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Lessons from Europe for the study of international central bank cooperation

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Chapter 7 – Analysis

Abstract

This chapter synthesizes the findings from the empirical chapters and relates them to the ideal-typical forms of central bank cooperation outlined in the introduction. It looks at the substance of the empirical chapters by applying the theoretical framework. It provides insight into the ideal-typical motivations for central banks to cooperate. It is argued that material factors, on their own, provide little insight into central bank cooperation – the value-based understandings of cooperation often provide a better approximation. Both for individual and collective actions by central banks, some plausible factors that could account for divergent cooperative outcomes are ventured. Lastly, the chapter discusses the role of ideas in shaping organisational interests and allowing entrepreneurs to initiate new forms of regional financial governance.

Introduction

This chapter takes stock of the case studies in the previous chapters and proposes wider theoretical conclusions. The analytical framework distinguishes between two ideal-typical motivations for central bank cooperation. One is based on a logic of consequence; the other expresses a logic of appropriateness. The other distinction is whether the action takes place at the individual or the collective level. This chapter reflects on the instances of central bank cooperation discussed in the preceding chapters from the perspective of the analytical framework set out in more detail in chapter 1. The present chapter aims to build a systematic account of the motivations for central bank cooperation that are observed throughout the study. The overall findings do not merely highlight the role of norms in guiding individual decisions and collective actions, but also emphasise the importance of ideas in shaping central banks' interests and underpinning new institutional forms of cooperation.

The analytical strategy for this chapter is as follows. The first objective is to formulate an answer to the research question of this study, of how best to understand central bank cooperation. Rather than propose a general explanation for central bank cooperation, it argues

that cooperation was dependent on context and contingent on circumstances. Different motivations matter in different contexts and both logics of action produce informative insights. For individual actions by central banks, this part of the analysis concludes that, while often both logics of action were at play, considerations of appropriateness often seem to have featured more prominently. Collective actions have largely relied on central banks' sense of appropriateness and the formulation of collective norms, rather than on fixed rules that were formulated through bargaining processes.

Second, the chapter turns to the contextual and idiosyncratic factors that might explain why certain logics of action were more prominent in specific instances. Why did central banks sometimes draw on material motivations and sometimes on norms and identities? The argument made here is that much depended on how they were constituted as actors, that is, which ideas, experiences, and identities shaped their outlook on the world. Individual central banks' decisions become clearer if they are considered against the backdrop of organisational cultures. The objectives and institutional forms of regional financial governance were initially formulated by some key entrepreneurs who persuaded others to reconsider their interests and perceptions of appropriateness. In short, ideas acted as 'switchmen' in reconfiguring central banks' individual and collective perceptions of what was the right thing to do.

The chapter begins by reviewing and analysing the empirical findings about individual actions, referring to the findings of chapters two, three, and four, which discussed central banks' credit lines and their role in Balance of Payments assistance. The second half of the chapter does the same for collective actions, specifically cross-border crisis management and macroprudential policy coordination, discussed in depth in chapters five and six.

7.1 Individual actions

What were the motivations of individual central banks to decide to cooperate? The narratives of individual actions in chapters two through four distinguish between a logic of consequence (where cooperation serves ulterior material goals) and a logic of appropriateness (where cooperation reflects value judgments). Chapters two and three find that central banks have, at times, provided credit lines in service of domestic policy objectives and, in other instances, because they generally found it appropriate to provide support to peers during a crisis. Chapter five highlights central banks' general reluctance to meddle with BoP financing both because of their subjective role understandings and their limited expertise in BoP programmes.

7.1.1 Logic of Consequences

By far the most common explanation for why central banks cooperate during financial crises in the literature is that they pursued some ulterior motives, such as domestic stability, protecting financial interests, or advancing strategic interests (Broz, 2014; McDowell, 2012; Sahasrabudde, 2019). The empirical exposition has consequently taken material explanations as a baseline to account for central banks' motives in providing financial support during the crisis. The case studies here have highlighted three main sets of material considerations that central banks responded to, namely *monetary policy objectives*, *financial stability concerns*, and *credit risk*.

A central bank's monetary policy objectives can provide a rationale for extending a credit line if doing so facilitates the transmission of its monetary policy. The empirical chapters identified two instances where credit lines could be linked to monetary policy objectives in such a way. First, for the SNB's swap line to the ECB, monetary policy objectives were a core concern. The SNB's swap was provided in direct response to specific market pressures that threatened its operational target and indeed, international market tensions were the SNB's main preoccupation

during the crisis (Auer & Kraenzlin, 2011). The SNB's swap with the ECB also aligned with its overall strategy of supplying international liquidity to prevent deflation. But even though from the SNB's perspective, its CHF/EUR swap lines to the MNB and the NBP were identical to the swap with the ECB, a policy motive is less plausible in those cases. Both before and during the crisis, the SNB had declared that the Hungarian and Polish exposures were too small to disrupt its policy objectives. A final telling observation is the consistency of the terms at which the recipients offered the Swiss francs that they could borrow: '[t]he conditions for these funds are similar across these countries, in effect the private sector instantly gained access to the primary source of [Swiss francs]: the SNB' (Auer & Kraenzlin, 2011, p. 412). For the SNB, the credit lines can therefore be seen as an extension of its monetary policy operations.

