

Eurozone Bailouts and National Democracy: Detachment or Resilience?

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Abstract

How did the Eurozone bailouts affect national democracies? Recent research indicates strong citizen detachment and diagnoses a legitimacy crisis due to the external constraints imposed by bailout programs on national autonomy. This paper re-examines the detachment thesis by broadening the view towards multiple dimensions of democracy and effect heterogeneity across time and space. More specifically, we analyze the causal effect of Eurozone bailouts on both satisfaction with democracy and electoral turnout. Using the generalized synthetic control method, we confirm a strong negative effect of bailouts on satisfaction with democracy, but show that it vanishes after several years. For electoral turnout, we estimate a moderate decline immediately after the crisis and do not find long-term effects either. We also show that these effects vary strongly across Eurozone bailout countries. In addition, we find resilient attitudes and behaviors in spite of national democratic institutions that continue to deteriorate. These findings indicate that economic policy outcomes have a stronger influence on satisfaction with democracy and electoral turnout than the quality of the democratic process.

Introduction: the Eurozone crisis and democratic detachment

In post-World War II European economic history, the Eurozone crisis stands out for the hardship it has caused citizens, the level of domestic and intergovernmental conflict it created, and the fundamental challenges it posed for European integration and national political systems. According to an influential argument, the management of the Eurozone crisis has left citizens dissatisfied with and detached from their national democracies. The external technocratic imposition of austerity on the bailout countries of the Eurozone has undermined the national democratic process and democratic legitimacy (Armingeon et al. 2016; Matthijs 2017; Ruiz-Rufino and Alonso 2017). Our paper revisits this argument based on a wider set of data, a broader measurement of democracy, and a better method for assessing the bailout effect.

The political and economic stakes of the Eurozone crisis were enormous. Economic and Monetary Union (EMU) had been the flagship project of European integration in the 1990s, crowning decades of progressive economic integration. For all of its constructional flaws (Copelovitch et al. 2016), a breakdown of the Eurozone would have had catastrophic economic consequences and raised serious

doubts about the viability of the EU.¹ Accordingly, creditor and debtor country governments agreed on the need to prevent sovereign defaults and preserve the Eurozone. Even so, they fought hard over the rescue conditions, with both groups trying to shift the burdens of adjustment to each other (Schimmelfennig 2015; Frieden and Walter 2017).

The creditor countries led by Germany reluctantly agreed to bail out the debtor countries but insisted that the rescue funds would come as credits and on the condition of austerity measures supervised by a Troika of international institutions: the European Commission, the European Central Bank (ECB) and the International Monetary Fund (IMF). Austerity implied cuts in pensions, social benefits, and wages as well as tax raises. It also led to massive unemployment, especially among the young. Politically, the distributional conflicts caused mass protests and changes of government in the affected countries (Bosco and Verney 2012). Across the Eurozone, Eurosceptic parties have been on the rise – with radical right parties mobilizing against immigration and financial transfers in the north, and radical left parties mobilizing against austerity in the south (Brack and Startin 2015). At the same time, public support for European integration plunged towards historic lows (Debomy 2013), in particular in the traditionally EU-friendly European south. From an economic voting perspective (Duch and Stevenson 2008; Lewis-Beck and Stegmaier 2007), these political consequences are not surprising. Economic downturns are bound to reduce support for incumbent governments – and a major recession as in the Eurozone crisis should reduce support especially sharply (Dassonneville and Lewis-Beck 2014).

Recent studies argue, however, that the political effects of the Eurozone crisis reach beyond disappointment with the economic performance of the government of the day and the corresponding electoral punishment. Rather, the crisis also erodes diffuse, affective support for national democratic political institutions – and potentially the institutions themselves (Armingeon et al. 2016; Matthijs 2017; Ruiz-Rufino and Alonso 2017). This effect has to do with how the Eurozone is constructed and how it has managed the crisis. The construction of EMU is technocratic. It removes monetary policy authority from the arena of national democratic politics and transfers it to a supranational body of experts (the ECB) bound by fixed policy objectives (price stability above all). The ECB is independent from the indirectly elected Council, composed of member state governments, and not accountable to the directly elected European Parliament. In addition, it binds Eurozone countries to the excessive deficit rules of the Stability and Growth Pact (SGP) and to review and sanctioning procedures carried out by the European Commission, another technocratic body.

Whereas EMU had been designed and institutionalized as a depoliticized, technocratic institution already in the 1990s, the effects on national autonomy and democracy only became manifest and

¹ See, e.g., the scenarios described in *The Economist*, 26 May 2012, 26-7 and by Petersen and Böhmer (2012).

apparent to citizens in the Eurozone crisis (Ruiz-Rufino and Alonso 2017). Given the enormous economic and financial risks associated with a breakdown of the Eurozone, governments and the ECB focused on the preservation and consolidation of EMU as their primary and *alternativos* (German chancellor Angela Merkel) political objective. However, whereas the northern creditor countries were able largely to shape the rescue and reform of the Eurozone according to their fiscal interests, this was not the case in the debtor countries. They had to implement austerity measures against their own preferences and the wishes of their voters, imposed by the creditors, and closely supervised by the technocratic international institutions of the Troika. The management of the Eurozone crisis limited national autonomy severely. In some countries (Italy and Greece), technocratic governments replaced elected leaders for a certain time. In other countries, governments were democratically elected, yet had to implement externally designed policies. In the absence of meaningful governmental autonomy and democratic choice, the function of elections to hold governments accountable and initiate policy change was undermined.

Consequently, so the argument continues, voters experiencing a lack of individual political efficacy and national democratic autonomy become dissatisfied not only with how the economy is doing but also with how democracy works in their country. They lose confidence in the national institutions and in the mainstream, centrist parties, which have traditionally led national governments and supported European integration. In sum, because of how the Eurozone is set up and the Eurozone crisis has been handled, economic crisis turns into something deeper – a legitimacy crisis of national democracy.

Recent studies provide empirical support to this argument. Klaus Armingeon and co-authors see a particularly strong negative effect on trust in national and European institutions and satisfaction with how democracy is working, where the EU and the IMF intervened (Armingeon and Ceka 2014: 94; Armingeon et al. 2016: 11). Rubén Ruiz-Rufino and Sonia Alonso (2017) confirm these results; they also find that knowledge about the EU increases in the crisis, especially in the bailout countries. This finding supports their argument that the crisis taught citizens about the democracy-undermining consequences of EMU.

In this paper, we probe the detachment effect of the Eurozone crisis further. We ask, first, whether it affects all bailout countries experiencing Troika intervention in the same way. Second, is the effect limited to attitudes on democracy, or does it also show in political behavior? Third, does it persist as the Eurozone recovers economically? Finally, how do attitudes and behaviors relate to the institutional development of national democracies?

To examine these questions, we employ the generalized synthetic control (GSC) method to study the effect of Eurozone bailouts on satisfaction with how democracy works, electoral turnout, and the

democratic quality of national government using most recent data. In contrast with what the detachment literature suggests, we find that satisfaction with national democracy rebounds a few years after the bailout and that the effects vary considerably across the bailout countries. Moving from attitudes to behavior, we find that the bailout effect on electoral turnout is also transitory and smaller than the negative effect on satisfaction with national democracy. Finally, satisfaction and turnout rebound in spite of a deterioration of national democratic institutions. In sum, our analysis confirms earlier findings that the Eurozone bailouts have had negative effects on attitudinal support for national democratic systems. We add to this by demonstrating that disenchantment had moderate effects on behavioral support for democracy. Our findings also back the assumption that the quality of national democratic institutions has suffered in the bailout countries. In contrast to the detachment thesis, however, our research suggests that the negative attitudinal and behavioral effects were short-lived and decoupled from the quality of national democratic institutions.

The contribution of our paper is threefold. First, we take a multidimensional perspective on the effects of the Eurozone bailouts on democracy. We are able to show that the effects are not homogenous. Negative attitudinal effects are stronger than behavioral effects and follow institutional developments only initially. Second, our analysis points to considerable effect heterogeneity across time and countries. Third, our paper applies a methodological innovation to the analysis of bailout effects. Taken together, our findings suggest that studies, which focus on attitudinal effects, limit themselves to a short post-bailout period and do not differentiate between the bailout countries, are likely to overstate the harm that Eurozone crisis management has done to support for national democracy.

Probing the Eurozone bailout effect on democracy

Our paper takes issue with several limiting features of the literature on Eurozone bailout effects on democracy. Regarding our main independent or treatment variable, these studies typically group all bailout countries in one category and contrast them collectively with non-bailout Eurozone countries as well as non-Eurozone IMF bailout countries. Yet EMU external interventions happened at different times and in different ways. For instance, Greece was the first bailout country in 2010, whereas Cyprus only followed in 2013. Greece also went through repeated negotiations on bailout programs, whereas other countries implemented a single program. Spain only experienced a partial bailout of the banking sector, and Italy did not have a formal bailout program at all. Debtor states also ended their bailout programs at different points in time – Ireland and Spain at the end of 2013, Portugal in May 2014, Cyprus in 2016 and Greece in the summer of 2018. In other words, we need to pay attention to treatment and effect heterogeneity.

In addition, the dependent variables of the detachment literature are attitudinal. It uses measures of satisfaction with democracy and trust in institutions (Armingeon and Ceka 2014; Armingeon and Guthmann 2014; Armingeon et al. 2016; Ruiz-Rufino and Alonso 2017). First, it is contested whether satisfaction with democracy actually measures diffuse and affective support (subjective legitimacy) or rather specific support for the current performance of the political system or the incumbents (Canache et al. 2001; Linde and Ekman 2003). Cordero and Simon (2016) distinguish ‘satisfaction with democracy’ (as a more performance-oriented measure) from ‘support for democracy’ (measured as how important it is for respondents to live in a democracy) as a better indicator for diffuse support. Interestingly, they hypothesize and find that the bailout experience actually strengthens diffuse support for democracy when measured in this way.

Second, there is evidence from earlier studies that the quality of democratic institutions affects satisfaction with democracy, as the detachment hypothesis claims. Consensus democracy (Anderson and Guillory 1997; Lipjhart 1999), the rule of law and good governance (Wagner et al. 2009) and perceptions of procedural fairness (Magalhaes 2016) have been shown to strengthen satisfaction. Yet the economic performance of democracies has an independent and potentially stronger influence (Armingeon and Guthmann 2014; Quaranta and Martini 2016). In the case of bailout effects, we need to be particularly careful to distinguish negative effects on the democratic from negative effects on the economic performance of national political systems.

