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Spielberger, L.

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Learning to manage the international role of the euro – The ECB’s credit lines to non-Euro Area central banks in 2008 and 2020

Lukas Spielberger

PhD Candidate

Institute of Political Science

Leiden University

Abstract

Credit lines between central banks can be a powerful instrument to restore international financial stability during a crisis. Yet, so far, few political scientists have ventured to study central bank cooperation in the context of European macroeconomic governance and the implications for the international role of the euro. This paper closes this gap in our knowledge by looking at the European Central Bank’s (ECB) cooperation with non-Euro Area central banks during the Global Financial Crisis 2008/09 and the COVID-19-crisis 2020. Based on recently declassified policy documents and eight insider interviews I find that the ECB’s handling of the international role of the euro has changed over time. In 2008, the ECB had decided the credit terms largely based on perceived sovereign credit risk. In 2020, the ECB granted better lending conditions to countries that were institutionally closer to the Euro Area. Based on this I argue that the ECB has redefined its interests during international crises from limiting financial risks to promoting the institutional objectives of the Euro Area. This indicates not just that the ECB has in 2020 acted more proactively as international lender of last resort, but also that it has done so largely in line with political considerations.

Keywords: European Central Bank; Swap lines; EMU; International role of the euro

6928 words (excl. References)

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1. Introduction

Both the COVID-19 crisis in spring 2020 and the Global Financial Crisis (GFC) in 2008 have been defining challenges for the European Union (EU) as a political system. For scholars of European political economy, the comparison between the EU's responses to these two crises is therefore an opportunity to see how economic governance has changed in the course of a decade. Both crises presented existential macroeconomic challenges that required bold decisions to resolve. In 2008, the incomplete institutional edifice and the policymakers of the Euro Area seemed ill-suited to handle what seemed like a once-in-a-lifetime crisis which could threaten the very existence of the new currency (Sandbu, 2015). Since then, therefore, comprehensive changes in the Euro Area's architecture have taken place (Schelkle, 2017). The major decisions in early 2020 contrast with the haphazard crisis response twelve years earlier: EU leaders' decisions in early 2020 to issue common debt under the €750bn Recovery Facility and to establish a joint unemployment insurance crossed two red lines of the euro crisis. The European Commission took to a flexible handling of state aid rules and suspended the deficit rules in favour of encouraging fiscal stimulus (Thompson Reuters, 2021). Lastly, the European Central Bank (ECB) ensured that both Euro Area governments and banks could borrow at favourable terms to support the economy. This comparison suggests that policymakers have learned many lessons from the arduous resolution of the euro crisis.

In this paper I contribute to the debate about changes in EU macroeconomic governance and the international role of the euro by looking at a particular aspect of financial crisis resolution, namely the cooperation between the ECB and other central banks during crises. I start with the observation that both in 2008 and 2020, central banks from EU member states outside the Euro Area requested credit lines from the ECB. Each time the ECB allowed some central banks to borrow under favourable terms through a so-called swap line, while others received repo

agreements which are less useful for borrowers. As we move from the one crisis to the next, I find that the ECB has adopted different criteria to determine who borrows and on which terms. After the ECB decided largely based on sovereign credit risk in 2008, in 2020, it offered favourable lending conditions also for clearly political reasons. At the centre of this shift, I argue, is a re-interpretation of the ECB's role towards member states that want to adopt the euro.

The issue of swap line provision is instructive for the study of the ECB. The ECB's mandate is very broad with regards to international cooperation, which leaves it with full discretion over the lending terms. In neither crisis fundamental issues of Euro Area stability were at stake and, especially in 2020, the amounts involved were tiny compared to the ECB's other monetary policy operations. There exists no institutional framework that regulates when the ECB has to apply specific credit conditions – I find that the Exchange Rate Mechanism II (ERM II; the antechamber to euro adoption) has played no consistent role for credit terms. Plainly, there was no apparent technical or legal reason why the ECB could not provide favourable swap lines to all central banks from EU member states. To understand why it did not, one needs to understand how the ECB defined its interests, both as the central bank of the Euro Area and as an EU institution, at two different points in time.

I employ the following strategy for my study. I begin by testing whether established explanations based on structural or institutional factors explain the ECB's actions in 2008 and 2020. Based on original interview material, financial market data, and public statements, I find, however, that the policy environments in both crises are remarkably similar. No single structural hypothesis can account for which member states received better credit terms for both crises. I conclude that instead it must likely have been changes inside the ECB that have resulted in a re-orientation of its lending policy during the COVID-19 crisis. This conclusion

is in line with studies that stress the importance of bureaucratic culture (Barnett & Finnemore, 1999, 2004; Lütz, Hilgers, & Schneider, 2019) and organisational change in supranational institutions (Abdelal, 2006; J. M. Chwieroth, 2010) in order to explain change.

The paper proceeds as follows. First, I provide a brief overview of what swaps and repos are as well as the ECB's governing structure. Second, I review the current literature on central bank cooperation and European integration and derive three hypotheses about why the ECB might have applied different lending terms. In the third section I test each of these hypotheses. The fourth section explores an alternative explanation that focuses on a change in the ECB's agency. The final section concludes.

