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Lessons from Europe for the study of international central bank cooperation

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Lessons from Europe for the study of international central bank cooperation

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Abstract

Cooperation between central banks has been crucial for stabilising the international financial system during the Global Financial Crisis in 2008 and the COVID-19 crisis in 2020. For students of international political economy, understanding why and how central banks cooperate is thus a highly relevant concern. This doctoral dissertation studies central bank cooperation in Europe during and after the Global Financial Crisis. It is based on 25 elite interviews, original archival material and other primary and secondary sources. It reconstructs how central banks came to the decision to conclude credit lines with one another, engaged in Balance-of-Payments assistance programmes, and built new regional institutions to coordinate crisis management and macroprudential policy measures. It finds that central banks motivated their decisions to cooperate not merely on the expected consequences of their actions, but also on their perceptions of appropriateness. Bilateral cooperation was often motivated by norms, such as solidarity, rather than being based predominantly on self-interest; regional financial governance takes the form of inclusive deliberations and consensus-building, rather than clashing national interests. These findings support the conclusions that central banks' agency, and the ideas that guide their behaviour, need to be better understood to grasp the dynamics of international monetary cooperation.

Keywords: Central bank cooperation; Europe; financial crisis management; logic of appropriateness; macroprudential policy

Samenvatting

Samenwerking tussen centrale banken is cruciaal voor het stabiliseren van het internationale financiële stelsel. Deze samenwerking was vooral nodig tijdens de wereldwijde financiële crisis in 2008 en de COVID-19 crisis in 2020. Voor studenten internationale politieke economie is het derhalve van belang om te begrijpen hoe en waarom centrale banken samenwerken. Dit proefschrift bestudeert de samenwerking tussen centrale banken in Europa tijdens en na de mondiale financiële crisis. Het onderzoek berust zich op 25 interviews met elites, archiefmateriaal en andere primaire en secundaire bronnen. Het reconstrueert hoe centrale banken kredietlijnen met elkaar sloten, betrokken waren bij betalingsbalansbijstandsprogramma's, en nieuwe regionale instellingen opbouwden om crisisbeheersing en macroprudentiële beleidsmaatregelen te coördineren. Het onderzoek toont aan dat de beslissingen van centrale banken om samen te werken niet alleen de verwachte gevolgen van hun acties weerspiegelden, maar ook hun percepties van gepastheid. Bilaterale samenwerking was vaak eerder ingegeven door normen, zoals solidariteit, dan door een welbegrepen eigenbelang; instellingen voor regionaal financieel bestuur waren bedoeld om inclusieve beraadslagingen en consensusvorming mogelijk te maken in plaats van onderhandelingen tussen nationale belangen. Deze bevindingen ondersteunen de conclusies dat de 'agency' van centrale banken, en de ideeën die hun gedrag beïnvloeden, beter moeten worden begrepen om de dynamiek van internationale monetaire samenwerking te kunnen doorgronden.

Sleutelwoorden: Samenwerking tussen centrale banken; Europa; financieel crisisbeheer; logica van gepastheid; macroprudentieel beleid

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Abbreviations

ASC – Advisory Scientific Committee

ATC – Advisory Technical Committee

BIS – Bank for International Settlements

BoE – Bank of England

BSC – Banking Supervision Committee

CBI – Central Bank of Iceland

CCyB – Countercyclical Capital Buffer

CEBS – Committee of European Banking Supervisors

CEE – Central and Eastern Europe

CESEE – Central, Eastern and Southeastern Europe

CHF – Swiss francs

EBA – European Banking Authority

EBRD – European Bank for Reconstruction and Development

ECB – European Central Bank

EIB – European Investment Bank

ERM/ ERM II – European Exchange Rate Mechanism (II)

ESRB – European Systemic Risk Board

EU – European Union

EUR – euro

FCL – Flexible Credit Line

FMA – Österreichische Finanzmarktaufsicht (Austrian Financial Supervision Authority)

FX – foreign exchange

GDP – Gross Domestic Product

GFC – Global Financial Crisis

IFI – International financial institution

IMF – International Monetary Fund

IPE – International Political Economy

JIFIAP – Joint IFI Action Plan

KNF – Komisja Nadzoru Finansowego (Polish Financial Supervision Authority)

LOI – Letter of Intent

MFAF – Medium-Term Financial Assistance Facility

MNB – Magyar Nemzeti Bank (Hungarian National Bank)

MoU – Memorandum of Understanding

NAB – New Arrangements to Borrow

NBMF – Nordic/Baltic Macroprudential Forum

NBMFC – Nordic/Baltic Monetary and Financial Committee

NBP - Narodowy Bank Polski (National Bank of Poland)

NBR – National Bank of Romania

NBSG – Nordic/Baltic Stability Group

NBU – National Bank of Ukraine

NGFS – Network for Greening the Financial System

NPL – Non-Performing Loan

PBoC – People's Bank of China

OeNB – Österreichische Nationalbank (Austrian National Bank)

SBA – Stand-By Arrangement

SEB – Skandinaviska Enskilda Banken

SEK – Swedish kronor

SNB – Schweizerische Nationalbank (Swiss National Bank)

US – United States

VI – Vienna Initiative

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Chapter 1 – Introduction

Abstract

This chapter begins by establishing the empirical and theoretical relevance of the subject of central bank cooperation by placing it within current debates in International Political Economy. It outlines the scope and the objectives of the present study and presents the analytical framework that is applied here. Ideal-typical conceptions of central bank cooperation, driven either by a logic of appropriateness or a logic of consequences are developed for both central banks' individual and collective actions. The chapter concludes with a reflection on the methodology employed here and the sources of the data on which the study is based.

Introduction

The decision by Sveriges Riksbank, the central bank of Sweden, to open a credit line with the National Bank of Ukraine (NBU) in September 2015 was controversial. Under the arrangement, a bilateral swap line, the Riksbank would lend up to $500m from its foreign exchange reserves to the NBU and accept Ukrainian hryvnia as collateral (Riksbank, 2015a). Its Governor, Stefan Ingves, maintained that the Riksbank was thereby 'helping to boost confidence in Ukraine's economic reform programme' (Riksbank, 2015a). The International Monetary Fund (IMF), which was providing Balance of Payments (BoP) assistance to Ukraine, concurred that the swap line would 'reinforce confidence in Ukraine's continued progress in restoring stability' (International Monetary Fund, 2015). Access to additional financial resources would bolster the NBU's capacity to withstand the financial crisis that had ensued after the Russian annexation of Crimea and the war in the Donbas region.

However, one of the three members of the Riksbank's Executive Board, Martin Flodén, entered his formal reservation against establishing the swap line, detailing a litany of reasons against doing so (Flodén, 2015). Ukraine's economic situation was highly fragile: its Gross Domestic Product (GDP) was falling, inflation was accelerating, the banking sector was beset by structural problems, and the government had instituted currency restrictions to rein in currency

speculation. Such a country was hardly a trustworthy borrower. Besides, Mr Flodén argued that 'Sweden's direct economic and financial ties to Ukraine are limited' and he did not 'see any reason why the Riksbank should single-handedly take considerable responsibility for managing the crisis in Ukraine' (Flodén, 2015, p. 1). If Sweden were to provide additional assistance in such a situation, that decision should be taken by the national government, not the central bank.

Mr Flodén's objections were based on the factors that most analysts would invoke to explain why central banks cooperate internationally. Central banks style themselves as apolitical institutions that act based on technocratic assessments of the costs and benefits of different options (Tucker, 2019). In a situation where instability abroad threatens a central bank's domestic mandate – in this case, financial or monetary stability in Sweden – one could thus easily explain why the Riksbank would provide international support. But for Ukraine, no such considerations applied: the country posed hardly any risk to Sweden's economic interests. Moreover, there was a risk that the country would be unable to repay its borrowing under the swap line, leaving the Swedish taxpayer with a loss. The Riksbank, in short, had no direct economic interest in lending to the NBU.

That it did so anyway presents an intriguing starting point for the remainder of this thesis. The anecdote about the Riksbank-NBU credit line illustrates the two core claims that are developed in the following pages. The first claim is that it does not suffice to analyse international central bank cooperation purely based on economic considerations. Central banks may justify their decisions in the technical terms of economic consequences and their policy mandate, but in practice, their cooperation is often influenced by social norms, such as trust or solidarity. By taking the role of international norms more seriously, alongside the conventional analysis of economic costs and benefits, one can develop a more refined understanding of why central banks choose to cooperate.

The second claim is that, even though central banks do consider political factors, their decisions to cooperate are largely taken independently. This assertion may not sound surprising given how deeply entrenched central bank independence is across the world – most central banks have considerable latitude in deciding on the content of their international policy. But often central banks' room for discretionary decisions is not explicitly discussed and their cooperation is instead cast as driven by national interests. The approach pursued in this study, by contrast, aims to take seriously central banks' international agency. It seeks to understand central bank cooperation in terms of how they, as organisations, motivate their decisions.

Combining these two claims, one can venture a different interpretation of the Riksbank's decision in 2015 to support the NBU. Without disputing any of the technical points that Mr Flodén offered against providing the credit line, the framework that this study proposes suggests that these concerns were simply not decisive. Instead, the decision by the other two Executive Board Members to go ahead was motivated by the ambition to show solidarity and help a central bank in need. Indeed, the Riksbank justified its credit line in these terms by arguing that it was 'in line with the Swedish tradition of supplying emergency liquidity assistance to foreign central banks beset by financial disruptions' (Riksbank, 2015b). If cooperation is interpreted as an expression of solidarity, rather than as serving immediate economic interests, the puzzling decision is easily resolved.[1]

---

[1] This account is of course somewhat stylized. Notwithstanding the criticism by Mr Flodén, Riksbank Mr Ingves provided a pro forma technical justification arguing that 'we also reduce the risk of financial instability in our neighbouring region which could have a negative impact on the Swedish economy' (Riksbank, 2015b). The Riksbank also took some precautions to insure against financial risks, including by aligning its loan with the conditionality of the IMF programme (Riksbank, 2015a). In the further course of the study, it will be seen that this reflected a more long-standing approach that the Riksbank pursued.

Ukraine benefited from more extensive financial assistance in 2014/15, including further swap lines from the People's Bank of China, the National Bank of Poland, and the Swiss National Bank (Gontareva & Stepaniuk, 2020), see Appendix 1, as well as macrofinancial assistance from the European Union.

The relevance of the present study

The credit line between the Swedish and Ukrainian central banks in 2015 is surely not the most prominent instance of central bank cooperation in the past fifteen years. Arguably, since the Global Financial Crisis (GFC) in 2007-2009, central bank cooperation has become a commonplace occurrence in international monetary affairs. During the GFC, especially the decision by the United States (US) Federal Reserve (Fed) to provide unlimited swap lines to several central banks, and thereby act as the de facto international lender of last resort has drawn attention (Tooze, 2018). After the GFC, the world's leading central banks established a standing network of bilateral swap lines, giving them permanent access to each other's currencies (Mehrling, 2015). More recently, in March 2020, during the financial market panic of the COVID-19 crisis central banks re-activated these credit lines to provide liquidity to the financial sector (FSB, 2020). Both after the GFC and the COVID-19 crisis, many financial market analysts have concluded that these swap lines were instrumental in preventing the collapse of the global financial system (Aizenman, Ito, & Pasricha, 2022; W. A. Allen, 2013).

Besides the eye-catching arrangements among the world's leading central banks, there have also been wider efforts to strengthen and deepen bilateral and regional cooperation (Eichengreen, Lombardi, & Malkin, 2018; McDowell, 2019). The European Central Bank (ECB) during the COVID-19 crisis supported several central banks across Europe (Panetta & Schnabel, 2020). In South East Asia, central banks pool their foreign reserves in the Chiang Mai Initiative (Kawai, Park, & Wyplosz, 2015). The People's Bank of China (PBoC) has even pushed central bank swap lines as a tool aimed at facilitating the internationalization of the renminbi (Liao & McDowell, 2015). This brief overview of international central bank cooperation over the past years leaves little doubt that the proliferation of central bank swap

lines has remade the international monetary system (Mehrling, 2015). As such, they deserve to be at the centre of the study of International Political Economy (IPE).

Some aspects of central bank cooperation are well-studied in the academic literature. Recent studies have, for instance, situated different forms of cooperation within the institutional architecture of the international financial safety net (Eichengreen et al., 2018; Kring & Gallagher, 2019; Murau, Pape, & Pforr, 2021) and highlighted the crucial role of central banks in facilitating international financial market integration (Braun, Krampf, & Murau, 2021). Financial economists have moreover documented in detail the effects of central bank cooperation on financial market conditions (Aizenman et al., 2022; Aizenman & Pasricha, 2009; W. A. Allen, 2013). However, these findings relate central banks' actions to international financial stability, rather than inquire about central banks' motivations for cooperating, which is what this thesis focuses on. Concerning the latter, the literature provides only an incomplete picture.

This thesis aims to tackle three major limitations of the IPE literature concerning why and how central banks have cooperated in specific instances. The first limitation concerns the dominant focus of the debate on a handful of instances of central bank cooperation. Many studies of central bank cooperation focus on the US Fed's credit lines, above all those that it provided during the GFC (Broz, 2014; Hardie & Thompson, 2021; Harris, 2015; Helleiner, 2014; Marple, 2021; McDowell, 2012, 2017; Morelli, Pittaluga, & Seghezza, 2015; Pape, 2022; Sahasrabuddhe, 2019). Comparatively few studies have attempted to provide detailed accounts of the wider phenomenon of central bank cooperation in other contexts (W. A. Allen, 2013; Kawai et al., 2015; Spielberger, 2022). The case of the Fed is without a doubt highly relevant for international financial stability, but its dominance in the literature is problematic for developing a rich and broad-based conceptual understanding of why central banks cooperate.

The Fed occupies an unrivalled structural position in the international monetary system, given the pre-eminence of the US dollar (Cohen, 2015; Helleiner, 2014), and the exercise of its power has often overlapped with other facets of US foreign policy (Kirshner, 1997). It is therefore questionable whether learning more about the Fed alone will deliver insights that can directly be applied to other central banks.

A second limitation pertains to what constitutes central bank cooperation. Many studies focus on crisis measures, such as credit lines. However, there are many other ways in which central banks can adjust their policies in a mutual interest that span different policy fields and may take different organisational forms. Economic historians have distinguished between various 'shallower' and 'deeper' forms of central bank cooperation (Cooper, 2006; Kahn & Meade, 2018; Simmons, 2008). For instance, the standardisation of data collection practices and regular exchange of data are considered shallow forms of cooperation; setting joint regulatory standards or coordinating policy frameworks are deeper by comparison because they have more far-reaching economic consequences and are more politically contested (Cooper, 2006; Simmons, 2008, p. 197). While credit lines are without doubt one crucial form of central bank cooperation, a systematic account should consider more ways in which central banks can act jointly.

Third, the recent literature has only considered a limited range of factors to explain individual instances of central bank cooperation, which jars with what is known about international cooperation more broadly. As mentioned earlier, the literature largely portrays central bank cooperation as serving some form of exogenously given national interest. To take one example, a former official recounts that 'the Fed generally viewed itself as acting in the enlightened self-interest of the United States' (Sheets, 2018, p. 14). Disagreements in the current literature largely revolve around which interest precisely was served. Some argue that the Fed aimed to serve its mandate for price stability and financial stability (McDowell, 2012; Pape, 2022) and

that it had little choice but to support other central banks if it wanted to avoid financial meltdown (Hardie & Maxfield, 2016; Hardie & Thompson, 2021; Morelli et al., 2015). Other studies invoke the strength of financial exposures (W. A. Allen, 2013; Broz, 2014) or trade linkages (Aizenman et al., 2022; Aizenman & Pasricha, 2009) between recipient jurisdictions and the US. Casting a wider net, some studies have invoked diplomatic (Sahasrabuddhe, 2019) and security interests (Flandreau, 1997; Walter, 2015) to explain instances of international cooperation.

Some work on multilateral cooperation between central banks provides similar accounts of how central banks have acted together (Keohane, 1984). When central banks agreed on international regulatory measures, such as capital standards or capital market harmonisation, these regulatory decisions have been cast as the result of intergovernmental bargaining (Kapstein, 1989; Simmons, 2001). In Europe, financial integration was seen as the outcome of a 'battle of the systems' (Story & Walter, 1997) where bargaining took place based on regulatory preferences which followed from domestic financial market structures (Moravcsik, 1998; Quaglia, 2007; Quaglia & Spendzharova, 2019; Stellinga, 2021). To explain the increase in central bank cooperation since the GFC, most scholars have used materialist explanations, primarily linked to the objectives of insurance (Eichengreen et al., 2018; Kring & Grimes, 2019; McDowell, 2019).

The ideational IPE literature on central banks, and technocratic cooperation more generally, disagrees however with the view that such material factors alone can explain cooperation. It emphasises the importance of international norms and shared identities in influencing central banks' behaviour. Thus, it is commonly argued that central banks form a 'transnational community' (Johnson, 2016, pp. 3–5) with a distinct culture (Marcussen, 2009b; Riles, 2018). Tight professional networks among central bankers have worked to develop shared policy

beliefs (Baker, 2006; cf. Hall, 1993; Johnson, 2016), and professional norms (Seabrooke & Tsingou, 2014). Several studies have argued that central banks have acted jointly as epistemic communities (P. M. Haas, 1992; Helleiner, 1994; McPhilemy, 2016; Verdun, 1999) where they leveraged their ideational consensus. Ideational approaches have so far hardly featured explicitly in the study of central bank cooperation: only one study (Marple, 2021) has so far attempted to explain central bank cooperation based on solidarity by linking the Fed's swap lines to joint social identities.

Another important contentious factor is the role of international institutions in facilitating central bank cooperation. The Bank for International Settlements (BIS) has long been at the centre of international central bank cooperation (Borio, Toniolo, & Clement, 2008; Clarke, 1967; Cooper, 2006; Helleiner, 1994), but there exist various other, 'minilateral' formats (Baker, 2006; Fioretos, 2019; Hampson & Heinbecker, 2011). In the European context, the cooperation of central banks was an everyday occurrence under the institutional framework of the European Exchange Rate Mechanism (ERM) in the 1980s (Höpner & Spielau, 2018; James, 2012) – though some studies argue that actual compliance with the ERM's rules was uneven (Bini Smaghi & Ferri, 2006; Cameron, 1993; Marsh, 1992). Similarly, the Chiang Mai Initiative, was not used during the GFC (Kawai et al., 2015).

Summing up, central bank cooperation is a central concern for the study of IPE. So far, however, the literature has mostly discussed a few, highly salient instances. As a result, little systematic knowledge exists about the drivers of central bank cooperation outside the US context and beyond the provision of credit lines. Moreover, the literature remains divided on how best to conceptualise central banks' agency. While many studies have highlighted the importance of norms and ideas, these insights have hardly been applied to understand central banks' efforts at

maintaining international financial stability. The following section outlines how this study tackles these shortcomings and disagreements and contributes to the overall theoretical debate.

1.1 Objective and analytical approach

1.1.1 The research question

The overarching objective of this study is to obtain a better grasp of international central bank cooperation. To achieve this objective, this thesis develops a conceptual framework for interpreting central banks' discretionary actions from their organisational perspective. The conceptual framework adds the perspective of a logic of appropriateness to the dominant approach of studying central bank cooperation as driven by a logic of consequences. By differentiating between these two perspectives, this study aims to inform a conceptually richer understanding of the actions of central banks. The research question that guides this study is therefore as follows: How can one best understand international central bank cooperation?