Third, attitudes do not give us the full picture of detachment effects on citizens. Dissatisfaction with the way democracy works may trigger qualitatively different behaviors – a retreat from political participation (such as abstention from voting), unconventional political participation (such as protests), or support of anti-establishment or anti-system parties. For instance, Häusermann et al. (2018) show that perceived government inefficacy is an important driver of low turnout – also among highly educated voters. Hernández and Kriesi (2016) find that, in Western Europe, radical and non-mainstream parties benefited the most from the losses of incumbent parties. And Bosco and Verney see both responses – voter demobilization and the rise of challengers – together in Southern Europe (2012: 147-149). We therefore add electoral turnout as an additional indicator of detachment.²

Fourth, it is useful to check for the democratic quality of national institutions independent of citizen attitudes and behavior. The detachment hypothesis assumes that weakened satisfaction with democracy responds to the perceived lack of citizen efficacy and of institutional responsiveness and

² Whereas the literature suggests that satisfaction and turnout are linked, the causal relationship and direction of the link are a matter of debate (e.g., Ezrow and Xezonakis 2016).

accountability. Typically, however, studies of the Eurozone crisis do not examine or control for the development of democratic institutions in the crisis (Matthijs 2017 is an exception).

Finally, the detachment argument has important implications for the post-crisis period. In an economic-voting or performance-based perspective, we should expect that political support for national democratic institutions rebound together with the economy and return to pre-crisis levels. Eurozone governments established a permanent rescue fund and the ECB provided 'quantitative easing', cheap liquidity and – crucially – a commitment to defend the euro 'whatever it takes'. They have thereby averted sovereign defaults and Eurozone breakdown. Moreover, the Eurozone has recovered from recession – with higher economic growth than the US since 2015, fiscal consolidation, and a significant reduction of unemployment.³

If, however, the Eurozone crisis taught citizens a lesson about the technocratic, unresponsive nature of EMU and the impotence of national democracy, we should observe that satisfaction remains depressed in the bailout countries in spite of economic recovery. After all, citizens will not forget what they have learned about the undemocratic nature of EMU. In addition, the reforms of the Eurozone did nothing to strengthen its democratic quality. Rather, they strengthened the supervisory powers of the ECB and the supranational constraints on the national budgets. The European Parliament was largely sidelined in the process of EMU reform, and whereas some national parliaments acquired additional rights during the crisis, the parliaments of the bailout countries, whose competencies in overseeing EU affairs had already been comparatively weak before the crisis, did not benefit (Rittberger and Winzen 2015).

Data and Method

We investigate the effect of the Euro crisis bailouts on three different dimensions of national democracy: 1) satisfaction with democracy (SWD), 2) electoral turnout, and 3) democratic institutions. The statistical approach – the generalized synthetic control method – we employ is explained below. Yet, we already want to highlight that this method requires us to analyze data not only for all EU member states, but also for a larger number of control cases (overall $N > 40$ is recommended). We therefore collected data on our outcome measures for a global sample of countries. The specific samples vary over the outcomes due to data availability. Yet, we mainly draw on control cases from the Americas.

³ See, e.g., 'Eurozone recovery becomes surprise economic story of 2017', *Financial Times*, 5 June 2017.

Our measure of SWD comes from the Eurobarometer, the Latinobarometer, the Latin America Population Surveys (LAPOP), and the Comparative Studies of Electoral Systems Surveys (CSES). In line with previous research, we calculate the share of satisfied respondents for each country-year, weighted by the accompanying post-stratification weight (cf., Armington et al. 2016; Ruiz-Rufino and Alonso 2017). We are able to measure satisfaction with democracy across Europe on a yearly basis from 1992 to 2017 using Eurobarometer. The only gap for this time series is in 2008. We complement this data with an identical SWD measure from the Latinobarometer. This allows us to add a time series on six Latin American countries for the period 1996 to 2017. We extend the number of control cases further by adding the SWD measure from the LAPOP surveys 2004-2016. Here, we can fill some gaps with the SWD measure from the CSES data. We can also extend the LAPOP data for Nicaragua and El Salvador to the end of the 90s, using additional surveys from the LAPOP archive files. Overall, we end up with a SWD time-series for 48 countries stretching from 1996 to 2017.⁴ We impute breaks within country panels using Stineman interpolation (Moritz 2018). However, this still leaves us with an unbalanced dataset as some panels start after 1996 or end before 2017. Figure A1 in the Appendix gives an overview of all panels and their temporal coverage.

Electoral turnout data is taken from the International Institute for Democracy and Electoral Assistance's (IDEA) database⁵, which gives us turnout rates for national elections from 1992 to 2018. Generally, we focus on national parliamentary elections. For presidential political systems, however, we use the turnout rate at the presidential election. The database does not cover the full period for every country, but we are able to assemble a balanced panel for 48 countries. As elections in the various countries take place in different years and in different intervals, we interpolate data from an election year to the following years, up until the next election. This provides us with a yearly dataset. Figure A3 in the Appendix presents panels and their temporal coverage for our turnout measure. In four bailout cases, we have data on two general elections after introduction of fiscal programs. For Cyprus, we have data on one election after the bailout (in 2016).

Our measure of democratic institutions comes from the Varieties of Democracy (V-Dem) data.⁶ The V-Dem dataset offers a range of democracy indices, tapping into different aspects of democratic quality. In light of our theoretical expectations, we select the electoral democracy (also called polyarchy) index.⁷ This index captures responsiveness of rulers to citizens, as well as competitiveness of elections and a pluralistic public (Coppedge et al. 2017). We would expect that conditionality under bailout

⁴ Even though we have SWD data for Europe starting from 1992, a lack of data on the control cases forces us to restrict the analysis to the period 1996-2017.

⁵ <https://www.idea.int/data-tools>.

⁶ <https://www.v-dem.net/en/>.

⁷ Our findings are robust if we use alternative V-DEM indices instead (not shown here).

programs erodes the responsiveness of rulers and decreases the competitiveness of elections, as austerity and reforms are presented without alternative. Based on the yearly V-Dem data, we select a sample of 54 countries over the period 1994 to 2017. Figure A5 in the Appendix provides an overview of the balanced panel and its temporal coverage.

Our treatment, the Eurozone bailout, is coded as a dummy variable that switches from zero to one if a country receives a Eurozone bailout. We put Cyprus (2013-), Greece (2010-), Ireland (2010-), Portugal (2011-), and Spain (2012-) in the treatment group. Previous studies have assumed homogenous treatment assignment by coding a specific year as treatment time for all Euro crisis bailout cases (Armingeon et al. 2016; Ruiz-Rufino and Alonso 2017). By contrast, our method allows us to vary the treatment time for every case. We therefore assign treatment based on the year a country entered a Eurozone bailout scheme (see years in parenthesis above). Ruiz-Rufino and Alonso (2017) also put Italy in the treatment group. However, since Italy has not entered a formal financial assistance program with the underlying conditionality, we refrain from adding Italy to the treatment group. We will test the sensitivity of our findings to this choice at the end of our analysis. Figures A1, A3 and A5 in the Appendix highlight the post-treatment years for each case in dark blue.

To estimate the causal effect of the Eurozone bailout programs on national democracies, we use the recently developed generalized synthetic control (GSC) method (Xu 2017). It extends the classical synthetic control method (Abadie et al. 2010), by allowing for several treated units, varying treatment periods, and easily interpretable uncertainty estimates. With this, we can extend previous research that used the (classical) synthetic control method to analyze the effect of the Euro crisis on SWD in Greece (Armingeon et al. 2016). We can also contribute to research that used difference-in-difference (DID) estimation to investigate the effect of the bailouts on SWD (Ruiz-Rufino and Alonso 2017). Here, the GSC avoids the often problematic parallel trends assumption of the DID estimator and reduces bias. Further, the GSC approach allows us to investigate effect heterogeneity across treated units. This is a crucial extension, as the effect of the bailouts on democracy might vary across cases. Moreover, we make an original contribution by extending the analysis to two additional outcomes: electoral turnout and democratic institutions. Below, we provide a short description of the GSC estimator. For a more comprehensive explanation, we refer readers to Xu (2017).

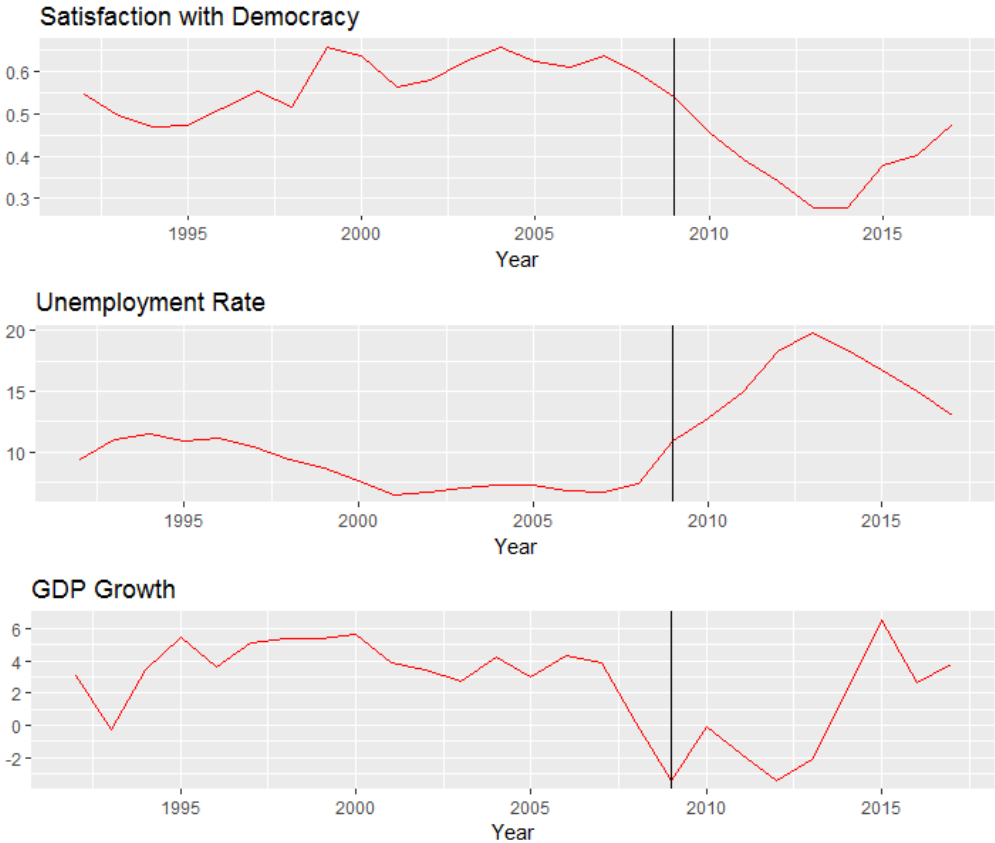
The GSC method estimates the average treatment effect on each treated unit (ATT). The goal of the estimation is to arrive at a counterfactual time trend, under the condition that the treatment would not have happened. For example, we do not know how SWD would have developed in Ireland if the bailout had not happened. The GSC method treats this fundamental issue of causation as a missing data problem. It imputes treated counterfactuals based on a linear interactive fixed effects model that incorporates time-varying coefficients with unit-specific intercepts (Bai 2009). Hence, the interactive-

fixed effects model includes time- and unit fixed effects. It also estimates a set of time-varying factors (unobservable controls) that further balance treatment and control group, conducting a factor analysis of the residuals. Therefore, the method does not require an explicit modelling of control variables. The balancing of treatment and control group is part of the estimation procedure.