For the ECB's swap line with the DNB, a similar policy rationale seems to have been considered. Euro shortages in Denmark threatened to spill over to Euro Area money markets and the DNB passed on its swap line from the ECB to Danish banks without any markup. But within the ECB's operations, the Danish swap stands out in this regard; none of the other credit lines was deployed with a view to monetary policy targets. As discussed below, concerns unrelated to policy arguably mattered greatly for the ECB's swap to the DNB as well.

Though *financial stability concerns* were prominent during the crisis, they were rarely decisive for individual decisions on credit lines. The Riksbank's efforts to prevent devaluation in Latvia can most directly be linked to potential financial spillovers. The Riksbank reasoned that Swedish banks, and domestic financial stability at large, would have suffered as a result of the loss of market confidence and the likely contagion that would have ensued if Latvia's currency, the lats, had been devalued. Against this backdrop, both the Riksbank's offer to provide a bridging swap line to the Bank of Latvia and its opposition to currency devaluation in the IMF

conditions can be seen as clear cases where cooperation was aimed at domestic financial stability.

Concerns over contagion also played a role for other central banks, including the Austrian central bank, OeNB, to oppose devaluation in Latvia. Though there were few direct financial linkages between Austria and the Baltics, the OeNB and other members of its IMF constituency were concerned that devaluation in the Baltics might lead to speculation against countries in Central Europe as well. By refusing the IMF's request to participate in the bailout of Hungary, the OeNB however revealed that its willingness to provide direct financial support was limited, even to a country that posed a major risk to Austrian financial stability.

For the ECB's credit lines to CEE, it seems that concerns about financial stability were deliberately downplayed to justify providing only limited support. Of course, financial stability concerns did feature prominently in the ECB's internal negotiations following the Hungarian and Polish requests for swap lines. National central banks with exposure to these countries, the OeNB first in line, advocated more generous support. Major Euro Area banks that had exposure to the region likewise pushed the ECB to provide support. But the ECB's Economics Department held a more restrictive line, out of concerns over credit risk. The ultimate decision to provide repo lines to both countries followed an internal negotiation process and the outcome was described as a 'compromise'²⁵⁸ between these two positions.

The issue of *credit risk* and the associated objective of protecting the central bank's balance sheet against losses was a third, material, factor that weighed on the terms of the credit lines. Both the ECB's repo lines and the SNB's CHF/EUR swap lines to the MNB and NBP included

²⁵⁸ Interview Nowotny (OeNB)

hard-currency collateral requirements that would protect the lenders against losses should the recipient default. While some interviewees have brushed off concerns about sovereign credit risk from the ECB's Economics department as a typically 'German' worry, the SNB, too, asked for high-quality collateral, and three major central banks turned down Iceland's request for a swap line. That said, there are reasons – albeit rather technical ones – to doubt that the ECB's apparent worry about its balance sheet was rooted in the actual default risk of the countries that requested financial support. Hungary was financially stable once it had received IMF support. Poland and the Czech Republic, which both pushed the ECB to provide swaps during the spring of 2009, had credit ratings far above some commercial securities that the ECB accepted on its balance sheet. In sum, the credit risk of potential recipients may play a role, but how prominently it weighs against other concerns seems to be context-dependent.

Another context in which central banks sought an additional layer of financial protection was the issue of funding the IMF. Some interviewees shared the view that the bilateral credit lines to the IMF in 2009 represented for them a way to ensure that sufficient resources would be available to bail out further CEE countries without lending directly. Not only was the IMF seen as a more trustworthy borrower, but the OeNB also calculated that it would be easier to win over political support for these kinds of loans rather than muster support for direct participation in a bailout.

The expected consequences played important roles in individual central banks' decisions to provide credit lines. It seems that central banks considered, to varying degrees, three material objectives: furthering *monetary policy objectives*, protecting *financial interests*, and containing *credit risk*. At one extreme, the SNB's credit lines conformed with its operational framework. The ECB paid lip service to both its Euro Area mandate and its balance sheet but based on these concerns one might easily have imagined it to be more forthcoming towards the CEE countries.

Lastly, the Riksbank and the DNB seem to have taken a rather flexible approach towards both the questions of credit risk and the extension of financial support to central banks that posed no systemic risk. The logic of consequences serves as a helpful starting point to categorise these outcomes, but on its own, it seems of limited usefulness for understanding several instances of central bank cooperation.

7.1.2 Logic of Appropriateness

The alternative conception has been to think of central bank cooperation as being the result of considerations of appropriate action. Though relatively few previous studies have ventured to invoke norms and identities as drivers of bilateral financial support, the findings in the empirical chapters suggest that those factors had a major influence on central bank cooperation during the period under investigation. Especially selectively invoked *identities* and *international agreements* were identified as key motivations for extending support.

