only a minimum of their clients' savings. The example of Northern Rock in the UK highlights what can happen in the industry if all customers simultaneously want to withdraw their savings. And in the case of Northern Rock, although the British government had offered a government guarantee scheme, the savers did not trust the British government enough to maintain their savings in the bank, and thereby triggering the collapse of the bank. But how has the financial crisis affected citizens' confidence in national banks? The question is difficult to answer as internationally comparable data for the period right after the financial crisis are scarce. One source of data, however, is a survey conducted by the Worldwide Independent Network of Market Research, the WIN CRISIS Index (2009 a, b, c), in three waves in the aftermath of the financial crisis.[25]

Figure 4.2 Trust in the stability of the banks (January-March 2009)



Source: WIN CRISIS INDEX - 1st, 2nd, and 3rd Wave of the Worldwide Barometer of the Financial Crisis.

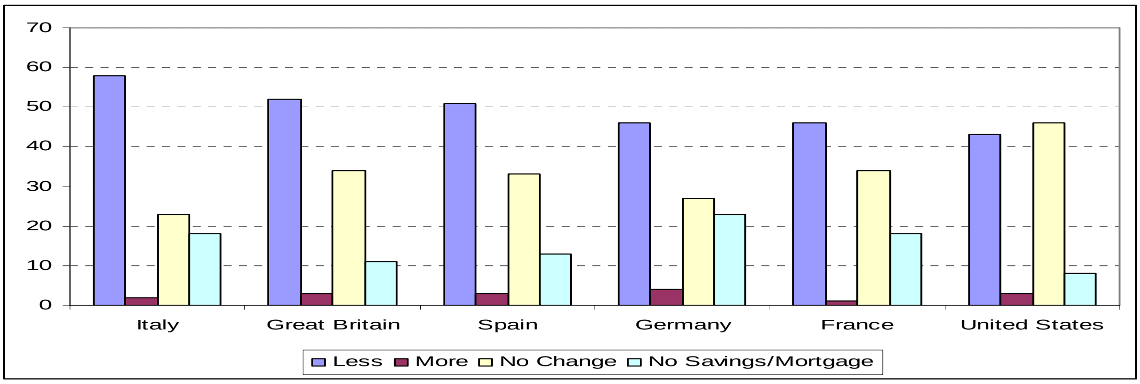
[25] It should be noted that the interviews were often conducted via online surveys and thus the quality of the results is lower than that obtained via telephone surveys.

Concerning the trends in the trust level towards the banks in the period after the financial crisis, almost all big countries experienced a decrease in confidence in July 2009 compared to January 2009. This decrease was especially marked in the case of the UK and Spain.

In Germany, Italy, France and the US, the decrease was moderate and the level remained pretty much the same. Remarkably, Austria is the only country where the level of confidence in financial institutions in July 2009 actually surpassed the January 2009 level. No other country has managed to recover its confidence to that extent. Moreover, the sharp decline in confidence in banks of the UK puts that country, in a cross-country comparison, on the lowest level of confidence in July 2009. The low levels for Germany in the immediate aftermath of the financial crisis in January 2009 (back then Germany had the lowest level of confidence in banks) are in accordance with Köcher (2008). She reported that only 23% of German citizens still had “some” or a “lot of trust” towards German banks in general, whereas 70% had “little” or “very little trust”. According to trend data from Infratest Dimap (2009a), an increasing number of Germans were afraid of losing their savings (50%) and their jobs (37%).

Another data source which renders a ‘before and after’ comparison possible is a survey from the FT-Harris Poll (2008) on security and banks. When citizens were asked whether they believed that their bank accounts were still safe, a majority of savers answered that they felt that their savings were less safe (Figure 4.3). Italy is the forerunner with almost 60% of the citizens polled expressing a clear lack in confidence. Only in the United States did a majority of citizens answer that there was “no change” in their feelings of trust compared to the period before the crisis.

Figure 4.3 Security of bank accounts/mortgages

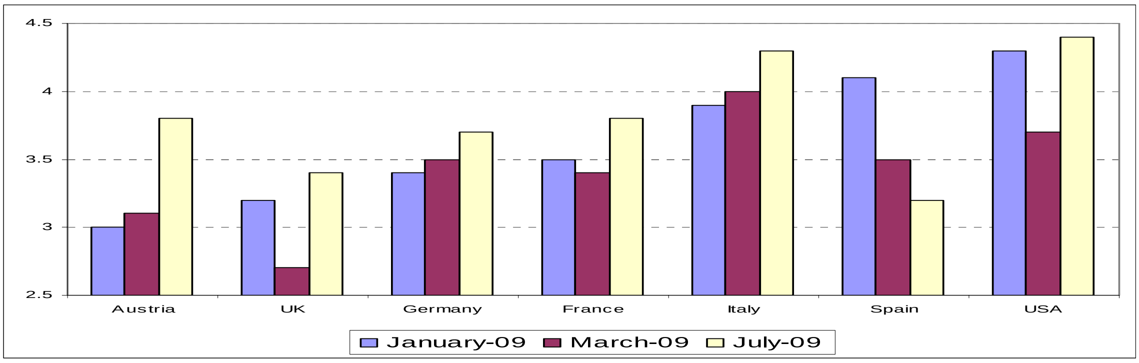


Source: FT-Harris Poll (2008).

4.3 Confidence in the stability of the stock market

Citizens’ confidence in the stability of the stock market has clear implications for the reform of social security systems that is still in the planning stages in many countries. In order to tackle the problems arising from Europe’s ageing citizens, especially the implementation of a funded pension insurance system instead of a solely solidarity financed pension system, and the implementation of a more competitive health system is important. In particular, when it comes to reforming the pension system in the European economies from a pure-solidarity financed system to a capital-based system, a certain degree of trust in the stock markets on citizens’ behalf would be necessary. To evaluate how citizens’ confidence levels evolved in the aftermath of the financial crisis, Figure 4.4 shows the confidence trend (from January-April 2009) in the stability of stock markets. The level of trust in the stability of stock markets shows a clear upward trend in all countries with the exception of Spain. Analogously, in all countries except Spain, the January 2009 level has been surpassed. Unlike banks, where the confidence levels have been more volatile in the three waves polled (see Figure 4.2), the stock markets have experienced a clear rebound in the corresponding levels of confidence. Spain's confidence drop is most likely due to its significant increase in unemployment - up to a massive rate of 20%.

Figure 4.4 Trust in the stability of the stock market (January-April 2009)



Source: WIN CRISIS INDEX - 1st, 2nd, and 3rd Wave of the Worldwide Barometer of the Financial Crisis.

5. The evolution of confidence levels towards free market economies

5.1 How did confidence levels in the free market economy evolve after the financial crisis?

So far the analysis has investigated the levels of confidence in state institutions and the institutions related to the financial industry. One of the crucial questions still not answered is how citizens' confidence towards the basic character of the economy has been influenced by the financial crisis. As always, finding time trend data on confidence levels in free market economies proved to be difficult. However, the time trend data from the Globescan survey[26] conducted from 2002-07 (thus before the financial crisis) was matched with a dataset constructed after the crisis in October-November 2008 and June-July 2009. This allows the evaluation of the actual impact of the financial crisis on systemic trust and gives some very interesting insights into the dynamics of the crisis. Depending on the actual regime typology of the country in question, different reactions to the incidence of the financial crisis can be observed.