1.1.2 Central banks as agents

One upfront clarification of the approach pursued here concerns the stance that is taken here on central banks' agency. 'Agency', in Giddens' (1984, p. 9) definition, 'concerns events of which an individual is the perpetrator, in the sense that the individual could, at any phase in a given sequence of conduct, have acted differently.' As just discussed, many accounts of central bank cooperation tend not to make a distinction between the central bank and the state at large. They treat the Fed's credit lines as structurally inevitable and as manifestations of US monetary power, rather than discretionary decisions by the Fed itself (Cohen, 2015; Hardie & Maxfield, 2016; Hardie & Thompson, 2021; McDowell, 2017). For this study, however, a sharp analytical distinction needs to be made between central banks as organisations and the theoretical abstraction of the state (Hay, 2014), in the sense that they can act in their own right and for their

own motivations. Therefore, in this study, central banks, not states, are the unit of analysis and the lessons drawn from the analysis contribute to the IPE of central banks. This study works towards a conceptual framework for understanding central banks' discretionary actions from their organisational perspective.

This assumption that central banks possess meaningful agency is easy to justify. After all, central banks enjoy a high degree of independence which grants them formal autonomy from the government (McPhilemy & Moschella, 2019) and considerable financial and technical resources (Dyson & Marcussen, 2009) while their mandates on international matters are usually vague and leave room for discretion (Best, 2005; Braun et al., 2021). Giving central banks meaningful agency then means that central banks can use their resources creatively and that cooperative outcomes are seen as contingent on their actions (cf. Jackson, 2014, p. 270). To understand why things were 'so and not otherwise' (M. Weber, 1999, p. 289) one needs to reconstruct how central banks themselves accounted for various factors and resolved conflicts and ambiguities.

Considering central banks as units of analysis does not rule out that they might ultimately pursue national interests. But it is crucial to understand the reasons for the central bank, as an organisation, to do so: in those cases in which the central bank responds to geopolitical considerations, it would matter whether these concerns were brought up because of formal coordination with the government or because the central bank itself had internalised and acted upon these geopolitical interests (cf. Harris, 2015). Accepting the agency of central banks implies that the meanings that they gave to a situation matter and that their actions are seen as inherently indeterminate.

1.1.3 Levels of action

Different forms of central bank cooperation are distinguished according to their levels of action: some forms are labelled *individual actions*, and others are classified as *collective actions*. Dividing all possible forms of central bank cooperation into these two categories may seem somewhat crude, but the exercise helps both categorise the different instances of central bank cooperation considered and choose suitable theoretical lenses to study them.

Individual actions refer to forms of cooperation that are provided by individual central banks. It is important to note that these forms of cooperation must still constitute 'social action' in the Weberian sense of being 'meaningfully oriented towards [the behaviour] of others' (Weber, quoted in Weerdesteijn, 2018, p. 149). This means that individual decisions to cooperate must differ from what a central bank would have done acting unilaterally. The instances of individual actions that this study is most interested in include the provision of credit lines to central banks, their participation in bailout programmes, and the provision of liquidity across borders.

Collective actions, by contrast, refer to actions that central banks undertake jointly or as part of an institutional framework. Central banks' collective actions refer to the mode of governance between central banks, that is, how they, together, arrived at decisions and how decisions were enforced. The instances of collective action analysed here cover how central banks developed joint principles for crisis management, how they related to official Balance-of-Payments support, and how they approached the challenge of international macroprudential governance after the crisis. The analyticist approach outlined next details the strategy followed here to study central banks' individual and collective agency.

1.1.4 An 'analyticist' approach to central bank cooperation

The methodological implication of taking central banks' agency seriously is that this study needs to aim at *understanding*, rather than *explaining* their cooperation. As Max Weber (1968, p. 4) wrote, social science 'concern[s] itself with the interpretive understanding of social action and thereby with a causal explanation of its course and consequences.' Understanding – Verstehen – does not aim to find causal effects of one variable on another, but about eliciting the subjective meanings that agents attach to their decisions (Ekström, 1992, p. 112). The objective is rich explanations of particular events, not to find generalisable causal inferences (Hay, 2002, p. 49). Social reality is seen as 'relative, multiple, socially constructed, and ungoverned by natural laws'(Costantino, 2008, p. 6), and specific actions

> '[…]can*not* be viewed as the result of a struggle between causes some of which strive towards the concrete result and some of which strive against it [but] [i]nstead, the totality of *all* conditions […]' (M. Weber, 1999, p. 289 author's translation from German, emphasis original)

This study then follows an 'analyticist' approach, using Jackson's (2011) term. Rather than testing specific propositions, the objective of an analyticist approach is to develop theoretical concepts that are suitable to clarify an inherently messy reality and can be applied in different contexts. Developing this conceptual framework relies on reconstructing the 'subjective rationalities' of individual actors (Ekström, 1992), in good part based on the researcher's subjective assessment. To arrive at a sufficient understanding of a particular finding, the researcher needs to rely on subjective judgments of the factors which were likely critical to the causal configuration that produced an outcome and which ones were not (Jackson, 2011, pp. 148–149). As a result, the concepts that are developed are not neutral measurements but embody the researcher's value judgments (Jackson, 2011).

Though such an approach is often associated with constructivism (Jackson, 2011; Searle, 2010), that label is avoided here given its looser application in the study of IPE, where it is often used

to refer to ideational explanations more broadly (Abdelal, 2009). While this study, too, develops explanations based on ideas and identities, its approach towards the production of knowledge aims to develop new concepts and relies on ideal types as analytical devices. By contrast, some ideational studies follow a neopositivist set-up of testing hypotheses and aiming to show causal effects (Nelson, 2020, p. 217), not least Marple's (2021) study of the Fed's swap lines.

This study considers central bank cooperation as a social phenomenon that is inherently contingent. Specific instances of central bank cooperation are likely to be influenced by all sorts of factors. To understand why central banks cooperated in a certain way, they need to be treated as creative social actors whose motives need to be reconstructed. The added value from a theoretical perspective consists then not in uncovering empirical regularities but to carve out analytical constructs that help inform not just the specific cases studied here, but can, in a more abstract form, also be transposed into other contexts.

1.2 Outline of the argument

1.2.1 Ideal-typical logics of action

The theoretical argument advanced in this thesis is that central bank cooperation should be understood as driven not just by material, but also by normative considerations. The fundamental idea that social action is not just oriented towards specific purposes, but also towards values is hardly new. Weber distinguished between instrumental rationality (*zweckrational*) and value-based rationality (*wertrational*) (Rutgers & Schreurs, 2006), and more recently March and Olsen (1998, 2011) have argued that action could be interpreted as driven by either a logic of consequences or a logic of appropriateness. These two labels are applied throughout this study. The logic of consequences entails that actors base their decisions on the expected outcomes of their actions; from the perspective of the logic of appropriateness, actions are geared at the fulfilment of a certain role or identity that an actor seeks to embody.

To be sure, the two logics of action refer to the perceived meaning that actors attach to their actions. They do not imply a judgment of whether those actions are rational according to some external, objective standard (Levine, 1981). Whether a decision *actually* served a given material interest is of less interest than whether it was seen as such by the actor that took it. Though, somewhat confusingly, the language of rationality is used here – note Weber's terms *zweckrational* and *wertrational* – these two logics, therefore, do not necessarily imply a rational choice view of the world, but label subjective logics of action. These logics of action are understood, and causally explained, through 'rational interpretation, which […] is a matter of reconstructing a context of meaning for the purpose of understanding why persons act as they do' (Ekström, 1992, p. 112). As Max Weber cautioned, it is 'not legitimate to interpret this procedure as involving a rationalistic bias […] but purely as a methodological device' (M. Weber, 1968, pp. 6–7).

Crude as the dichotomy between these logics of action may be at first glance, it helps position the main claims of this thesis against the literature on central bank cooperation, where the logic of consequence has by far been the dominant perspective. The studies that conceive of central bank cooperation as motivated by national material interests – be they economic (McDowell, 2012), diplomatic (Sahasrabuddhe, 2019), or strategic objectives (Helleiner, 2014) – by definition argue that cooperation served some ulterior purpose. Similarly, many accounts of international financial governance cast new institutions as the outcomes of bargains between fixed material interests (Howarth & Quaglia, 2016; Schelkle, 2017; Stellinga, 2021). Only a few studies have sought to base their accounts on the logic of appropriateness (Johnson, 2016; Lütz, Hilgers, & Schneider, 2019a; Marple, 2021). This study aims to demonstrate the added value of the latter perspective by setting up a 'three-cornered fight' (Hancké, 2009) in which both theoretical approaches are applied to the same empirical material.

The two logics of action are throughout this study treated as ideal types. Ideal types are conceptual devices that serve as deliberate, theoretical oversimplifications that serve to guide the empirical analysis. They are

> '[…] formed through a one-sided accentuation of one or more points of view and through bringing together a great many diffuse and discrete, more or less present and occasionally absent concrete individual events, which are arranged according to these emphatically one-sided points of view in order to construct a unified analytical construct. In its conceptual purity, this analytical construct is found nowhere in empirical reality; it is a utopia' (Weber, quoted in Jackson, 2011, p. 143).

The value of ideal types for analyticist studies does not consist in predicting real-world outcomes, but in structuring and disciplining the analysis. Ideal types are theoretical elaborations of what would have to be the case logically if a certain set of propositions about an actor were true (Jackson, 2011, p. 144). They should be seen as 'heuristic artificial constructions' (Ekström, 1992, p. 112), which serve to provide a clear way of categorizing empirical observations, not to represent anything that exists empirically. They aid the empirical inquiry precisely because of their exaggerated and abstract character. Ideal types' usefulness lies in their being 'used as a means for the comparison and measurement of actuality' (Weber, quoted in Jackson, 2011, p. 144), or in short, as a conceptual yardstick. As conceptual yardsticks, ideal types cannot be right or wrong, but at best, more or less useful. To evaluate whether ideal types are useful for the analysis, one needs to determine whether they reveal some previously unrecognised, but causally relevant properties of the subject to which they are applied (Bailey, 1994, p. 19; Jackson, 2011, pp. 145–146).

To argue the point central bank cooperation can be usefully understood as being driven by perceptions of appropriateness, two things need to be accomplished. First, before the empirical inquiry, one needs to elaborate on two ideal types in conceptual terms and outline, at least schematically, their contrasting observable implications for the subject of central bank cooperation. Once that is done, one needs to demonstrate the analytical added value of assuming a norm-based perspective. Throughout the empirical chapters, a great number of individual

decisions and institutional choices will be discussed that are puzzling from a logic of consequence, but seem more plausible if interpreted as guided by normative considerations. In the analysis, the ideal types will then be re-considered and refined considering the empirical findings.

1.2.2 Outlining the ideal-typical logics of action

Individual action

The two logics of individual action are distinguished concerning the interests that central banks pursue and how they formulate these interests. Central banks may either pursue material or normative interests and formulate them through cost-benefit calculations or assessments of appropriateness. In any case, actions by individual central banks need to be 'rationalised' at the organisational level.

An analysis based on the logic of consequence assumes that central banks strive to achieve specific purposes and see their actions as instrumental to these purposes (Rutgers & Schreurs, 2006, p. 406). One would expect some indications of a rational decision-making process, for instance, that actors weigh the pros and cons and evaluate different possible courses of action and their likely second-order effects (Parsons, 2007, pp. 62–65; M. Weber, 1968, p. 26). This perspective conceives of central banks as utilitarians – '[i]n the ideal-typical case, they are ruthlessly systematic, acting only on the calculation of all variables germane to their objectives' (Oakes, 2003, pp. 38–39).

Two different sets of expected consequences can be distinguished based on the literature. First, some actions are aimed at the fulfilment of specific monetary policy objectives are classified under the rubric of monetary policy factors. This category would cover concerns related to central banks' operational targets, such as interest rates or exchange rates (Bindseil, 2014;

Eichengreen, 2013), their interest in preventing financial stresses to spill over onto their home markets (Masson, 1998), or their desire to protect their balance sheets in line with their collateral frameworks (Nyborg, 2016). Seeing central banks' international actions as being motivated by the fulfilment of their mandate is common across many studies (W. A. Allen, 2013; Braun et al., 2021; McDowell, 2012; Pape, 2022).

Second, material objectives that go beyond the central bank's monetary policy interests are classified as political considerations. Cooperation that is aimed at ensuring specific foreign policy objectives would be counted here: regulatory (Sahasrabuddhe, 2019), diplomatic (Liao & McDowell, 2015), or security-related (Walter, 2015) concerns. Partisan considerations at the national level, such as protecting domestic banks against losses come to mind (Broz, 2014; McDowell, 2017), or the preservation of the central bank's independence and autonomy (Chant & Acheson, 1972; Forder, 2002) would be considered political motivations.

Conversely, the logic of appropriateness implies that social action is motivated by a

> '[…] conscious belief in the value for its own sake of some […] form of behaviour, entirely for its own sake and independently of any prospects of external success' (M. Weber, 1968, pp. 24–25).

In the context of international politics, the logic of appropriateness refers to an action that is based on rules that are considered legitimate and the obligations that actors ascribe to a certain role or identity that they seek to embody (March & Olsen, 1998). Central bank cooperation out of value-based rationality would therefore be primarily concerned with policymakers' understanding of what would be the 'right' thing to do in each situation based on a standard that they hold themselves to. Actions would follow a cognitive process of 'matching […] identities, situations, and behavioral rules […] based on experience, expert knowledge, or intuition' (March & Olsen, 2011, p. 479) which aims at determining the appropriate behaviour in a given setting.

International institutions are considered the normative environment within which central banks operate. The logic of appropriateness would interpret cooperation as being based on rules, norms, or shared identities that are shared intersubjectively between central banks. These norms could be developed through socialization and persuasion (Johnson, 2016; Johnston, 2001), shared identities (Marple, 2021), or perceptions of hierarchy or obligation derived from international institutional frameworks (Bruneau, 2021). What matters here is that central banks consciously choose a course of action that reflects what is seen as legitimate by others, based on formal or informal institutions.

Collective actions

The two logics of consequence and appropriateness also suggest different patterns of collective actions and governance among central banks. Following March and Olsen (1998, p. 968), the former perspective 'interprets changes in an international political order primarily in terms of exogenously specified interests and capabilities, rational actors, expectations of consequences, and environmental pressures.' From the latter perspective 'changes in a political order' are seen 'more as involving the construction and evocation of rules, institutions, and identities, the development of capabilities, and the path-dependent meanders of an inefficient history.' The two ideal types are thus, ex-ante, distinguished according to their mode of interaction and the degree of hierarchy.

While the logic of consequence would interpret the interaction between central banks as a process of strategic bargaining, from a perspective of appropriateness, the more fitting analogy would be collective problem-solving (Benz, 2000; Hopmann, 1995; Risse & Kleine, 2010). In the former case, each central bank would aim to maximise its national interest, potentially at the expense of others (Scharpf, 1997); compliance with rules would be separate from their intentions and instrumentally aimed at avoiding sanctions. The alternative is that central banks'

interactions would be geared at formulating collective rules by transforming their perceptions of what constitutes appropriate actions through 'soft' modes of interaction, such as deliberation (Joerges & Neyer, 1997; Sabel & Zeitlin, 2008), socialization (Johnston, 2001), or learning (Dunlop & Radaelli, 2013; Quaglia & Verdun, 2022).

The logic of consequences expects cooperation to take place in highly hierarchical formats (Treib, Bähr, & Falkner, 2007). Rules would be imposed through legislative or executive decisions and take the form of hard law with sanctioning mechanisms that allow for little flexibility in the implementation process. Such a governance arrangement would result in a highly formalized way of enforcing standards. Collective action based on a logic of appropriateness would by contrast be characterised by the relative absence of formal hierarchies. Governance would rely on soft law instruments and compliance would largely be ensured through reputational considerations and the general acceptance of the rules.

Of course, there are many other ways to categorise central banks' collective governance (see e.g. Treib et al., 2007). One could for instance consider the degrees of centralization, formality, or inclusivity of the new governance arrangement. All these dimensions will be considered in the final analysis. However, neither of these dimensions neatly maps onto the two logics of collective action that form the backbone of the study; the assessment of whether, say, a more inclusive institutional set-up conforms to a logic of consequence or appropriateness has to be made contextually. How this study aims to account for such factors is elaborated next.

1.2.3 Applying the two logics

The contribution of this study does not consist in arguing one corner in the dispute between material interests and social institutions: both matter in certain instances. The two logics of action serve as conceptual yardsticks to interpret specific outcomes. Paradoxically, however, their analytical value for understanding individual outcomes consists in highlighting where real-

world outcomes deviate from the theoretical abstraction (Bailey, 1994, pp. 17–19; Jackson, 2011, p. 115). Since both perspectives elucidate important aspects of international central bank cooperation, they should be thought of as complementary, rather than mutually exclusive. In practice, one can assume that central banks will follow both instrumental and normative considerations; if the two ideal types were yellow and blue, reality would likely be different shades of green.

As theoretical abstractions, the ideal-typical logics will structure analytical narratives of events by directing attention to different sets of factors that have been causally relevant for bringing about a certain outcome (Jackson, 2011). One needs to separate those factors that are implied in ideal types – say, the constellation of financial interests – from those that are merely coincidental from the perspective of the ideal type, but may still have played a role in a specific event – for instance the professional background of a central bank governor (cf. Adolph, 2013). In other words, precisely because the two ideal-typical claims are so stylised, one will inevitably have to consider factors outside them to account for specific outcomes.

Drawing on coincidental factors helps clarify how this study conceives of the relationship between the two ideal-typical logics of action. Several theoretical perspectives posit a fixed relationship between the two logics by subsuming one as a special case of the other. Constructivist scholars might note that following material interests may be considered appropriate in some situations (Finnemore & Sikkink, 1998, pp. 912–913) while more materialist approaches, inversely, would argue that apparently norm-oriented behaviour follows higher-level calculations (Ostrom, 1990; Schelkle, 2017). March and Olsen (2011) venture that one logic of action may dominate because it provides clearer prescriptive guidance in a given context.

This study departs from these perspectives and instead argues that it is the agency of central banks that leads them to conform more to either logic of action. It is at this point that this study draws on Weber's metaphor of ideas as 'switchmen' between material and value orientations:

> 'Not ideas, but material and ideal interests, directly govern men's conduct. Yet very frequently the "world images" that have been created by "ideas" have, like switchmen, determined the tracks along which action has been pushed by the dynamic of interest' (Weber, quoted in Swidler, 1986, p. 274).

Two concepts from sociological institutionalism are used to tease out how ideas mattered for central bank cooperation. First, it is argued that bureaucratic cultures – the prevalent rules, economic ideas, and identities inside the organisations (Barnett & Finnemore, 2004; Nelson & Weaver, 2016) – affected how individual central banks defined their interests and conceived of appropriate action. Second, it is crucial to highlight the role of agents as institutional entrepreneurs (Battilana, Leca, & Boxenbaum, 2009) to understand changing patterns of collective action. These institutional entrepreneurs were individuals or organisations that introduced new institutional frameworks, or changed existing ones, by formulating visions and mobilizing resources. The influence of ideas is reflected in the degree to which they allowed for these forms of agency.