The degree to which *shared identities* influenced cooperation during the crisis has thus far been the most remarkable finding of this study. In many cases, central banks made explicit reference to joint identities and solidarity as decisive factors for providing support. Two sets of identities seem to have mattered in particular. On the one hand, leading central banks, roughly identified by their G10 membership, had an implicit agreement to assist one another in case of financial distress, already before the GFC. This norm is for instance reflected in the ECB's prepared swap agreements with the Bank of Japan and the SNB. Indeed, when the ECB opened its swap line with the Riksbank in late 2007, it discussed the agreement as a 'favourable development in line with the objective of co-operation among central banks' (European Central Bank, 2007b, p. 2), rather than with reference to financial market conditions. Though Denmark is not a G10 member, the ECB still considered it a peer, given its longstanding cooperation with West European central banks. Policymakers referenced Denmark's status as an 'shadow member of

the Eurosystem' and the remote prospect that the country might still adopt the euro as reasons for providing a swap. By contrast, the Baltic states which also participated in the ERM II, and actually wanted to join the Euro Area – indeed they were making preparations for that objective (Dandashly & Verdun, 2020) – received very limited support from the ECB. The prestige of belonging to the club of leading Western central banks was an undeniable facilitator of central bank cooperation.

IMF constituencies are another important setting for facilitating central bank cooperation based on joint identities. The cooperation in the Nordic/Baltic constituency was by far the closest in this regard (in line with close policy cooperation among the Nordic countries in other policy fields (Stie & Trondal, 2020; Strang, 2015)). The joint Nordic swap lines to the Icelandic central bank (which were negotiated during a meeting of the IMF constituency) are probably the clearest example. After all, the Nordic central banks had the same dismal assessments of Iceland's financial situation as other central banks, such as the Fed or the ECB, which had refused to provide a swap. The eventual support to Iceland, even in its highly conditional form, was explained based on 'Nordic brotherhood.' Similarly, for the other credit lines, solidarity offers a plausible interpretation. The Riksbank's swap with the Bank of Estonia was aimed at helping the Estonians resolve a conflict with the IMF, not solving any operational issues. Finally, the involvement of the DNB in the bridging loan to Latvia was neither necessary from the Riksbank's perspective, nor did the swap serve Danish policy interests. Instead, it represented an effort to show broader Nordic solidarity with Latvia; the Danish side presented its support as solidarity with a fellow IMF constituency member.

Solidarity was also a keyword for the SNB's credit lines to the Polish and Hungarian central banks. From the perspective of the SNB's material interests, both these countries posed no risk. But the SNB recognized these countries' needs for Swiss franc liquidity and, after ensuring

sufficient financial safeguards, offered support to both. In the case of the SNB's credit line with the NBP, Poland's membership in the Swiss IMF constituency had already created linkages at the staff level, too.

Appropriate action with regards to *international agreements* mattered for the role that central banks assumed under the ERM II and regarding BoP programmes. The ERM II, and what the ECB saw as appropriate action under the framework, had a discernible impact on its response to the crises in Denmark and Latvia. In both those cases, the ECB ruled out that its loans could be used for exchange rate interventions. For both recipients, but especially the Bank of Latvia, this clause was a major limitation because the loans were of no help to fend off speculative attacks against their currencies. From the ECB's perspective, this course of action had a puzzling logic: although policymakers recognized the potential material and reputational risks from an uncontrolled devaluation in Latvia, they insisted that it would be inappropriate for the ECB to lend directly to Latvia to defend the peg. The ECB similarly blocked alternative exchange rate arrangements in Latvia because they would have been incompatible with the ERM II framework.

When it came to BoP assistance, central banks generally had the view that they should not get involved in programme design. They argued that they did not possess the requisite expertise and legitimacy at the time to design structural adjustment programmes. Thus, the Riksbank made its swap to Latvia conditional on the latter's approval of the IMF country programme for Latvia. As regards the Icelandic loan, it designed the conditions for the Icelandic loan together with the IMF. Neither the ECB nor the OeNB participated in programme negotiations for Hungary and Romania. But this deference was also context specific. When the EU's central banks, for various individual reasons, opposed the IMF's position that Latvia should devalue

its currency, they weighed heavily on programme design – both in the public debate and in discussions with the IMF’s Executive Board.

Taking stock, this study has found several instances when central banks either assisted without a clear expected material benefit of doing so or deliberately limited the scope of their actions based on perceptions of appropriateness.

7.1.3 Why were certain logics dominant in certain instances?

What emerges from this comparison is that central banks cooperate out of a variety of motives. Rather than try and rationalize their actions from a single logic of action, the crucial question seems to be why central banks sometimes draw more on material motivations and sometimes base their decisions on normative considerations. The findings suggest that the organisational cultures of individual central banks play an important role in shaping their overall approaches to financial crises.

Sociological research into organisational culture emphasises the norms, ideas, and identities that constitute an organisation (Hall & Taylor, 1996; March & Olsen, 1996). Culture affects how organisations ‘define their purposes in the world and interpret and respond to feedback produced by their environments’ (Barnett & Finnemore, 2004; Nelson & Weaver, 2016, p. 930). Central banks, from this perspective, cooperate because they see cooperation itself as legitimate based on identities, rules, and routines that are accepted inside the organisation. When rules are ambiguous, they need to be interpreted (Best, 2012), though public organisations differ in the degree to which they can improvise outside established procedures during crises (Boin, ’t Hart, Stern, & Sundelius, 2017, p. 62; Deverell & Olsson, 2010). References to prevalent beliefs, the existence of protocols, or organisational identities, would be indicative of the influence of organisational culture on central banks’ cooperation (Lütz et al., 2019a; Marcussen, 2009a).