2. Background

2.1 Central bank swaps and repos

Central banks have concluded lending agreements with one another for a long time (Bordo, Humpage, & Schwartz, 2015). Over time these lending arrangements have served various concrete purposes, from stabilising the gold standard (Eichengreen, 2008), to pooling gold reserves during the Bretton Woods era (Bordo, Monnet, & Naef, 2017); from stabilising exchange rates under the original ERM in the 1980s (James, 1996) to backstopping the global dollar market in 2008 (Tooze, 2018). Each time, the basic idea was that central banks that held or issued international reserve currencies lent these to central banks that needed them in order to intervene in currency markets or provide liquidity to banks. This way, the borrowing central banks would temporarily not be constrained by their own level of foreign reserves when they needed to stop a panic. Central bank lending arrangements thus offer a complement to International Monetary Fund (IMF) programmes because they can be set up and unwound

quickly and informally, potentially in huge volumes, and without the government needing to sign up to conditionality.

A short glance at the operational differences between swaps and repos shows why the choice of credit terms matters for the borrower. Two central banks can set up a swap line simply by opening accounts in each other's names. Whenever the borrower draws the credit line, it has to provide the equivalent amount its own currency as collateral on the lender's account; once it repays the loan, both balances disappear (Mehrling, 2015). Importantly this means that swap lines result in a temporary increase in the borrower's foreign reserves. Sale-and-repurchase (or repo, for short) agreements, by contrast, do not increase the borrower's foreign reserves because they require the borrower to pledge a foreign asset that they already hold as collateral if they want cash. Unlike swap lines, which increase the borrower's capacity to intervene in markets, repo lines can, at best, allow it to do so a bit faster.

If a swap is hence more favourable to the borrower, for the lender, the major difference involved concerns financial risk. A swap line is secured merely on trust that the borrower will repay the amount, while a repo agreement protects the lender's balance sheet because it can seize the collateral asset in case of non-repayment. In effect, thus, the choice between swaps and repos reflects whether the lending central bank trusts the borrower's promise to repay – or whether it demands collateral as it does with commercial banks. The question how the ECB's lending terms align with sovereign credit ratings is discussed in the empirical sections 4 through 6.

2.2 The ECB's governance structure

To understand the politics of the ECB's decisions on lending arrangements for other EU central banks, let us first reflect on the fact that the ECB is both an EU institution as well as the central bank of the Euro Area with its current 19 members. The ECB is created through EU treaties

and all member states of the EU own a share in its capital. The ECB hosts various technical committees where representatives from the entire EU participate and provides advice and opinions for all EU central banks. Lastly, the ECB, together with the European Commission, assesses whether a member state fulfils the conditions to adopt the euro before that is officially decided by other institutions.

When it comes to the ECB's decision-making, however, non-Euro Area central banks are all but excluded; they only participate in the General Council, which takes no substantive decisions. The Governing Council of the ECB is composed of, on the one hand, the Governors of the National Central Banks, representing their member states, and on the other hand, the six members of the ECB Executive Board, which represent the interests of the Euro Area as a whole (Umbach & Wessels, 2009). For decisions on lending arrangements, the Executive Board relies on staff analysis, especially from the its Economics, International, and Operations Departments.¹

The ECB enjoys considerable latitude when it comes to deciding the international conduct of its policies. The relevant passages in the Treaties (Articles 138 and 219, 1.-3. TFEU) stipulate that the Council of the EU sets the overall priorities of exchange rate policy and concludes formal agreements. In practice the ECB has however acted fairly independently (Henning, 2007). As a party to the ERM II, the ECB enters exchange rate agreements with member states that aspire to adopt the euro.² ERM II participants commit to keep their exchange rate around a central value against the euro for at least two years. Since its creation, the ERM II has included not just a 'Very Short-Term Financing Facility' (which is in effect a swap line) but even a provision under which the ECB intervenes in potentially unlimited amounts if a currency

¹ Interview Papadia

² Denmark is in the ERM-II but has an opt-out of the Treaty requirement to join the euro.

threatens to devalue against the euro (Deutsche Bundesbank, 1998). On paper, at least, the ECB might thus be obliged to support some member states withstand financial market pressures.

3. Three hypotheses on credit terms

Which considerations might lead the ECB to demand stricter credit terms from some central banks than from others? This question hinges on the definition of what kind of actor one thinks the ECB is. The ‘sovereign credit risk hypothesis’, which is developed first, starts out depicting the ECB as a bureaucracy that is concerned with its own reputation; the ‘financial risk hypothesis’, which comes second, assumes that the ECB aims to protect Euro Area banks against spill-overs; the ‘European integration hypothesis’, finally, assumes that the ECB sets credit terms based on political considerations.