Bringing it all together, this section has outlined how two interpretations of international cooperation, the logic of consequences and the logic of appropriateness, will be used to structure the empirical analysis. Table 1 summarises the observable implications that will be counted towards either perspective. Following Weber's set-up (Norkus, 2000, pp. 261–262) throughout the empirical study, the logic of consequence will be considered as a baseline against which value-centred approaches have to be distinguished. In the end, however, the thesis argues that both perspectives are informative which means that the ideational perspective should be taken more seriously. Having clarified the theoretical set-up, it is now time to turn to the empirical context in which central bank cooperation will be studied.

Table 1 Ideal types of central bank cooperation

<table>
<tr><td colspan="2" rowspan="2"></td><td colspan="2">Logic of action</td></tr>
<tr><td>Central banks driven by logic of consequences</td><td>Central banks driven by logic of appropriateness</td></tr>
<tr><td rowspan="2">Level of cooperation</td><td>Individual action</td><td>Instrumental cooperation

Decisions based on analysis of material consequences</td><td>Value-based cooperation

Decisions based on a judgment of reputational and normative considerations</td></tr>
<tr><td>Collective action</td><td>Hierarchical governance based on hard laws

Strategic bargaining</td><td>Non-hierarchical governance, based on soft laws, norms, and principles

Collective norm formation through deliberation, persuasion, learning</td></tr>
</table>

1.3 The context of the financial crisis in Europe

1.3.1 Empirical relevance

The GFC in Europe and its aftermath offer a highly instructive context to learn more about international central bank cooperation. To begin with, central banks in Europe entered into various bilateral credit arrangements. However, unlike those of the US Fed, many of these credit lines, particularly to central banks in Central and Eastern Europe (CEE), were not bilateral foreign exchange swaps but took rather unconventional forms (W. A. Allen, 2013; Moessner & Allen, 2010). For instance, both the ECB and the Swiss National Bank (SNB) refused to accept the Hungarian and Polish currencies as collateral. Especially the ECB's refusal to provide more assistance to the European Union's (EU) CEE member states has been heavily criticised afterwards (Åslund, 2010, p. e.g.; Gabor, 2016; Tooze, 2018).

Second, in response to the financial crisis, various new institutional arrangements have been set up to help maintain international financial stability. The so-called Vienna Initiative (VI), which

was set up early into the crisis to facilitate the coordination between banks and public officials (Pistor, 2011), has developed into an established forum for regional financial cooperation in CEE. In 2010, the European Systemic Risk Board (ESRB), a new European Union (EU) agency housed with the ECB, was tasked with developing rules for macroprudential policy conduct (Stellinga, 2021). Lastly, the central banks in the Nordic/Baltic region intensified their cooperation on both crisis management and macroprudential policy in separate dedicated settings. In short, the financial crisis in Europe was a catalyst for central bank cooperation.

So far, the decisions and motivations that led to these arrangements are only partially understood. Beginning with the credit lines, some studies have discussed especially the ECB's refusal to take a more active role in the CEE crisis. Gabor (2016) and Åslund (2010) confine themselves to criticising the ECB's crisis handling without probing its motivations. Johnson (2016, p. 243) is left puzzled at the ECB's limited support, given the 'transnational central banking community's expensive, concerted, hands-on efforts to remould postcommunist central banks in its own image' (Johnson, 2016, p. 39). Two studies have applied the lens of bureaucratic cultures to learn more about individual decisions by the ECB (Lütz et al., 2019a; Piroska, 2017), but both considered the ECB as a supranational institution, alongside the European Commission and the International Monetary Fund (IMF) rather than as a central bank. Bill Allen (2013) has provided an exhaustive, but superficial, study of all credit lines worldwide during the GFC. Only Epstein (2017) has paid attention to the credit lines among the Nordic and Baltic central banks, and largely considered these as derivatives of Swedish banks' business strategies. A systematic analysis of central banks' credit lines in Europe has, to the best of the author's knowledge, so far not been attempted.

When it comes to regional financial governance, both the origins of the VI and the ESRB have been scrutinised, but considerable gaps in knowledge remain. The success of the VI has largely

been considered on the terms of a financial rollover agreement. Many authors have argued that it has helped overcome collective action problems and compel West European banks to keep supporting their operations in CEE (Åslund, 2010; Cerutti, Ilyina, Makarova, & Schmieder, 2010; R. De Haas, Korniyenko, Pivovarsky, & Loukoianova, 2012; Kudrna & Gabor, 2013; Mitra, Selowski, & Zalduendo, 2009; Pistor, 2011). Epstein (2014, 2017) has, however, convincingly countered that its success in ensuring bank exposure was limited, as the banks had long-term commitments in CEE and had no intention of 'cutting and running' either way. By contrast, the role of the VI for coordinating public policies, which, as will be seen, has become its main field of activity after 2010 (EIB, 2019) has received very limited attention (Kudrna & Gabor, 2013 offer a partial exception).

The ESRB is perhaps the best-studied instance of central bank cooperation covered in this study. Previous studies have probed the logic of delegation (Lombardi & Moschella, 2017), and the role of central banks (McPhilemy, 2016) in its creation. The ESRB's work has by some been portrayed as effective (Ehrmann & Schure, 2020) and consensus-based (Thiemann & Stellinga, 2022), while other work has lamented its 'convoluted' organisation (Sibert, 2009; Stellinga, 2021) and its limited success in prevailing against national interests (Thiemann, 2019; Thiemann, Birk, & Friedrich, 2018). This study's main contribution to this debate consists of highlighting the ESRB's role in coordinating national policies and formulating an international macroprudential governance agenda.

All in all, this study covers a variety of instances and institutional formats: a total of thirteen credit lines, provided by four central banks alongside three IMF programmes, and four different settings for international financial governance. Yet, for all its breadth, this study does not consider all cases of central bank cooperation in Europe. Substantively, it confines itself to those institutional forms of central bank cooperation that are generally seen as most demanding

to establish, namely credit lines and joint regulatory actions (cf. Cooper, 2006; Simmons, 2008). Geographically, it focuses on the documented cases of central bank cooperation in Central Europe and the Nordic/Baltic region.[2] The involvement of the US Fed and the Bank of England is only mentioned in passing lest the empirical material be spread too widely. Individual central banks' roles are discussed with regard to the degree that they mattered in a given policy field.

1.3.2 Theoretical relevance

Europe also offers a suitable context for developing insights that are more widely applicable to the study of international central bank cooperation. Whereas most current studies analyse a limited number of institutional settings or credit lines (and, again, mostly those extended by the Fed), this study can synthesise a wealth of comparative material based on the actions of several central banks. Since analyticist approaches generally aim at developing case-specific narratives (Jackson, 2011, p. 152) including so many individual cases in a single study may seem a surprising choice. After all, it means that each instance of central bank cooperation – each credit line and each institutional set-up – is discussed individually. However, both for practical and for methodological reasons, this approach is considered suitable for this study. From a practical perspective, it will soon become clear that individual instances were in practice often related to each other. Thus, the terms of the ECB's credit line to the Hungarian central bank influenced those of the subsequent credit lines to Poland and Latvia; and both the VI and the Nordic/Baltic Macroprudential Forum (NBMF) formally acknowledge the ESRB as the ultimate authority. To build a sufficiently contextualised understanding of how these choices were made it is

[2] In fact, this study finds evidence of some precautionary credit lines that were missing from William Allen's (2013) otherwise comprehensive account of central banks' liquidity cooperation during the GFC. A timeline that chronicles all documented central bank credit lines in Europe between 2007 and 2010, including those left out of the empirical analysis, is provided in the Appendix.

crucial to be able to acknowledge these interdependencies between individual outcomes, rather than artificially separate them.

From a methodological perspective, the choice to consider various instances is less problematic than it may seem at first (Jackson, 2011, pp. 152–153). After all, this study does not attempt any sort of controlled comparison between the cases: in each case, several ideal-typical and coincidental factors interact differently. To develop a rich and grounded conceptual understanding of the wider phenomenon of central bank cooperation, it is advantageous to be able to draw on a range of instances. By showing that the logic of appropriateness accounts well for a variety of specific outcomes, the study can make a more convincing case for the wider application of that interpretive lens.

1.4 Data

This study relies on 25 semi-structured elite interviews, conducted between September 2020 and May 2022. As a form of data collection, elite interviews are highly suitable for reconstructing policymakers' motivations and interests (Richards, 1996) because they allow the researcher to learn about interviewees' subjective understandings of an event (Morris, 2009). Interviewees included, among others, board members and senior officials from seven central banks and the two initiators of the VI. They were usually contacted via email – either individually or through their organisations – and initially selected based on their roles during the GFC. Each interviewee was also asked to recommend further informants, which allowed for 'snowballing' (Richards, 1996, p. 200) in some cases. Several interviewees have requested to remain anonymous, but Table 2 provides an overview of all interviewees' institutional and, if applicable, national affiliations.

Table 2 Overview of Interviewees

Sector	**Affiliation**	**Number of interviews**
Central banks	Austria (2), Denmark (2), ECB (3), Estonia (2), Hungary (1), Poland (1), Sweden (2),	13
Commercial banks	Austria	1
Financial supervisors	Poland	1
Finance Ministries	Austria, Denmark, Estonia	3
International organisations	EBRD, European Commission, IMF (3)	5
Academia	Denmark, Switzerland	2

The geographic distribution of the officials is uneven, as some central banks were more responsive and two planned interview trips had to be cancelled at short notice due to COVID-19 travel restrictions. As a result of the COVID-19 pandemic, only two field trips, to Luxembourg and Copenhagen, were possible and the remaining interviews were conducted through video calls. Relying primarily on online interviews has imposed some limitations on the quality of the interactions, owing not just to connection glitches and the reduced scope for interaction, but also the limited space for speaking to top officials with busy agendas, or having off-the-record conversations and chance encounters. But conversely, the medium of online interviews has also opened up the possibility to speak to officials from a variety of places, not least Washington, D.C., who would likely not have been interviewed otherwise. Bearing this in mind, the interviews have been instrumental in reconstructing both the historical course of events and policymakers' perceptions of the drivers of central bank cooperation for all cases.

The interviews took between 30 and 90 minutes, and in some cases were followed up by email. All interviewees were asked to sign a participant consent form which had previously received human ethics approval from Leiden University. While the questions were always adapted to the individual interviewees and, if applicable, time constraints, all interviews followed a similar question structure. The consent form and a sample question outline are included in the Appendix. In those cases where interviewees agreed to go on the record, the interview transcripts can be made available on request.

Interview data always pose a challenge to the credibility of the conclusions. Besides the ever-present possibility that interviewees may have omitted or misremembered certain events (Morris, 2009), the challenge of the 'double hermeneutic' (Giddens, 1984) for drawing theoretical conclusions needs to be acknowledged upfront. This research aims to study the behaviour of central banks, that is, of organisations, yet interviewees can only provide their own interpretations of that behaviour. It is these subjective interpretations that are in turn being interpreted for this research (Jackson, 2014). This challenge is compounded by the fact that the interviewees are overwhelmingly economists by training, which might predispose them to justify policy decisions regarding their economic consequences. Arguably the interviewee selection has therefore made it less likely that interpretations in line with a logic of appropriateness would be provided.

To ensure the credibility of the findings, both factual information and, if possible, the interpretations provided in interviews were triangulated via other sources. Internal documents of central banks, including some files that the ECB made available after a request for public access,[3] were an additional important source of original data. Moreover, official publications,

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[3] All available under: Documents released under public access regime - Market operations (europa.eu).

speeches, and newspaper and online articles have been used to substantiate the empirical narratives. On the few occasions when there were disagreements or incongruencies between interviewees' interpretations or with written sources, these divergences are acknowledged as such, and the overall interpretation takes both perspectives into account.

1.5 Outline of the thesis

The remainder of the thesis comprises five empirical chapters, a chapter with an overall analysis, and a concluding chapter. The next two chapters cover central banks' credit lines, the principal form of individual actions considered here. Chapter 2 looks at five credit lines that were concluded between the ECB, the SNB, and the Hungarian and Polish central banks and offers nuanced assessments of why central banks attached stricter borrowing terms to some credit lines than to others. At first glance, it seems plausible to understand the credit lines as motivated by economic considerations, specifically financial stability and credit risk. However, the chapter argues that these factors have to be balanced against an existing norm of solidarity and that the ECB's and the SNB's decisions were no structural inevitability, but reflected situational judgments. Chapter 3 on credit lines in the Nordic/Baltic region paints a similar picture: economic interests account for some aspects of the six credit lines that were concluded, but more frequently, considerations of appropriateness, based on joint identities and international institutions, seem more decisive.

Chapter 4 shifts the attention to the relationship between central banks and IMF support. It shows that central banks' roles in BoP programmes varied across cases and that central banks preferred to cooperate outside the frameworks of BoP programmes. These findings do not just bolster the conclusion that central bank cooperation should be considered on separate terms from governments, but they also demonstrate that there is no fixed role that central banks play

during BoP programmes, but that they decide on their involvement based on situational judgments.

Chapters 5 and 6, then turn to central banks' collective action. In chapter 5, emergency liquidity provision, the quintessential form of crisis management is covered. It is found that central banks coordinated largely informally and ad hoc on how to provide liquidity to the financial sector. The creation and functioning of two new crisis management settings, the VI and the NBSG, is interpreted as a process of collective learning and norm formation.

Chapter 6, finally, studies three institutional forums for regional macroprudential governance in Europe. All three set-ups considered, the ESRB, the VI's successor (dubbed VI 2.0), and the NBMF are characterised by varying, but high degrees of inclusivity. These settings seem particularly geared towards exchange, deliberation, and collective norm formation. This chapter details not just the institutional relationship that has developed between these three forums, but also sketches how they have developed a macroprudential policy agenda aimed at the regional financial system.

The analysis in chapter 7 takes stock of the empirical findings by re-examining the ideal-typical logics of action outlined in this chapter. In many instances, European central banks' decisions and institutional choices can better be understood if central banks are thought of as social actors, rather than as merely motivated by material interests. The ideas and experiences of agents inside central banks matter for how they perceive their roles and which norms and identities they invoke to justify specific actions.

Chapter 8 concludes by outlining the contributions of this study and assessing its implications for future research on international central bank cooperation. The empirical findings of this study offer a new angle for understanding the resolution of the GFC in Europe and regional

financial governance thereafter. They suggest that norms and identities played an important role in shaping how central banks would cooperate. The methodological implication for future studies consists in stressing that one needs to study explicitly the different facets of central banks' international agency. While material interests do matter, they are not all that matters, and how they matter is a question of context. Taking this thought more seriously will enrich the study of central bank cooperation in other contexts, too.

Chapter 2 – Central bank credit lines in Central Europe

Abstract

In the context of the financial crisis in Central Europe, the ECB and the SNB concluded credit lines both with each other and with the Hungarian and Polish central banks. These credit lines offer an intriguing starting point to learn about individual central banks' decision-making because both the ECB and the SNB demanded exceptionally strict credit terms. This chapter argues that the expected consequences account only partially for these decisions. The ECB chose to pursue a highly restrictive approach towards credit lines despite considerable financial linkages. The SNB, conversely, had few financial interests at stake but provided support out of solidarity. This chapter concludes that one needs to account for social norms and economic ideas to understand important facets of the decisions of both central banks.

Introduction

Credit lines are a powerful and well-established way in which central banks can assist each other during financial crises (Cooper, 2006; Fratianni & Pattison, 2001; Simmons, 2008). The recipient of such credit lines gains immediate access to additional liquidity in foreign currency and can use these resources to stabilise financial markets. So-called swap lines represent the most common loan instrument between central banks. Under swap lines, the borrowing central bank can provide its own currency as collateral for its drawings. All fourteen credit lines that the US Fed made available during the GFC took the form of such swaps.

The credit lines that the ECB and the SNB provided to central banks in Central Europe stood out in the context of the GFC (W. A. Allen, 2013, p. 150). Among themselves, the ECB and the SNB agreed on a swap arrangement under which the ECB obtained Swiss francs (CHF) against euros. However, while both set up credit lines with the central banks of Hungary (Magyar Nemzeti Bank, MNB) and Poland (Narodowy Bank Polski, NBP) they demanded these central banks provide collateral from their foreign exchange reserves instead of their own currencies. Especially the decision by the ECB to demand additional securities has since been criticised, because the stricter borrowing terms rendered the credit lines less useful for the recipients (Åslund, 2010; Tooze, 2018; Vallee, 2010).

This chapter aims to understand the ECB's and the SNB's credit lines in the context of the financial crisis in Central Europe. It applies the two perspectives of consequential and appropriate action to distinguish between important factors that bore on each decision. While the logic of consequences helps identify the roles of financial linkages and sovereign credit risk in shaping the terms of the loans, neither of these factors can fully account for them. Norm-based approaches have more traction, especially when it comes to the SNB's decisions, which were seen as expressions of solidarity. The ECB's reluctance becomes clearer against the backdrop of strong opposition from the Economics department and a set of principles for liquidity assistance developed early into the crisis. The chapter thus argues that, rather than responding to clear-cut financial imperatives, both the ECB's and the SNB's credit lines were affected by prior strategic choices and subjective understandings of appropriate action.

To substantiate this argument, the chapter proceeds as follows. The next section provides some background on the financial crisis in Central Europe to contextualise the central bank credit lines that were concluded. After that, the ECB's and the SNB's decision-making processes are analysed in turn. The empirical questions that these sections tackle concern the roles that material interests, such as bank exposure and credit risk, played, in juxtaposition with ideational and institutional dynamics. The final section summarises the findings and offers the first conclusion.

2.1 The financial crisis in Central Europe

The financial crisis in Central Europe initially took the form of a classic liquidity crisis. In October 2008, banks suddenly found themselves unable to access money markets and central banks were forced to step in as lenders of last resort. The ECB, the MNB, the NBP, and the SNB all played that role, supporting their banks with liquidity both in domestic and foreign currency. In this context, the credit arrangements varied in their usefulness, both for central

banks to intervene in markets and to restore banks' confidence in individual countries. Whereas the swap line between the ECB and the SNB was instrumental in restoring international stability, their credit lines with the MNB and the NBP were used to a much smaller extent and both Hungary and Poland secured additional support from the IMF.

2.1.1 Background

The financial crisis in Central Europe needs to be understood against the backdrop of rapidly growing foreign currency loans across the region. In Austria, Hungary, and Poland, firms and households tried to take advantage of low interest rates. On the eve of the GFC, foreign currency mortgages represented a significant share of banks' assets in these countries. The expansion of foreign currency mortgages started in Austria, in the 1990s when households started to borrow in Swiss francs, given that Swiss interest rates were traditionally lower than those for Austrian schilling and later euro loans. In 2007, 30% of all loans in Austria were denominated in foreign currencies (Beer, Ongena, & Peter, 2010). In Hungary and Poland, foreign currency loans only became popular after these countries joined the EU in 2004. But thereafter they rose steeply and in 2007 foreign loans made up more than half and about a quarter of all loans, in these countries respectively. The foreign currency loans in both countries were predominantly denominated in Swiss francs – 56% in Hungary and 69% in Poland – with the euro accounting for most of the remainder (Brown, Peter, & Wehrmüller, 2009). From the perspective of financial stability, these loans posed two different risks, namely credit risk and liquidity risk.