Figure 5.1 shows the time trend for two countries, Germany and France.[27] In both countries, the financial crisis had a significant impact on citizens' net confidence[28] towards free market

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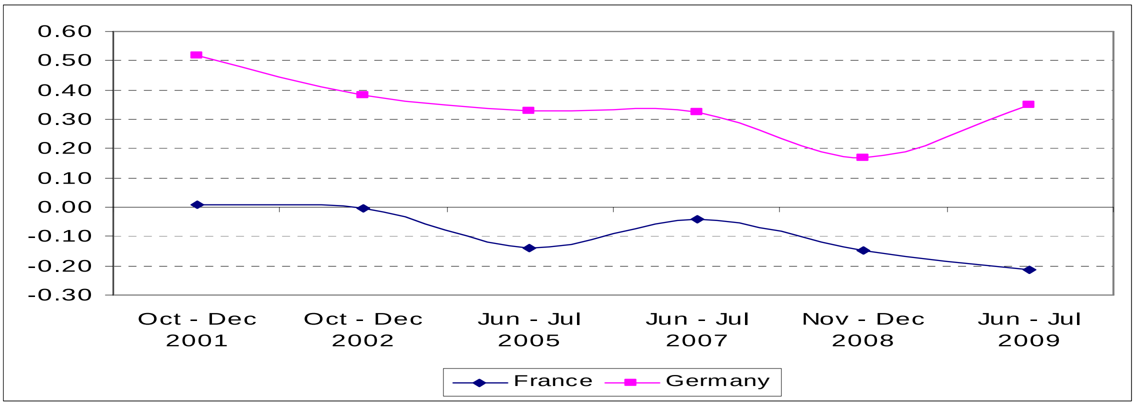
[26] The GlobeScan's GIM/GSR/CSR tracking data from 2002 to 2009 was purchased from GlobeScan Incorporated of Toronto. Globescan surveys used are "The Global Issues Monitor (GIM) 2002", "The Global Issues Monitor (GIM) 2003", "The GlobeScan Report on Issues and Reputation (GSR) 2005", "The GlobeScan Report on Issues and Reputation (GSR) 2007", "The Corporate Social Responsibility Monitor (CSR), 2009", "The GlobeScan Report on Issues and Reputation (GSR) 2009" (GlobeScan 2002, 2003, 2005, 2007, 2009a, 2009b).

[27]GlobeScan data do not include Austria, and unfortunately, the author was not able to obtain alternative data on Austrian citizens' confidence in the free market economy. In France, in 2001 and 2003, the interview method chosen was face to face. For all other waves, the interviews were conducted over telephone; thus it was CATI (Computer Assisted Telephone Interview). The data from France from the wave in 2002 were consulted in February 2003.

economies.[29] In Germany and France,[30] net confidence levels dropped from 32% to 17% and from -4% to -15%, respectively. However, unlike in France, where the net confidence levels deteriorated further in October 2009, in Germany a significant recovery of citizens' confidence in the free market economy can be detected. This recovery to a net confidence level of 35% is higher than before the financial crisis (the net confidence level amounted to around 32% in 2007). This incidence should be highlighted in particular as German data on the support of social market economy (Allensbach, 2009) highlight a systematic decrease in confidence in the social market economy among German citizens up until November-December 2008.

Figure 5.1 Trends of net confidence in free market economies in German and France, 2001-09



Source: Globescan data: GIM 2002, GIM 2003, GSR 2005, GSR 2007, CSR 2009, GSR 2009.

The German strategy to restore citizens' trust seems to have been successful. The increase in citizens' confidence might also be connected to the argument by Gros (2009) that the actual level of consumption is a crucial determinant of citizens' confidence. In France, the net level of -15% deteriorated further to -21%. However, one should also denote the stark difference between Germany and France. Whereas Germanys confidence levels have recovered to a net level of over 30%, France's levels reach the lowest net confidence level from 2001-09. The actual difference between Germany and France is thus more than 50% of net confidence. Interestingly, as depicted in Figure 5.2, the three Anglo-Saxon countries behave in completely opposite manners. In all three countries, the incidence of the financial crisis actually reinforced citizens' support for the free market economy. From June-July 2007, net confidence increased from 47% to 65% in the US, from 29% to 52% in the UK and from 36% to 53% in Canada. However, unlike in France and Germany where the confidence dropped immediately after

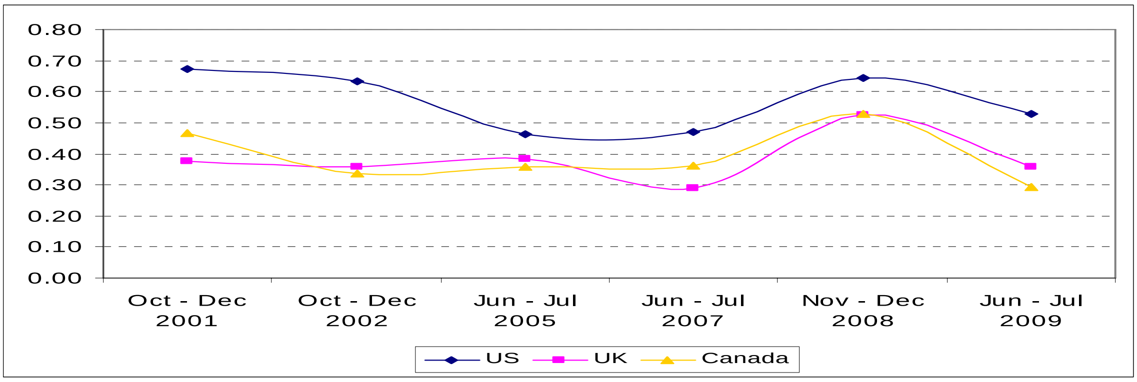
[28] The net confidence value was constructed by subtracting the percentage of the sum of those people who answered that they "somewhat disagree" and "strongly disagree" from the percentage of the sum of those who answered that they "agree" and "strongly agree". Those people who answered "neither agree or disagree" or those who did not give an answer were not considered.

[29] The actual question asked in the GlobeScan survey is: "The free enterprise system and free market economy is the best system on which to base the future of the world." Respondents had the possibility to answer "strongly agree", "somewhat agree", "somewhat disagree", "strongly disagree", "neither agree/disagree" or "don't know".

[30] In Japan, one can also observe a deterioration of net confidence levels, but since data are only available before the financial crisis for 2002 and 2003, the country was not included in Figure 5.1. The decrease from 2003 is 12 percentage points from 33% to 21%.

September 15th, in these three liberal countries a clear drop in confidence is visible nine months later, in June-July 2009 [as mentioned earlier, Gros (2009) offers a possible first explanation].

Figure 5.2 Trends of net confidence in free market economies in the US, the UK and Canada, 2001-2009



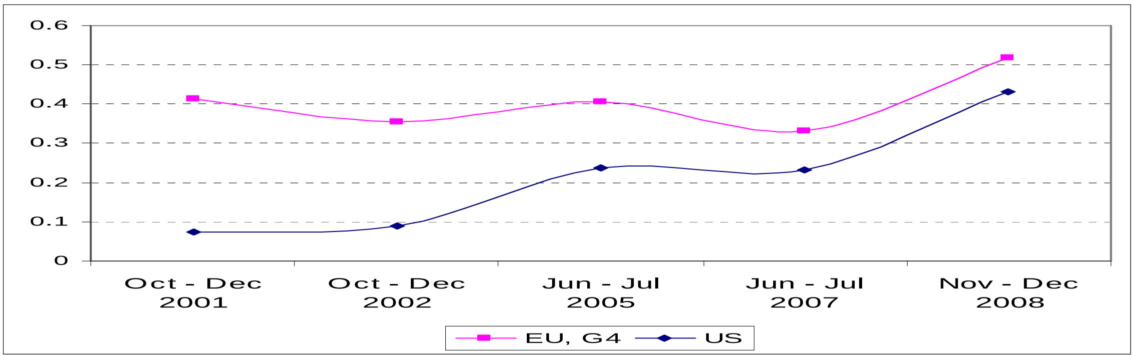
Source: Globescan data: GIM 2002, GIM 2003, GSR 2005, GSR 2007, CSR 2009, GSR 2009.