For this, the GSC method requires a rather large set of countries ($N > 40$) and data that offers information on long pre-treatment periods ($t > 15$). This is because the estimator learns to approximate the time trend in the treatment group using all available information from the pre-treatment period. It then applies the trained estimator to predict the treated counterfactual in the post-treatment period. A built-in cross-validation scheme automatically selects the best prediction model, reducing the risks of overfitting.⁸ Besides the specific data requirement, the method comes with one major caveat. The GSC estimator can lead to excessive extrapolations, especially under imprecise estimates (Xu 2017: 73). Similar to the common support issue in matching estimators, one should check whether factor loadings of treated and control units resulting from the interactive-fixed effects regression fall within the same convex hull. We check all our estimation results for excessive extrapolation and report the results in the Appendix. For all three outcomes, we do not find evidence for excessive extrapolation.

⁸ This refers to the number of unobserved factors resulting from the factor analysis of the residuals. The cross-validation procedure selects that number of factors that minimizes the prediction error.

Figure 1: Trends in SWD, unemployment, and GDP growth across the five Eurozone bailout cases



Even though the GSC estimates a number of unobservable factors that balance treatment and control, the method allows including observable co-variables that are likely to confound the treatment. The issue of confounded treatment is important in an analysis of Eurozone bailouts, especially as the bailouts coincide with a severe economic crisis. Previous accounts were limited, however, in their ability to control for the effects of the economic crisis.⁹ Figure 1 plots time trends in SWD, the unemployment rate, and gross domestic product (GDP) growth across the five Eurozone bailout cases. It suggests that unemployment and SWD trends are inversely related, with SWD falling around the same time as unemployment increases. Moreover, we see that GDP growth turns negative around the same time as SWD falls and rebounds towards 2015. To account for the possibility that the economic crisis rather than the bailouts affect national democracy, we control for the unemployment rate and

⁹ Armingeon et al. (2016) have not systematically differentiated between economic and bailout effects. Ruiz-Rufino and Alonso (2017) only control for fiscal deficit. We are not able to measure fiscal deficit for our global samples. However, we propose economic performance indicators that are more direct measure of economic crisis effects. For instance, unemployment has been shown to be a key driver of economic voting (Fossati 2014).

GDP growth. We get a complete time series on the unemployment rates using the model estimates from the International Labor Organization.¹⁰ GDP growth data comes from the World Bank.¹¹

Results

Satisfaction with democracy

We start by investigating the effect of the Eurozone bailouts on satisfaction with democracy. Of our three outcome measures, SWD probably is best covered by recent research. Using the classical synthetic control method, Armingeon et al. (2016) find that the Euro crisis decreases SWD in Greece by 50 percent. However, Armingeon et al. (2016) probably have investigated the case with the largest negative bailout effects. Here, it remains open whether similar effects appear for the other bailout cases. Ruiz-Rufino and Alonso (2017) cover all bailout cases (plus Italy), estimating a decline in SWD of up to 20 percent. Yet, their method of choice (DID) can only provide an estimate of the pooled treatment effect. It also does not control for unemployment or GDP growth. Moreover, previous studies have not analyzed how persistent the effect of the bailout is. We offer an analysis that presents yearly estimates over the post-treatment period, up until 2017.

Our result for the pooled ATT of bailouts on the three dimensions of democracy are reported in Table 1. We call it the pooled ATT as it is the averaged ATT across all five treated cases and all post-treatment years. The ATT equals the difference between the observed time trend in SWD in the treated cases and the estimated trend under the counterfactual condition. Figures A2, A4, and A6 in the Appendix plot the observed and counterfactual trends for all three outcomes.

In model 1, we estimate a pooled ATT of -0.13, with a standard error of 0.03. This suggests that – on average – satisfaction with democracy decreased by 13 percent in countries that experienced a bailout. This effect is highly significant ($p < 0.01$). The estimated effect is within the range of the results presented by Ruiz-Rufino and Alonso (2017). Depending on the modelling strategy, Ruiz-Rufino and Alonso (2017) present diff-in-diff estimates of up to 20 percent. However, model 2 suggests that they overestimate the effects of bailouts. Controlling for unemployment rate and GDP growth, the ATT decreases to -0.10. It appears that part of the effect is driven by the economic crisis as such. We also see that unemployment and GDP are significant predictors in the interactive fixed-effects regressions. The two observable covariates seem to account for one of the unobservable factors estimated in model 1, as the GSC estimator only uses the first factor in model 2. Figure A7 in the Appendix plots the

¹⁰ https://www.ilo.org/empelm/projects/WCMS_114246/lang--en/index.htm

¹¹ <https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG>

remaining factor and confirms that the estimates for the treated cases are not suffering from excessive extrapolation.

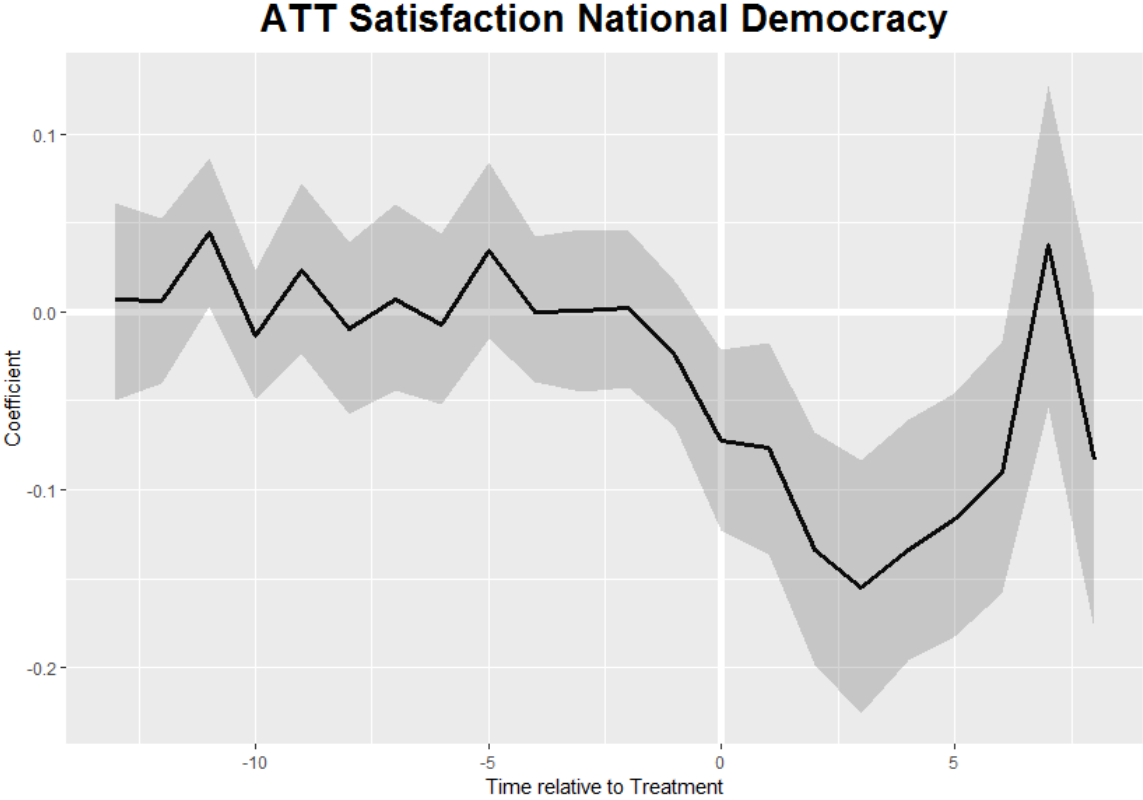
Table 1: The effect of bailouts on three dimensions of democracy (GSC estimates)

	(1) SWD	(2) SWD	(3) Turnout	(4) Turnout	(5) Electoral Democracy	(6) Electoral Democracy
Bailout	-0.13** (0.03)	-0.10** (0.02)	-4.23** (0.94)	-4.13** (0.90)	-0.01** (0.003)	-0.03** (0.005)
Unemployment Rate		-0.15** (0.01)		-0.77* (0.31)		0.03** (0.002)
GDP Growth		0.06** (0.01)		-0.34 (0.33)		-0.002 (0.002)
State-fixed effects	X	X	X	X	X	X
Year-fixed effects	X	X	X	X	X	X
Unobserved factors	2	1	5	5	5	4
Observations	1'056	1'056	1'296	1'296	1'296	1'296
Treated states	5	5	5	5	5	5
Control states	43	43	43	43	49	49

Note: Standard errors based on parametric bootstrap with 2'000 runs. Coefficients on unemployment and GDP growth are multiplied by 10 to improve readability.