The ECB's internal organisation and culture, at the time of the GFC, provide several indications for why the ECB would be more forthcoming towards the Nordic central banks' requests for swap lines than those of the CEE central banks. The first was its lack of an accepted internal protocol for responding to financial crises at the onset of the crisis. Even to the ECB's staff, it was initially uncertain how the ECB would respond to requests for credit lines. The ECB's approach to the crisis in CEE was justified based on principles of liquidity assistance, which the ECB devised only after it had received the first requests for swap lines in October 2008.

Similarly, the ECB had no prior experience with BoP crises in EU member states and thus no established approach as to how to treat them. Only after November 2008 did it start building up a unit with dedicated expertise. The initial uncertainty inside the ECB explains the contested process leading up to the credit lines. The ECB's insistence that it would focus on its Euro Area mandate and that it was 'not responsible' for financial stability in CEE need to be understood not as a structural inevitability, but as a deliberate organisational choice. Over the further course of the crisis, that choice constrained the ECB's decisions and led it to refuse swap lines even to countries with good credit ratings.

The ECB's stance towards the ERM II, by contrast, was more clearly understood and operationalized. The ECB's strict adherence to the formal rules of the ERM II underpinned its principled stance against supporting exchange rates in Denmark and Latvia, despite the otherwise different terms of those credit lines. In both cases, the ECB's preferred outcome was to avoid a devaluation. Nevertheless, supporting exchange rates directly would have been against the disciplinarian logic underpinning the ERM II. Concerning the Baltic states, the ECB had long before the crisis already defined for itself that it would not support narrow exchange rate pegs. In the event, it drew on that prior policy line as a justification for not supporting the pegs directly.

Similarly, the ECB's opposition to the proposal of the IMF to embark on an early euroisation, as part of Latvia's BoP programme, appears to be motivated by the rules of the ERM II framework, and the ECB's professed commitment to equal treatment of all ERM II members rather than the technical merits of that option. The ECB's stance that Latvia should maintain its exchange rate peg on its own left the government in the worst of both worlds: it had to conduct a painful internal devaluation and was exposed to currency speculation. The following statement by ECB Executive Board Member Gertrude Tumpel-Gugerell offers a particularly clear indication that the procedures of euro adoption were the decisive factors to underpin the stance by the ECB to oppose the 'technically more attractive' proposal by the IMF to euroise:

'[...] the financial crisis has not changed our policy for adopting the euro. Therefore, to prematurely adopt the euro, in particular if not accompanied by a sufficient degree of sustainable convergence, is certainly not a solution to overcome the impact of the crisis' (Tumpel-Gugerell, 2009, p. 4)

Another factor that may explain the ECB's choices concerns the intellectual climate inside the ECB at the time. The influence of 'German' ideas in shaping the ECB's institutional design and self-understanding is well-documented (Howarth & Loedel, 2005; Quaglia & Verdun, 2022). Several key actors and institutionalized ideas influenced the ECB's response to the crisis. This study has found that the key officials in the Economics Department that analysed the CEE countries were all (!) German. It had been the Economics Department, led by Executive Board Member (and former Bundesbank Vice-President) Jürgen Stark, which voiced objections against a swap to Hungary out of concerns over credit risk.

Similarly, the ECB's neglect of the international role of the euro, relative to its Euro Area inflation objective, reflected traditional Bundesbank thinking. For decades the German central bank's understanding of the role of its currency was that it prioritised domestic policy objectives over international ones – with little regard for international repercussions (Höpner & Spielau, 2018; Scharpf, 2018). However, 'Bundesbank thinking' hardly means that these were ideas that

were only held by Germans. The reluctance to get involved in CEE was more widely shared in the Governing Council. Other hawkish officials, such as Yves Mersch of the Banque du Luxembourg, expressed these same views in public. Neither were they insurmountable. Several interviewees criticised ECB President Jean-Claude Trichet for not advocating on behalf of the CEE countries, praising his successor Mario Draghi's more pragmatic approach.²⁵⁹ Indeed, under Mr Draghi's leadership, the dogmatic Bundesbank economists would lose influence over the following years (Mugnai, 2022; Quaglia & Verdun, 2022).

Against the backdrop of the ECB's a priori ambivalent stance on emergency liquidity provision, it becomes easier to understand why perceptions of appropriateness, shaped by the hawkish Bundesbank thinking could be so influential on the ECB's crisis approach. With regards to the Swedish and Danish requests, other processes, including heuristic thinking, may have played a role: the ECB emphasized the international prestige of both central banks and omitted detailed discussions of the severity of the Danish financial crisis. Ultimately, disentangling material and normative considerations may be impossible, since these states with higher international prestige also had AAA credit ratings and high bilateral exposures to the Euro Area. Conversely, it is also possible that the indicators for the principles for liquidity may have been selected in a way to privilege recipients that were selected for other reasons. However, based on the data collected here, it is plausible to conclude that the ECB's internal constitution privileged a course of action more based on rules and norms than merely instrumental considerations.