The first of these risks, credit risk – which materializes when the domestic currency depreciates against the currency in which the loan is denominated and leaves the borrower unable to repay – was, perhaps surprisingly, no major issue during the crisis.[4] Indeed, most of the households

[4] Interview Martin Wohlmuth (Head of Strategy, Erste Bank)

that had taken out foreign currency mortgages were financially sound enough to bear the risks (Beer et al., 2010). In Poland, the financial regulator KNF in 2006 issued ‘Regulation S’ which restricted these loans to affluent households.[5] As a result, even though the euro, the Hungarian forint, and the Polish zloty all depreciated relative to the Swiss franc, the banks holding these loans faced only limited increases in non-performing loans (Pann, Seliger, & Übeleis, 2010).[6]

Liquidity risks, on the other hand, were more serious and highlight the importance of a second development before the crisis: foreign bank entry. Since the transition to market economies, foreign banks had expanded their operations into retail markets across Central Europe (R. A. Epstein, 2014), owning 76.5% of all financial assets in Poland and 84% in Hungary in 2008 (EBRD, 2009). While all banks, domestic and foreign, provided foreign currency loans (Banai, Király, & Nagy, 2010), only foreign banks’ subsidiaries could count on their parent bank for funding (R. de Haas & Naaborg, 2005). Domestically-owned banks, such as OTP (Országos Takarék Pénztár – 'National Savings Bank'), the largest bank in Hungary, relied on money markets, especially foreign exchange swap markets, to fund their foreign currency loans (Mák & Páles, 2009; Szpunar, 2009). Although Hungarian and Polish policymakers were aware that banks were left vulnerable to a potential breakdown in foreign exchange swap markets, they did not expect a crisis to materialise.[7]

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[5] Interview Stanislaw Kluza (Head of the Polish Financial Supervision Authority, KNF)

[6] Later into the crisis, both Hungary and Poland would take aggressive measures to convert foreign currency loans into domestic currencies at favourable exchange rates. However, that was no immediate concern in 2008.

[7] Interviews Júlia Király (former Deputy Governor, MNB) and Kluza (KNF)

2.1.2 Central bank credit lines during the financial crisis

The funding problems materialized first slowly and then aggravated very quickly. Starting in 2007, turnover in unsecured Swiss franc money markets declined, as more and more lenders asked for collateral and increasingly shorter maturities (Auer, Kraenzlin, & Liebeg, 2012). Then, in October 2008, the financial market panic spread to Eastern Europe and money markets froze almost entirely. In the Swiss franc money markets, spreads between secured and unsecured increased rapidly leaving borrowers without suitable collateral unable to borrow Swiss francs short-term (Auer & Kraenzlin, 2011). On October 9 financial markets suddenly stopped completely in Hungary: a government bond auction failed, the currency came under depreciation pressure, OTP's stock price collapsed, and the foreign exchange swap market dried up, leaving banks to scramble for liquidity. In Poland, money market turnover also declined, albeit in a less dramatic fashion than in Hungary.

In this context, both these central banks turned to the ECB and requested swap lines to be able to manage the crisis. However, the ECB only agreed to a repo agreement, which meant that the borrowers would have to provide bonds of Euro Area governments that they already held in their foreign reserves as collateral. The repos would thus not increase their foreign exchange reserves, but allow the MNB and NBP to use their existing reserves faster. Given the dismal situation in Hungary, the MNB immediately drew on the ECB's repo to forward euros to the Hungarian banking sector, even though it was already running low on reserves. The MNB was disappointed that it received only a repo because it still needed to draw down its dwindling foreign exchange reserves.[8] However, market participants still took its announcement as a

[8] Interview Király (MNB)

positive signal (Société Générale, 2008). By contrast, the NBP never drew its credit line with the ECB.

The SNB agreed to swap Swiss francs against euros with all three central banks. For the ECB, this meant that it had a bilateral swap facility; the MNB and the NBP would only be able to obtain Swiss francs to the degree that they already had liquid euro reserves. All three recipients made use of the SNB's arrangement, though the ECB drew by far the largest amount.

In the spring of 2009, central banks' collective actions had succeeded in stabilizing foreign exchange swap markets and the crisis entered a new phase. However, a new problem materialized when Central European currencies depreciated heavily against the euro and the Swiss franc. The ECB, however, resisted calls for more support to the Central European central banks until the worst of the crisis had passed. Only in September 2009 did it agree informally to convert half the volume of the repo lines into swaps, but the credit lines were hardly used after that. The SNB resolved the problem of liquidity shortages single-handedly after March 2009 by taking the highly unconventional step of outright buying foreign currency to stem the appreciation of the franc (Moschella, 2015). Over the year, these purchases flooded international markets with Swiss franc liquidity and all four central banks agreed to discontinue Swiss franc swaps in early 2010.

2.1.3 Applying the ideal-typical logics of action

Before moving on to the empirical narratives, it is worth restating briefly how each logic of action would interpret the terms of credit lines in its ideal-typical form. The logic of consequences has outlined two different sorts of factors – considerations related to domestic monetary or financial stability and political interests – as reasons that could speak for providing a credit line. The central banking literature also proposes three considerations that could account for the ECB's and SNB's refusal to provide full-fledged swap lines (Bindseil, 2014, p. 285).

The credit lines could, first, result in an unwanted monetary expansion or, second, trigger moral hazard by allowing the borrower to delay necessary adjustments (Auer & Kraenzlin, 2011). Third, if the recipient defaulted on the loan, a swap would leave the lender with the useless local currency (W. A. Allen, 2013, pp. 99–100). Bindseil (2014, p. 285) explains further that '[t]his fear may be particularly justified if, overall, [the recipient country] is in a disastrous state and politically unstable.'[9] In short, a central bank purely concerned with its self-interest would likely see a reason to assist if its domestic policy targets were at stake, but if the potential borrower posed a clear financial risk, collateral might be required to protect the balance sheet.

Conversely, the logic of appropriateness would point to identities or behavioural norms to account for the unequal treatment of different central banks. Central banks of higher social status might thus receive concessionary terms, while those lower in the international hierarchy might be spurned. Similarly, indications of prior agreements to cooperate in case of a crisis would provide a norm-based reason to extend support. As the remainder of the chapter will argue, material concerns by no means provided unequivocal reasons to justify the ECB's and SNB's decisions. To understand the credit terms in Central Europe, it is crucial to understand the institutional and normative context.

2.2 The ECB's repos

The ECB's handling of the financial crisis and especially its controversial decision to provide repos to Hungary and Poland have widely been criticized, especially in comparison with the swap lines for Denmark and Sweden which will be the subject of the next chapter. So far, however, there has been more speculation than a systematic analysis of the reasons to decide to

[9] This textbook is written by an ECB staff member, who might be under some institutional pressure to provide an exculpatory rationale for the ECB's actions in 2008, given that collateralized central bank credit lines were formerly unprecedented.

do so. This section interprets the ECB's decisions through the lenses of both ideal types. Material factors provide little systematic guidance to the ECB's crisis handling; it appears if anything, even more puzzling. Yet the ECB also lacked a clear normative understanding of what it ought to be doing. Instead, the strength of a specific set of economic ideas during an initial period of uncertainty shaped the ECB's restrictive approach to the crisis in Central Europe.

2.2.1 The ECB's repo's seen through the lens of the logic of consequences

Patterns of bank ownership presented a plausible reason for the ECB to support regional financial stability and provide swap lines to the Hungarian and Polish central banks. Almost all the foreign parents of banks in these countries were domiciled in the Euro Area. Austrian banks had by far the biggest exposure across the region, with regional exposure amounting to 70% of Austrian GDP in 2008 according to BIS data[10], but major banks from Belgium, France, Germany, Italy, and the Netherlands had all established a presence (Árvai, Driessen, & Ötker-Robe, 2009). In terms of the Euro Area's overall international exposure, even in comparison with the Eurodollar market alone,[11] the exposures to Central Europe remained relatively small and were diversified across Euro Area member states. Nonetheless, analyses by the IMF cautioned that regional financial contagion could turn a local problem in Central Europe into a problem for the parent banks (Árvai et al., 2009).

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[10] The Austrian exposure was in practice likely even higher, closer to 100% of GDP, given that Hypo Alpe Adria and Bank Austria were both subsumed under their German and Italian parents' exposure in the BIS calculations, Interview Franz Nauschnigg (Head of Division, European Affairs and International Financial Organizations, OeNB).

[11] Interview Francesco Papadia (former Head of the Market Operations department, ECB)

The Euro Area banks that were active in the region had no intention of reducing their exposure when the financial crisis reached Eastern Europe in September 2008 (Stepic, 2019).[12] In fact, the largest foreign banking groups in the region pressured the ECB to alleviate liquidity problems in the region. In January 2009, nine major European banks active across Eastern Europe (including two Swedish banks) wrote a joint letter to the ECB and their home central banks in which they described both the nature of the financial risks to their operations. They urged the ECB to support euro liquidity conditions in Eastern Europe through central bank swap lines and other unconventional measures (the letter is reproduced in Würfel & Atroszczak, 2019, p. 238). This pressure from commercial banks amounted however to surprisingly little action from the ECB.

Not only did the exposed banks themselves push for swap lines to Hungary and Poland, but so too did their national central banks. The Austrian National Bank (Österreichische Nationalbank, OeNB) was, perhaps unsurprisingly, the biggest advocate of swap lines. One of its concerns in that regard was the exposure of the parent banks and the risk of a spillover of financial instability.[13] The OeNB's worries extended however beyond the financial risks to their banks: when financial market conditions deteriorated across Eastern Europe in early 2009, worries about Austrian banks' exposure led to speculative pressure against Austria's sovereign finances as well. Austria's Credit Default Swaps (the insurance against sovereign default) rose to the same level as Greece's – although Austria itself had no domestic banking crisis to speak of (Nauschnigg, 2011). New York Times columnist Paul Krugman drew the ire of the Austrian government when he wrote that Austria's East European exposure was 'off the charts'

[12] Interview Wohlmuth (Erste Bank)

[13] Interviews Nauschnigg, Ewald Nowotny (former Governor, OeNB)

(Krugman, 2009).[14] From Austria's perspective, restoring confidence in Eastern Europe was an unequivocal matter of self-interest.[15]

Other central banks in the Eurosystem advocated swap lines for Hungary and Poland for similar reasons. The Banque de France joined Austria's calls for a swap line with the Hungarian central bank (Vallee, 2010).[16] As regards Poland, Austria did not have major financial interests at stake, but Germany's Bundesbank advocated a swap line for their Polish colleagues – with an eye to German investments in Poland.[17] Considering the lobbying by major shareholders and the expected material consequences of inaction, the ECB's reluctance to open swap lines with the central banks in Eastern Europe becomes just more surprising.

Considering such compelling material reasons to provide swaps, the question is whether there were similarly strong concerns about credit risk that could justify demanding collateral. However, the ECB's approach to sovereign credit risk was too inconsistent to serve as a clear explanation. Before the crisis, the ECB had accepted a broad pool of euro-denominated collateral, rated at least A-, but in November 2008 it expanded its collateral pool to allow foreign currency bonds and securities rated as low as BBB- (European Central Bank, 2008f). Throughout the crisis, Poland maintained an A- rating. Hungary, by contrast, was initially rated BBB and only downgraded to BBB- in April 2009. Both these ratings would normally have qualified for ECB support. In other words, while the ECB considered Hungary and Poland too risky for swaps, it was ready to accept on its balance sheet commercial securities with a lower

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[14] Interview Nauschnigg (OeNB). Reflecting the impact of Krugman's blog entry, Epstein (2017, pp. 55, 86) found similar assessments in interviews with commercial bankers.

[15] Interview Nauschnigg (OeNB)

[16] Interview Nauschnigg (OeNB)

[17] Interviews Nauschnigg, Nowotny (OeNB)

credit rating. Thus, it is unlikely that the imminent risk of non-repayment was the sole motivation for the ECB to insist on repo lines.

Many other factors suggest that the ECB may have been excessively cautious in insisting on collateral from both central banks. Hungary was indeed running out of foreign reserves and needed a sovereign bailout, but Poland was seen as a 'beacon of resilience in Europe' (N. Epstein, Goretti, Llaudes, & Velculescu, 2012). Throughout the crisis, the Polish government was able to raise debt in euros, Swiss francs, and dollars. Moreover, once Hungary had the IMF Stand-By Arrangement (SBA) in place, the central bank felt assured that it would not default on a short-term swap.[18] Poland was one of the first countries to receive a Flexible Credit Line (FCL) from the IMF which had been created explicitly for countries with sound fundamentals and policies (N. Epstein et al., 2012, p. 158).[19] Both the MNB and the NBP were seen as responding competently to the crisis. For instance, a contemporary account in the British weekly *The Economist* concluded that the 'Hungarian Central Bank is impressively well-run' ("Who's Next?," 2008, p. 30). On balance, there were hence few indications that either country was on the brink of collapse.

The ECB's actions over the further course of the crisis are, if anything, even less consistent. In the spring of 2009, when currencies in Eastern Europe came under renewed pressure, the Czech, Hungarian, and Polish central banks once more unsuccessfully appealed to the ECB to provide swap lines to restore confidence in their currencies (Verma & Thornton, 2009). The Czech Republic had not had any financial bubble and was good credit, with an A+ rating. The ECB's decision to informally convert half the repo line with the Hungarian central bank, €2.5bn, into

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[18] Interview Király (MNB)

[19] Interview IMF 2

a swap line in September 2009 (Király, 2020; Magyar Nemzeti Bank, 2010b, p. 5) supports the conclusion that it could have agreed to a swap from the start of the crisis.[20] All in all, the ECB's initial insistence on collateral, therefore, seems somewhat at odds with the repayment risks in Hungary and Poland.

The ECB's relative neglect of financial stability risks can be understood against the institutional backdrop of its mandate. In its initial conception, the ECB had no formal responsibility for financial supervision, which was instead a national responsibility. The ECB even lacked access to banks' balance sheets which it might have needed to assess risks in detail.[21] For these analyses, it relied instead on Member State authorities, including the National Central Banks. Spillovers from Central Europe would only be relevant to the ECB if they threatened financial stability in the entire Euro Area. ECB officials considered individual banks' exposures to Central Europe a problem for national authorities, but not for the ECB itself.[22]

2.2.2 The ECB's self-perception

The provisions in the ECB's mandate on their own do not provide a clear prescription for how the institution should respond to financial crises outside the Euro Area. Nevertheless, to understand the ECB's justification for its opposition to material interests, one needs to bear in mind how actors inside the ECB interpreted their obligations under the mandate considering

[20] In July 2010 the ECB reversed its lenience and again demanded euro-denominated collateral from the MNB (Magyar Nemzeti Bank, 2010a). This did, however, not stop the MNB from using the ECB repo to back up a forint/euro swap facility on which it drew sporadically until 2017 (including a €1.8bn drawing at the end of 2010). The author thanks Júlia Király and current MNB staff for providing this reference.

[21] Interview ECB 1

[22] Interview ECB 1

the financial crisis in Eastern Europe. In this regard, both its approach towards the international role of the euro and its general understanding of its financial stability mandate are relevant.

During the GFC, the ECB enjoyed full autonomy in setting its international policy conduct (Henning, 2007) – its mandate is purely domestic and the international dimension left underspecified (Verdun, 2009). However, shortly after its creation, the ECB decided to pursue a 'neutral stance' towards the international role of the euro. It argued that currency internationalisation should be the outcome of a 'market-driven process, not steered by central banks' (Duisenberg, 2000, p. 2). The ECB had thereby made clear that it would not feel bound to assume any international responsibility beyond its domestic mandate.

The ECB's handling of the international role of the euro becomes clearer against the backdrop of the intellectual influence of the Bundesbank which had served as an institutional blueprint for the ECB (Howarth & Loedel, 2005). The neutrality doctrine inherited core beliefs from the Bundesbank which had traditionally prioritized domestic policy targets over the international implications of its monetary policy (Marsh, 1992; Scharpf, 2018), not least when it triggered the ERM crisis in 1992 in pursuit of domestic price stability (James, 2012). Otmar Issing, the ECB's first Chief Economist, (and a previous Bundesbank Chief Economist), for instance, summarises his view of the appropriate role of the central bank as follows:

> 'Being ultimately responsible for the currency, the central bank also has a special responsibility as regards the role its currency plays internationally. It can best fulfil this by maintaining confidence in the stability of its currency' (Issing, 2010, p. 184).

The power of German ideas during the early years of the ECB was especially felt in the economics department. Both Issing and his successor as ECB Chief Economist, Jürgen Stark, played key roles in establishing German ordoliberal economic thinking as central to the ECB's policy approach (Dyson, 2009, p. 43; Dyson & Maes, 2018, Chapters 7–8; Warlouzet, 2019),

not least by bringing with them several former Bundesbank officials.[23] The Economics department ran not just the economic analyses for the Euro Area, but also all other EU member states. In these analyses, the ECB showed awareness of the build-up of foreign currency loans in Eastern Europe (European Central Bank, 2007a), but focused on supply-side factors and did not derive any potential implications for its policy.

Of course, within the ECB, there were different views on what the appropriate stance towards currency internationalisation should be. Tommaso Padoa-Schioppa, the first Executive Board member responsible for International Cooperation, was among those who argued that the euro occupied a new role and should be managed differently. '[T]here is no ground, for the Eurosystem, to inherit the traditional Bundesbank mistrust toward an international role of the currency, for fear that this could thwart a price stability-oriented monetary policy' (Padoa-Schioppa, 2008, p. 143). Overall however, the ECB struggled to formulate a continental approach to its currency. Its officials' attitudes were still coloured by their prior experiences working in smaller central banks, as well as the Bundesbank's neglect of the international role of the German mark.[24] The ECB's attempts to avoid direct responsibility for the international role of the euro can be seen as an institutional choice that reflected these inherited beliefs.

The ECB faced few legal constraints regarding support to central banks outside the Euro Area, especially in EU member states. Both the ECB and national central banks could 'acquire and sell spot and forward all types of foreign exchange assets' and 'conduct all types of banking transactions in relations with third countries […] including borrowing and lending operations' (European Central Bank, 2002 Art. 23). Concerning the ECB's responsiveness to financial

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[23] Interviews Jesper Berg (Head of Danish Financial Supervisory Authority, previously Market Operations department, ECB and Head of Market Operations, Danmarks Nationalbank), Nowotny (OeNB)

[24] Interview Papadia (ECB)

stability risks, it is important to note that it pursued a decidedly narrow interpretation of its mandate to justify its limited support for Eastern Europe. As a member of the European System of Central Banks, the ECB had to 'contribute to the stability of the financial system' (European Central Bank, 2002 Art. 3.3) – but it took that to refer only to the Euro Area as a whole, not the EU's financial system. In other words, the ECB decided that it would only respond to systemic threats to the Euro Area. If banks took financial risks in Eastern Europe, that was seen as an issue for financial supervision, which was still outside the ECB's mandate at the time. The ECB would provide liquidity to the parent banks, but not backstop capital risks from foreign operations.[25] This framing allowed it to evade acknowledging responsibility both for financial stability in EU member states outside the Euro Area and for responding to pressures from individual EU banks.