Although the levels in the US and UK are still higher than those from 2007, the conclusion should be drawn that, although there has been an increase in the short run, the long-run effect of the financial crisis on citizens' confidence in the free market economy might have been significantly affected in these liberal countries. Whereas the UK and Canada have already reached levels equal to and below those of Germany, the US still manages to maintain a net confidence level of over 50%. The question remains whether the decrease from November-December 2008 to June-July 2009 is going to continue in the future. A similar argument has been stressed by Alesina (2009) who raises the question whether Americans will turn into "*inequality-intolerant Europeans*" and therefore hints at the long-term consequences of the financial crisis.

5.2 Will the crisis result in citizens' demands for stronger state regulation?

One of the crucial questions highlighted in the beginning of this report is whether the financial crisis has increased citizens' demand for more redistribution or, in other words, citizens' demand for more state intervention within the free market economy? (For a further discussion on trust and stronger state regulation, see also Annex 3). To tackle this issue, a second question asked by the Globescan company gives a first indication whether the financial crisis has triggered a demand for stronger regulation. The Globescan company asked citizens in various large economies whether they "strongly agree", "somewhat agree", "somewhat disagree" or "strongly disagree" to the question: "The free enterprise system and free market economy work best in society's interests when accompanied by strong government regulations".

Figure 5.3 EU, G4 and US – Free market economy works best with strong regulation



Note: Data on this item are not yet available for June-July 2009 (GSR 2009).

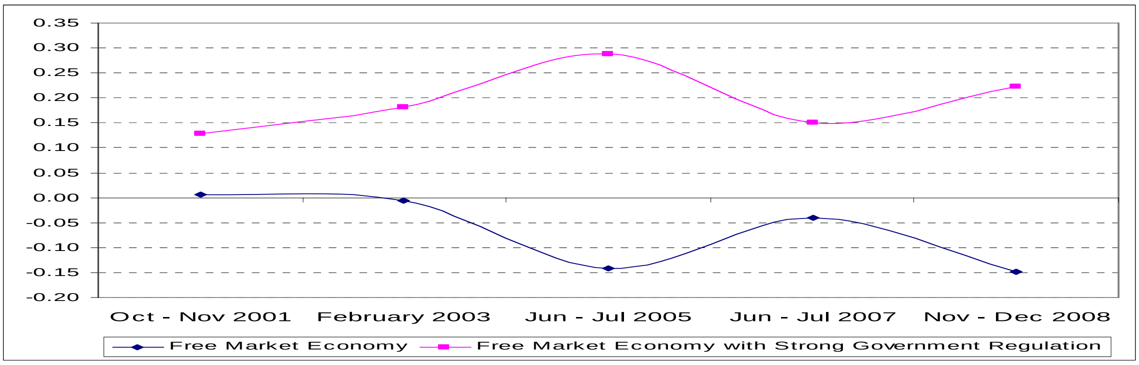
Source: Globescan data: GIM 2002, GIM 2003, GSR 2005, GSR 2007, CSR 2009.

Figure 5.3 highlights the significant increase in citizens' demand for stronger regulation. In the US the increase in net confidence is 20% (from 23% in 2007 before the crisis to 43% in November-December 2008 after the crisis), and from 2001 to 2008, the US experienced a staggering increase of 36% (from 7% to 43%). In Europe the net increase is 18% (from 33% to 51%) but only 10% from 2001 to 2009 (from 41% to 51%). Thus the real comparative advantage of the US of 34% has been diminished to 8% in 2009. Thus in contrast to the opposing results of citizens' net confidence in the free market economy, the trend in the support for a stronger regulated market economy is equally distributed across the Atlantic and supported by the different regime typologies mentioned previously. But how is the decrease of net confidence associated with citizens' wish for stronger regulation of the free market economy? Looking at country average, one detects no significant picture.[31] However, looking at the French case in Figure 5.4, one sees a perfectly diametrical picture between the decrease of net confidence and the increase in the support for stronger regulation.[32] In analysing the German case in Figure 5.5, a clear diametrical trend can be observed in the aftermath of the financial crisis.

[31] Econometric results on fixed-effects and cross-section analysis show no significant results. Estimations can be obtained from the author upon request.

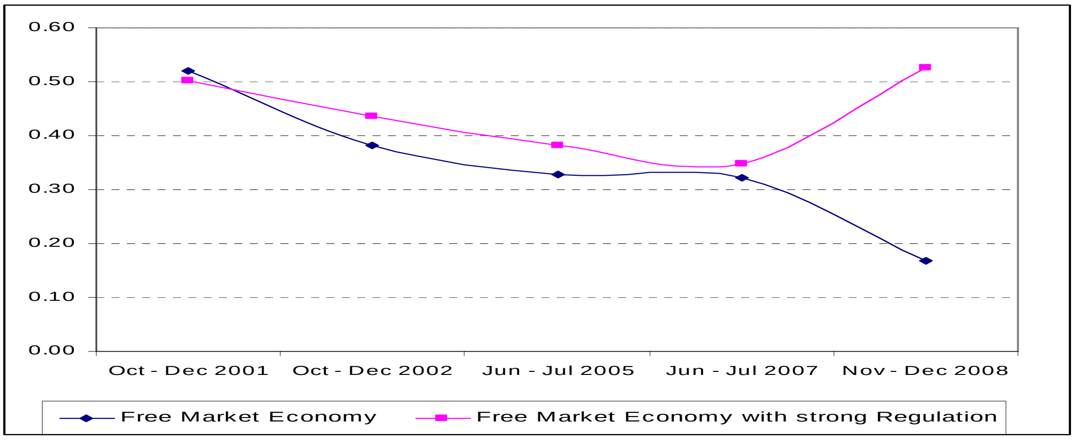
[32] Although one should denote the low level of French citizens' demand for stronger regulations compared for example to the US, it might be that French citizens disapprove of the free market economy per se even with strong government regulation. This argumentation is reinforced. Figures 5.9 and A 4.5.

Figure 5.4 Net confidence in free market economy vs. free market economy with strong government regulation – The French case



Source: Globescan data: GIM 2002, GIM 2003, GSR 2005, GSR 2007, CSR 2009.

Figure 5.5 Net Confidence free market economy vs. free market economy with strong government regulation – The German case



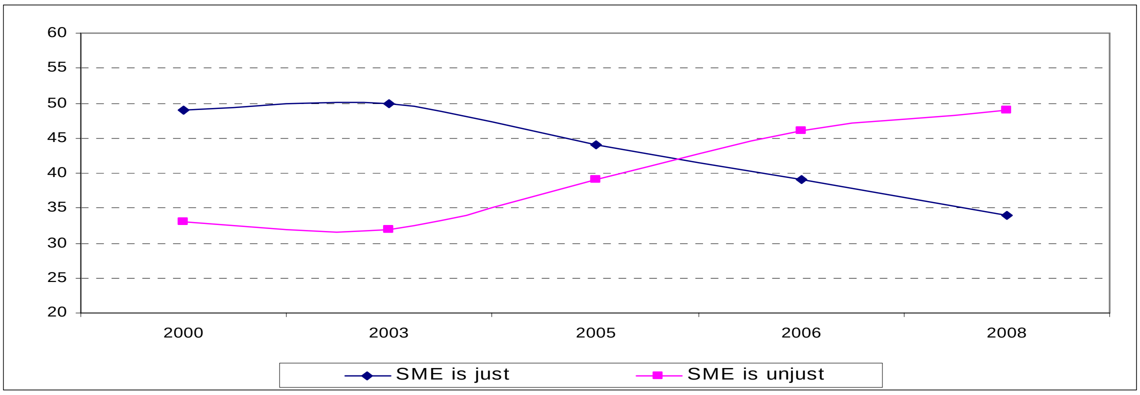
Source: Globescan data: GIM 2002, GIM 2003, GSR 2005, GSR 2007.