The experience of the Riksbank illustrates that the experiences and ideas inside an organization can also facilitate a more proactive response to a crisis. Key officials at the Riksbank had played a leading role in resolving the Swedish financial crisis in 1992 and formulating an approach to

²⁵⁹ Interviews Király (MNB), Nagy-Mohasci (EBRD)

banking crisis that was considered an international benchmark (Borio, Vale, & von Peter, 2010; Eglund, 2015; Mayes, 2009). Governor Ingves drew on his personal experience from both the Nordic crisis and at the IMF in devising the Riksbank's approach. Indeed, its staff remembered the role that the Riksbank had played during BIS-coordinated bailouts in the 1990s. Thus, early into the crisis, Mr Ingves established that the Riksbank would not be involved in programme design. It would only provide a swap line after a country had approved IMF conditionality, to bridge the interval between approval and disbursement. Unlike other central banks, the Riksbank sent its own financial stability experts to evaluate the situation in Iceland. In Latvia, it participated alongside the IMF missions and provided technical assistance with bank resolution.

A clear understanding of the requirements of financial crisis management did not necessarily predispose the Riksbank to respond more to either material factors or international norms. Indeed, both financial exposures and the joint Nordic-Baltic identity could justify some of the terms of the Riksbank's swap lines to the central banks of Estonia, Iceland, and Latvia. However, beliefs and perceptions inside the organisation did play an important role in shaping the Riksbank's outlook. The Swedish officials interviewed for this study have stressed that, for all the public insistence on protecting Swedish financial interests, solidarity was a key motivation. The Riksbank had assumed an 'implicit responsibility' (Riksrevisionen, 2011, p. 12) for financial stability in the Baltic states after considering these countries as part of the Swedish home market. Its strict handling of the Icelandic swap request was driven by Mr Ingves' sense of fairness, rather than immediate credit risk. The Riksbank conceived of its actions as more based on norms than financial interests, as a result of how it interpreted the situation.

Thus, when it comes to central banks' individual actions, it appears that both material considerations and notions of appropriateness can explain why certain decisions were taken. Among material considerations, *monetary policy objectives*, *financial stability*, and *credit risk* have stood out across cases; from a normative perspective *identities* and *international institutional frameworks* have been influential. How and when precisely these factors matter is dependent on the context: rather than being structurally determined, central banks' actions reflect a contingent process of sense-making. That said, this section has argued that by learning more about the specific actors involved, especially about the *organizational culture* inside individual central banks, analysts can gain a better understanding of the features that privileged a particular course of action for certain actors in specific settings.

7.2 Collective actions

Turning to collective actions, this study has investigated how central banks have governed international risks during and after the global financial crisis. Chapter five has found that central banks' cooperation regarding liquidity provision to cross-border banks was mostly ad hoc and informal. Chapter six, finally, has found that even institutionalized settings for macroprudential governance have relied on soft governance and deliberation.

The initial formulation of the ideal types of collective action has distinguished between the degree of formal hierarchy and the dominant modes of interaction. The logic of consequences conceives of institutions primarily as bargaining settings; the logic of appropriateness interprets institutions as systems of meaning that remake actors' perceptions of legitimate action. In the former case, compliance would be ensured through formal sanctioning mechanisms and hierarchical enforcement, whereas in the latter case actors adhere to rules out of a sense of moral obligation (March & Olsen, 1996). The following discussion considers two additional characteristics, namely the high degrees of inclusivity and informality, that have stood out

throughout the empirical chapters. Both these findings bolster the overall conclusion that some aspects of regional financial governance can be understood better as a process of emergent norm formation than a bargaining process over fixed interests.

7.2.1 Institutional changes in regional financial governance

Before the crisis the EU's framework for crisis management and macroprudential policy coordination had been patchy and incomplete. One problem had been the mismatch between supervisory responsibilities and de facto authority over financial stability conditions that had resulted from the principle of mutual recognition that underpinned the EU's home/host rules and financial market integration (Schure & Verdun, 2018). Another problem was that governance happened in functionally separate committees and that the principles for joint crisis management were not accepted. As a result, policy coordination on macroprudential risks took place in unstructured, bilateral formats and the EU-level Memorandum of Understanding on crisis management went completely ignored when the crisis broke out.

The institutional framework that was developed during the crisis broke with some of these principles. The probably most profound shift was the explicit recognition of international systemic risks, which had been missing before the crisis, and the development of a regional macroprudential policy agenda. After the VI originally sought to ensure participating regulators and banks contribute to regional stability, its successor, the VI 2.0, piloted ideas for a regional deleveraging trajectory. This new outlook has thus served to establish new perceptions of responsibilities and frame the common good in regional, rather than national terms.

However, the regional financial stability perspective has not been coupled with the delegation of formal powers to the new institutions. Policy implementation has remained a national responsibility; what has changed are principles that affected the relative distribution of regulatory powers. Central banks shared a consensus that macroprudential policy and crisis

management would have to be decided based on specific local circumstances, which spoke against formulating too binding a set of central rules.

Regarding liquidity provision, the key to maintaining stability during the crisis was to align the de facto responsibility for liquidity provision with banks' business models. Home authorities ensured that parent banks had sufficient resources and that they could keep supporting their CEE operations. This approach to crisis resolution happened almost by default, though formal commitments by home authorities not to ringfence liquidity were made under the Vienna Initiative. Crucially, this task division relieved pressure on CEE countries to provide liquidity to major parts of their banking sector. It was therefore crucial that home central banks assumed responsibility for their extended home markets.