Statements of EU Board Members at the time back up this account. ECB President Jean-Claude Trichet was 'determined to lead his institution exclusively under the treaties – in other words, avoiding any steps not exclusively outlined under the Maastricht and other treaties' (Bastasin, 2015, p. 87). Another senior ECB official stressed that the ECB was 'not assigned the responsibility to stabilise the East European states.'[26] Lorenzo Bini Smaghi clarified that 'the ECB did not want to get too much involved [...] because it did not feel responsible.'[27] Luxembourgish central bank governor Yves Mersch provided perhaps the bluntest statement by stressing that the ECB had a 'eurozone mandate, not a mandate to be a United Nations Agency' and that it could not be 'a regional IMF' (Atkins, 2009). In short, many Governing

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[25] Interview ECB 1, Nauschnigg (OeNB)

[26] Interview ECB 1

[27] Interviews Bini Smaghi, Papadia (ECB)

Council members were highly sceptical of involving the ECB in Central Europe (Atkins & Wagstyl, 2009).

Both the long-standing influence of German economic thinking inside the ECB, as well as the defensive framing of its responsibilities during the early phase of the crisis bore heavily on the ECB's refusal to agree to swaps.

2.2.3 Contingent dynamics of the ECB's decision making

It was initially unclear how the ECB would respond to the Hungarian and Polish requests.[28] The ECB staff simply had not thought about how it should respond if a liquidity crisis were to occur in an EU member state outside the Euro Area The Hungarian and the Polish National Bank reached out to the ECB on October 10th 2008 with their requests,[29] but it took the ECB several days to respond (Király, 2020). It was not until October 20th that the Governing Council approved a set of 'principles on liquidity assistance by the ECB to non-euro area EU countries' (European Central Bank, 2008h).

In the negotiations about the swap requests, the ECB Governing Council was divided. As mentioned earlier, several national central banks – the Banque de France, the Bundesbank, and the OeNB – supported swaps. Among the ECB staff, the International Relations and Market Operations Departments were likewise ready to provide swaps.[30] However, both ECB Executive Board and the Economics Department were sceptical about providing swaps.[31]

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[28] Interview Papadia (ECB)

[29] Documents released under public access regime - Market operations (europa.eu)

[30] Interview Papadia; from an operations perspective a central bank swap is also easier to organize than a repo, interview Nauschnigg (OeNB).

[31] Interview Papadia (ECB), Nowotny, Nauschnigg (OeNB)

Tellingly, protecting the balance sheet was seen as a 'very German argument' against providing swap lines.[32] Whether the credit lines would be useful for the recipients was less of a concern: 'the Economics department was mostly aloof towards Eastern and Central Europe.'[33] In the end, the decision to provide repos represented a compromise between the two camps, which would offer some sort of assistance, but assuage concerns about the ECB's balance sheet.

Though the 'principles' themselves are not public, the ECB's official justification is murky. It has stated that it considered 'a broad set of factors'[34] (European Central Bank, 2014, p. 75). Inside the ECB the decisions were considered as being taken on a case-by-case basis.[35] Nevertheless, the ECB's decision to provide a repo to the MNB would influence its approach over the further course of the crisis and limit its readiness to provide swap lines even to more economically stable countries like Poland. The official ECB response to the NBP, which was sent out on October 24th – a full two weeks after the NBP's request – bases itself on the newly written guidelines for liquidity assistance. The Executive Board proposed a repo for the NBP 'to be consistent with the precedent set by the recent repo agreement established between the ECB and [the Hungarian National Bank].'[36]

Recalling that Poland was in a very different economic situation than Hungary, this decision is hard to justify on technical grounds. The NBP had sufficient foreign reserves and the

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[32] Interview Nowotny (OeNB)

[33] Interview Papadia (ECB)

[34] '(i) the existence of exceptional circumstances […] (ii) the systemic relevance for the euro area of the country requesting a swap line […] (iii) the presence of sound economic fundamentals; (iv) the financial risk for the Eurosystem; and (v) the consistency with any parallel support provided by the IMF' (European Central Bank, 2014, p. 75).

[35] Interviews Bini Smaghi, Papadia (ECB)

[36] Request for a EUR repo agreement from National Bank of Poland (NBP): Executive Board proposal (europa.eu)

government enjoyed continued bond market access. And yet, before approving even the repo, the ECB first required the NBP to document the market dysfunctions that it was experiencing and to detail the measures that it had already taken.[37] The decision not to treat Poland better than Hungary, therefore, reflected the ECB's concerns of not stigmatising Hungary and a certain unwillingness to differentiate between these countries.[38]

In the further course of the crisis, the ECB missed further chances to help relieve market pressure against East European currencies and local government bonds. Yet it held its line without offering any public justification. In May 2009, the ECB said was only ready to provide swaps on a case-by-case basis but, in letters to the Czech, Hungarian, and Polish central banks, ECB President Jean-Claude Trichet re-emphasised that the ECB would only provide swaps in 'exceptional circumstances' (Verma & Thornton, 2009). By that time, it was however clear that these central banks asked for the swaps as a signal to markets and to rebuild confidence, rather than to use them. When the ECB finally agreed to informally convert half the repo with the Hungarian central bank into a swap line in September 2009, the crisis had abated.

Summing up, the ECB's approach towards credit lines in Central Europe can at best be partially understood based on material interests. Arguably if the ECB had granted swap lines to the MNB and the NBP, it could easily have justified these on the grounds of Euro Area banks' exposures and its overall collateral standards at the time. However, during an initial period of uncertainty, the ECB took many discretionary decisions that were influenced by perceptions of appropriate action. Both the ECB's restrictive interpretation of its mandate and its concern with balance

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[37] Request for a EUR repo agreement from National Bank of Poland (NBP): Executive Board proposal (europa.eu); Letter from the National Bank of Poland (NBP) to the European Central Bank, 30 October 2008 (europa.eu); No such requirements were imposed on the DNB.

[38] Interview Nauschnigg, Nowotny (OeNB)

sheet protection were organisational choices that were internally contested. The ECB's overall approach to the crisis reflected the outcome of an internal bargaining process where these ideas won out against material interests. In the end, the decision to provide repos represented a compromise that would offer some sort of assistance, but assuage concerns about the ECB's balance sheet.[39]

2.3 The SNB's swap lines

Though the SNB's swap lines have received far less attention, they represent an intriguing case of central bank cooperation. In a way, the SNB offered the same terms to all its borrowers, since it swapped Swiss francs against euros in each case. But while consistency with its overall monetary policy framework was an important consideration, this course of action was enabled not just by more lenient political judgments, but also by a better degree of organizational preparedness than seen at the ECB.

2.3.1 The SNB's view of the international role of the franc

For the SNB, the international role of the Swiss franc was a central policy concern both before and during the GFC(Jordan, Ranaldo, & Söderlind, 2009). Switzerland occupied a unique position not just because it is a small open economy that issues an international currency, but also because this position is reflected in a central bank monetary policy framework that was more open towards currency internationalization than any other.

The SNB had long grappled with the international strength of its currency but pursued a different strategy for handling it. The Swiss franc had been under more or less constant appreciation pressure during the Bretton Woods period, culminating in the 'currency crisis' of

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[39] Interview Nowotny (OeNB)

1978, when the SNB had to take unprecedented measures to deflect and sterilize capital inflows (Roth, 2009). From the 1980s onwards, the SNB gradually gave up its resistance and opened towards internationalizing the Swiss franc. While its overriding objective remained price stability,[40] in 1999, it adopted an innovative operational framework tailored to the international role of the franc. Since then, the SNB targeted the 3-month LIBOR, an international market rate (Jordan, Peytrignet, & Rossi, 2010). It also gave foreign banks access to its facilities(Kraenzlin & Nellen, 2015), and expanded its collateral basket to accept securities denominated in seven different currencies (McCaughrin, Gray, & Chailloux, 2008). After having resisted the internationalization of the franc, the SNB now pursued an 'internationalized monetary strategy' (author's translation from German Roth, 2009, p. 16).

Despite the new framework, the SNB's main policy concern remained to limit currency appreciation to prevent deflation. To do so the SNB pursued a course of relatively lower interest rates than the ECB or the Fed. As a result, the Swiss franc became attractive as a carry-trade currency where investors would borrow in a low-interest rate currency and invest in a higher-yielding one.

That said, Swiss franc-denominated loans were a somewhat common instrument both in some Euro Area countries and Eastern Europe. In the late 1990s, Austrian households started taking out mortgage loans in Swiss francs to take advantage of the lower interest rates (Beer et al., 2010); after 2004, franc-denominated mortgages became popular in Hungary and Poland, too (Brown et al., 2009). The SNB was at first unaware of these mortgages – only in 2007 did the issue come to public attention[41] (for instance Fehr, 2007). In response, the SNB started

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[40] Price stability was only explicitly made part of its mandate when the SNB law was amended in 2004 (Jordan et al. 2010).

[41] Interview Martin Brown (Professor of Banking at the University of St.Gallen)

collecting data in the 'Swiss Franc Lending Monitor' and ran several analyses of the implications of these loans for its monetary policy (Beer et al., 2010; Brown et al., 2009; Yesin, 2012).

These analyses also found that some banks from the Euro Area depended on Swiss banks to finance their Swiss franc lending. Austrian, German, and Luxembourgish banks funded their loans 'on balance sheet' which meant that they issued bonds on Swiss capital markets (Brown et al., 2009). The Austrian banks were also active in the Swiss franc repo market before the crisis (Pann et al., 2010). By contrast 'the Swiss financial sector shows almost no direct involvement in refinancing of [Swiss franc] lending in Hungary and Poland' (Brown et al., 2009, p. 12). These banks relied primarily on their foreign parent banks or, if they had none, on 'off-balance' funding, such as foreign exchange swap markets to get funding in Swiss francs (Mák & Páles, 2009). As a result, Swiss cross-border claims on the entire region of Eastern Europe, including Russia and Ukraine, in late 2008 amounted to the equivalent of CHF 40bn or about 2% of Swiss international exposure – and only CHF 1.9bn of those claims were denominated in the Swiss currency (Roth, 2009, pp. 10–11).

The SNB concluded that there was 'no reason to react to the phenomenon of "carry trades." What the SNB can however react to within the context of its [monetary policy] concept are potential consequences for the exchange rate' (Hildebrand, 2007, p. 14, author's translation from German). Foreign borrowers were usually affluent enough to tolerate the currency risks (Brown & De Haas, 2012; Brown et al., 2009) and Swiss banks' exposure was not considered

systemically relevant. A reversal of fortunes might be problematic for borrowers in Hungary and Poland but would not require any response from the SNB.[42]

2.3.2 The SNB's swap lines and its operational framework

The SNB's institutional preparedness for international liquidity demand proved invaluable. About 80% of the Swiss franc emergency liquidity that the SNB provided throughout the crisis went to foreign banks (Auer & Kraenzlin, 2011). In contrast with the ECB, the SNB's credit lines are consistent with its overall operational framework.

The SNB's swap line with the ECB was set up in response to a concrete problem in international Swiss franc money markets. Whereas in normal times, the rates of secured and unsecured money markets are closely aligned, in October 2008, unsecured Swiss franc money markets broke down and prices rose to 300 basis points against the secured repo market (Auer & Kraenzlin, 2011, p. 411). However, the SNB could not on its own supply Swiss franc liquidity to foreign borrowers that relied on unsecured money markets. SNB staff noted that a breakdown of the Swiss franc money market could lead to the unravelling of outstanding Swiss franc carry trades, which could ultimately have negative consequences for the Swiss banks that owned their debt (Auer & Kraenzlin, 2011, pp. 411–412). Enabling the ECB to access Swiss franc liquidity sufficed for the SNB to overcome these market frictions and the spreads between secured and unsecured market rates duly normalized once the ECB started holding EUR/CHF swap tenders.

A second concern for the SNB was the appreciation pressure on the franc. As the currency strengthened against the euro, the risk of domestic deflation increased. On March 12th 2009, the SNB single-handedly decided to cap the exchange rate and announced that it would buy foreign

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[42] Interview Brown (University of St.Gallen)

exchange in unlimited amounts to enforce that goal (Swiss National Bank, 2009, p. 9). The foreign exchange purposes represented an unprecedented monetary policy intervention (Moschella, 2015) that quickly resolved the international Swiss franc shortage and thereby staved off both the deflation risk and the financial stability risk from a disorderly wind-down of outstanding carry trades (Auer & Kraenzlin, 2011, p. 409). In short, the SNB pursued domestic interests by flooding international markets with its currency.

Whereas the SNB's swap to the ECB came in response to identifiable market dysfunctions, it is less clear to which extent the CHF/EUR swap lines to the MNB and NBP furthered these Swiss monetary interests. Both recipients could need the credit line to replace the foreign exchange swap markets that had dried up. As Swiss franc swap markets only slowly recovered, the SNB's swap lines were helpful because they helped the receiving central banks themselves when they were unable to convert their existing euro reserves into Swiss francs.[43] In the Euro Area, the Swiss franc shortages could disrupt the operational objectives of the SNB, but Hungary and Poland had problems in market segments that were less central to the SNB's operations.

There are further indications that the SNB would not have needed the swaps with the Hungarian and Polish central banks to meet its own monetary policy goals. The SNB's swap facilities for the NBP were set up in November 2008 and the Hungarian central bank began its Swiss franc auctions in February 2009. By that time, the spreads in international short-term money markets had already begun to stabilize. In addition, most of the banks there could already access Swiss franc liquidity through their parent banks. After all, the ECB covered Euro Area banks' Swiss franc needs and allowed them to forward these funds to their foreign subsidiaries. Moreover,

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[43] Interview Király (MNB)

many parent banks could transact directly with the SNB.[44] Foreign-owned banks in Hungary and Poland therefore most likely already had access to Swiss franc liquidity.

On the issue of the collateral framework, the SNB's stance may have been strict, but at least it was consistent. Throughout the crisis, the SNB maintained a demanding minimum credit rating of AA- for securities that it would accept on its balance sheet (Jordan et al., 2009) – higher than any East European sovereign at the time. Its refusal to accept zloty and forint on its balance sheet may have been at odds with its overall openness towards foreign currency collateral, but the SNB was also a more financially prudent institution than the ECB, given its generally stricter collateral standards.

Finally, the size of each central bank's drawings supports the conclusion that the ECB swap was operationally far more important. The ECB had, at the peak of its drawings, CHF 40bn outstanding under the swap line with the SNB and supplied between CHF 15.5bn and CHF 36.5bn a month to its banks from October 2008 until August 2009 (W. A. Allen, 2013, p. 121). By contrast, both the MNB and the NBP made it expensive for banks to borrow Swiss francs from them to discourage the use of the facility (Király, 2020; Szpunar, 2009).[45] Neither of them ever auctioned off more than CHF 1bn in a single month (W. A. Allen, 2013, p. 121) –compared to the size of the SNB's balance sheet, the Swiss franc loan sector in Hungary and Poland was negligible.[46]

[44] Interviews Nauschnigg (OeNB), Wohlmuth (Erste Bank)

[45] Interview Kluza (KNF)

[46] Interview Brown (University of St.Gallen)

2.3.3 Deciding the SNB's credit lines

The SNB's approach to the GFC was consistent with its monetary policy framework and the financial market risks that it had identified before. Nevertheless, its cooperation was not merely aimed at the fulfilment of its policy mandate: these decisions also reflected international agreements and (limited) solidarity.

The SNB had ample experience with providing central bank swap lines before the GFC. Indeed, it had some standing agreements with West European central banks to establish a swap line during a crisis. Since the 1980s a swap agreement with the National Bank of Belgium has existed (which had been set up related to payment transactions).[47] Given the OeNB's potential need for Swiss franc liquidity, these two central banks had a precautionary bilateral agreement in place before the crisis.[48] Moreover, there was an agreement that the SNB would cooperate with the Eurosystem in case of an international crisis. A precautionary swap agreement that would allow the SNB to borrow euros from the ECB had been signed in 2003.[49]

According to the ECB's internal documentation,[50] the SNB took the initiative in proposing the swap facility in October 2008.[51] The conclusion of the agreement was facilitated by the previously established agreement. The swap agreement from October 2008 contains just an amendment to make the existing swap agreement reciprocal and allow the ECB to borrow

[47] Swiss National Bank (SNB) - Questions and answers on foreign exchange swaps

[48] Interview Nowotny (OeNB)

[49] Amendment to the euro-Swiss franc swap agreement between the European Central Bank and the Banque Nationale Suisse-Schweizerische Nationalbank (europa.eu)

[50] Provision of 1-week Swiss franc liquidity to Eurosystem counterparties: Executive Board proposal, 14 October 2008 (europa.eu)

[51] Though inside the Eurosystem, the OeNB was already keen to secure access to Swiss franc liquidity, interview Nauschnigg (OeNB).

francs. Moreover, the SNB understood the international context and was aware that the announcement of the joint facility with the ECB might lead to further requests or assistance. But the SNB was initially reluctant to lend directly to the Central European central banks. At first, it proposed that those central banks should access Swiss franc liquidity via the ECB, rather than through separate bilateral swap agreements.[52]

Against this backdrop, it becomes clearer that the subsequent agreements between the SNB and the Polish and Hungarian central banks were not just motivated by credit risk. The fact that the SNB set up separate bilateral swap lines with both Central European central banks suggests that the ECB refused to act as an intermediary, as the SNB had initially asked. When the SNB negotiated the credit line with the NBP, = the ECB was informed about that. Concluding that the ECB's repo and the SNB's CHF/EUR swap were in any way related seems nevertheless implausible, considering that only the latter was drawn.[53] Cooperation with the NBP was facilitated because Poland belonged to the same IMF constituency and staff contacts were well-established.[54] Once the SNB had agreed to swap Swiss francs for euros for Poland, it could quickly extend the same offer to Hungary (though the MNB had asked for a swap against forint).[55] Both these credit lines were provided despite the SNB's prior conclusion that it had nothing at stake in those countries and its initial reluctance to lend to the central banks – they

[52] Provision of 1-week Swiss franc liquidity to Eurosystem counterparties: Executive Board proposal, 14 October 2008 (europa.eu)

[53] Interview Kluza (KNF)

[54] Interview Brown (University of St.Gallen)

[55] Interview Király (MNB)

can therefore be understood as expressions of solidarity than as serving Swiss financial or policy interests.[56]

At the same time, the SNB paid close attention to ensuring the overall consistency of its international lending with its overall monetary policy stance. The swap lines with the NBP and the MNB were both integrated with the SNB's efforts to supply Swiss francs to foreign banks and both central banks 'joined' the foreign exchange swap operations of the SNB and the Eurosystem.[57] All these central banks coordinated their Swiss franc swap tenders at the same time as the SNB, which also determined the maximum allotment, though they could set the price themselves. The NBP offered to swap Swiss francs against zloty at a forbiddingly high price to push banks back to the market (Szpunar, 2009); the MNB relayed the SNB's credit line by asking domestic banks for euro collateral as well (Magyar Nemzeti Bank, 2010a).[58] By insisting on extraordinarily strict borrowing terms, the SNB ensured that the conditions were consistent with the SNB's policy framework. Under these circumstances adding the MNB and the NBP to the tenders had no operational downsides for the SNB.