5.3 The case of Europe's largest economy: Germany[33]

A similar picture, as indicated by the Globescan data, can be drawn when analysing data on confidence towards social market economies (soziale Marktwirtschaft). Figure 5.6 indicates that, on the one hand, in 2000 49% of the population still believed that the concept of the social market economy would lead to social justice. On the other hand, 33% believed that the concept of social market economy would lead to social injustice. Yet a steady reversal was progressing until 2008, when eventually only 34% of the population still believed that the concept of the market economy would lead to social justice, whereas 49% believed the opposite. It has to be stressed here that the 2008 data were retrieved after the financial crisis and the actual field work was conducted between November 1st and November 12th. So from 2006 (before the financial crisis), to 2008 (after the financial crisis) the net confidence level has dropped once more by 8%.

[33] See Annex 4 for additional case studies of other key world economies.

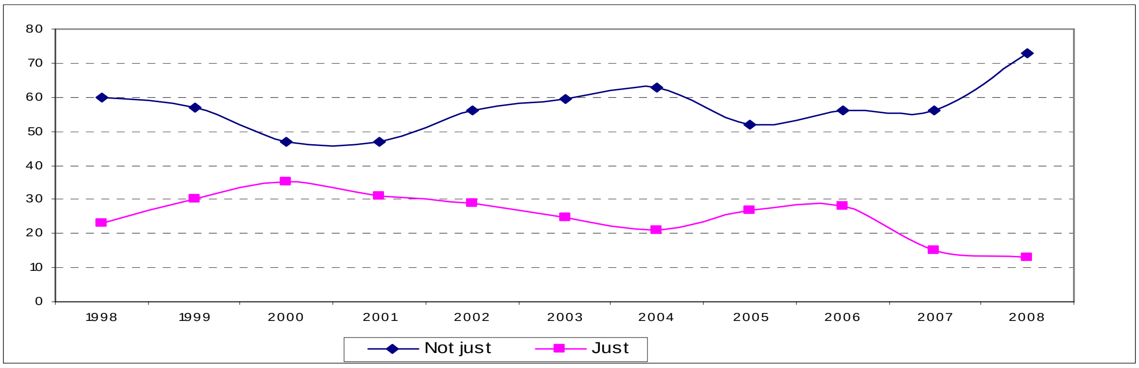
Figure 5.6 Social market economy is socially just versus socially unjust



Source: Institut für Demoskopie Allensbach (2008).

A similar result is obtained when it comes to the issue of whether the population believes that the income is evenly distributed. Figure 5.7 shows that in April 2008, 73% of the German population believed that the income distribution was unjust (Bertelsmann Stiftung 2008).

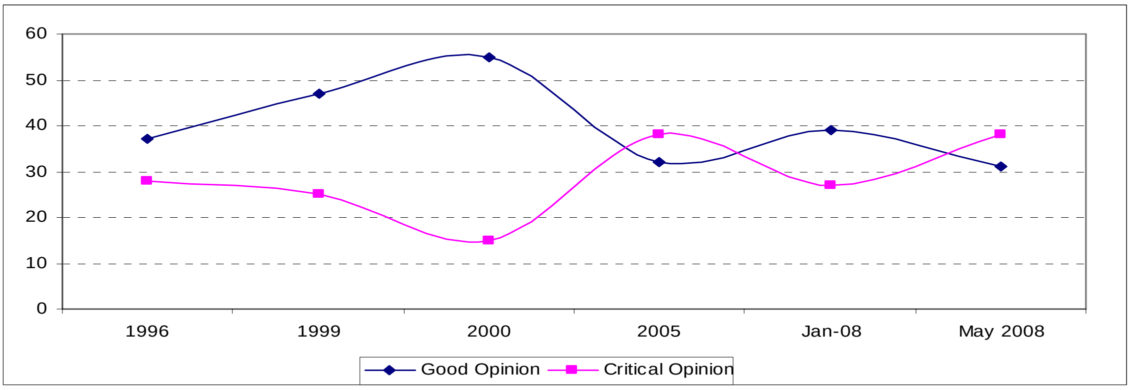
Figure 5.7 Feeling of fairness towards income distribution



Source: Bertelsmann Stiftung (2008).

According to the same poll by the Bertelsmann Stiftung (2008), when citizens were asked if they had a good or critical opinion towards the social market economy in 2005 and May 2008, already a majority of citizens answered that they had a critical opinion towards the social market economy. Figure 5.8 highlights that from 2000 to 2008, there was a significant increase in the share of critical opinions compared to the opinions in favour (in net trust terms, there was a decrease in net trust 47%).

Figure 5.8 Good or critical opinion towards social market economy



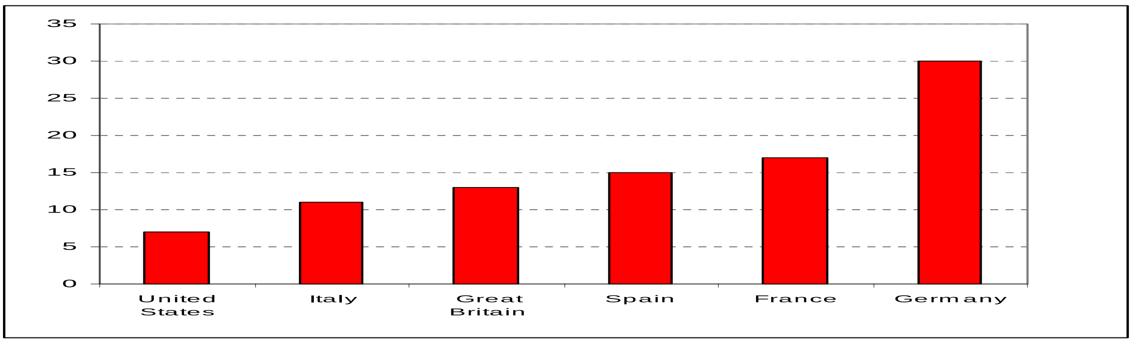
Source: Bertelsmann Stiftung 2008.

This result is backed by other German surveys. According to Infratest Dimap (2009b) data from its Deutschland trend data, in May 2009, 57% of the German respondents stated that in Germany the situation is rather unjust in contrast to 40% who answered that the contrary was the case.

5.4 Confidence towards the mode of production – Has capitalism failed?

As already discussed above, the bail-out of the financial industry by billions of euro of taxpayers' money, which might be obtained by means of cutting social expenditure, might evoke feelings of being treated unjustly or unfairly. This argument was also highlighted by Körber (2008) who emphasised that the financial crisis has clearly violated the basic preconditions for the German social market economy. Concerning this specific issue, Figure 5.9 shows the results of a very interesting poll that indicates citizens' attitude towards the mode of production is a poll conducted by Harris poll (2008) for the Financial Times in which citizens were asked whether the financial crisis should be merely seen as an "abuse of capitalism" or whether it should be seen as a "failure of capitalism itself". When asked in October 2008, in the direct aftermath of the financial crisis, an astonishing 30% of the German population answered that the financial crisis is an indication of a "failure of capitalism itself". This response is nearly twice as much as in France and four times that in the United States, where only 7% of the population believed that the financial crisis is a failure of capitalism. Therefore, these results underline a strong 'anti-capitalistic' tendency of the German society.