**p<0.01, *p<0.05

Figure 2: ATT of Eurozone bailouts on SWD, controlling for unemployment



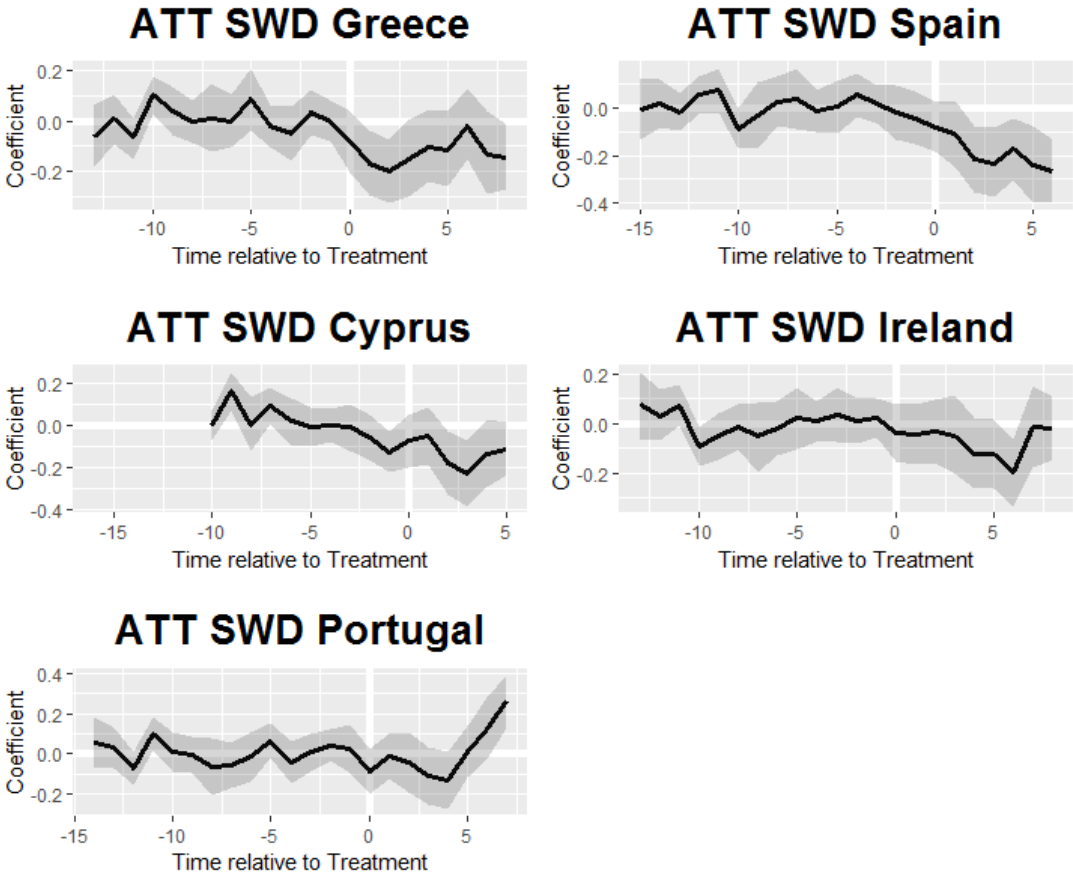
Note: 95% confidence intervals displayed. Standard errors based on parametric bootstrap with 2,000 runs. Estimated with two-way fixed-effects, controlling for one unobserved factor, unemployment rate, and GDP growth.

Based on model 2 in Table 1, Figure 2 plots the pooled ATT over time. We see that the black line is not significantly different from zero in the pre-treatment period. This indicates that the GSC estimator did a good job in approximating the trend in the treatment group. Yet, in the post-treatment period, treatment and counterfactual trends deviate significantly. The bailouts have substantially decreased satisfaction with democracy. The ATT is largest three years after treatment, with a predicted decrease of 15 percent. However, we also see that the treatment effect disappears towards the end of the observation period (2017). Accounting for the estimation uncertainty, we find that the bailout effect vanishes six years after the start of the financial programs.

The analysis of the pooled ATT confirms that there is a negative, statistically significant, and substantial effect of the Eurozone bailouts on SWD. However, the effect disappears towards the end of the observation period. In the next step, we are going to investigate whether and how this effect varies across the treated cases. Figure 3 plots the ATTs and their confidence intervals for each bailout case. We see large and significant effects in Greece, Spain, Cyprus, and Ireland. However, the ATT does not reach statistical significance in Portugal. Further, we see a rebound in the ATT in every case, except of Spain. Overall, Figure 3 confirms that there are substantial, but transitory declines in SWD due to the

financial assistance and austerity programs. Strong and persistent declines in SWD can only be found for Spain. The weakest effects are estimated for Ireland and Portugal. Moreover, we estimate a maximal decline in SWD of 20 percent in Greece, three years after the first bailout. This is substantially smaller than the 50 percent reported by Armingeon et al. (2016).

Figure 3: ATTs across treated countries (SWD)



Note: 95% percent confidence intervals displayed. Standard errors based on parametric bootstrap with 2,000 runs. Estimated with two-way fixed-effects, controlling for one unobserved factor, unemployment rate, and GDP growth.

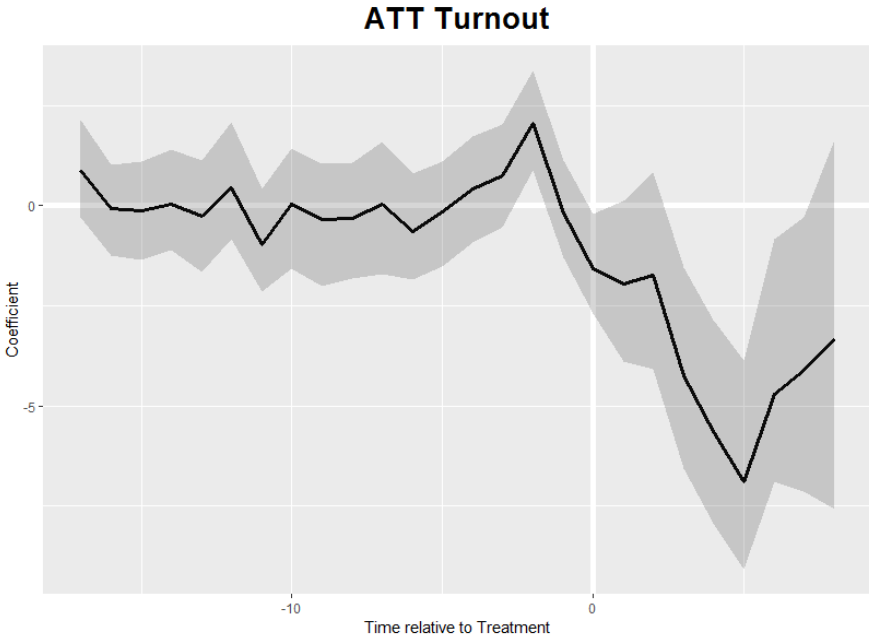
Our analysis of SWD offers a number of new insights. Considering the pooled ATT, we see that the effect varies across time. Accounting for the effects of unemployment and GDP growth, the pooled ATT is smaller as previously suggested, predicting a decrease in SWD of 10 percent. Crucially, however, this negative effect does not last. After the third year, SWD recovers and the bailout effect seems to dissolve six years after the start of the bailout program. If we look at effect heterogeneity across the treated cases, we find that this rebound takes place in most cases, except Spain. Finally, we do not find a significant effect of the bailout on SWD in Portugal.

Turnout

We now move from evaluative attitudes to democratic behavior by asking how the bailouts affected electoral participation. Has detachment made voters turn their back on conventional political participation? Model 3 in Table 2 estimates a four percent decline in turnout across Eurozone bailout cases. This effect is statistically significant at the one percent level. Here, the GSC estimates are based on an interactive fixed-effects model with five estimated factors. We add unemployment and GDP growth as observable control in model 6 to account for the economic crisis. The result is robust, as the ATT is nearly identical and remains significant.

As Figure 4 shows, the pooled ATT for turnout follows a similar pattern as in the SWD analysis. It reaches its maximal negative effect in the fifth year after treatment, with a predicted decrease of seven percent. After that, the ATT rebounds and becomes insignificant towards the end of the observation period. These findings offer two conclusion. First, there seems to be a transitory effect of Eurozone bailouts on electoral participation, similar to the effects on SWD. Second, with a moderate decrease of four percent on average, this effect is less pronounced than the effect on SWD.

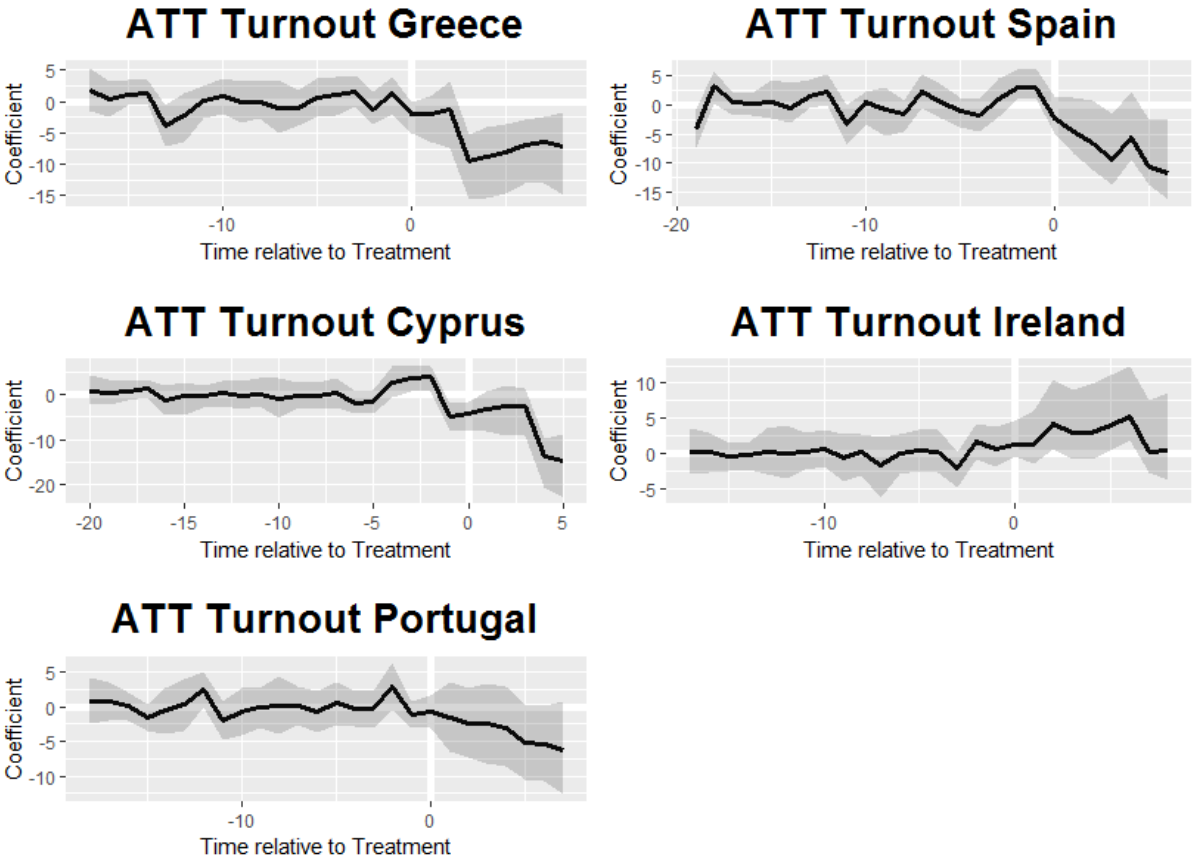
Figure 4: ATT of Eurozone bailouts on turnout



Note: 95% confidence intervals displayed. Estimated with two-way fixed-effects, controlling for five unobserved factors, unemployment rate, and GDP growth.