After the SNB's swaps were allowed to expire in 2010, the SNB deepened its cooperation on credit lines. The ECB and SNB re-established a swap in 2011 when they joined the system of standing bilateral swap lines with the US Fed, the Bank of England, the Bank of Japan, and the Bank of Canada (European Central Bank, 2014, p. 66) and in 2012 the SNB also set up a new, precautionary swap line with the NBP, this time accepting zloty as collateral.[59] However, when

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[56] Interview Brown (University of St.Gallen)

[57] Narodowy Bank Polski - Internet Information Service (nbp.pl); Swiss National Bank and Magyar Nemzeti Bank cooperate to provide Swiss franc liquidity (mnb.hu)

[58] The MNB had originally asked the SNB to swap francs for forint, but was turned down. Interview Király.

[59] Swap agreement between the Swiss National Bank and the National Bank of Poland (snb.ch)

the MNB unofficially suggested an out-of-market swap deal in 2011, the SNB declined politely.[60]

The SNB's agreement with the ECB reveals a prior norm of cooperation in crisis times and that a set of prepared swap line agreements was in place with West European central banks. However, this solidarity was not extended to every central bank, as the credit lines to Hungary and Poland show. Though the SNB had been aware of the potential need for support in Central Europe, it was initially reluctant to provide support directly to these central banks. In the end, the credit lines were useful for the recipients in combatting specific local market failures, but they also served to protect the SNB against financial risks. The SNB acted consistently within its operational framework, but it does not appear that the credit lines to Hungary and Poland furthered any national interests. It rather seems that the SNB extended the support in response to the recipients' needs, provided that its own policy conduct would not be undermined.

Conclusion

This chapter has studied central bank credit lines in Central Europe and aimed to understand why both the ECB and the SNB took the unconventional step of asking for collateral from the Polish and Hungarian central banks while they concluded a swap line among themselves. While financial interests certainly played a role, normative considerations, the question of what is the 'right' course of action undeniably influenced the terms of these credit lines.

The SNB-ECB swap could relatively clearly be linked to the expected consequences for Swiss monetary policy. Failure to supply Swiss francs to Euro Area banks would have disrupted the SNB's key money market segment and led to unwanted currency appreciation. Yet, the ECB's

[60] Interview Király (MNB)

and SNB's credit lines with the MNB and NBP cannot be linked that clearly to material objectives, albeit for opposite reasons. The SNB had already in 2007 concluded that it had no interests at stake in Central Europe, but decided to provide support as long as it was consistent with its operational framework. The ECB pushed back against exposed banks and ended up refusing swap lines to central banks of states with solid credit ratings. If the SNB thus lacked any self-interested reason to extend support, the ECB was seemingly unconcerned with them.

Factors that are associated with the logic of appropriateness clarify both puzzling decisions towards the Central European central banks. The SNB seemed to be influenced by existing norms and agreements to cooperate during crises – even its swap with the ECB can easily be understood in those terms. The West European central banks had signalled their readiness to provide mutual support long before the crisis erupted. When it came to applying this norm in the context of the Hungarian and Polish crises the SNB faced a trade-off between showing solidarity and protecting its balance sheet. The SNB had already decided that it would only accept limited exposure to Central Europe before it received any requests. By adding them to its swap tenders with the ECB, the SNB found a way of allowing those central banks to access Swiss franc liquidity that would not jeopardise its balance sheet or its policy implementation. While the benefit for the recipients was clear, for the SNB this support had only a limited downside.

In the ECB's case, international solidarity was no decisive concern. On the contrary, the ECB sought to interpret its mandate in a way that excluded potential responsibilities for financial stability in Central Europe. One needs to understand the thinking inside the ECB to make sense of its reluctance to get involved: its neglect of the significance of the international role of the euro and the overly strict concern with credit risk were both linked to the strong intellectual influence of former Bundesbank economists. The evidence of internal disagreements and

bargaining about the right way of responding to the Hungarian swap request shows how contested these ideas were. The compromise to provide repos – to offer some form of assistance, but protect the balance sheet – reflected not just material considerations but also a distinct perception of what would be appropriate for the ECB to do. The repo to the MNB also set in motion a path-dependent process since the ECB's subsequent decisions of rejecting swaps to the Czech and Polish central banks were influenced by that precedent.

The credit lines in Central Europe were unconventional. As this chapter has shown, despite their similarities, they reflected starkly contrasting approaches to financial crisis management by the ECB and the SNB. Material concerns may align with or contradict perceptions of appropriateness. However, as the following chapter shows, in the Nordic/Baltic region, central banks found different ways of reconciling these two logics of action.

Chapter 3 – Central bank credit lines in the Nordic/Baltic region

Abstract

This chapter covers central bank credit lines in the Nordic/Baltic region. It first turns to the ECB's credit lines with the Danish, Latvia, and Swedish central banks; then it considers the swap lines between the Nordic countries and Estonia, Iceland, and Latvia. The terms of these credit lines differed in each case – which highlights especially the Nordic central banks' creativity in reconciling financial risks and normative considerations. The chapter finds that joint identities were a key facilitator of support, both for the ECB and the Nordic central banks, while material consequences played no consistent role.

Introduction

Central bank credit lines were a commonly used instrument in the Nordic/Baltic region during the GFC. Almost all central banks in the Nordic/Baltic region received a central bank credit line between 2007 and 2009. This chapter posits that these credit lines represent not just a remarkable degree of cooperation, but they also took unprecedented institutional forms. These two factors render them intriguing cases to study. This chapter investigates central banks' motivations for setting up six credit arrangements. The ECB opened credit lines with the central banks of Denmark, Latvia, and Sweden; the Nordic central banks opened credit lines to their colleagues in Estonia, Iceland, and Latvia. The findings point to various motivations and considerations that influenced the terms of credit lines. Jointly, they suggest that considerations of appropriateness help understand these cases of cooperation.

The Nordic central banks provided credit lines that stand out within the context of central bank cooperation during the GFC because they resorted to novel techniques of providing liquidity assistance to fellow central banks (Moessner & Allen, 2010). Both for the swap lines to the Central Bank of Iceland and the Bank of Latvia, the Nordic central banks acted jointly. Furthermore, they took the unconventional step of lending out their foreign exchange reserves.

The Swedish-Estonian credit line is even more remarkable because it would have violated the statutes of the Estonian central bank had it ever been used.

The ECB's credit lines to the Nordic and Baltic central banks are also intriguing. It provided a repo agreement for the Bank of Latvia, whereas both the Danish and Swedish central banks received swap lines. This selection of credit terms is noteworthy since the central banks of the Baltic states and Denmark were all linked to the ECB through the Exchange Rate Mechanism II (ERM II) framework. The ERM II included provisions for assistance facilities in the event of a currency crisis. However, it turned out that the agreement proved largely irrelevant during the crisis. This chapter finds that the existence of the framework, counterintuitively, led the ECB to limit the scope of its credit lines with the Danish and Latvian central banks.

To understand why these central banks chose these credit arrangements, this chapter applies the two theoretical perspectives first presented in chapter 1, namely the logic of consequence and the logic of appropriateness. It finds that the expected consequences of providing a credit line were often ambiguous. If anything, it appears that credit risk was a relevant material consideration. But all in all, the credit lines can be better understood as following normative judgments, related to shared identities and how the ECB interpreted appropriate action under the ERM II framework. Taken together, the findings presented in this chapter, therefore, support the proposition that considering central banks' decisions as driven by the logic of appropriateness helps clarify why they cooperated in these cases.

The remainder of the chapter is structured as follows. Section 3.1 provides a brief overview of the credit arrangements in the region. Sections 3.2 and 3.3 cover the ECB's credit lines to Sweden and Denmark and Latvia, respectively. The Nordics' credit lines to Iceland are the subject of section 3.4. In section 3.5, the Swedish and Danish credit line to the Bank of Latvia

is discussed. Finally, section 3.6 discusses the swap between the Riksbank and the Bank of Estonia before the final section offers some words of conclusion.

3.1 The financial crisis in the Nordic/Baltic region

The Nordic and Baltic states experienced severe financial crises between 2008 and 2010. The Baltic states, Denmark, and Iceland all needed to fend off speculative attacks against their currencies. Whereas the Central Bank of Iceland (CBI) was eventually overwhelmed with Icelandic banks' financing needs, the Danish and the Baltic central banks ultimately managed to defend their currency pegs. Swedish banks withstood the crisis better but were vulnerable because of their exposure to the Baltic states. The credit lines had different impacts on central banks' abilities to manage the crisis. While some were essential for maintaining regional financial stability, others were set up as precautionary measures without the recipients intending to use them.

3.1.1 Background

During the run-up to the GFC, the Nordic/Baltic region saw a massive expansion of the financial sector. Though all countries saw rapid house price growth, the dangers of overheating were clearest in the Baltic states and Iceland. In these small states, it had become clear by 2007 that the rate of growth had become unsustainable, as inflation and current account deficits reached double digits. In Denmark, a housing bubble grew, with real estate prices increasing by 200% between 2000 and 2007 (Rangvid, 2013, p. 16). Even in Sweden, sharp growth in debt and house prices occurred until 2008, though in that country, a domestic banking crisis could be avoided.

The second distinctive characteristic of financial markets in the region was the high degree of cross-border banking. The Baltic states stand out because there almost the entire banking sector

consisted of foreign banks: in Estonia, 98% of all financial assets were held by foreign-owned banks, and in Lithuania, 93%. In Latvia, the second-largest bank in the country, Parex, was owned domestically and the share of foreign bank ownership was a bit lower, at about two-thirds (EBRD, 2009). Foreign ownership in the Baltic region came predominantly from two Swedish-domiciled banks. Swedbank and SEB, together controlled market shares between 55% and 80% in each of the three countries (Ingves, 2010, p. 1). Bank linkages between the Baltic region and Sweden were not only a crucial concern for the Baltic states. Given that Swedbank's exposure amounted to 16% of its total lending and SEB's to 14%, it was also a concern for Swedish financial stability. Sweden's central bank, the Riksbank, was aware of these risks and had cautioned about banks' Baltic exposures in its financial stability reports before the crisis (Sveriges Riksbank, 2007a). Icelandic banks had themselves become international investors and acquired subsidiaries in the Nordic states. However, these linkages were relatively small compared to their exposure to the United Kingdom and the Euro Area (Gudmundsson, 2011).

3.1.2 Central bank credit lines

The first signs of a financial crisis in the Nordic and Baltic states appeared in the second half of 2007 when house prices across the region descended from a peak. Pressure on Icelandic banks started to mount in the first half of 2008. By the middle of the year Roskilde bank, the seventh-largest in Denmark, had to be put into resolution (Rangvid, 2013) and depositors started withdrawing their funds from Latvia's largest bank Parex (Åslund & Dombrovskis, 2011). Financial market stresses became acute after the bankruptcy of Lehman Brothers on September 15th 2008. Both commercial paper and FX swap markets dried up, depriving, among many others, Danish and Swedish banks of necessary funding in foreign currencies(McGuire & von Peter, 2009). By October, both the Latvian and Icelandic governments were unable to stabilize their domestic banks and requested Balance-of-Payments assistance from the IMF (Åslund & Dombrovskis, 2011, pp. 35–45; Sigurgeirsdóttir & Wade, 2015).

Given the rapidly deteriorating situation in Iceland in the first months of 2008, the CBI sought external assistance well before the Lehman shock. In May 2008, after the Icelandic króna had weakened and the Icelandic banks struggled to raise funding, the CBI established bilateral swap facilities with the central banks of Denmark, Norway, and Sweden of €500m each. The CBI (2008) was not coy about the fact that it had approached various other central banks for assistance but that those had denied its requests. After the three largest Icelandic banks failed within a week, the government had to impose capital controls to prevent a complete collapse of the currency (Sigurgeirsdóttir & Wade, 2015).

The Bank of Latvia likewise faced the risk of currency devaluation when capital fled the country. Yet its request for assistance from the ECB in October failed to elicit much support: the ECB offered a repo agreement of €1bn,[61] which did not strengthen the central bank's ability to prevent devaluation. While negotiations for an IMF programme were ongoing the Bank of Latvia was running out of foreign reserves. However, in mid-December, the Swedish and Danish central banks agreed to provide another credit line to tide Latvia over until the disbursement of the first IMF tranche (Leung, 2020). They would swap up to €375m and €125m, respectively, from their foreign reserves in exchange for Latvian lats.

The Danish and Swedish central banks benefited from swap lines that the US Fed opened with them in September 2008. A month later, when funding stresses had spread to euro money markets, the ECB opened a swap line of up to €12bn with the Danish central bank (Danmarks Nationalbank, DNB) under which the latter could provide euro liquidity to its banks. These additional liquidity sources were crucial for both central banks: The DNB faced severe pressure on its foreign reserves and lost a third of its foreign reserves in October 2008 (Rangvid, 2013,

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[61] Master agreement for financial transactions between European Central Bank and Latvijas Bank: special provisions (europa.eu)

pp. 303–308),[62] which brought it close to requesting international assistance.[63] The Riksbank provided $100bn in liquidity to its banks during the whole crisis, of which almost three-quarters were borrowed from the US Fed (Leung, 2020).

In the first half of 2009, the financial crisis became more severe throughout the Baltic region. When the Latvian government collapsed in February 2009, not only Latvian credit default swaps spiked and widespread fears of currency contagion led to speculation against Estonia and Lithuania (Purfield & Rosenberg, 2010, p. 9). Around that time, the Bank of Estonia and the Riksbank set up another swap facility under which the Estonian side could borrow up to SEK 200m to enable it to provide liquidity under its currency board arrangement. It is worth noting that this facility was never activated (Leung, 2020). In April, the swap for the Bank of Latvia was extended. From then on, however, the DNB no longer participated, so the Riksbank guaranteed the full €500m (though the credit line remained unused). Shortly after that, the Riksbank itself announced that it would borrow €3bn under a swap agreement with the ECB, concluded in 2007 which had thus far been kept secret (Sveriges Riksbank, 2009b). Over the summer, following a final devaluation scare in Latvia, the situation in financial markets calmed down (Åslund & Dombrovskis, 2011, pp. 78–83).

In summary, central bank credit lines were a common tool during the financial crisis in the Nordic/Baltic region, though their precise credit terms differed from case to case. The following in-depth discussions of the individual decisions are divided according to who provided the credit lines. First, it examines how best to understand the ECB's decision to provide better credit terms to the DNB and the Riksbank than to the Bank of Latvia. Second, it probes the

[62] Interview Berg (DNB)

[63] Interview Berg (DNB)

Nordic central banks' motivations for their swap lines to the CBI and two Baltic central banks. These arrangements are particularly intriguing because the decisions to lend out foreign exchange reserves to Iceland and Latvia and the swap line between the Riksbank and the Bank of Estonia were unique in the context of the GFC (Moessner & Allen, 2010).

3.2 The ECB's swap line with the Riksbank

The swap agreement for €10bn between the ECB and the Riksbank on 20 December 2007 marked the conclusion of the first central bank credit line in Europe in the context of the GFC. At that time the stresses in the Eurodollar market were already visible and just a week prior, on December 12, the US Fed had opened swap lines with the ECB and the SNB to allow these central banks to provide dollar liquidity to their banks (McDowell, 2017, p. 165).[64] Money markets in Europe were still relatively isolated from what looked like a crisis in the US housing market. The Riksbank, in its financial stability report in December 2007, had warned that Swedish banks were vulnerable to problems in the interbank market given their reliance on commercial paper and FX swap markets. However, it concluded that '[t]o date, the Swedish banks have only been affected marginally' (Sveriges Riksbank, 2007b, p. 22).

The intention behind the Riksbank´s swap request was, then, not to solve an acute problem, but to have a precautionary agreement in place in case the situation deteriorated. Riksbank governor Stefan Ingves (2018, p. 9) remembers that

> '[…] you started to sense that something was fundamentally wrong and that the problems on the financial markets were indeed more serious than many had perhaps hoped they were. It was actually this feeling, rather than any concrete problem that needed to be rectified, that prompted me to raise the question of setting up a so-called swap agreement in euro with the European Central Bank.'

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[64] The Fed had been offering a swap line since the summer of 2007, but the ECB initially refused, in order to be able to present the crisis as a US problem (McDowell, 2017, p. 166). The Riksbank does not say officially when it requested the swap from the ECB.

The ECB's handling of the Riksbank's request likewise suggests that the latter was not perceived as responding to any urgent operational need, but rather as an uncontroversial measure of cooperation. The Riksbank was, after all, not the first central bank to ask for a precautionary swap from the ECB. In the Executive Board proposal for a decision on the swap with the Riksbank, the ECB staff notes that similar agreements had already been signed with the Swiss National Bank (see the previous chapter) and the Bank of Japan. A swap agreement with the Bank of England was also ready, but not signed in advance (European Central Bank, 2007b). The staff even stressed that 'this draft swap agreement [i.e. the one with the Riksbank] has been closely modelled on the text of the existing swap agreement with the Swiss National Bank' (European Central Bank, 2007b, p. 1). The matter was so self-evident that the Governing Council was not even invited to decide on the agreement, but just to take note that it had been concluded.

The ECB's readiness to open a precautionary swap with the Riksbank fits with the practice of institutionalised cooperation between the world's leading central banks. Since the early 2000s, the central banks belonging to the G10 had intensified their cooperation in financial stability matters.[65] The conclusion of precautionary swap lines in this context represented a shared agreement to be prepared for a potential crisis. Many senior central bankers had experienced crises in which central bank cooperation had proven crucial.[66] The swap agreements before the crisis were therefore not set up in response to concrete financial market stresses, but out of a broader agreement around mutual support. The Board proposal for the ECB-Riksbank swap expressed this sentiment explicitly, stressing that '[t]he signature of the swap agreement may

[65] Interview Bini Smaghi

[66] Interview ECB 1

be seen a favourable development in line with the objective of co-operation among central banks' (European Central Bank, 2007a, p. 2).

The Riksbank benefitted not only from enjoying international esteem thanks to its G10 membership. Given Sweden's AAA sovereign credit rating, it also profited from its credibility as a borrower. Francesco Papadia, the ECB's Director for Market Operations recounts that 'it was much easier to reach [an] agreement with the Swedes […] because […] the dominating factor was: we trust the Swedes.'[67] One ECB Board member added that the Swedish krona, though not a major currency was still an international currency.[68] Both the Riksbank's reputation as a leading central bank and the limited credit risk involved facilitated the conclusion of the swap line.

It is true, based on some material considerations, Sweden would also have been a likely candidate to receive a credit line from the ECB for self-interested reasons. There were strong financial linkages between the Euro Area and Swedish banks. Based on BIS data, at the end of 2008 Sweden had the second-largest euro shortage in the world (W. A. Allen, 2013, p. 39). Liquidity shortages there could therefore have disrupted interest rates in the Euro Area. Swedish banks had direct access to the ECB's facilities through their subsidiary operations in Finland and Germany. But although there existed some financial spillover risks, these were neither acute nor named by any people involved as a central concern when the swap agreement was concluded.

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[67] Interview Papadia (ECB)

[68] Interview ECB 1

The Riksbank itself saw the swap with the ECB more as a safety measure than as central to its operations. It communicated that it would first draw on its euro reserves before activating the swap (European Central Bank, 2007a, p. 2). The swap with the ECB offered some reassurance to the Riksbank even if the agreement itself remained secret at first. Governor Ingves (2018, p. 9) explains that ‘it was good to have this option as a safety back-up when we subsequently lent euro to the Icelandic and Latvian central banks at the height of the crisis in 2008.’ When it activated the swap with the ECB in April 2009, the ostensible purpose was to fund a structural increase in Sweden’s foreign exchange reserves (Sveriges Riksbank, 2009a). However, that decision must be seen in the context of the impending threat of currency devaluation in Latvia and was interpreted as a form of indirect backup for the Latvian central bank, given the ECB’s own unwillingness to provide more direct support (Atkins, Chaffin, & Anderson, 2009) which is discussed next.