Figure 5.9 Failure of capitalism itself



Source: FT-Harris Poll (2008).

6. Conclusion

Four main conclusions can be drawn from the current analysis.

First, our analysis of the impact of the financial crisis on confidence in the European institutions shows a severe decrease in citizens' trust in the immediate aftermath of the financial crisis with a slight recovery nine month later. In particular citizens' net trust in the ECB hit an historical low point in the aftermath of the financial crisis with a majority of people distrusting the ECB.

Second, the trend in confidence in European institutions is diametrically opposed to citizens' confidence in the national government and parliament. When citizens' confidence in the European institutions decreased in the immediate aftermath of the crisis, confidence in the national government actually increased. When the confidence in European institutions recovered nine months later, confidence in the national government decreased. However, not all data support this conclusion. Data from the Edelman Trust Barometer suggest a continuous increase in the confidence in the government.

Third, our analysis of confidence in business and citizens' confidence in banks and stock markets produces ambiguous results. Whereas citizens' confidence in stock markets and business confidence has recovered in most countries, confidence in banks has deteriorated nine month after the crisis.

Fourth, confidence levels in free market economies seem to have dropped in a majority of countries nine month after the crisis. Only in the German case could one actually detect an increase in confidence in the free market economy. However, separate data sources show that levels of net confidence in the free market economy in the US remain significantly higher than in the two European economies Germany and France. Given that in particular in France and Germany a decrease in net confidence is associated with an increase in citizens' demands for stronger state support and that German and French citizens have the highest level of anti-capitalist sentiments, French and German governments will have to invest more effort in trust-enhancing policies. Nevertheless, one has to highlight that the financial crisis also had a deep impact on the US economy as citizens' demand for stronger state regulation has risen immensely and has almost reached European levels.

Although, overall one can observe a first slight recovery of citizens' systemic trust, policy-makers are advised to closely monitor future trends. To the extent possible, future policy decisions should be directed to trust-enhancing measures.

The shock triggered by the financial crisis has opened a wide range of questions for the future research agenda on trust-related issues. This study intended to give a first descriptive overview of what happened to levels of systemic trust in the aftermath of the financial crisis; the actual channels of how the crisis affected citizens' systemic trust could not be elaborated upon. Hence, the next step is to conduct econometric estimations on these questions. Further study of trends in citizens' trust in the coming months would also allow us to evaluate whether first signs of recovery are robust.

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Annexes

Annex 1. A new dimension of systemic trust - Confidence in the mode of production

Taking a Marxist argument into consideration one might want to consider the tradition of class struggle or less strongly put class tension. Class tension is produced within the production system primarily as the tension between the interest of capital and labour. To moderate this tension and the exclusive tendencies of the capitalistic production process advanced democratic societies have implemented extensive welfare state institutions to guarantees universal rights to health coverage and a decent minimal standard of living (Offe 1984). This system with the scope to i) share both risk and opportunity widely across society, ii) cultivate social solidarity or cohesion, iii)protect the most vulnerable members of society through active social intervention, iv)encourage consultation rather than confrontation in industry and v)provide a rich framework of social and economic citizenship rights for the population as a whole, is often identified as the European Social Model (Giddens 2006: 2).

Furthermore, in the coordinated or continental country (Albert 1991 and Hall and Soskice 2001) such as Germany the implementation of the “Mitbestimmungsrecht” and the “Flächentarfivertrag” have also helped to appease the convergent interest of capital and labor. One could argue that all these measures aimed at fostering citizens confidence’ in the capitalistic mode of production, free market economy or in the German case the “social market economy”. Thus one could plausibly argue that depending on the actual level of anti-capitalistic sentiments the amount of redistributional measures might vary across countries. For instance, one of the major and significant differences between the biggest and better performing economy of the US and the third and fourth biggest economies Germany and France are the significant higher amounts France and Germany does pay for social transfers. Whereas the US has spent 15% of their GDP on social transfers, Germany and France had to spend almost twice the amount on their GDP, 30% and 32% respectively, on social transfers (OECD 2004). This is strongly due to a significant difference in citizens’ perceptions on income inequality, social justice and what is considered to be a fair distribution of income within the production system. Should confidence levels towards the mechanisms of free market economies be declining this most often will lead to citizens being discontent of what they feel to be just and fair, thus once losing the confidence they will most likely pressure their national governments for redistributive policies resulting in an increase in taxes to finance more social transfers. The money which is spent however on the “unproductive” field of social transfers cannot be spent on the productive fields as here we have to mention education, R&D expenditure and intangible capital overall (Bassanini and Scarpetta 2001). However one has to mention that depending on the citizens’ will for redistributive measures implies that a certain amount of social transfer has to be spent on citizens so as to guarantee social peace and political stability, these being the prerequisites for the capitalist economies we currently encounter. Thus a decrease of citizens’ confidence most likely will and must be associated with stronger public interventionism which will hamper productivity growth in the long run.

Annex 2. Determinants of net trust in the ECB

Table A2.1 analyses the relationship between GDP and net confidence levels in the ECB for the period 1999-2009 using bi-annual data from Eurobarometer surveys 51-71.1 for the EA12. Regression 1, using a fixed-effects estimation, indicates that once controlling for the populations size,[34] an increase of GDP is positively and significantly (significance at 99%-level) related to an increase of net trust levels in the ECB. However, an increase of growth of GDP is also strongly related to an increase of net trust in the ECB. Once the 10 observations from Special EB71.1 in January-February 2009 are excluded, the relationship between growth of GDP and net trust in the ECB loses statistical significance and is actually rendered in the negative.[35]

Table A2.1 Determinants of net trust in the ECB – fixed-effects estimation and cross-section

Estimation Method	Fixed Effects, Robust Estimation	OLS, Robust Estimation
Equation	1	2
GDP	1.04*** (2.67)	0.59*** (4.96)
GDP growth	1.47*** (2.97)	1.57** (2.18)
Population size	-4.27*** (-3.68)	-0.91*** (-6.31)
R-Squared	0.11	0.24
Countries	12	12
N	246	246
Period	1999-2009	1999-2009

* Significance at the 90% level (one-tailed test).

** Significance at the 95% level (one-tailed test).

*** Significance at the 99% level (one-tailed test).

Note: Numbers in parentheses are heteroskedasticity-adjusted *t*-ratios. R-Squared is the within-R-Squared for fixed effects.

[34] A similar model has been used by Fischer and Hahn (2008).

[35] Results for this sensitivity analysis can be obtained from the author upon request.

In contrast, when performing a sensitivity analysis by restructuring the data by shortening the timeframe for regression 1 in Table A2.2, the positive association remains stable over all different periods. Other variables, such as inflation, public expenditure, unemployment rate did not turn out to be significant.[36] As the R-square value of 0.11 in regression in Table A2.1 is not satisfactory the actual variable driving net confidence in the ECB has not yet been detected and further research on the determinants on net trust in the ECB is crucial.

Table A2.2 Sensitivity analysis for GDP (equation 1 – table 1) – fixed effects robust estimation

Row	Specification Change	Coefficient on GDP	t-ratio	Countries	Observations	R-Square
1	None	1.04***	(2.67)	12	246	0.11
	Restructuring of data					
2	1999-2008	1.07***	(2.97)	12	236	0.06
3	1999-2007	1.60***	(3.86)	12	212	0.11
4	1999-2006	1.45***	(2.76)	12	188	0.13
5	1999-2005	1.58***	(2.41)	12	164	0.13
6	1999-2004	1.99***	(2.83)	12	140	0.11
7	1999-2003	1.99***	(2.82)	12	116	0.19
8	1999-2002	1.89***	(2.55)	12	92	0.23

* Significance at the 90-percent level (one-tailed test)

** Significance at the 95-percent level (one-tailed test)

*** Significance at the 99-percent level (one-tailed test)

Note: Numbers in parentheses are heteroskedasticity-adjusted *t*-ratios. R-Squared is the within-R-squared.