3.1 Sovereign credit risk

As discussed in the previous section, the major difference between swaps and repos from the lender’s perspective consists in credit risk. The first hypothesis developed here investigates which logic of action the ECB would be following if that were indeed the overarching concern. A number of studies that approach central banks from a public choice perspective (Chant & Acheson, 1972) see them as organisations that engage in strategic action to maintain their independence (Forder, 2002; Hardy, 2020), their credibility towards different audiences (Lohmann, 2003) or their legitimacy (Dietsch, 2020; Torres, 2013). Too generous a provision of swap lines could have drawbacks from the perspective of the ECB’s reputation because it exposes the balance sheet to losses and might encourage moral hazard (Bindseil, 2014, p. 285).

Differentiated treatment based on credit risk would not be unprecedented. Accounts of the lending decisions by the US Federal Reserve (Fed) during the 2008 crisis document that when the Fed lent to emerging markets, policymakers expressed worries about the latter’s ability to

repay. The Fed was ready to seize these central banks reserve accounts if needed (McDowell, 2017b, p. 172). Fed managers stressed that the swap recipients had a solid track record for macroeconomic management and that applications for swaps were generally discouraged to reduce the strain on the balance sheet (Sheets, Truman, & Lowery, 2018).

Hypothesis 1: ECB extends swap lines to central banks with higher sovereign credit ratings and repo lines to central banks with lower sovereign credit ratings.

3.2 Financial interests

As the central bank of the Euro Area, the ECB has not just an interest in its own balance sheet, but also in the stability of the financial system. Taking this liberal perspective of international relations as a point of departure, one would assume that central bank lending arrangements would serve to protect domestic banks against losses. A similar line of arguing is commonly provided to explain why the IMF has imposed stricter conditionality on some countries than on others. Several studies have found that the IMF has shown more leniency when economic interests of major shareholders were at stake, either as a result of financial lobbying through powerful member states (Broz, 2005; Copelovitch, 2010; Kang, 2007; Steinwand & Stone, 2008; Stone, 2008) or following direct appeals to the IMF by private creditors (Gould, 2006).

The literature on central bank lending arrangements has postulated that central banks also aim to protect their domestic banks against international instability (Braun, Krampf, & Murau, 2020). The swap line provision of the US Fed once more provides some suggestions of how this might play out. The Fed was more likely to provide a swap line to a country if US banks were exposed (Aizenman & Pasricha, 2009; Broz, 2014; McDowell, 2017a) and officials involved emphasised that, above all, the “Fed was seeking to satisfy its statutory dual mandate, which is domestically focused, and to facilitate stability in US markets” (Sheets et al., 2018). Indeed, when there were overriding financial risks, worries about the balance sheet faded into

the background (Hardie & Maxfield, 2016; Sahasrabuddhe, 2019). One could therefore expect that the ECB set the lending terms with a view to the exposures of Euro Area commercial banks.

Hypothesis 2: The ECB extends swap lines to countries where Euro Area commercial banks are more exposed and repo lines to central banks where Euro Area banks are less exposed.

3.3 European Integration

Scholarship on international monetary cooperation has long recognised that international currency issuers, most prominently the US, have used access to their currency as a diplomatic tool. The ability to issue an international reserve currency, in this view allows a state to exercise “economic statecraft” by supporting some countries but not others (Cohen, 2017; Kirshner, 2006). In the context of the Fed this has been seen in outright coordination with the State Department (Harris, 2015; Tooze, 2018) and the rejection of swap lines for countries that held diverging trade policy interests from the US (Sahasrabuddhe, 2019). Similarly, the active promotion of renminbi swap lines by the People’s Bank of China is widely seen as a way to increase the geopolitical influence that goes together with an international currency (McDowell, 2017b).

The ECB lacks a direct counterpart to a foreign ministry which could instruct it how to treat different member states. Nevertheless, it entertains bilateral relations with all central banks outside the Euro Area as one of the actors involved in the euro adoption process. In this context, the politics of euro adoption has by now spawned a literature in its own right which has examined the question why some countries have been keener to join the Euro Area than others (Dandashly & Verdun, 2018; Dyson, 2006; Epstein & Johnson, 2010; Johnson, 2008). In addition, as previously discussed, central banks whose currencies already participate in the ERM II may have access to the liquidity assistance facilities that it includes. Thus, one might

expect the ECB to offer preferential treatment to central banks that want to integrate more closely into the Euro Area.

Hypothesis 3: The ECB extends swap lines to countries that seek closer integration with the Euro Area and repo lines to countries that delay euro adoption.

The following three sections examine each proposition in turn, only to conclude that neither of them offers a comprehensive explanation for the ECB's selection of swap and repo recipients during both crises.

4. Sovereign credit risk

Was the ECB's overriding motivation for setting credit terms the protection of its own balance sheet? At first glance, the ECB's provision of swap lines in 2008 largely seems to conform to states' sovereign credit ratings (Table 1). Denmark and Sweden, the two countries that received swap agreements, had the best possible credit ratings while the three Eastern European countries that received repos had weaker credit standings. Hungary and Latvia even had to request a sovereign bailout from the IMF and the European Commission.