3.3. The ECB’s credit lines to Denmark and Latvia

3.3.1 The ERM II

The ECB’s credit lines to the DNB and the Bank of Latvia were concluded in a special institutional context. At the time of the GFC, Denmark and Latvia participated in the European Exchange Rate Mechanism (ERM) II.[69] This fixed-exchange rate agreement had originally been intended as an antechamber where states that wanted to adopt the euro had to prove that they could maintain stable exchange rates for at least two years. While the Baltic states participated

[69] The ERM II was created with the introduction of the euro in 1999. It was the successor to the European Exchange Rate Mechanism (ERM) under which central banks had fixed their exchange rates within adjustable bands of ±2.25% (Höpner & Spielau, 2018). In the course of the ERM crisis in 1992-93, several currencies dropped out of the ERM, and the official bands were widened to ± 15%. While Denmark succeeded in narrowing its fluctuation band back to ±2.25%, the standard band for the ERM II remained at 15% (Abildgren, 2010, p. 14).

in it intending to adopt the euro, Denmark treated the ERM II as a semi-permanent arrangement, as it had an opt-out from euro adoption.

To understand how the ERM II affected the ECB's credit lines, one needs to contrast its operating principles with the specific way that the ECB interpreted them. In principle, the ERM II rules stipulated that participants would have to keep their exchange rates within ±15% around the central parity. In case a currency got under pressure, the ERM II agreement foresaw assistance facilities. The ECB would provide a so-called 'very short-term financing facility' (Deutsche Bundesbank, 1998, pp. 21–22) that was in effect a euro swap line which the recipient could use to prop up its currency. If a currency reached its official fluctuation band, stabilizing exchange rate interventions from the ECB would in principle be automatic and unlimited (Deutsche Bundesbank, 1998, p. 20). According to these rules, participating central banks would thus be able to count on a framework for liquidity support from the ECB.

However, the operation of the ERM II deviated from its rules in two respects. First, none of the four EU member states inside the ERM II observed the 15% fluctuation band. Denmark´s fluctuation band was ± 2.25% for historical reasons linked to its prior participation in the original ERM in the 1980s (Abildgren, 2010, p. 14). The Baltic states observed even narrower pegs: Estonia and Lithuania had currency board arrangements and the Bank of Latvia operated a 1% fluctuation band. Though the ECB deemed these approaches compatible with the ERM II, only the Danish fluctuation corridor was officially accepted. The Baltic states were technically in the 15% band and their narrower pegs represented 'unilateral commitments that placed no obligation on the ECB' (European Central Bank, 2005).[70]

[70] This choice was the outcome of an internal discussion at the ECB about whether currency board arrangements should have been allowed into the ERM II at all or whether all Euro Area aspirants should be obliged to widen their fluctuation bands to 15%.

Second, the ERM II played no role in the ECB's policy before the crisis and it was already understood that the ECB would not intervene if any currency in the ERM II would come under pressure.[71] According to Lorenzo Bini Smaghi, 'the commitment for the ECB was non-existent.'[72] Following this line of reasoning, participants in the ERM II would have to demonstrate the macroeconomic discipline necessary to keep their currencies aligned with the euro. The ECB emphasized that countries aspiring to adopt the euro as their currency would have to ensure that their nominal and real exchange rates were aligned with the Euro Area. Chief Economist Otmar Issing discouraged what he saw as premature ERM II entry before sufficient convergence had taken place (Detken, Gaspar, & Noblet, 2005).[73] In the ECB's Economics department which oversaw the ERM II, a disciplinarian interpretation of the ERM II's role in the process of Euro Area entry prevailed.[74] If participants had to show that they could keep their exchange rates aligned with the euro, automatic assistance would have undermined the entire logic of the mechanism.[75]

3.3.2 The ECB's credit lines

Turning now to the ECB's decisions in October 2008, the two central banks' participation in the ERM II does not suffice as an explanation for why the DNB should receive a swap line and

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[71] Interviews Per Callesen (fr. Danish finance ministry), Andres Sutt (Deputy Governor Bank of Estonia)

[72] Interviews ECB 1, Bini Smaghi, Papadia (ECB)

[73] Interview ECB 1, Bini Smaghi

[74] This puzzling mismatch between theory and practice can be linked to the strong intellectual influence of characteristic Bundesbank thinking. Under previous fixed exchange rate arrangements in Europe, such as the ERM, the Bundesbank had often been in a position to support weaker currencies and had often been unwilling to fulfil its international obligations at the expense of domestic price stability (Höpner & Spielau, 2018; Marsh, 1992; Scharpf, 2018). This attitude later also prevailed inside the ECB, which saw itself as an even more central player within the ERM II than the Bundesbank had been in the predecessor mechanism. Interview Papadia (ECB)

[75] Interview Bini Smaghi

Latvia a repo. However, these varying levels of support had a clear impact on how useful these credit lines were for their recipients. The swap facility helped the DNB alleviate the strains on Danish foreign reserves. The Bank of Latvia could hardly use its repo line and, eventually, the country needed to request IMF assistance.

One intuitive way of interpreting these decisions would revolve around financial risks to the Euro Area. The choice to provide a swap line to the DNB and a repo to Latvia aligns with the sovereign credit risks of both countries. Since a repo offers protection against default and a swap line does not, it seems logical that AAA-rated Denmark would receive better terms than Latvia with its BBB- rating. The ECB itself stresses that it took Denmark's good credit standing into account (European Central Bank, 2014).[76]

Financial linkages point in a similar direction. While there were hardly any financial linkages between the Euro Area and Latvia, the liquidity problems in Denmark had become big enough to disrupt Euro Area money markets. The ECB's swap line with the DNB helped resolve this domestic policy issue. Especially the largest Danish banks drew on the DNB's euro facility in late 2008 (Rangvid, 2013, p. 307). Consistent with this interpretation, the DNB's former director of market operations remembered that it had been the ECB that took the initiative in October 2008 to establish the swap with the DNB, whose willingness to enter an agreement had already been signalled beforehand.[77]

The ECB's decisions can, however, also be understood as reflecting more normative considerations. After all, the terms of the ECB's credit lines in October 2008 were officially

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[76] Interview Papadia

[77] Interview Berg (former Director of Market Operations, DNB); however, none of the ECB interviewees, not even the Head of Market Operations, Francesco Papadia has remembered this rationale.

derived from the principles for liquidity assistance that the ECB had set out in its decision for a repo to the Hungarian central bank. The Bank of Latvia was aware of this precedent and conceded upfront that it 'would be ready to accept terms and conditions of aid similar to those [of the ECB's repo agreement] with the National Bank of Hungary' (Rimšēvičs, 2008, pp. 1–2). Latvian central bank governor Rimšēvičs furthermore asked the ECB to support the exchange rate of the lats (Rimšēvičs, 2008). But the ECB refused this request, citing its narrow interpretation of the ERM II: Latvia's official band was 15% and the ECB would not support any unilateral commitments (González-Parámo, 2008).

Though the loans differed in many respects, the credit terms for the DNB and the Bank of Latvia reveal that the ERM II framework, rather than facilitating cooperation between the ECB and participating central banks, limited the scope of the credit lines. The ECB distinguished between lending for liquidity provision (which it deemed appropriate in the context of the crisis) and interventions to support the exchange rate (which was not). Both the agreements with the DNB and the Bank of Latvia specify that the swap or repo could only be drawn to provide euro liquidity to banks. However, the ECB made one crucial concession to the DNB: their agreement included a clause that outstanding amounts would automatically be rolled over if the DNB could not pay in time (European Central Bank, 2008g, Art. 5.3). Consequently, the ECB's swap allowed the DNB to forward euro liquidity to Danish banks without having recourse to its foreign reserves (European Central Bank, 2008d). Still, if the ECB's swap had been purely motivated by worries about instability, allowing the DNB to borrow money for exchange rate interventions would have seemed the more straightforward option.

Lastly, notwithstanding the strong financial linkages, various interviewees expressed that these conciliatory terms were linked to the DNB's standing in the international community of central banks. Denmark enjoyed special trust from the ECB. After all, Denmark had been a founding

member of the original ERM in 1979 and the DNB had participated in all but the final stages of the creation of the euro (Abildgren, 2010; Marcussen, 2005). Given this long-term cooperation with the European central banking community, Denmark was considered a 'special case through the decades'[78] and a 'shadow member of the Eurosystem.'[79] Two members of the ECB Governing Council indicated that there were still hopes that Denmark would still adopt the euro and that a swap might support that.[80] This reasoning is noteworthy because Danish citizens had ruled out euro adoption in a referendum in 1992 (the DNB has remained in favour of euro adoption afterwards) (Marcussen, 2005). Thus, while Denmark was not a member of the G10, it was regarded as one of the ECB's peers and its swap was presented in line with the precautionary agreements with the Riksbank and the SNB. The guidelines for liquidity assistance to non-Euro Area central banks, which the ECB had drawn up a few days earlier, after the Hungarian request, are conspicuously not referred to in the Executive Board proposal (European Central Bank, 2008d). Whereas the ECB demanded further information about the nature of market dysfunctioning and the measures undertaken by the central bank so far in response to the Latvian and Polish requests, no such information was required for its decision on the swap for the DNB.

Summing up, both material and normative considerations help understand the ECB's unequal treatment of the Danish and Latvian central banks. Somewhat surprisingly, these central banks' participation in the ERM II had only a limited effect on the terms of the credit lines – which reflected a narrow interpretation of its rules by the ECB. While both the strength of financial linkages and Denmark's credit standing provided reasons for the ECB to extend more support,

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[78] Interviews Papadia (ECB), Bini Smaghi

[79] Interview Nauschnigg (OeNB)

[80] Interviews Nowotny (OeNB), ECB 1

it appears that social status, specifically the view that Denmark was considered an informal member of the Eurosystem, whereas Latvia was not, tilted the balance.

3.4 The Nordic central banks' swap lines to Iceland

The financial situation in Iceland deteriorated seriously in March 2008 and the CBI started discussions with foreign central banks on the liquidity problems in its banking sector (Special Investigation Commission, 2010, p. 66). The problems of the Icelandic banking sector are widely documented. In brief, three major domestic banks, Glitnir, Kaupthing, and Landsbanki, had expanded internationally at an incredible pace, buying banks across Europe and funding two-thirds of their balance sheets through short-term borrowing by late 2006(Sigurgeirsdóttir & Wade, 2015; Special Investigation Commission, 2010). The CBI was spurred into action when the Icelandic króna depreciated by 6% in mid-March and foreign lenders started a small run on Landsbanki. While financial markets in Europe were still relatively calm, the Icelandic financial situation was already deteriorating.

These events led the CBI to explore the possibility of swap agreements to shore up its foreign exchange reserves without having recourse to an IMF programme (Special Investigation Commission, 2010, pp. 75, 66–68). However, its initial efforts were rejected by the Bank of England (BoE), the ECB, and the US Federal Reserve. The main problem for these central banks was that they thought that Iceland's crisis was too severe to handle, but that it did not pose a systemic risk. An International Relations committee meeting at the ECB, for instance, concluded that the Icelanders were 'beyond help.'[81] Yet the issue of providing swap lines to Iceland occupied the central banking community for some months over the spring of 2008. In

[81] Interview Nauschnigg (OeNB)

the end, it became clear that only the Nordic central banks would be ready to lend to the CBI when the topic was discussed over a dinner of the G10 central bank governors at the BIS on May 4th 2008 (Gissurarson, 2018). On May 15th 2008, each of the Nordic central banks opened a swap facility with the CBI under which it would lend up to €500m from its foreign exchange reserves.

Purely looking at the expected consequences, however, it would be hard to find a reason for the Nordic central banks to lend to Iceland. Their assessment of the state of Iceland's financial system was as dire as the other major central banks' (Ingves, 2018, p. 10). Jesper Berg of the DNB remembers his assessment at the time that liquidity support would only delay necessary adjustments.[82] Indeed, Riksbank Governor Ingves himself was highly sceptical of lending to Iceland at all.[83] By July it was clear to CBI Governor Oddson that 'a consensus had been reached at the European Central Bank and the Nordic Central Banks [*sic*] that it would be better to let the Icelandic banks go into bankruptcy than to allow them to jeopardise the deposit-guarantee schemes of Europe' (Special Investigation Commission, 2010, p. 73). The consequences of letting Iceland fail, in short, were deemed acceptable.

If the Nordic central banks were so clearly convinced of the weakness of the Icelandic state, how can one understand their decisions to provide swap lines regardless? Financial linkages were not a decisive concern: though the Icelandic banks had subsidiaries in all three countries, none of them was systemic (Mayes, 2009). Once the Icelandic banks had failed, the Swedish and Danish authorities had no problem ringfencing and resolving the local subsidiaries to

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[82] Interview Berg (DNB)

[83] Interviews Berg (DNB) and Riksbank officials

maintain domestic stability (Leung, 2020).[84] From the Nordics' perspective, the Icelandic state was not just financially vulnerable, but Icelandic banks posed no interest to domestic financial stability.

The principal reason in favour of supporting Iceland was instead the country's membership in the Nordic community. After all, Iceland had long been part of the Danish empire and cooperated closely with the other Nordic states in many policy fields (Stie & Trondal, 2020; Strang, 2015). To understand the Nordic swap lines, it is crucial to bear the perceived need to show solidarity in mind. Interviewees offered explicit references to 'Nordic brotherhood'[85] and Iceland being 'part of the club'[86] to explain why they provided the swap line. Jesper Berg put it more bluntly in an internal assessment of the DNB: 'the only reason we should do a swap line and lend to Iceland [was] because of [Denmark's] colonial guilt.'[87]

Nordic solidarity was not unconditional. On the contrary, the Nordic central banks attached exceptionally strict conditions to the swap lines with the CBI. The CBI would have to pay the same interest on its drawings on the swap lines as it would for an IMF loan[88] and the Nordic central bankers demanded a statement, signed by three Icelandic ministers, in which the Icelandic government agreed to a set of policy conditions in return for the loan. The conditions included not just the downsizing of the banks, but also fiscal adjustments and changes to

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[84] Interview Berg (DNB)

[85] Interview Berg (DNB)

[86] Interview Callesen (Danish MoF)

[87] Interview Berg (DNB)

[88] Interview Riksbank officials

mortgage provisions in Iceland (Special Investigation Commission, 2010, p. 109). It was, in Mr. Ingves' (2018, p. 10) own words, 'an IMF programme without the IMF.'

But the Icelandic government failed to uphold its commitments over the next months and the consensus among European central bankers shifted even more against showing solidarity. The Icelandic government's Special Investigation Commission (2010, p. 110) concludes that 'this lack of action, when added to the prevailing attitude among foreign central banks towards Iceland […] the Icelandic government had become very isolated […] in the international community.' When all three Icelandic banks collapsed in October 2008, only the Danish and Norwegian central banks allowed the CBI to activate the swap line (Reuters, 2008) – the Riksbank rejected the request because the government had not kept its promises.[89]

In short, the Icelandic government, and the CBI, had lost much international trust in their management of the financial sector. The country's financial position was widely regarded as unsustainable. The decision by the Nordic central banks to provide a loan regardless can best be understood as an expression of solidarity within the Nordic community. However, even against this backdrop, they sought protection against credit risk. The Riksbank was especially insistent that the swap would only be provided in return for Icelandic reforms. In the case of Iceland, these factors resulted in an extraordinarily strict loan agreement. But, as is discussed below, the Nordic's swap lines to Latvia proved more helpful.

3.5 The Riksbank's and DNB's swap line with the Bank of Latvia

The operational need for another credit line for the Bank of Latvia was straightforward. As the negotiations for a sovereign bailout with the IMF, the European Commission, and several

[89] Interview Riksbank officials

bilateral lenders dragged on the central bank's foreign reserves were almost exhausted by capital flight (Åslund & Dombrovskis, 2011, p. 44). Without help from the ECB, the central bank looked unable to defend its currency peg. On December 16th 2008 it was announced that Latvia's central bank would receive a swap line equal to €500m, of which the Riksbank would cover three-quarters and the DNB would provide the remainder. The stated purpose of that credit line was to keep the Latvian central bank liquid until the disbursement of the first IMF tranche, which happened on December 26th 2008 (Åslund & Dombrovskis, 2011, p. 35). The swap allowed the Latvian government to maintain its fixed exchange rate.

There were many arguments for Latvia to maintain its currency peg and some of them related directly to Swedish financial interests. After all, SEB and Swedbank owned half of all financial assets in Latvia and most household loans were denominated in euros, rather than lats. The Riksbank had warned about potential risks for Swedish banks from overheating in the Baltic states since 2005 (Johansson, Molin, Niemeyer, & Berntsson, 2018). It had concluded that currency devaluation in Latvia would impose even more losses on the banks than a massive austerity programme not least because Latvian courts would be overwhelmed by all the bankruptcy proceedings. Thus, Swedish banks, the government, and the Riksbank agreed that preventing devaluation in Latvia was in their interest. A further concern was the risk that devaluation would spark contagion to the other two Baltic states, where similarly high levels of euro-denominated loans and fragile currency boards could easily follow Latvia (Riksrevisionen, 2011, pp. 60–62). Finally, the financial risks related to SEB's and Swedbank's exposure to the Baltics made it even more difficult for these banks to restore market access. The Riksbank's intention behind the swap line for Latvia 'was ultimately a question of maintaining financial stability at home' (Ingves, 2018, p. 13).

By contrast, such material self-interests provide little analytical leverage for explaining the involvement of the DNB in the swap to Latvia. After all, though Danske Bank had a small subsidiary there, the links were by no means relevant for financial stability in Denmark.[90] Likewise, possible financial contagion in the Baltic region was not seen as a threat to the credibility of the Danish currency peg.[91] From a financial risk perspective, Latvia would have been expendable to Denmark.

There were, however, other, immaterial reasons for both the Riksbank and the DNB to help the Bank of Latvia. Since gaining independence in 1991, the Baltic states had been members of the (now) Nordic-Baltic IMF constituency which had traditionally cooperated closely.[92] Technical cooperation between the central banks and the finance ministries had facilitated good contacts at both staff and executive levels already in the run-up to the crisis (Sutt, Korju, & Siibak, 2011).

The Riksbank made efforts to present the credit line to Latvia as being a joint Nordic endeavour. From a practical perspective, the Riksbank would not have needed the DNB to participate in the bridge loan. It could easily have provided the €500m on its own. Indeed, when the DNB let its share of the loan expire in early 2009, the Riksbank did cover the entire amount. Ingves had tried to involve both the Danish and Norwegian central banks to signal broad support for Latvia, but the latter declined to participate.[93] The Norwegians' refusal suggests that the bond with

[90] Interviews Berg (DNB), Callesen (Danish MoF)

[91] Interview Berg (DNB)

[92] Interview Märt Kivine, Tanel Ross (both Bank of Estonia), Riksbank officials

[93] Interview Riksbank officials

Latvia may not have been considered as strong as the one with Iceland, but the DNB was ready to cooperate.