Macroprudential policy has also remained a national competence after the formation of the ESRB, but in this field, regulatory power has been dispersed. In the early 2000s, the principle of 'mutual recognition' concentrated macroprudential policy competence with the home authority and banks often bypassed measures by host authorities. After the crisis, 'reciprocation' has been seen as crucial for maintaining international stability and governability, even if the principle implied a relative strengthening of host authorities. The ESRB now serves as a hub where national authorities can inform each other of macroprudential measures and request reciprocation.

General principles also needed to be translated into specific contexts. Thus, measures aimed at unwinding cross-border exposures were necessary to strengthen host authorities' policy autonomy and allow them to pursue more locally suitable policy choices. But the two sub-regional bodies – the VI and, later, the NBSG – can both be seen as attempts to build arrangements suitable to local circumstances. The VI has held dedicated country meetings in parallel with its development of more high-level principles and the NBSG has pioneered work

on regional stability groups, including one working group just for the Nordea conglomerate. It appears that the perception that joint principles on crisis management and macroprudential governance would have to be translated into specific national contexts was embedded as an institutional design feature.

A final institutional difference has been the increased inclusivity of post-crisis governance bodies. The ESRB includes 69 members, among which central banks, financial supervisors, various EU agencies, and even three voting members from academia. The VI has been a highly inclusive setting from the beginning, bringing together national and European authorities, IFIs, and transnational banks. The VI 2.0 comprises about 100 members in the full forum configuration. Participation in the Nordic/Baltic governance bodies is limited to central banks and financial supervisors, but this still means that they are still more inclusive settings than had existed before the crisis. Where previously different authorities met in separate committees, after the crisis, various institutional actors are assembled in the same setting to discuss matters of regional financial stability.

7.2.2 Post-crisis patterns of governance

Regional financial governance in Europe takes place in institutional settings that are characterized by a relative *lack of internal hierarchies*. Central bank cooperation was largely based on soft enforcement tools. None of the governance formats has instruments that can lead to financial sanctions against a member. Agreements on cross-border burden-sharing take the form of non-binding, if increasingly detailed, MoUs. The basic principles of the VI 2.0 have highlighted transparency and peer scrutiny as the main enforcement mechanisms (though banks' commitments under the VI were initially tied to countries' compliance with IMF programme conditions). Macroprudential policy coordination at the VI 2.0 works through information exchanges, recommendations, and financial and technical assistance. Lastly,

although the ESRB is seen as the most binding venue, it disposes only of soft policy instruments, namely, recommendations and warnings – the highest level of escalation is making a national recommendation public. Adherence is ensured through soft mechanisms, peer pressure, or comply-or-explain rules. One can therefore conclude that central banks' collective governance relies on reputational, rather than material pressure.

Without formal hierarchies, it seems that the general acceptance of the principles that the participants develop is the most important source of authority in these new governance arrangements. The role of external expertise in forming such authoritative views is noteworthy. The VI has, for instance, relied heavily on the expertise of the IMF to develop its 'Vienna principles' for home/host burden-sharing. In the ESRB, the role of academic experts is remarkable, not just because they contribute to the Board's agenda, but also because they hold three of the total 39 votes. By contrast, national financial supervisors have no voting rights on the ESRB. The Nordic/Baltic groups aim to facilitate open discussions and develop their principles based on consensus.

At the same time, there exists an openly acknowledged *hierarchy between the different governance arrangements*. The ESRB is seen as the most formal and binding format. Unlike the VI 2.0 and the Nordic settings, it is anchored in EU legislation. As an EU body, the ESRB has formal relations with other EU institutions and has explicit procedures for influencing its members' policies, voting procedures, and follow-up reports based on an indicator scorecard. Owing to this more official character, the ESRB is explicitly acknowledged as the ultimate authority on macroprudential policy in Europe in the statutes of both the VI 2.0 and the NBMF. Nevertheless, there exists a considerable overlap between the VI 2.0, the NBMF, and the ESRB. It is striking that participants pushed for both the VI 2.0 and the NBMF to be maintained despite this duplication of responsibilities. Indeed, a certain task division between these forums has

emerged as policy norms were often developed in one setting and then developed further elsewhere. The Nordic/Baltic experience informed the VI 2.0's principles for cross-border burden sharing and the VI 2.0 had done some intellectual groundwork for the ESRB's first recommendation on foreign currency loans. While the existence of several concurrent formats may seem inefficient if governance is conceived of as a bargaining process, for the process of developing rules that are broadly seen as legitimate, this set-up thus has considerable advantages. The more informal character of the sub-regional settings has enabled them to develop and pioneer ideas and principles that would later be codified at the ESRB, as happened in the case of policy reciprocity and foreign currency loans.

The principal finding regarding the interaction inside these institutional settings is that they function predominantly as *deliberative bodies* that aim to facilitate consensus and mutual understanding. Participants in all settings echo the value of frank exchanges of opinion: the NBMF facilitated 'good discussions' (Farelius & Billborn, 2016, p. 140); 'open discussions' were a 'ground rule' of the VI (Berglöf et al., 2019, p. 63); and the ESRB functioned thanks to 'candid and open discussions' (Ingves, 2016, p. 2). Open discussions do not imply that decisions are always based on consensus – in the ESRB, issues are commonly voted on – but the institutions strive at least to facilitate a meaningful exchange of points of view. The NBMF provides perhaps the clearest indication that intellectual agreement is the goal: not all its participants are actually in charge of macroprudential policy implementation at home – if they receive negative peer feedback, they still have to convince their governments to change course. Casting regional financial governance as a deliberative process implies that it should be conceived of as technocratic politics aimed at problem-solving, rather than distributive bargaining over national interests.