Table 1: Overview of lending arrangements and sovereign credit ratings 2007-08

<i>Date</i>	<i>Central Bank</i>	<i>Sovereign credit rating</i>	<i>Lending arrangement</i>
20/12/07	Sveriges Riksbank	AAA ³	€10bn <i>swap</i> line
16/10/08	Hungarian National Bank (MNB)	BBB+	€5bn <i>repo</i> line
26/10/08	Denmark's National Bank (DNB)	AAA	€12bn <i>swap</i> line
11/11/08	Bank of Latvia (BoL)	BBB	€1bn <i>repo</i> line
21/11/08	National Bank of Poland (NBP)	A-	€10bn <i>repo</i> line

³ AAA signifies the strongest rating, followed by AA, A, BBB etc.

Table 1: Source: ECB website and ECB (2014), tradingeconomics.com

A closer look at the decision-making procedure in 2008 supports the conclusion that sovereign credit risk was decisive. Sweden's central bank approached the ECB for a precautionary credit line already after the first round of market stresses. A €10bn swap agreement was signed between the Swedish central bank and the ECB in December 2007, but was kept secret both from market participants and other central banks (Leung, 2020). The Swedish request was seen in line with other swap lines that the ECB had concluded earlier and the Executive Board did not even ask for approval from the General Council.⁴ The Danish central bank approached the ECB after the Lehman shock because it needed to provide euro liquidity to Danish banks (Jensen & Spange, 2009). For those countries where credit risk was not a question, the ECB readily provided swaps.

When the Hungarian central bank, however, approached the ECB for a swap line the day Hungarian markets froze, the ECB was divided on how to respond. Among the ECB's staff, the Economics Department voiced concerns about sovereign credit risk, whereas the International and Market Operations Departments were ready to agree to a swap.⁵ In the Governing Council, the Austrian National Bank and the Banque de France pushed unsuccessfully for a swap line, against the Executive Board and the German Bundesbank. The repo for Hungary eventually reflected a compromise between those actors that wanted to provide assistance and those that wanted to protect the ECB's balance sheet.⁶

After the decision on Hungary, the ECB Governing Council developed a set of principles for future requests from non-Euro Area EU countries. Though the Polish request came the same day as the Hungarian, it was handled later and based on that precedent.⁷ The Latvian central

⁴ [Swap agreement between the European Central Bank and Sveriges Riksbank: Executive Board proposal](#)

⁵ Interviews Papadia, Nowotny

⁶ Interviews Nauschnigg, Nowotny

⁷ Interviews Nauschnigg, Nowotny

bank agreed upfront to accept the same terms as Hungary.⁸ The ECB asked the Polish and the Latvian central banks to demonstrate that they suffered market disfunctions before agreeing to the repo.⁹ Though the Hungarian and Polish central banks kept pressuring the ECB to loosen the credit terms throughout the crisis (Verma & Thornton, 2009) it only relented after the worst of the crisis had passed (Vallee, 2010). All in all, the ECB's decision on repo lines for Hungary, Poland, and Latvia does hence seem to reflect an institutional approach more than any in-depth analysis of the credit risks involved in each country.

Besides that, the ECB was not entirely consistent in its insistence on good collateral. In fact, the sovereign credit ratings of Hungary and Poland were above the collateral quality that it asked from Euro Area banks. On 15 October 2008, the ECB lowered its collateral standards to accept even assets rated BBB- as collateral. At this time Hungary maintained a BBB rating, despite its request for an IMF bailout, and Poland an A-.¹⁰ This meant that while the ECB argued based on sovereign credit risks, it stood ready to accept commercial securities that were rated as riskier than the governments in question.

The ECB's selection of swap recipients in 2020 (Table 2), however, fits less easily with credit risk. Granted, AAA-rated Denmark again received a swap line. But the ECB's decision to provide swap lines to the Bulgarian and Croatian central banks, but not to those of Hungary and Romania, seems out of line with an explanation around credit risk. After all, the Hungarian state enjoyed a better rating than Croatia, which had just recovered an investment-grade rating in 2019.

⁸ [Letter from Latvijas Banka to the European Central Bank on financial transactions between European Central Bank and Latvijas Banka, 27 October 2008](#)

⁹ [Letter from the President of the European Central Bank to the Governor of the National Bank of Poland \(NBP\), 24 October 2008](#); [Letter from the European Central Bank to Latvijas Banka on repurchase transaction agreement, 30 October 2008](#)

¹⁰ <https://countryeconomy.com/ratings/poland>; <https://countryeconomy.com/ratings/hungary>

Table 2: Overview of lending arrangements and sovereign credit ratings 2020

<i>Date</i>	<i>Central bank</i>	<i>Sovereign credit rating</i>	<i>Lending arrangement</i>
20/03/20	Denmark's National Bank	AAA	€24bn <i>swap</i> line
15/04/20	Croatian National Bank (HNB)	BBB-	€2bn <i>swap</i> line
22/04/20	Bulgarian National Bank (BNB)	BBB	€2bn <i>swap</i> line
05/06/20	National Bank of Romania (BNR)	BBB-	€4.5bn <i>repo</i> line
23/07/20	Hungarian National Bank	BBB	€4bn <i>repo</i> line