Regression 2 in Table A2.1 indicates that countries with higher levels of GDP and higher growth rates tend to have higher net levels in the ECB. This association is most likely driving the Scandinavian countries which have high levels of GDP and high levels of net trust. Only 24% of the cross-country variance can be explained.

To conclude although the development of GDP seems to play a significant role in both cross-country and fixed-effects regressions upcoming research has to detect the real drivers of net trust level in the ECB to be able to implement trust enhancing policies to increase net trust in the ECB. As the independence of the ECB is heavily dependent on citizens' confidence, trust-building mechanisms would seem to be important for policy makers. The loss of trust in the ECB should still be a cause for concern, since there is a widespread feeling that EU institutions lack democratic accountability. A monetary union whose central institution does not have the trust of its citizens is bound to run into political problems sooner or later.

[36] Results for this sensitivity analysis can be obtained from the author upon request.

Annex 3. The evolution of trends towards globalisation: Is lower trust associated with stronger demands for stronger government regulation?

A 3.1 Does a decrease of trust lead to more protectionism and nationalism?

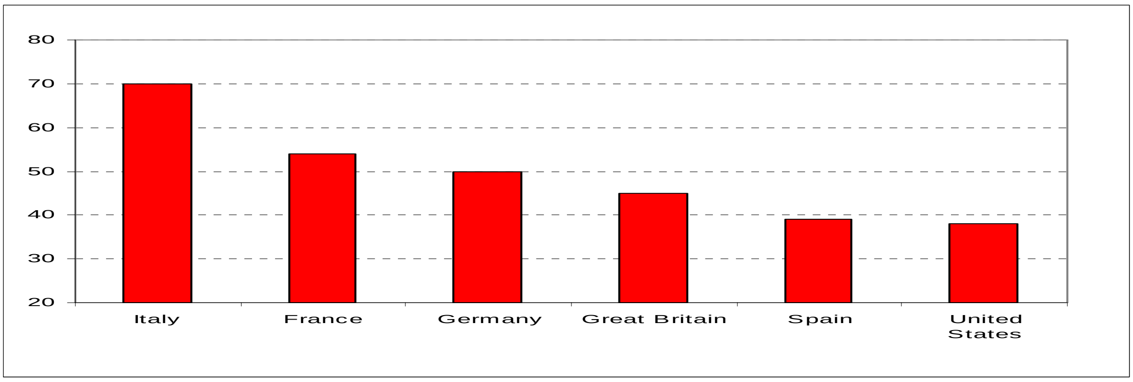
Does the lack of trust really lead to a desire for more state intervention? According to data from the Institut für Demoskopie Allensbach (2008), it does in the German case. The relationship between the drop in confidence and a demand for more state intervention seems to reflect a mirror image. Some 33% of German citizens declared themselves to be in favour of the possibility that the state should forbid that companies might fire employees. Only 42% were against such a prohibition. Asked whether the state should prohibit risky transactions on the stock markets, 48% voted for a prohibition and only 25% voted against. In East Germany, the corresponding ratio is 62% against 13%.

More dramatically, 60% of German citizens opt for a prohibition of price increases against 24% who choose a price cap. Furthermore, a very interesting result should be pointed out in this context; state intervention is considered to foster a favourable (pro-human) climate within society. The liberal state, however, which stresses the basic values of freedom, is considered to foster an anti-human climate. Taking the results from the Institut für Demoskopie Allensbach (2008) into consideration, it seems to be the case that citizens' decreasing confidence levels trigger their demand for more state intervention. But is this also directly related to citizens' wish for more protectionism?

Protectionism is most often also a reaction of politicians to citizens' demands for establishment of more protectionist regimes. As an article in The Economist recently argued, the European Union is one of the guarantees that protectionist, nationalist and even fascist tendencies can be prevented. During the financial crisis one could observe upcoming tendencies to foster protectionism and nationalism. One good example was the call of the British labour union for "British labour for British workers" For an overview of the effects of EU and US stimulus packages on international trade, see Langhorst and Mildner (2009).

Empirical research has found indeed that in those countries in which there are higher levels of interpersonal trust, citizens are less likely to raise voice against the opening up of the economy and thus those economies can better benefit from more trade (Uslaner 2002).

Figure A3.1 Net support of government regulation



Source: FT-Harris Poll (2009a).

Figure A3.1 shows the strong request of European citizens for more government regulation. The question posed to the citizens was: "How much do you support or oppose increased regulation by your own government of business activities to prevent future financial global market crises?", with the possibility to answer: Strongly support, Somewhat support, Somewhat oppose, Strongly oppose.

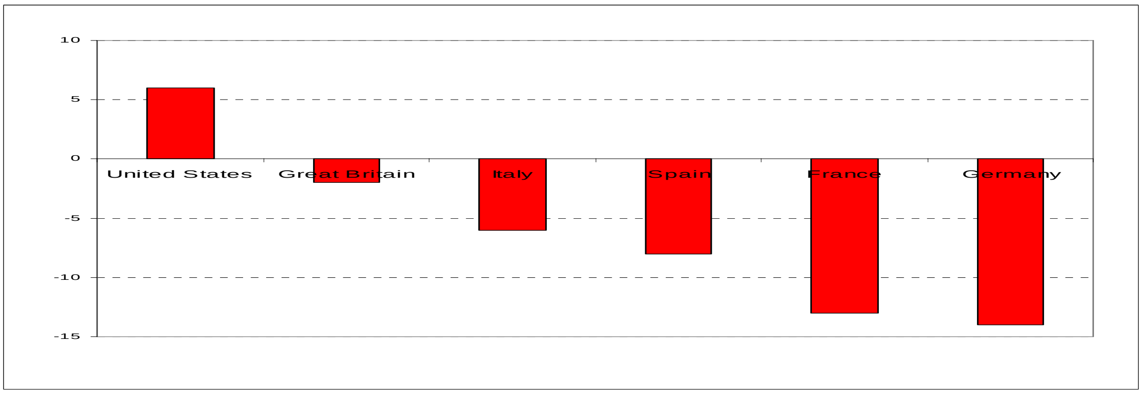
As visible in this figure, the citizens of all countries have, in light of the current crisis, shown an overwhelming support for the increased government regulation. Italy is the absolute leader followed by France and Germany. At the bottom is the United States, a traditional free-market society (FT-Harris Poll 2009a). However, similarly to GlobeScan data, Figure A3.1 highlights that the gap between the US and Europe is getting smaller.

A 3.2 Does it affect citizens' confidence towards globalisation?

According to polls by the Globescan Company on the attitude towards globalisation and measures of protectionism conducted on 14 November 2009, the worldwide support for protectionist measures remains strong. A strong majority in 23 countries expressed its approval of various measures of job and national industry protection (72% overall), and 63% are in favour of restricting foreign ownership of national companies. According to the Globescan polling, such protectionist sentiment is strongest in emerging economies, including Chile, India, Indonesia, Kenya, Nigeria, and Russia, whereas it is divided in China.

Furthermore, according to a new release of the GlobeScan Company, "for the first time in GlobeScan's 7 years of tracking worldwide, less than a majority see economic globalisation as being in their family's interest" (GlobeScan 2008).