Figure 5 presents the estimated ATTs for all treated countries. Again, pre-treatment trends are not significantly different, except for some short deviations in Spain and Cyprus a few years before treatment. Especially in Greece, Spain, and Cyprus, we see a substantial drop in turnout compared to the counterfactual scenario. There is a small rebound in the case of Greece, but the negative effect of the bailout on participation remains significant until the end of the observation period. There is no rebound in Spain, which is in line with the findings from the SWD analysis. We also do not see a rebound in Cyprus, even though SWD recovered. This might be because we only observe one election for Cyprus in the post-treatment period (2016). It remains to be seen what the long-term consequences are for electoral participation in this case. Finally, we do not find an effect of the bailouts on turnout in Ireland and Portugal. Interestingly, these are also the two cases with the weakest treatment effects in the SWD analysis.

Figure 5: ATTs across treated countries (turnout)



Note: 95% confidence intervals displayed. Estimated with two-way fixed-effects, controlling for five unobserved factors, unemployment rate, and GDP growth.

Our turnout analysis uncovers a number of novel insights. First, we see that effects on turnout are limited. We do find a statistically significant decline in turnout due to the Eurozone bailouts. Yet, the negative turnout effect is smaller than the SWD effect. Moreover, turnout effects are restricted to Greece, Cyprus, and Spain. We do not see significant declines in Portugal and Ireland, which are also the cases with the weakest slump in SWD. This is good news considering the substantial decreases in SWD reported above and in previous studies. Considering the pooled ATT, the bailouts did only lead to a transitory and moderate slump in turnout. Disenchantment did not initiate a sustained withdrawal from politics, even in countries that experienced a strong decline in SWD for several years. Rather, as studies on protest behavior during the Euro crisis suggest, voters seem to have turned their dissatisfaction into political action and opted for initiating change in the domestic political arena (e.g. Hernandez & Kriesi 2016). One exception seems to be Spain, for which we estimate a sustained decrease in SWD and turnout until the end of the observation period.

Electoral democracy

Finally, we ask how these individual-level effects relate to institutional effects of the bailouts. Let us recall that the detachment hypothesis assumes that dissatisfaction with democracy mirrors (perceived) quality losses for national democratic institutions. We should therefore observe attitudinal, behavioral and institutional trends develop in parallel. To test this expectation, we analyze the effects of the bailouts on V-Dem's electoral democracy index.

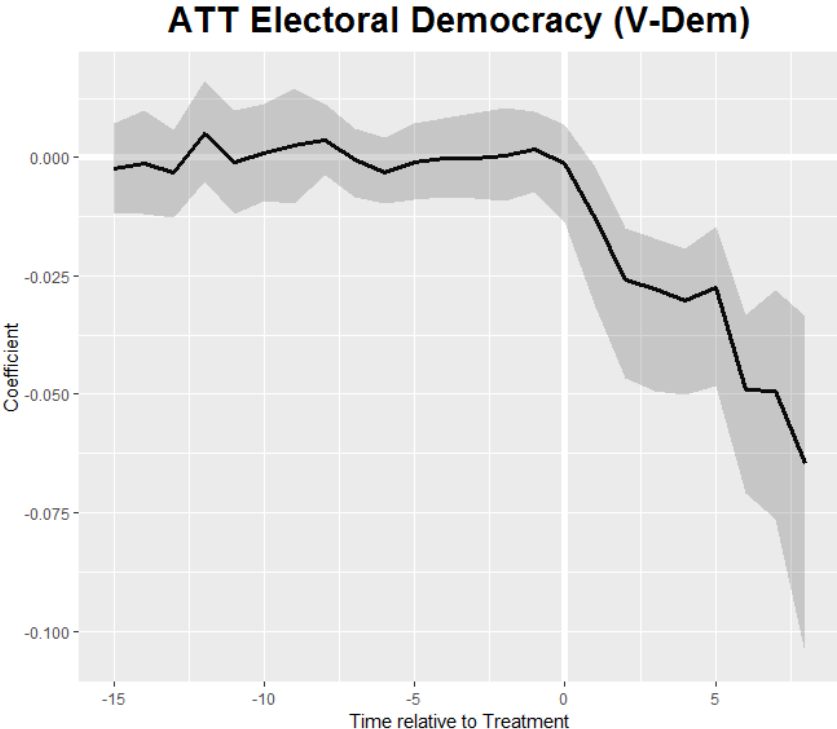
As model 5 in Table 1 shows, the pooled estimated ATT is -0.01, with a standard error of 0.003. This suggests that there is a tiny, but statistically significant negative effect of the bailouts on electoral democracy. As the scale of the electoral democracy index ranges from zero to one, a decrease of -0.01 appears irrelevant. Yet, the result becomes stronger if we add unemployment and GDP in model 6. The ATT rises to -0.03 and remains significant. These estimates are based on an interactive fixed-effects model with four factors. Figure A9 plots the factors and shows no sign of excessive extrapolation.

Figure 6 plots the pooled ATT over time. The estimator predicts a significant decrease in the electoral democracy indicator. Figure 6 shows an incremental erosion of the democratic institutions. Towards the end of the observation period, the average ATT predicts a decrease in electoral democracy of six percent. To put this in context, consider that the standard deviation in the electoral democracy index time-series for Greece from 1980 – 2017 is only 0.025. As the V-Dem index does show such limited temporal variability, the reported ATT seems relevant.

Figure 7 plots the ATTs for electoral democracy across all five Eurozone bailout cases. We see that the result presented in model 6 of Table 1 is mostly driven by Greece. Our GSC estimates suggest that,

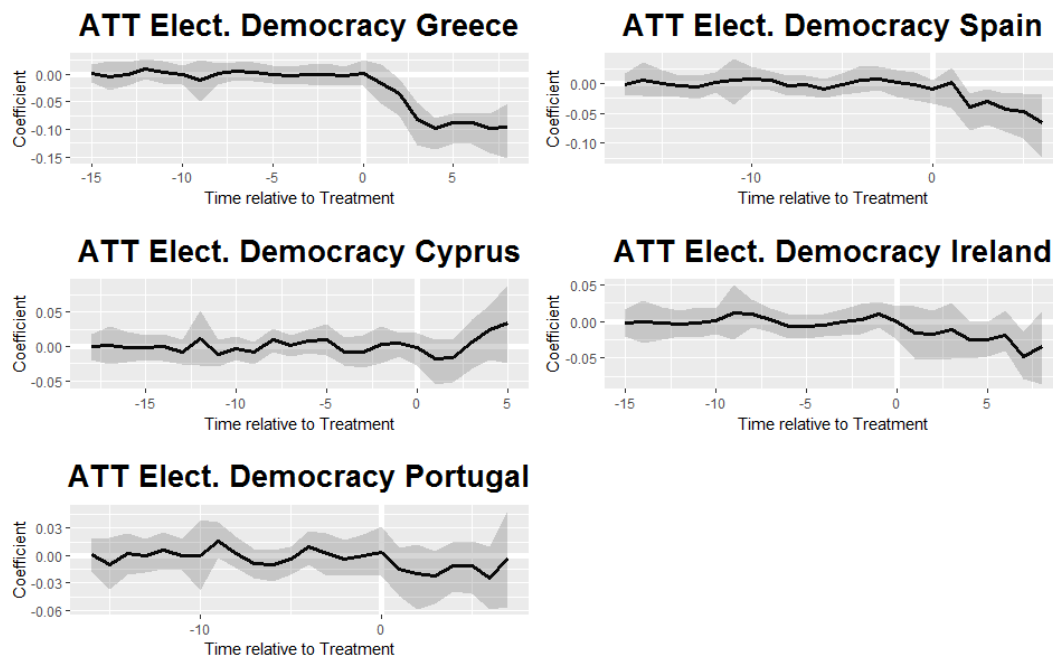
three years after the start of the assistance program, the bailouts led to a drop in Greece’s electoral democracy index by 10 percent. This negative effect remains equally strong until the end of the observation period. We do not find significant effects of the bailout on electoral democracy in Cyprus and Portugal. Spain and Ireland show moderate, partially significant, but sustained decreases in democratic quality.

Figure 6: ATT of Eurozone bailouts on electoral democracy



Note: 95% confidence intervals displayed. Standard errors based on parametric bootstrap with 2,000 runs. Estimated with two-way fixed-effects, controlling for four unobserved factors, unemployment rate, and GDP growth.

Figure 7: ATTs across treated countries (electoral democracy index)



Note: 95% confidence intervals displayed. Standard errors based on parametric bootstrap with 2,000 runs. Estimated with two-way fixed-effects, controlling for four unobserved factors, unemployment rate, and GDP growth.

Overall, our analysis of electoral democracy shows a significant negative effect for the pooled ATT. Even though it is substantively small, it breaks with a pre-crisis pattern of stability in democratic quality in the bailout countries. Moreover, the negative effect of bailouts becomes more substantial over the post-treatment period, indicating that institutional changes are slower than changes in attitudes and behavior. Most importantly, however, the pooled ATT does not rebound towards the end of the observation period, as was the case in the SWD and turnout analyses. This is a pattern that is – in varying degrees – supported by three out of the five bailout cases.

On the one hand, the slow and continuing deterioration of electoral democracy in the bailout countries is in line with the detachment hypothesis and its underlying assumption that the bailouts have a detrimental effect on national democratic institutions. That Greece and Spain report the strongest and most persistent effects across all three dimensions of democracy supports the hypothesis, too. On the other hand, however, the finding that the overall negative institutional effect of the bailout continues until the end of the period of observation makes the rebound of satisfaction and turnout even more puzzling. They suggest that we might witness a different kind of detachment: that between individual and institutional responses to the bailouts. Because the V-DEM index is based on expert evaluations, the discrepancy could result from a misalignment of expert and citizen perceptions of national democracy: experts might simply be more critical than citizens are. Alternatively, satisfaction with the

way democracy works and participation in elections might be less aligned with the quality of democratic institutions than institutional explanations of satisfaction would have it.