Table 2: Sources: ECB website, tradingeconomics.com

The ECB's first swap line in response to the COVID-19 crisis went to the Danish central bank in March 2020. Since both central banks had already entered a swap before, the credit line from 2008 could simply be reactivated, though its volume was doubled to €24bn. In April, the ECB sent on to establish two new swap lines of €2bn each with the Croatian and Bulgarian central banks. The purpose of these swap lines appears to reassure markets in the value of the currencies and both credit lines were presented as precautionary instruments. Neither the Croatian or Bulgarian central bank was at immediate risk of running out of foreign reserves as both had far higher foreign reserve levels than their Romanian and Hungarian colleagues.¹¹ But in March 2020 the Croatian currency was under a speculative attack and the central bank had to spent around €2.25bn to defend the exchange rate.¹² The ECB swap lines had the intended

¹¹ For sense of proportion, even after the interventions, Croatia's central bank still had gross foreign reserves equal to €15.7bn and remained comfortably in all the IMF's adequacy ratios <https://www.hnb.hr/en/-/ima-li-hrvatska-dovoljno-me-unarodnih-pricuva>

¹² <https://www.total-croatia-news.com/business/42903-ecb>

effect as attacks on the currency stopped as soon as the swap was announced.¹³ Informally the Croatian central bank was reassured it could get a bigger volume if needed.¹⁴

By contrast, the National Bank of Romania and the Hungarian National Bank received only repo lines from the ECB later in summer 2020. To date, Romania's central bank has not yet activated its €4.5bn repo line or provided any euro liquidity to banks. The Hungarian National Bank in mid-2020 reached out to several central banks for liquidity lines. It secured repo lines from the ECB (€4bn) and Bank of International Settlements (€2bn), as well as access to the US Fed's repo facility for central banks. It has drawn on its repo lines for providing euro liquidity since September (Magyar Nemzeti Bank, 2020, p. 53). Taken together, it seems however questionable that the ECB's lending arrangements were strictly necessary for either of these central banks to resolve the crisis.

Officially, the ECB insisted that credit risk was an important consideration for setting the terms of central bank credit lines in both crises (European Central Bank, 2014; Panetta & Schnabel, 2020). The above analysis has found, however, that the ECB was at best inconsistent in its application of credit risk. In 2008, sovereign credit risk seemed to have been an important concern, but the ECB was also unwilling to grant a swap to Poland, despite its good credit standing. In 2020, the ECB even applied different credit terms to states with similar credit ratings. The risk to the balance sheet alone cannot account for its selection of swap recipients.

5. Financial interests

Both the GFC and the COVID-19 crisis shook confidence in international financial stability. In the densely integrated European financial markets, financial instability could easily spill

¹³ According to Croatian central bank governor Boris Vujcic: https://www.imfconnect.org/content/imf/en/annual-meetings/calendar/open/2021/04/06/159086.html?calendarCategory=T2ZmaWNpYWwvQnkgSW52aXRhdGlvbg%3D%3D.UHJlc3M%3D.T3Blbg%3D%3D&utm_medium=email&utm_source=govdelivery

¹⁴ Interview Nagy Mohasci, referring to comments by Governor Vujcic.

over from one country to another, impose losses on Euro Area banks and potentially cause contagion (Árvai, Driessen, & Ötker-Robe, 2009).

Table 3: Foreign bank claims in 2008

		Member state				
		<i>Sweden</i>	<i>Denmark</i>	<i>Latvia</i>	<i>Hungary</i>	<i>Poland</i>
Claim	Total claims Q2 2008	326 890	332 758	24 476	98 463	139 289
	Top 3 Euro Area	79,512	126,302	8,850	58,328	53,737

Source: Bank for International Settlements, International Banking Statistics, Table 6.2, million US \$; Data for Sweden refer to Q4/2007

As shown in Table 3, the two countries that received swap lines in 2007-2008 were indeed also the ones to which Euro Area banks were most exposed, though Euro Area banks also had considerable interests at stake in Central and Eastern Europe. Major shares of the banking markets in Poland and Hungary — as in most other countries in the region — were largely controlled and funded by West European banking groups (Árvai et al., 2009; Mitra, Selowski, & Zalduendo, 2009). Especially Austrian banks, but also major players from Belgium, France, Germany and Italy had expanded into the region over the preceding decade. Arguably, direct financial linkages to Euro Area banks were present for all countries except Latvia (where Swedish banks dominated).

Financial interests and worries about contagion played an important role during the negotiations in the ECB Governing Council. Especially the Austrian National Bank strongly advocated swap lines for Hungary and Poland because it was worried that financial instability might spill over to the parent groups in Austria (Nauschnigg & Schieder, 2011). Even the Bundesbank, which had still reacted with reservation after the Hungarian request, supported a

swap for the Polish central bank with a view to German investments in Poland.¹⁵ However, these material interests were insufficient to overcome the resistance of the ECB staff.