If financial governance is interpreted as a process of deliberation, the choices to cooperate through *informal settings* also become clearer. Informality was a strength because it allowed for adaptation and experimentation as the crisis unfolded. But both the VI and the Nordic/Baltic settings were deliberately maintained as informal settings after the crisis. In these settings, informality was a way to ensure the frank exchange of opinions and ensure participants' voluntary commitments to the principles developed. Despite its anchoring in EU law and its more structured working method, the ESRB has also maintained some of these features. It lacks legal personhood and participation in individual work streams remains voluntary. Informality, in brief, has been chosen to ensure the quality of discussions and the buy-in from participants.

Another indication that these new institutions were intended to facilitate deliberations is their *inclusive participation*. The ESRB's case is especially telling in this regard because central banks had initially pushed for limited membership. Observers who thought of the ESRB as a negotiation setting were worried that too many participants would hamper its decision-making capability. Over time the broader participation in the ESRB and the input from experts have been recognized as the 'ESRB's main strengths' (Ingves, 2016, p. 2). These features are referred to as a 'major asset' (ESRB, 2019b) because they bolstered the intellectual heft and the moral authority of its recommendations. In the VI, IFIs have made similar contributions and provided essential input on the formulation of the basic principles. The inclusive settings and transparent monitoring have also increased the amount of peer pressure that could be exercised.

Involving a variety of actors was also helpful for accomplishing *systemic change* in the financial system (and, in the case of the VI 2.0, even the international financial system). Quite simply, the institutional responsibilities for macroprudential tools vary across countries. Bringing all potentially relevant authorities together was a way to ensure no relevant authority was left out. Moreover, the VI acknowledged the pivotal role of transnational banks in ensuring the regional

distribution of liquidity at the time. The institutional norms underlying the VI shared the responsibility for contributing to regional stability between public and systemically relevant private actors. Regional macroprudential policy relied therefore not just on holistic assessments but also on a variety of actors for implementation.

That said, these inclusive governance formats emerged because of contextual factors. The launch of the VI to coordinate the actions of banks and supervisory authorities during the liquidity crisis represented a response to perceived coordination problems in Central Europe. In the Nordic/Baltic region, the Riksbank's leadership in setting up the NBSG and NBMF provided a new impetus to regional cooperation between supervisory authorities and central banks. Thus, while all settings ultimately converged around the idea that inclusive settings would improve deliberations, this feature reflected responses to fairly different contextual considerations.

All these findings do of course not deny that negotiations took place within these new frameworks. But these negotiations took place within institutional settings that had already established a fundamentally new approach to regional financial governance. Rather than focusing on the details of the agreements, it is more important to consider how these negotiations have recast international financial stability as a common good to which all participants should contribute. As the founders of the VI explain:

'[C]oordination was not a simple "mediation" between home and host countries, or banks and IFIs [...] the Vienna Initiative created ground rules for an informal governance framework [...] to effectively stabilize the financial system' (Berglöf et al., 2019, p. 63).

Summing up, regional financial governance seems to be geared at facilitating deliberations rather than negotiations (cf. Risse & Kleine, 2010). Many institutional features, such as *informality*, *inclusivity*, and *lack of internal hierarchies*, had at first been criticised as hampering effective negotiations. Participants came to view these institutional choices as strengths,

however. They appreciated the openness of the exchanges and the authority and legitimacy lent by external experts in formulating broadly accepted norms and principles. These findings suggest that regional macroprudential policy in Europe should be understood as a case of technocratic cooperation, aimed at consensus and peer feedback. This conclusion dovetails with findings about the informal and deliberative character of economic policymaking in the EU (Bokhorst, 2019; Joerges & Neyer, 1997; Kleine, 2013; Sabel & Zeitlin, 2008) and committee governance of macroprudential policy (Thiemann & Stellinga, 2022). Rather than clashing negotiations between fixed positions, these forms of central bank cooperation often involved a process of collective puzzling in each situation over the appropriate course of action.

7.2.3 Understanding institutional change

Regional financial governance in several respects represented a clear departure from the status quo before the crisis. Both the institutional arrangements and the economic ideas that underpinned them had changed considerably. The findings in the empirical chapters suggest that these processes of change were driven by institutional and normative *entrepreneurs* (Battilana et al., 2009, p. 72; DiMaggio, 1988; Finnemore & Sikkink, 1998). The resulting governance arrangements can then be understood as the result of the institutionalisation of new practices, informed by a new set of economic ideas.

The processes of ideational change pertained to the formulation of a macroprudential policy agenda and, even more specifically, the regional dimension of macroprudential policy. Recall from chapter 1 that norm entrepreneurs initially create new cognitive frameworks to interpret issues or events. They then use this framework to convince others to reconsider their perceptions of appropriateness or their own interests (Blyth, 2002; Finnemore & Sikkink, 1998, p. 897). Initial efforts to recast policymakers' understanding of financial stability issues in Eastern Europe took place even before the crisis. Klaus Regling of the European Commission

warned the Austrian and Swedish central banks about their banks' regional exposure. The report by the de Larosière group put macroprudential policy on the EU's agenda and proposed the creation of the ESRB (Baker, 2013). The new framework for interpreting regional financial integration, that these entrepreneurs had proposed, was crucial for defining the missions of the governance arrangements that were formed during the crisis.