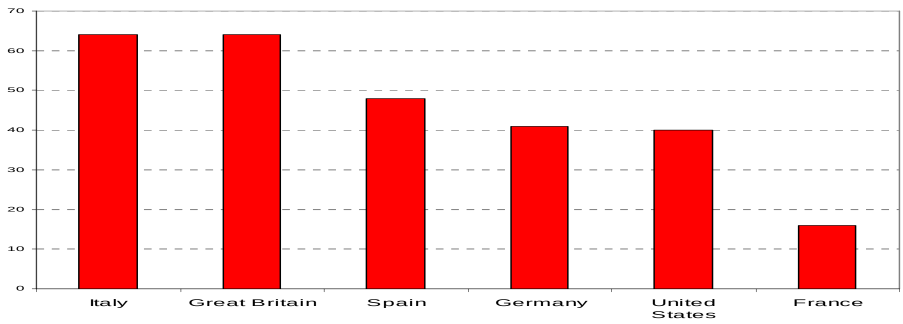
Figure A3.2 Can protectionism contribute to an end to the economic recession? (net measure)



Source: FT-Harris Poll (2009c).

Figure A3.2 shows whether citizens perceive protectionism as a means to end the crisis. Interestingly a majority of citizens in the five European countries UK, Italy, Spain, France and Germany voted against protectionist means. In contrast, in the US there is a majority of citizens who believe that protectionism could contribute to coming out of the economic recession (FT-Harris Poll 2009c).

Figure A3.3 Net support of the wish for migrants to leave if they do not have a job



Source: FT-Harris Poll (2009c).

Similarly, in numerous countries the current crisis has strengthened the fears of many domestic workers vis-à-vis migrants, the first expressing their anxiety toward the possibility that the latter might take over their jobs. As Figure A3.3 demonstrates, Italy and Great Britain are the leaders here, with no less than 64% of the net approval for the leave of unemployed migrants (FT-Harris Poll 2009c).

Annex 4. Selected country studies

A 4.1 Austria

Figure A4.1 highlights the net confidence trend in Austria with respect to the European Parliament. Only in spring 2000 did Austria have a lower net confidence level (1.3%) than it did in the direct aftermath of the financial crisis (2%). The recent amount of 2% of net trust is far below the value of autumn 2002 (32.9).

Figure A4.1 Net trust in the European Parliament in Austria

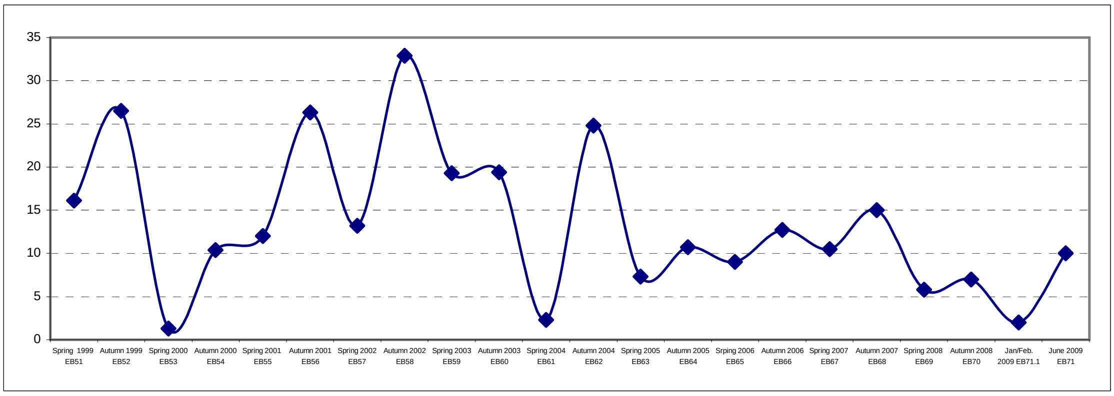
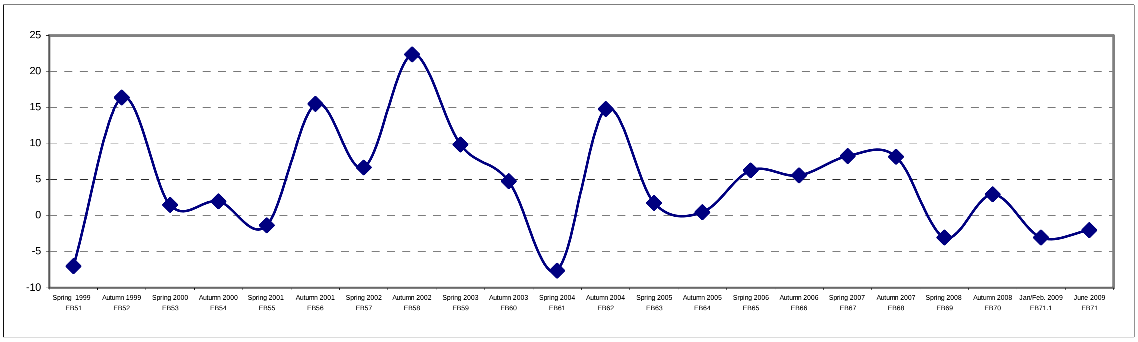


Figure A4.2 once more highlights the net confidence trend towards the European Commission. The net confidence levels have not reached its historical low point as the net confidence levels have already reached lower levels in spring 1999 (-7%) and spring 2004 (-7.6%). In contrast in the immediate aftermath of the crisis (January-February 2009), the net confidence level was -3% recovering to -2% in June-July 2009. However the recent level is in strong contrast to such a high value as 22.4% in autumn 2002.

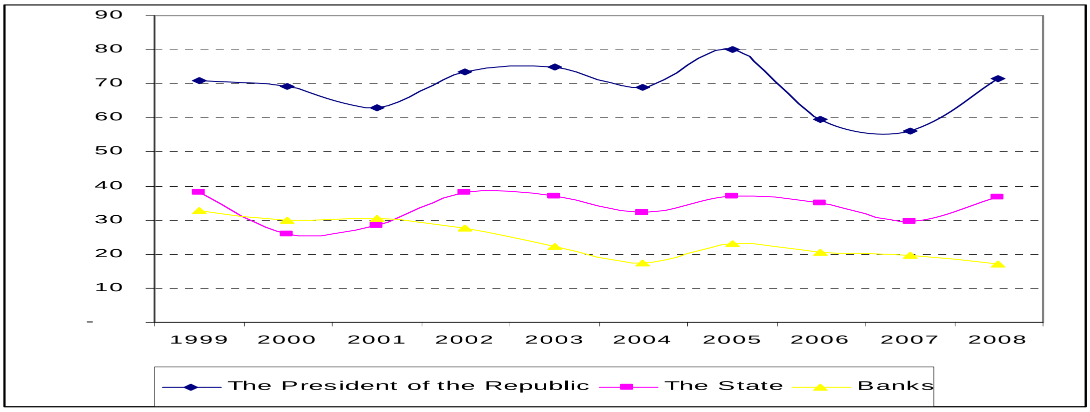
Figure A4.2 Net trust in the European Commission in Austria



A 4.2 Italy

Figure A4.3 replicates the findings from the Eurobarometer data that in the direct aftermath of the financial crisis, citizens' confidence in the state (and here also a proxy for the state: the president of the republic) has increased. In contrast confidence in banks has decreased.