Exposed banking groups later called directly on the ECB to provide assistance to Eastern Europe. In late 2008 the most exposed banking groups coordinated to set up an initiative to ensure support for financial stability in the region – the so-called Vienna Initiative (Pistor, 2011). In January 2009, ten major EU banks wrote a joint letter in which they proposed several concrete measures as to how the ECB could support credit conditions in the new member states, including swap lines, accepting local currency bonds as collateral, and by providing liquidity directly to foreign subsidiary banks (the letter is reproduced in EIB, 2019, p. 238). The rough response by ECB Board Member Yves Mersch was that the ECB did not have “a mandate to be a regional United Nations agency” and “cannot be a small god for everyone and for everything” (Atkins & Wagstyl, 2009).

Twelve years later, cross-border exposures had declined considerably, even if West European banks often maintained their market shares. Table 4 shows that while Euro Area banks still had their biggest exposure out of all countries in question to Denmark, the other two swap line recipients, Croatia and Bulgaria posed relatively smaller financial risks than Hungary and Romania. Patterns of bank ownership have remained relatively unchanged since 2008 in Romania, Bulgaria, and Croatia, where almost the entire banking systems remain foreign-owned. In Hungary, the share has declined – though it remains considerable – as the government has pursued an aggressive course of ‘financial nationalism’ after 2010 and taken several measures to limit the involvement of foreign banks (Ban & Bohle, 2020; Johnson & Barnes, 2015; Oellerich, 2019).

Table 4: Foreign bank claims in 2019

¹⁵ Interviews Nowotny, Nauschnigg

		Member State				
		<i>Denmark</i>	<i>Hungary</i>	<i>Croatia</i>	<i>Bulgaria</i>	<i>Romania</i>
Claim	Total claims Q4 2019	247 008	36 345	12 489	10 125	29 203
	Top 3 Euro Area	107 560	13 392	10 694	5 681	17 972

Source Bank for International Settlements, *International Banking Statistics*, Table 6.2, million US \$

Table 5: Market shares of foreign-owned banks

		Member state					
		<i>Bulgaria</i>	<i>Croatia</i>	<i>Hungary</i>	<i>Latvia</i>	<i>Poland</i>	<i>Romania</i>
Year	2008	83,9%	90,6%	61,2%	66,6%	72,4%	88,5%
	2019	77,7%	91,1%	43,5%		46%	73,6%

Source: European Central Bank, *Statistical Data Warehouse*, CBD2: Consolidated Banking data; Croatian National Bank

In sum, it does not seem that financial interests of Euro Area banks had a decisive impact on the terms of the ECB credit lines to central banks in either 2008 or 2020. In 2008, the ECB insisted on repos for Hungary and Poland despite considerable bank interests at stake; in 2020 the two East European swap recipients posed the smallest direct financial risks to Euro Area banks.

6. European Integration

The last possible explanation considered here is that the ECB might have granted better terms to countries that sought closer integration with the Euro Area. The fact that Denmark, which participates in the ERM II but has an opt-out from euro adoption (Umbach & Wessels, 2009),

received swap lines indicates that close cooperation with the ECB could be an advantage.¹⁶ But the ERM II has played a more nuanced role and been re-interpreted over time.

First, it should be noted that the lending arrangements with Denmark and Latvia were both legally outside the ERM II framework. In fact, the ECB insisted that the credit lines only be drawn for purposes of liquidity provision to banks and not to defend the exchange rate.¹⁷ For Denmark, that was exactly what the central bank needed to do (Jensen & Spange, 2009), but the major risk in Latvia was a devaluation of the currency and it never used the ECB's repo line despite falling reserves.

Second, although the ERM II provides assistance facilities, the ECB never had any intentions of supporting the currency regimes in the Baltic countries despite their ambitions to adopt the euro as soon as possible. When Latvia had joined the ERM II in 2005, the central bank continued the 1% fluctuation band against the euro, instead of the customary 15% and the ECB insisted that this remain a unilateral commitment that placed no obligations on it to support it (European Central Bank, 2005).¹⁸ In November 2008, the Executive Board noted in an internal document that "the ECB's policy line has always been that currency board or unilateral pegs by third countries are not backed in any way by policy commitments from the ECB."¹⁹ The bizarre conclusion was that the ECB opposed devaluation in Latvia, but was not ready to provide substantial support because a swap line from the ECB would contradict the disciplinarian logic of the ERM II.²⁰

¹⁶ Interviews Papadia, Nowotny

¹⁷ [Letter from the European Central Bank to Latvijas Banka on repurchase transaction agreement, 30 October 2008; Euro-Danish krone swap agreement between the European Central Bank and Danmarks Nationalbank](#)

¹⁸ Interview Papadia

¹⁹ [Vulnerabilities in the Central and Eastern European Member States: Executive Board proposal](#)

²⁰ Interview IMF 1

By contrast in 2020 the ambitions of Bulgaria and Croatia to join the euro were an advantage. Both countries had applied to be included in the ERM II in 2019 and the ECB and the European Commission had delayed approval for ERM II expansion out of concerns over the quality of financial supervision (as joining the ERM II nowadays entails becoming part of the Banking Union).²¹ With the onset of the COVID-19 crisis, these concerns were put to the side and both countries entered the ERM II in July 2020 – ahead of schedule. Previous reform efforts and a commitment to future reforms by the Bulgarian and Croatian governments (European Commission, 2020, p. 35) clearly improved their chances for a swap line from the ECB in 2020.²² The Bulgarian swap line was welcomed by both the ECB Governor Christine Lagarde and the Bulgarian prime minister.²³