However, ideas on their own do not tell the whole story of institutional reform. While the ESRB was created through EU legislation, to understand the formation of the VI and the Nordic/Baltic Initiatives the findings here highlight the role of *institutional entrepreneurs*. These entrepreneurs are 'agents who initiate, and actively participate in the implementation of, changes that diverge from existing institutions' (Battilana et al., 2009, p. 67). The creation of the VI offers probably the clearest example of how individual agents can propel institutional change. After previous efforts at coordination had failed (not least because of the ECB's unwillingness to act), the VI arose out of the initiative of the Austrian deputy finance minister and an EBRD policymaker who at first tried to emulate the Paris Club. In the Nordic/Baltic region, Sweden's Riksbank played a similar role: its governor Ingves provided the impetus for closer regional cooperation and the Riksbank hosts the secretariat of the NBMF. The creation of regional macroprudential governance was driven by agents who had not just new economic ideas but also proposed new institutional blueprints for acting upon them.

It is noteworthy that many key proponents of regional macroprudential governance were former IMF officials. Mr Regling and Ms Nagy-Mohásci had both been at the Fund before and could draw on their experiences from previous crises.²⁶⁰ Two central bank governors who had been department heads at the IMF became key players in post-crisis governance. Riksbank Governor

²⁶⁰ Interviewees from the IMF also stressed their experience from the Asian crisis in shaping their approach to the crisis in Eastern Europe (cf. Blustein, 2015).

Ingves led the Nordic/Baltic forums and chaired the technical committee at the ESRB; NBP Governor Marek Belka (who had headed the IMF's European Department until 2010) took leading roles at the VI 2.0 and the ESRB. While this study has not sought to provide systematic evidence regarding the placement of officials, these are at least suggestions that the socialisation of individuals mattered in facilitating the formulation of a coherent set of macroprudential policy norms in Europe.

As norms around regional financial governance developed, the institutions would also adapt over time. The VI was explicitly converted from a crisis management setting into a setting that formulated a regional macroprudential agenda and which had a new organisational structure. The ESRB assumed the central role in policy coordination by serving as an information hub after the principle of mutual recognition had been replaced by policy reciprocity. As discussed above, sometimes ideas that were developed in one setting would be also diffused in others. Such processes thereby initiate broader changes in patterns of regional financial governance.

How best, then, to understand the collective actions of central banks? This section has argued that regional financial governance in Europe happens through relatively *non-hierarchical* and *deliberative* settings. These settings are all *inclusive* of more actors than just central banks and have remained *informal*. These institutional features did not reflect the failure to agree on more stringent cooperation but were often conscious choices by the actors involved to facilitate frank exchanges of opinions. In line with the understanding of institution building as a process of norm formation, the role of individual entrepreneurs in reframing perceptions of financial risks and initiating new governance institutions has been highlighted. As the interaction between the three macroprudential forums suggests, post-crisis regional financial governance thus

resembles a process of developing a set of norms for national policy conduct that are generally seen as authoritative and legitimate.

Conclusion

This chapter has discussed the suitability of the two ideal-typical motivations to understand why central banks, both individually and collectively, cooperate. The two logics of action have indeed proved to be helpful in understanding central banks' motivations in specific instances of cooperation and have highlighted different facets of central banks' international agency. The overall thrust of the descriptive part of the argument has been that the logic of consequences, which is common to materialist explanations of central bank cooperation, only accounts for some facets of central bank cooperation but leaves other instances unexplained. Central banks often, though by no means uniformly, relied on judgments of appropriateness based on international norms and shared identities to decide how much support they would extend individually. Central banks' collective actions to maintain regional financial stability have been cast as a process of norm formation, rather than clashes between fixed interests. As such, these findings imply that perceptions of appropriateness should be applied more systematically to understand international monetary cooperation.

To understand better why certain identities or interests mattered in specific instances, the analysis has drawn on Max Weber's analogy of ideas as switchmen. The preferences and actions of individual central banks have reflected organisational cultures. Ideas and experiences that were institutionally embedded in the organisations shaped both how central banks perceived certain situations and which implications they derived from these assessments. The comparison between the ECB and the Riksbank has shown that different organisational cultures can bear both on central banks' perceptions of appropriate action and the degree of support that they provide during a crisis. To explain central banks' specific motivations, the chapter argues

that one needs to reconstruct the subjective perceptions that central banks had of specific situations.

The development of a new institutional framework for international financial governance in Europe has been portrayed as a process of norm development and change. Except for the rules pertaining to the set-up of the ESRB, the institutional reforms studied here were not the outcomes of international bargains. Rather they are the creation of the actors who participated in devising them. The processes of institution-building were hardly efficient. Instead, the second half of this chapter has argued that one needs to account for the role of institutional entrepreneurs and path-dependent dynamics to identify the drivers of change. Central bank cooperation, then, needs to be understood as contingent processes with its own internal dynamics which are, at least in part, separate from developments in financial markets.

There is, then, a lot that can be learned about central bank cooperation if it is approached as a process informed by norms and perceptions of appropriateness. The following chapter concludes the thesis by reflecting on the wider implications of this argument.