Figure A4.3 Trust towards institutions in November 2008

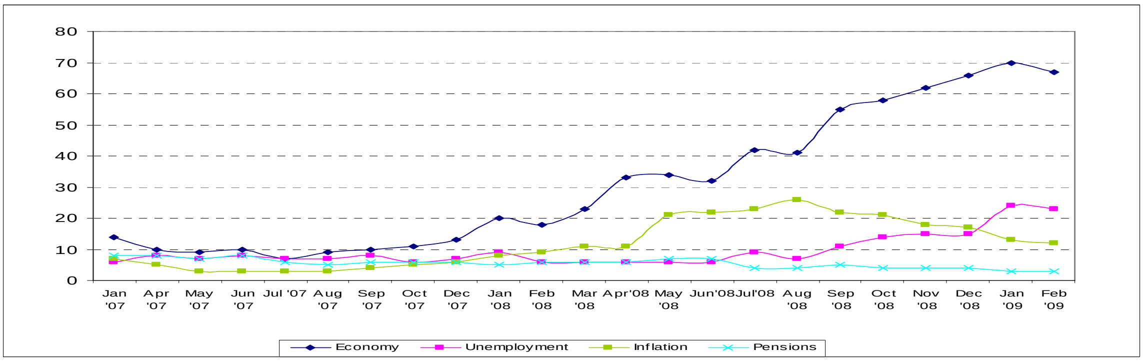


Source: Demos & Pi XI report "Gli Italiani e lo Stato", 2008.

A 4.3 United Kingdom

Not surprisingly, Figure A4.4 highlights that most British citizens consider their economy as an important and challenging issue. On the other hand, the fear of unemployment has also grown in the previous several months, whereas the inflation anxiety has declined.

Figure A4.4 Important issues facing Great Britain

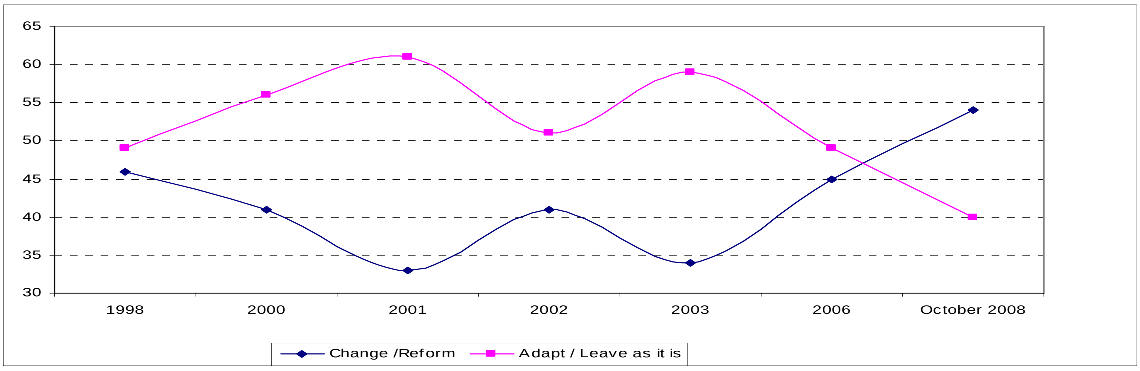


Source: Ipsos Mori, *The most important issues facing Britain today*, August 2009.

A4.4 France

Figure A4.5 shows a similar picture to that of the German case. An increasing number of French citizens consider the need to thoroughly change capitalism as an imperative.

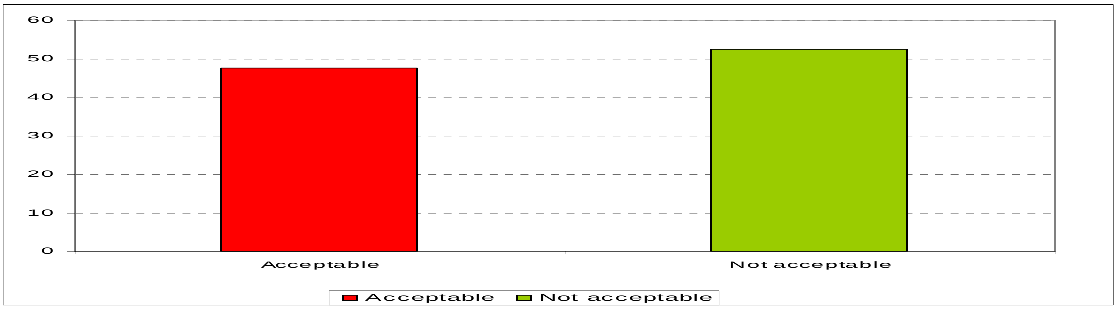
Figure A4.5 Change of capitalism versus adaptation



Source: CSA-L'Humanité Dimanche (2008).

Correspondingly, the proportion of them who believe capitalism should be only slightly adapted has been reduced as the effects of the crisis have progressed. This rise in anti-capitalist sentiments is also highlighted by Figure A4.6.

Figure A4.6 Is it acceptable to kidnap managers?



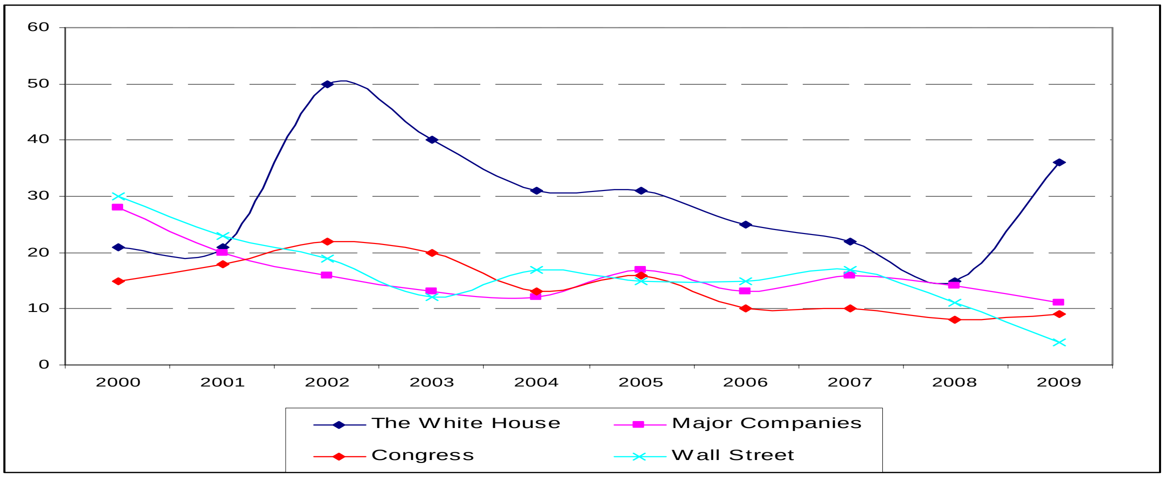
Source: CSA-Le Parisien (2009).

The answers given in France to the question of whether managers should or should not be kidnapped is quite astonishing: only a very small percentage of citizens are not in favour of kidnapping compared to those who would support such an act. Clearly, French citizens blame businesses and those in charge of them for the current situation.

A 2.5 United States

Figure A4.7 shows that the confidence in the White House has shown a clear recovery, demonstrated by the surge between 2008 and 2009. Only the trust in Congress has remain more or less stable and on a relatively low level when compared to the trust in the Executive. On the other hand, there has been a clear decline in confidence in the Wall Street and major US companies (FT-Harris Poll 2009b).

Figure A4.7 Confidence in leaders of institutions (2001-2009)



Source: FT-Harris Poll (2009b).

A4.6 Poland

In contrast to the big European economies, Poland has not been hit as hard by the financial crisis. In a representative survey conducted in December 2008 by the "Centrum Badania Opininii Spolecznej" (CBOS 2009), 75% of Polish citizens answered that their household did not feel the financial crisis. Only 12% reported that the financial crisis already had significant impact on the Polish economy, only 5% reported that the financial crisis had a significant impact on their workplace. A majority of 67% those Polish citizens who have a bank account think that their bank savings are safe.

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