Finally, our results are robust to adjustments in the treatment status. This paper focuses on the effect of formal bailout programs. However, previous research included Italy in the treatment group, because the ECB's intervention in 2011 aimed also at stabilizing Italy (Ruiz-Rufino & Alonso 2017) and the technocratic Monti government replaced the Berlusconi government without an election. Moreover, this intervention was connected to an agreement between Italy and the ECB on reform and austerity programs. In order to see whether our findings are affected by the exclusion of Italy, we replicated our analyses by adding Italy to the treatment group from 2011 onwards. Table A1 in the Appendix reports the ATTs for the three dimensions of democracy. Across all three outcomes, results are highly similar. The Italian case therefore does not change the substantive conclusions we draw from our analyses.

Conclusions: a democratic legitimacy crisis of the Eurozone?

The Great Recession has been the most severe economic crisis in post-World War II Western Europe. It hit the deficit countries of the Eurozone particularly hard. Thanks to the economic credibility they enjoyed as members of the Eurozone, most of them had benefited from a credit-financed economic boom after the introduction of the common currency. When financial markets lost confidence in the deficit countries during the recession, they experienced a 'sudden stop' of credit and massive capital outflow, pushing banks and, subsequently, the states that rescued them to the brink of bankruptcy. Within the Eurozone, deficit countries were unable to adjust by devaluing their currencies. To avoid sovereign default and crushing out of the euro, they required massive external financial support. Yet the creditor states of the Eurozone made their bailouts conditional on harsh austerity programs supervised by international financial institutions, which severely limited the fiscal and political autonomy of the recipient countries.

Economic crises are always testing times for democracies. That they harm the reelection chances of incumbents is bad for them, but not for democracy as such. That they reduce specific support for democracy among citizens is unproblematic as long as diffuse support (or legitimacy) remains intact. Deep and prolonged economic crisis, however, potentially threatens democratic regimes as in the global economic crisis of the 1930s. The Eurozone crisis was particular in that it not only caused extreme economic hardship. It also forced democratically elected governments to accept externally imposed and supervised policy programs, which posed additional challenges to national democracies. What is the point of national democracy if core policies are determined by unelected and electorally

unaccountable international organizations? Why turn out for elections if the election outcome cannot truly change the fiscal and welfare policies that voters care about most?

It is not far-fetched to expect that these conditions would have a strong and lasting negative impact on the democratic institutions, attitudes and behaviors of the bailout countries. Critics of the Eurozone have warned of a democratic legitimacy crisis (Scharpf 2011; Schmidt 2015) and recent survey research has shown a large detachment effect of the bailouts on citizens (Armingeon et al. 2016; Ruiz-Rufino and Alonso 2017). By contrast, our study cautions against alarmist conclusions.

Applying the generalized synthetic control method to assess the effects of the bailouts, we concur with the literature that Eurozone bailouts have had a negative impact on citizens' satisfaction with their national democracies. The estimated effect, however, is substantially smaller as previous research suggests. Importantly, dissatisfaction has been transitory and not affected all bailout countries equally. Moreover, dissatisfaction is not tantamount to a retreat from conventional democratic participation. The effects we find in this respect are smaller and transitory as well. Apparently, a considerable number of citizens have taken their dissatisfaction to the ballot box rather than turning away from democracy. Finally, we find that satisfaction and turnout rebound in spite of a persistent and increasingly negative – albeit substantively small – negative effect of the bailouts on democratic quality over the post-treatment period.

Even though we do not focus on vote choice, our findings are largely in line with the economic voting argument.¹² Voters become dissatisfied with governments, and the way democracy works, in times of economic hardship – and they are very dissatisfied when and where the hardship is particularly pronounced, as most clearly in Greece. Yet satisfaction returns when the crisis recedes and the economy improves. In the same vein, our results fit the (economic) performance-based interpretation and explanation of satisfaction with democracy better than the institutional account. Whereas our study should not be read as a vindication of Eurozone crisis management, citizens appear to be more forgiving and less concerned about the bailouts' impact on democratic institutions than the Eurozone's academic critics.

At any rate, bailouts as such do not have systematically strong effects. Whereas their negative impact was considerable in Greece and Spain, there was hardly an effect in Ireland and Portugal. The type of bailout did not matter in predictable ways either. Both the multiple and full Greek bailouts and the partial Spanish bailout have had strong negative effects; the partial Spanish bailout has had stronger

¹² For a recent experimental study of international constraints on economic voting in Greece, see Kosmidis (2018).

effects than the full Irish and Portuguese bailouts; and the informal Italian bailout does not change the picture of the formal bailouts in the other five cases.

The effect heterogeneity uncovered in our analysis provides fertile ground for future research. Most likely, the effects of bailouts on national democracy depend on the political and societal pre-conditions present in each country, as well as the structural distortions resulting from the conjunction of economic recession and austerity. For instance, it has been shown that electoral effects of the bailouts depend on the ideological leaning of the governing parties (Alonso and Ruiz-Rufino 2018). Moreover, it appears that the two countries for which we find the most severe effects on national democracy – Greece and Spain – have witnessed the strongest, long-term social distortions. Figure A10 in the Appendix plots the change in poverty rates from 2007 to 2016 for the five bailout cases. It demonstrates that poverty rates increased markedly in Greece and Spain, while they stayed rather stable in Portugal and Ireland. Future research should study more systematically how contextual factors have shaped the effects of bailouts on national democracies.

Our analysis clearly has its limits, too. The effects we report are country-level not individual effects. This leaves uncharted territory on the micro-level mechanisms. The time that has passed since the crisis is still short, and it is unclear how persistent the overall recovery of satisfaction and the creeping deterioration of democratic institutions will turn out to be. The puzzling misfit between institutional and behavioral effects requires further research. Our analysis does not provide a systematic explanation of the cross-country heterogeneity either. Finally, we are not able to apply our approach to an investigation of bailout effects on party choice or political protest in crisis countries. However, if we combine our findings with studies on voting behavior, it seems that the Eurozone crises made citizens express their discontent within the democratic arena, rather than retreat from democracy.

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Appendix

Table A1: The effect of bailouts on three dimensions of democracy, adding Italy to treatment

	(1) SWD	(2) Turnout	(3) Electoral Democracy
Bailout	-0.09** (0.02)	-4.13** (0.85)	-0.02** (0.006)
Unemployment Rate	-0.15** (0.01)	-0.65* (0.31)	0.03** (0.003)
GDP Growth	0.06** (0.01)	-0.34 (0.33)	0.004 (0.002)
State-fixed effects	X	X	x
Year-fixed effects	X	X	x
Unobserved factors	1	5	5
Observations	1'056	1'296	1'272
Treated states	6	6	6
Control states	42	42	48

Note: Standard errors based on parametric bootstrap with 2'000 runs. Coefficients on unemployment and GDP growth are multiplied by 10 to improve readability.

**p<0.01, *p<0.05

Figure A1: Panel view of satisfaction with democracy

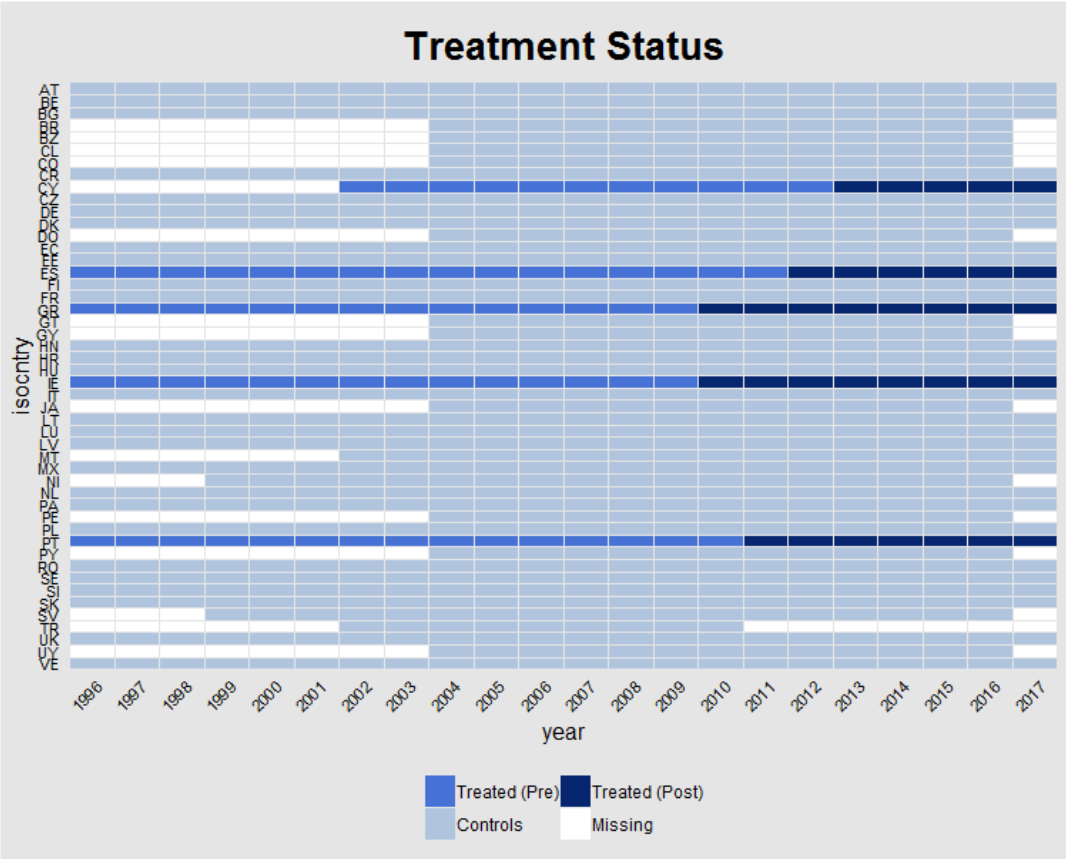


Figure A2: Observed trend and estimated counterfactual in satisfaction with democracy