The two repo recipients are farther away from EMU integration. Romania's government aspires to adopt the euro, but does not envisage ERM II entry before 2024 and the ECB has considerable concerns about the central bank legislation (European Central Bank, 2020; European Commission, 2020). Hungary is even less likely to seek integration and the government has deliberately dragged its feet on euro adoption (Dandashly & Verdun, 2018) as prime minister Orbán has undermined the independence of the central bank since taking office (Johnson & Barnes, 2015; Király, 2020).

Thus, though the assistance facilities included in the ERM II were not used as a basis for the central bank credit lines, it is clear that the ECB's handling of aspiring EMU members has pivoted. After ERM II membership did not help Latvia in 2008, Governor Lagarde sent out

²¹ <https://www.reuters.com/article/us-bulgaria-euro-idUSKCN1L717Z>

²² Interview Nauschnigg

²³ <https://bnt.bg/news/bulgaria%E2%80%99s-pm-held-talks-with-the-president-of-the-european-central-bank-267980news.html>

unequivocal political signals that the ECB would support member states that aspired to adopt the euro fast and conformed to its demands, apparently irrespective of their credit rating.

7. Discussion: From Euro Area central bank to EU institution?

The previous three sections have found that none of the structural hypotheses explains the ECB selection of swap recipients in both crises. At the onset of the GFC, the ECB staff aimed to defend the interests of the Euro Area by protecting its balance sheet against credit risk (Piroska, 2017). The Nordic central banks, considered good debtors, received swap lines because “we trust the Swedes,”²⁴ whereas the East European central banks received only repo lines. This decision reflected ECB staff resistance to pressures from commercial banks to do more. In 2020, the ECB swap line decisions no longer align with sovereign credit ratings or bank exposures; instead, they correspond to those countries which would participate in the ERM II by the end of the year. Thus, during the COVID-19 crisis, the ECB’s swap line provisions seem coloured by the Euro Area political considerations.

Why would the ECB prioritise the integrity of its balance sheet at one point in time, and the willingness of a government to adopt the euro at another? Rather than trying to rationalise ECB decisions based on changes in the environment, I propose now to turn to an analysis of the changes inside the institution in order to see whether it might explain its divergent behaviour in the two crises.

The literature on international organisations has long argued that bureaucratic cultures can shape an organisation’s preferences. Building on sociological and constructivist approaches, this literature argues that the actions of international organisations are not primarily driven by efficiency concerns, but organisational rules, professional norms, and legitimacy requirements

²⁴ Interview Papadia

(Barnett & Finnemore, 1999, 2004). A variety of internal processes may lead to policy change, including the arrival of new leadership (Abdelal, 2006; Marcussen, 2009), staff recruitment (Ban, 2015; J. Chwioroth, 2008, 2015; Woods, 2006) and the embedding of past experiences in new organisational routines (J. Chwioroth, 2008; Levitt & March, 1988).

Changes in ECB leadership and policy learning among staff provide plausible explanations of the reordering of ECB preferences (Adolph, 2013). The role of the ECB during the Euro Area crisis has commonly been studied from the perspective of institutional leadership (Tortola & Pansardi, 2019; Verdun, 2017). Given the ECB Executive Board's opposition against swap lines in 2008, let us look at the impact of change in persons holding two key leadership positions may be of influence. Both Governor Jean-Claude Trichet and Chief Economist Jürgen Stark were in 2008 considered as quite hawkish²⁵ central bankers with conservative views of the role of the central bank in the economy and European integration (Lebaron, 2013). By contrast, in 2020 Christine Lagarde came into the role as Governor of the ECB without prior experience in managing a central bank.²⁶ Her Chief Economist Philip Lane is considered a dove and has taken strong pro-European stances on several issues.²⁷ The preferential treatment of aspiring EMU members in 2020 might thus reflect a more politically savvy and pro-European ECB leadership.

Moreover, the ECB has during the 2010s expanded the scope of its activities and taken a more political role (Howarth & Quaglia, 2015). During the Euro Area crisis, the ECB repeatedly pushed against its original mandate to ensure the safeguarding of the systemic interests of the Euro Area as a whole (Yiangou, O'Keefe, & Glöckler, 2013). The change in orientation was

²⁵ Central bankers are commonly divided into 'hawks' who focus narrowly on monetary policy doctrine and 'doves' that balance monetary policy concerns against wider calculations (Adolph, 2013)

²⁶ Lagarde did however have experience as French finance minister and, later, as IMF managing director <https://www.dw.com/en/christine-lagarde-will-need-all-her-skills-to-steer-ecb-through-trying-times/a-51046045>

²⁷ <https://www.bloomberg.com/opinion/articles/2019-02-28/ecb-is-likely-to-tap-ireland-s-philip-lane-as-chief-economist>

not just the result of changing leadership, but also incremental policy learning among ECB staff (Ferrara, 2020) and a changing justification for its policies (Schmidt, 2016).