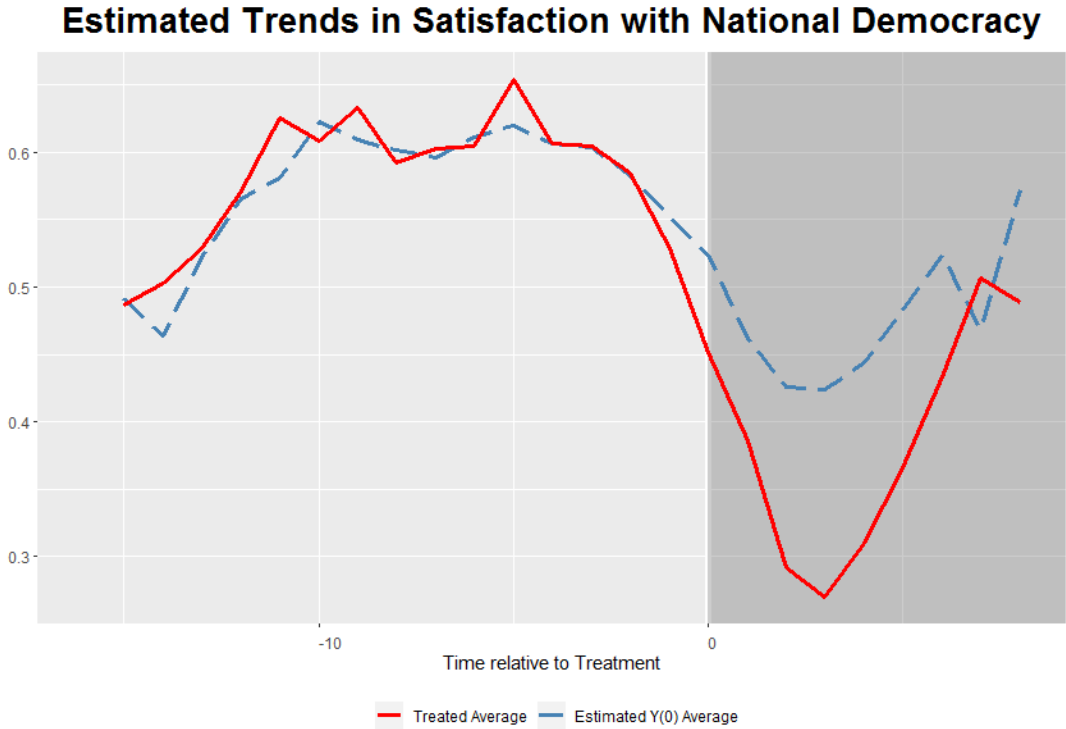


Figure A3: Panel view of turnout

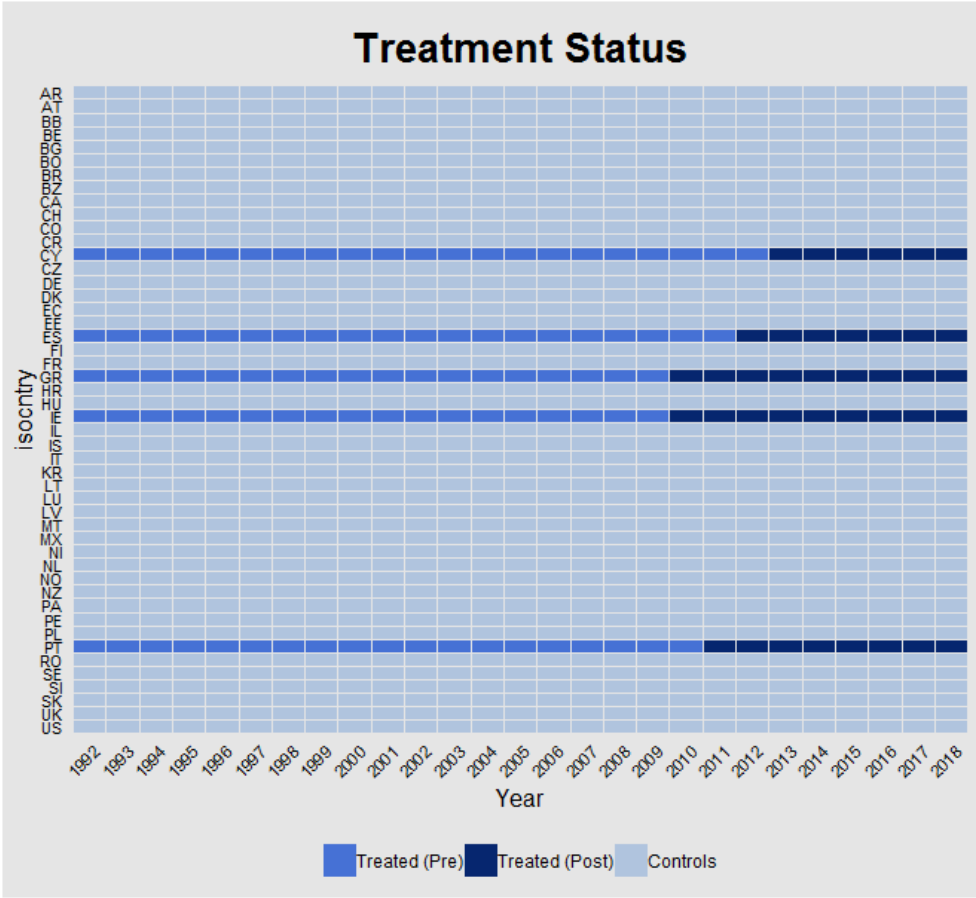


Figure A4: Observed trend and estimated counterfactual in turnout

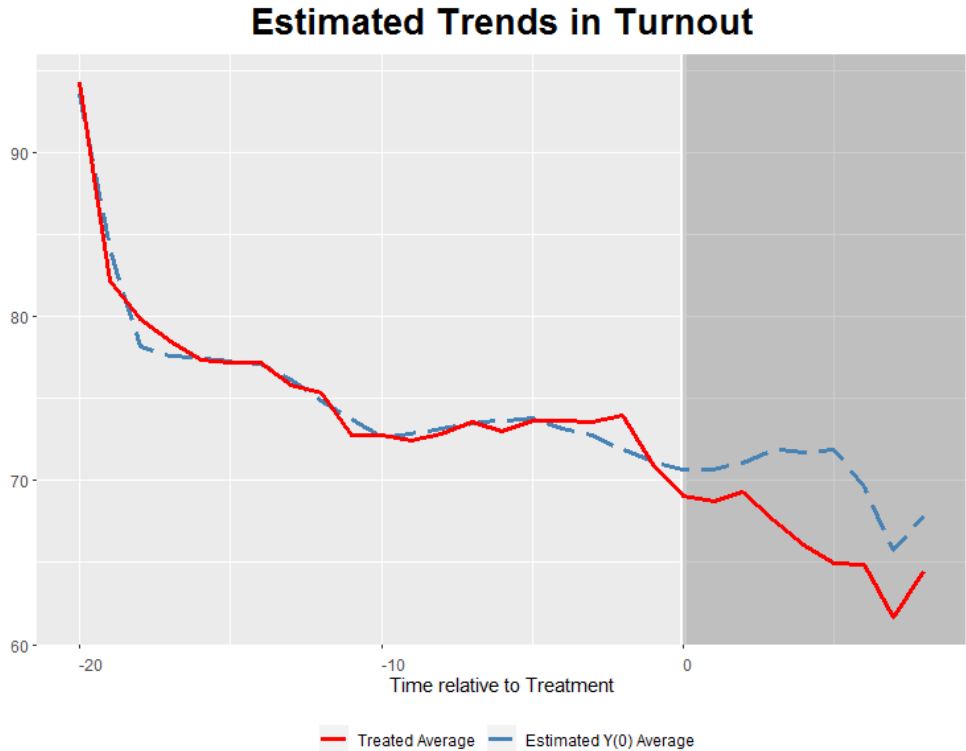


Figure A5: Panel view of electoral democracy index

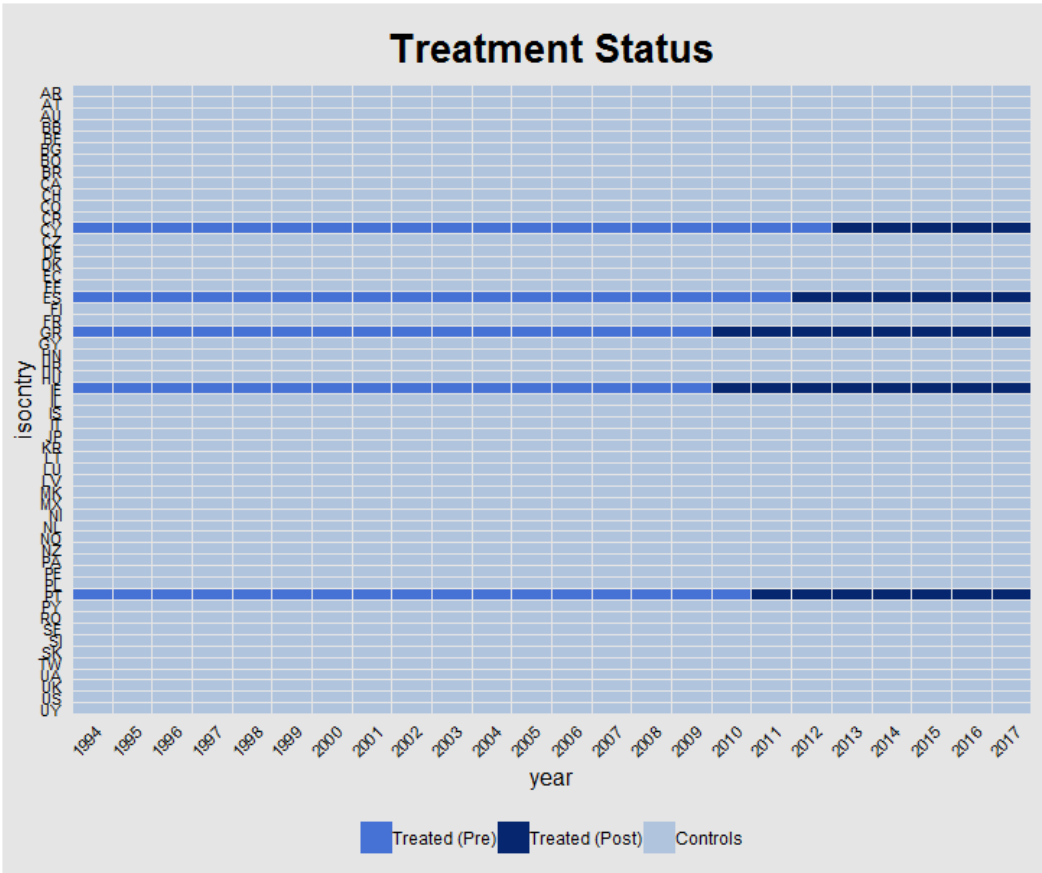


Figure A6: Observed trend and estimated counterfactual in electoral democracy