For the issue of international liquidity provision, a similar process might have played out. Back in 2008, the lack of experience with international financial crises within the ECB left it without any organisational or political guidance as to how to respond. An evaluation of its research activities lamented the lack of expertise for international issues (Freedman, Lane, Repullo, & Schmidt-Hebbel, 2011).²⁸ Only in response to the unfolding crisis in Eastern Europe did the ECB invest in staff capacities for Balance-of-Payments crises, including the staff members that would later join the Troika missions.²⁹ The ECB position on the international role of the euro has moved from taking a ‘neutral’ stance (Duisenberg, 2000), to active promotion of the euro as an international currency and acknowledging the potential need to act as international lender of last resort (European Central Bank, 2019).

This brief overview indicates that the ECB decision to provide swap lines to Croatia and Bulgaria – despite their weak credit standings and the limited financial risk they posed to the Euro Area – might reflect a wider shift in how the ECB acts as an EU institution. Since the GFC, the ECB has taken a more expansive view of the role that it should take as an EU institution. This new view might explain why it granted better lending terms to the countries that showed most political readiness to join the Euro Area. In 2008 Latvia, under similar conditions, did not enjoy such an advantage.

²⁸ Note that this study was co-authored by Philip Lane – still working as an academic

²⁹ Interviews, IMF 1 and 2, Kiraly

8. Conclusion

This paper started with the question why the ECB offered swap lines to some central banks from EU member states during the financial market stresses in 2008 and 2020 and repo lines to others. After examining three structural hypotheses about which countries might receive better lending terms, I conclude that the ECB has prioritised different interests in its selection of swap line and repo recipients during both crises. During the GFC, the overarching concern was to limit risks to its own balance sheet by insisting on euro collateral from countries with relatively weaker credit rating. When COVID-19 rattled international financial markets, the ECB, by contrast, granted swap lines to two countries with relatively weak credit ratings, but which were aiming to adopt the euro soon, while insisting on repos for euro laggards. The choice of lending terms was in no case crucial to the survival of the Euro Area. Rather, I argue that in both crises the ECB has exercised considerable discretion in setting the lending terms. That it shifted from financial to political considerations provides a new insight into how the ECB understands its role in EU macroeconomic governance edifice and as international currency issuer.

I have also argued that this shift in priorities is more likely the result of organisational changes inside the ECB than of a profoundly changed international environment. Over the past decade, the ECB has vastly increased its technical capacities towards international cooperation and obtained more politically perceptive and open leadership. Most strikingly the institution of the ERM II has been completely reinterpreted: in 2008, the ECB insisted on Latvia's unilateral commitment to a narrow fluctuation band; in 2020 it provided swap lines to Croatia and Bulgaria before fast-tracking their acceptance into the ERM II. Internal changes provide some explanation why the ECB focus might have moved from narrow technical considerations to political objectives.

These findings about the ECB lending arrangements have several implications for the wider study of European macroeconomic governance and the political consequences of the international role of the euro. First, I would argue that the changes in governance and the increasing use of political discretion on the supranational level should not only be understood as the result of institutional reforms (Bauer & Becker, 2014; da Conceição-Heldt, 2016; Yiangou et al., 2013). The change in the ECB's lending priorities, I would argue, rather reflects the internal reorganisation of the ECB and a change in its organisational culture that deserves more attention (Marcussen, 2009; Mudge & Vauchez, 2018).

A second question for future research concerns the implications of this shift for the institutional legitimacy of the ECB. Over the past decade the ECB has become more outward-looking and has sought to legitimise its broader interpretation of its mandate by engaging with more political stakeholders. Yet the ECB has no clear mandate to discriminate between different EU member states – which all own a share of its capital – along political priorities. The empirical question of how the ECB legitimises its measures during the COVID-19 crisis may still be too early to answer. But the normative question to which extent the ECB should follow political rather than economic priorities has been debated since its creation. The findings in this paper suggest that it may also have to turn towards a more political justification of its international policy.

In sum, the ECB may still not be willing to be a “small god for everyone and for everything,” as Yves Mersch said in 2009. But in 2020 it has at least come to recognise that it is able to, if that serves the political interests of the Euro Area.

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Appendix: List of Interviewees

Name	Function	Date
[anonymous] IMF 1	Senior IMF official	23 and 27 September 2020
[anonymous] IMF 2	IMF official	8 October 2020
Julia Király	Former Vice Governor, Magyar Nemzeti Bank	1 October 2020
Stanislaw Kluza	Former Head, Polish Financial Supervisory Authority	2 November 2020
Piroska Nagy	Former Chief Economist, European Bank for Reconstruction and Development	10 November 2020
Franz Nauschnigg	Head of the International Department, Austrian National Bank	2 November 2020
Ewald Nowotny	Former Governor, Austrian National Bank	9 November 2020
Francesco Papadia	Former Head of Market Operations, ECB	22 October 2020