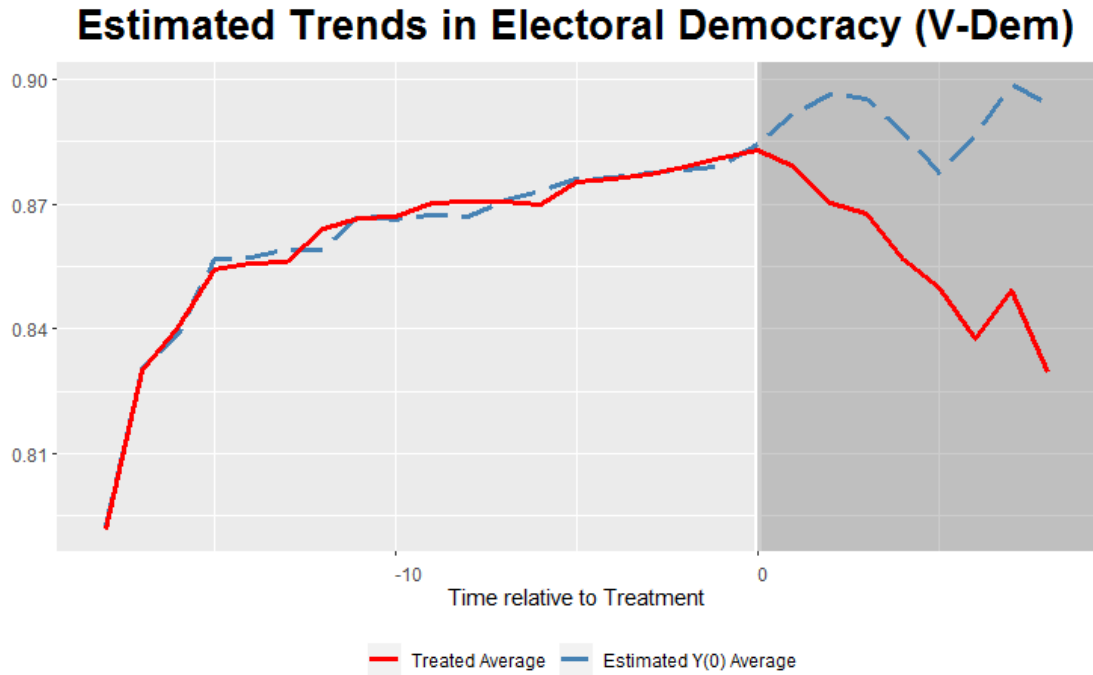


Figure A7: Estimated factor for SWD

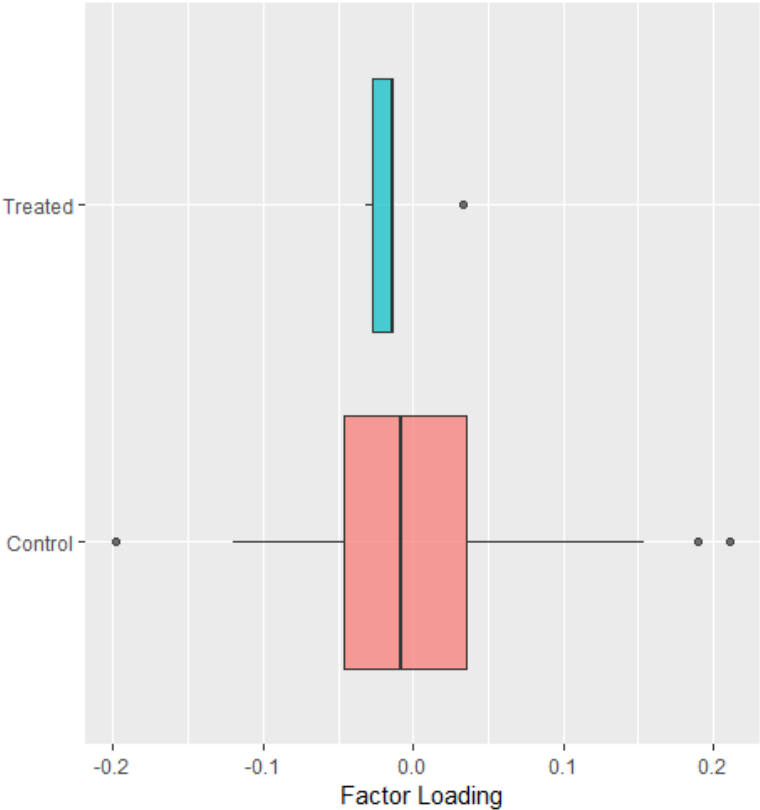


Figure A8: Estimated factors for turnout (first four factors shown)

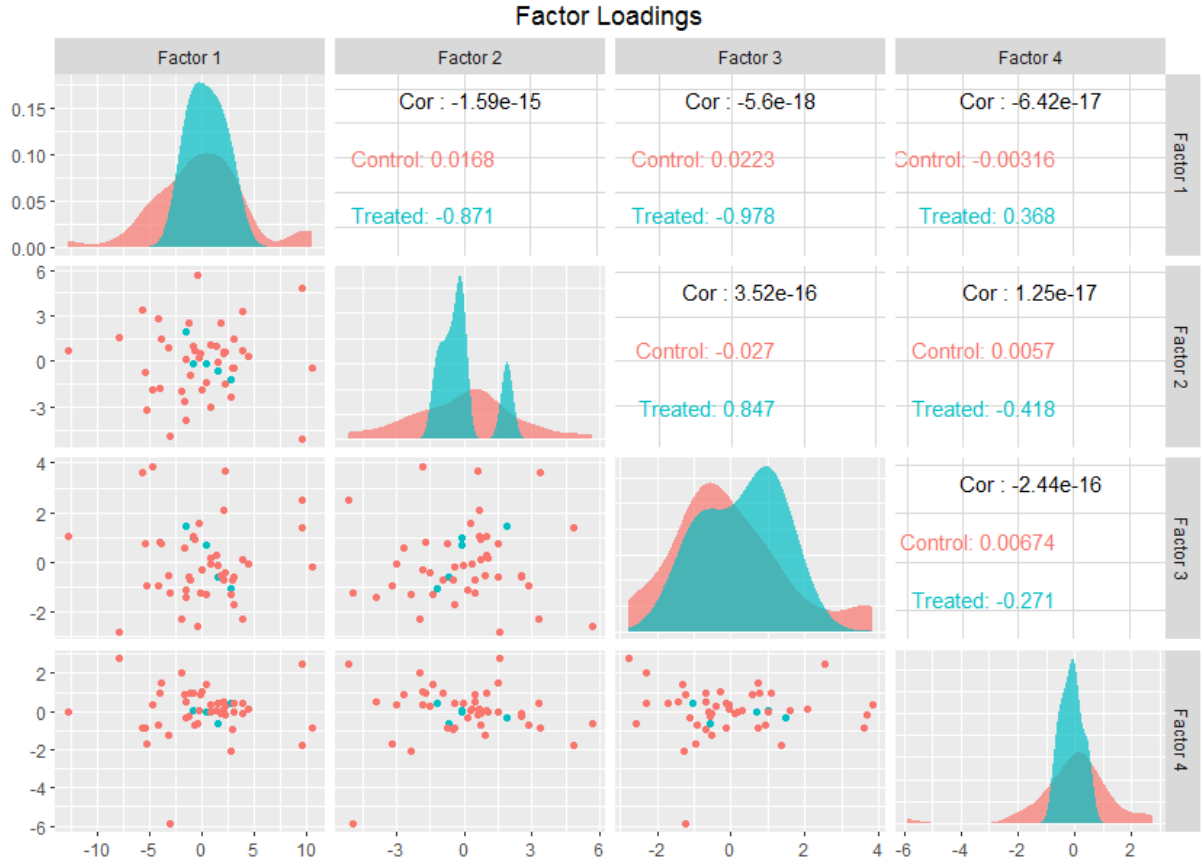


Figure A9: Estimated factors for electoral democracy

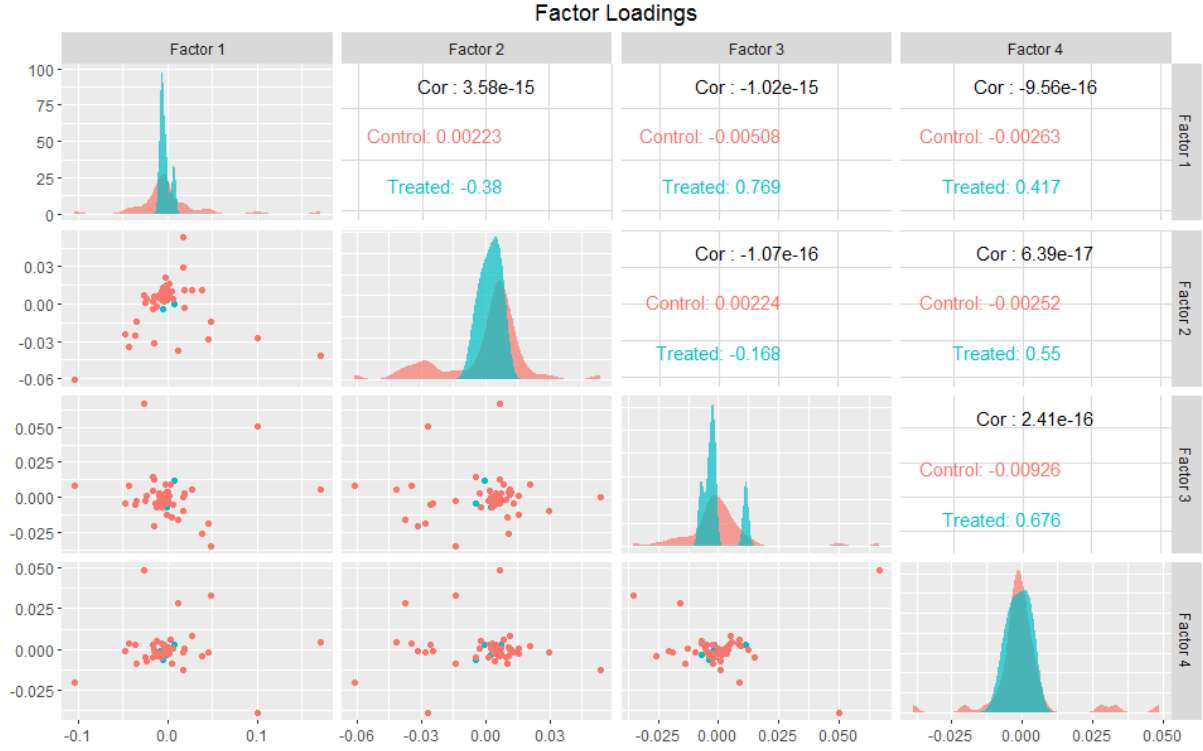


Figure A10: Change in poverty rates across Eurozone bailout cases