For the DNB, the swap line to Latvia was motivated purely by solidarity – Danish banks' exposure to Latvia was contained.[94] According to Per Callesen, a senior finance ministry official in Denmark at the time, it was a sense of 'pan-Nordic solidarity', rather than financial interests that drove Denmark's swap line provision. He went on '[t]hey were part of the club, and we felt the responsibility to assist both Iceland and Latvia.'[95] Even if it had no impact on Danish financial stability, Latvia was close enough to receive support. Moreover, the Nordic central banks also supported the peg in Latvia because they considered it in Latvia's interest. The Danish central bank's staff could relate well to Latvia's worry about devaluation and agreed with their Latvian counterparts that maintaining the peg was the best way forward. According to Jesper Berg '[the swap for Latvia] was purely out of […] a strong belief in fixed exchange rates.'[96]

Even in the Swedish case, bank exposures did not tell the whole story. One Riksbank interviewee acknowledged that 'officially, you will hear that it's because of the Swedish banks.'[97] However, apart from that, he recalled that Riksbank governor Ingves had a strong perception of the necessity to help his Latvian colleagues avoid a worse course of events.

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[94] Interview Berg (DNB)

[95] Interview Callesen (Danish MoF)

[96] Interview Berg (DNB)

[97] Interview Riksbank officials

> '[Mr Ingves] knows himself that he is well acquainted with dealing with crises and areas of crisis. […] Is it because he wanted to help his central bank colleagues? Yes, I will say he certainly wanted that […] because he had a lot of experience how disastrous real financial crises can be.'[98]

Even if Swedish financial interests were at stake, the Riksbank's governor saw avoiding a crisis in Latvia as something worth pursuing for its own sake.

Still, the IMF programme was an important precondition for the conclusion of the swap line between central banks. Riksbank governor Ingves had signalled to his Latvian colleagues early into the crisis that the Riksbank would stand ready to provide a swap to prevent devaluation.[99] A recent report by Leung (2020, p. 27) states that '[f]or the Riksbank, it was important to ensure that an agreement was tied to commitments by the authorities to address the inherent problems in the economy. The Riksbank withheld the swap until Latvia had signed a Letter of Intent (LOI) with the IMF stipulating the action necessary to be taken by the authorities to draw on IMF financing.[100] Making the swap conditional on prior approval of the IMF programme served two purposes. First, it ensured that Latvia would not have to devalue because of delays with the disbursement of IMF funds, and second, it included a clear policy commitment by the Latvian authorities to rectify the economic situation.

In sum, the Bank of Latvia needed the swap line for technical reasons, namely, to avert an unintended currency devaluation. The Swedish and Danish central banks' decision to provide a swap line was in this regard simply a short-term fix that, while it supported financial stability in Sweden, was also an expression of solidarity within the Nordic/Baltic IMF constituency. Again, however, the Riksbank's insistence that Latvia agreed to the IMF conditions to receive

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[98] Interview Riksbank officials

[99] Interview Riksbank officials

[100] Another IMF official once remarked to me informally that coupling the swap to the approval of the SBA was a 'typical Ingves.'

the loan speaks not just to the limited purpose that the credit line was supposed to play, but also the principled approach that Mr Ingves pursued towards central bank credit lines more broadly.

3.6 The Riksbank's swap with the Bank of Estonia

From the perspective of Estonian monetary policy, the swap line between the Riksbank and the Bank of Estonia in February was a highly unconventional arrangement. If drawn upon, it would allow the Bank of Estonia a way to get around a constraint imposed on it by its currency board rules. Since currency boards must back up all of their central bank reserves with foreign exchange reserves, they are unable to 'print' new central bank reserves and act as lenders of last resort (Wolf, Ghosh, Berger, & Gulde, 2008). Though the Bank of Estonia had some 'excess reserves' – that is, its foreign assets exceeded the amount of base money – it would not be able to intervene if a bank in Estonia experienced liquidity problems. However, given that the foreign banks that made up almost the entire banking market in Estonia operated as subsidiaries, the Bank of Estonia, as the host authority, would be responsible to act as a lender of last resort (Altmann, 2006). The swap line would allow it to increase its foreign reserves to create emergency liquidity and that was also the stated purpose of the agreement with the Riksbank (Eesti Pank, 2014, p. 151; Leung, 2020).[101]

The swap line becomes even more surprising given that the entire structure of the Estonian financial system had been built in a way to obviate the need for the Bank of Estonia ever to act as lender of last resort. Since gaining independence, the Estonians had very consciously pursued a strategy of outsourcing both monetary stability (through the currency board arrangement) and

[101] The Bank of Estonia (2014, p.152) goes further to explain how unconventional the agreement was as follows: '[u]sing such a lending facility would have been a de facto abandonment of the strict currency board arrangement. Although no loan would have been shown officially on the central bank's balance sheet, it would have breached the principles of the currency board by allowing unbacked currency into circulation.'

financial stability (by selling off the entire banking sector to foreign owners) (Khoury & Wihlborg, 2006). Virtually the entire Estonian banking sector was foreign-owned, with about two-thirds from Swedish banks (EBRD, 2009; Ingves, 2010). As one official explains:

> 'We were […] supportive of […] banking groups obtaining banking assets in Estonia, […] this was our implicit policy goal. So, that overarching goal for us was to ensure that [the] Estonian banking system is fully integrated with European /Scandinavian systems. And our intact policy goal was to ensure that this integration is of such a nature that the parent then would essentially make the liquidity management within the group […]. So indistinguishable of whether the subsidiary is, Estonian or Swedish, or Finnish or Danish.'[102]

Long before the crisis, it was understood that the complete delegation of liquidity management to foreign banks complemented the currency board arrangement. There was no need to establish domestic money markets if all external financing could come from the parent banks and domestic government debt was virtually non-existent (Wolf et al., 2008, p. 153). As a result, Estonia was for all practical purposes part of the Swedish banks' home markets and the Riksbank acknowledged just as much (Ingves, 2010). The need for the Bank of Estonia to act as a lender of last resort appeared remote.

Instead, the driver behind the swap line was external pressure from the IMF for reasons relatively unrelated to the specific situation in Estonia. In 2007, the IMF had relaunched its monitoring of exchange rate misalignments, especially in countries with currency pegs, as part of its Article IV reporting (Aylward, 2007). The initiative was mostly driven by the United States' objective to be able to brand China as a currency manipulator by showing that its currency was fundamentally undervalued. Estonia was caught in this process because the IMF considered its currency overvalued.[103] During the credit boom in the run-up to the crisis, capital had flowed into the country, and, because the currency board prevented nominal appreciation,

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[102] Interview Ross (Bank of Estonia)

[103] Interviews Sutt (Bank of Estonia), Kivine (Estonian MoF)

double-digit inflation had indeed led to considerable real exchange rate appreciation.[104] Before China could be sanctioned, another smaller country with a currency peg and obvious imbalances would have to serve as an example.[105]

The formal concerns about the exchange rate held up the approval of the Article IV report on Estonia for the year 2008. After the first Article IV mission in May 2008 had not mentioned the issue of liquidity provision (International Monetary Fund, 2008c), the approval was later held up by the IMF Board which wanted to open an excessive imbalance procedure against Estonia.[106] After tense negotiations, the Bank of Estonia Deputy Governor Andres Sutt and IMF Managing Director Dominque Strauss-Kahn agreed that Estonia would 'have some swap line with Sweden, so [the IMF] can basically take you off the hook.'[107] A second Article IV mission was dispatched in December and the report completed on February 16th 2009. A week later the swap line was approved and on March 2nd 2009, the IMF issued an additional update of its staff conclusions (which were fundamentally unchanged) and a Public Information Notice from the Fund's Directors who 'endorsed the recent swap agreement between the Estonian and Swedish central banks that underpin [*sic*] a new framework for extending emergency liquidity assistance to large banks' (International Monetary Fund, 2009c). With the swap in place, the Article IV report could go ahead.

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[104] Though within the IMF there were considerable disagreements about whether the credit boom in Eastern Europe was actually problematic (Bluestein, 2015). Interviews IMF 1, IMF 2

[105] The IMF raised the same concerns in Latvia. In the 2007 Surveillance decision, Latvia was labeled as having a fundamental exchange rate misalignment, and based on this assessment both the 2007 and 2008 Article IV reports were not approved by the Executive Board (Kincaid, 2016, p. 52)

[106] Interview Sutt (Bank of Estonia)

[107] Interview Sutt (Bank of Estonia)

One remaining question is why Estonia requested this liquidity backup from the Riksbank rather than from the ECB. After all, as an ERM II participant, Estonia could have plausibly sought liquidity assistance, similar to the arrangements that the ECB had granted to Denmark and Latvia. But Sutt stated that the Estonians had not even asked the ECB for a loan: '[t]he ECB was out of [the] question. […] They would never do it.'[108] Such unconventional agreements were beyond what the ECB would be willing to do. Cooperation among the Nordic/Baltic states was, by contrast, pragmatic, but, as Sutt stressed 'it was pragmatic for a reason because we were […] jointly in it.'

The Swedish-Estonian swap line is perhaps the clearest indication that central bank cooperation is not necessarily policymakers' response to financial risks. Indeed, the Estonians had achieved a degree of international financial integration that would allow them to withstand the crisis without taking any monetary policy measures at all. From the Riksbank's perspective, concluding the swap was a way of helping the Estonians resolve a dispute with the IMF, not tackle any pressing financial market situation. In brief, while this credit line appears plausible as a pragmatic gesture of support, it is difficult to find a clear material rationale that explains why the Riksbank would step in.

Conclusion

This chapter has reviewed the five central bank credit lines concluded in the Nordic/Baltic region. Two swap lines, between the ECB and the Riksbank, and the Riksbank and the Bank of Estonia were set up as precautionary measures; two others, between the ECB and the DNB, and the Nordic central banks and Latvia, came in response to an urgent operational need. Lastly,

[108] Interview Sutt

the ECB's reluctance to offer more than a repo to Latvia, to help support the exchange rate, heightened the financial stability risks in the Baltic region. It is, against this backdrop, unsurprising that several considerations influenced each of these arrangements. Yet, the role of immaterial considerations and mere circumstances can hardly be denied.

It would be convenient to argue that financial risks predict credit lines. Euro Area banks were far more exposed to Swedish and Danish banks than they were to the Baltic states, but conversely, exposure to the Baltic states was one of the main problems that Swedish banks experienced during the GFC. The presence of a factor does, however, not imply that it was causal in bringing about a certain outcome. The ECB's internal documents about the swap with the Riksbank do not suggest that the financial exposure played a role; and when it came to the situation in Estonia, the Riksbank could almost single-handedly ensure financial stability by supplying liquidity to the two Swedish banks that controlled 80% of the market. In the Latvian case, avoiding a devaluation was also seen as part of the Swedish national interest. But the DNB was ready to provide a swap, too despite the weak financial linkages between Denmark and Latvia. Financial interests were important, no doubt, but they hardly tell the entire story.

Considering the different borrowing terms as based on recipients' credit risks likewise does not lead to a consistent explanation of the findings. The ECB maintains that credit risk was the main consideration for its credit terms and granting swaps to two AAA-rated countries. This justification appears plausible at first sight. But a closer look at the situation in Denmark shows that the DNB was as much at risk of running out of foreign reserves as their Latvian colleagues. Without the swap lines from the Fed and the ECB, Denmark would likely have required international assistance as well. Denmark was not per se a fundamentally sound country, but access to the swap lines helped the DNB stave off a far worse course of events. And even in the case of Latvia, which had undoubtedly experienced severe imbalances, the Swedish and Danish

central banks – unlike the ECB – provided a swap line. Rather than worrying about credit ratings, the government's approval of the sovereign bailout conditions sufficed as a reassurance.

When it comes to the role of the ERM II framework, a rather surprising picture presents itself. The agreement did not facilitate the conclusion of credit lines but rather resulted in more restrictive terms. Based on the rules of the ERM II, one might have expected the opposite, namely that the ECB would have been forthcoming with its support. But the ECB had a different, highly formalistic interpretation of the rules of the ERM II. This interpretation rendered the framework obsolete when Denmark and Latvia were facing speculative attacks on their currencies because the central banks were barred from using ECB funds for exchange rate interventions. The Bank of Estonia did not even countenance approaching the ECB for informal assistance. Furthermore, the ECB imposed constraints on itself by insisting that the narrower currency pegs in the Baltic states were unilateral commitments. The ECB's actions offer a strong suggestion that it followed what it saw as the ERM II's rules with relative disregard for the potential consequences. It would rather risk an uncontrolled devaluation in Latvia and potential financial contagion than violate what it considered the disciplinarian logic of the ERM II.

How useful have the two logics of action proven for analysing the considerations that shaped the credit lines? It seems that social identities and different perceptions of appropriate action between the ECB and the Nordic central banks made a difference. For both its swap lines, the ECB referred to indicators of social status: G10 membership in the case of Sweden and a 'special relationship' with Denmark. In contrast, in its communication with the East European central banks, it stressed coherence with the guidelines on financial assistance to non-Euro Area central banks that it had devised on the spot. One potential interpretation is that the ECB pursued

a 'bespoke' approach to credit lines, as Lorenzo Bini Smaghi put it.[109] Another, more plausible one, is that the ECB was generally more willing to open swap lines for central banks that had a high standing in the international community and were generally trusted.[110] Regarding the EU's new member states, the ECB had a generally more sceptical attitude.[111]

These findings suggest that the shared identity among the Nordic and Baltic central banks is an important facilitator of cooperation. It seems that within the Nordic/Baltic IMF constituency cooperation was characterized by overall higher levels of mutual trust and closer personal relations. Strong bonds did, however, not mean that support was unconditional: the conditions attached to the swap lines for Iceland were exceptionally strict for a central bank loan and Latvia had to sign an IMF loan agreement before getting support.

Taking stock, credit lines are a powerful form of cooperation between central banks, but it does not appear that they are only granted for instrumental reasons. This chapter has only identified a plausible link to the domestic monetary policy objectives of the swap provider for two out of six credit lines. In the other cases, more normative motivations have both helped and hindered the conclusion of credit lines. Among central banks that saw each other as peers, the norms of solidarity and general crisis preparedness can be documented. By contrast, the ECB's aloof approach to Eastern Europe and the deliberately restrictive interpretation of the ERM II framework justified the limited degree of support that it was ready to provide to the Baltic central banks. Having hinted at linkages between central bank credit lines and IMF

[109] Interview Bini Smaghi

[110] Interview Papadia (ECB)

[111] Interviews Kivine (Estonian MoF)

programmes, the following chapter turns in more detail to central banks' input to Balance-of-Payments assistance programmes.

Chapter 4 – Central banks and Balance of Payments Assistance

Abstract

The objective of this chapter is to probe the relationship between central bank cooperation and Balance-of-Payments (BoP) programmes. It asks, first, to which degree central banks have been involved in the design and negotiations of BoP programmes in EU member states and, second, which role conditionality or domestic reforms played in the cooperation between central banks. It finds that central banks' engagement with individual BoP programmes varied because of the degree to which they felt responsible for the crisis and whether they had the requisite expertise. These findings imply not only that individually, central banks saw their roles in BoP programmes contextually, but also that the norms regarding their role in BoP assistance remained relatively stable throughout the crisis.

Introduction

Balance-of-Payments support programmes resemble central bank credit lines. Ultimately, both are forms of financial support that give the recipient access to additional foreign reserve assets (Murau et al., 2021). But while credit lines have the advantage of being set up quickly to offer short-term support, BoP programmes are usually intended for the medium term and linked to structural adjustment programmes and monitoring. For this reason, BoP programmes, and the associated reform programmes have often been controversial in public debate, while central banks' functionally very similar support is usually less salient.

By studying the relationship between central banks and BoP programmes, this chapter sheds light on a somewhat neglected form of central bank cooperation. Although central bank credit lines and BoP assistance programmes have been linked for a long time, central banks' input to the programme conditions has often not been considered explicitly. McDowell's (2017) account stops at the conclusion that the Fed's swap lines were provided precisely in moments when the IMF was unable to step in. However, central banks have contributed to BoP programmes more explicitly. Especially during crises in Emerging Markets joint loans from central banks, often brokered through the Bank for International Settlements (BIS), have often served as bridge credits (Cooper, 2006; Simmons, 2008). In the European context, the ECB has even tried to

weigh in on programme conditionality in its role in the 'troika' of creditors during the sovereign debt crisis (Fontan, 2018; Lütz & Hilgers, 2019; Lütz, Hilgers, & Schneider, 2019b; Lütz & Kranke, 2014). A systematic appraisal of how central banks relate to BoP programmes is necessary to capture an important way of how they cooperate.

The empirical findings in this chapter show central banks participated in BoP programmes to different degrees. Both the Hungarian and the Romanian programmes saw little involvement from foreign central banks, despite their strong financial linkages with West European banks. By contrast, both the ECB and the Sveriges Riksbank weighed in on central aspects of the Latvian programme. The Riksbank also linked the availability of swap lines to prior acceptance of IMF programme conditions. Lastly, central banks' involvement in the reform of both the European and global financial assistance architecture after 2008 further suggests that central banks preferred drawing on the IMF's expertise and credibility to committing to a role as major creditors themselves. Overall, the chapter finds that while central banks were reluctant to participate officially in BoP programmes, they sometimes linked their support to IMF support or tried to influence the loan conditions. To understand their involvement, it is necessary not merely to consider the material interests that were at stake for them, but also their perceptions of fairness, international norms, and the appropriate role of central banks in international financial assistance.

These findings contribute important insights to the overarching argument of this thesis. A first, relevant takeaway is that central bank cooperation on credit lines happened largely separate from formal negotiations for BoP support. Accordingly, it should be considered as following separate norms. Second, central banks' involvement often weighed considerations of appropriateness, including whether they had sufficient expertise and legitimacy to involve themselves directly in BoP programmes. Lastly, the reforms following the crisis left the

institutional ambiguity around access to central bank support and BoP assistance intact; even if the crisis in CEE led the ECB to improve its expertise for BoP programmes ahead of the Greek bailout. Central banks' role in BoP assistance reflected not a fixed institutional order, but contextual judgments, which were based on normative considerations and their confidence in their own technical capacities.

The chapter is structured as follows. The next section looks at the ECB's involvement in the BoP programmes in Hungary, Latvia, and Romania. Then the Nordic central bank's roles in the Icelandic and Latvian programmes will be considered, above all that of the Swedish central bank. The last substantive section turns to the evolving understanding of central banks' role in the international financial assistance architecture.

4.1 The ECB's involvement with BoP programmes

For the ECB, the financial crisis in Eastern Europe presented an unprecedented challenge. The ECB lacked experience with international financial rescues in general, and its specific role within the EU's BoP support architecture was not established. It pursued a contextual approach to the three BoP programmes in Eastern Europe, in two out of three cases it only joined the missions late, whereas in Latvia it was outspoken over the programme's conditions. These decisions can be understood against both the role that the ECB saw appropriate under EU norms and its limited expertise for BoP programmes at the onset of the GFC.

4.1.1 Central banks and the BoP programme in Hungary

The broadly shared assessment among interviewees of the ECB's and the European Commission's response to the outbreak of the financial crisis in Hungary was that both institutions were completely overwhelmed with responding to a BoP crisis in an EU member

state.[112] The Commission had a BoP instrument, called medium-term financial assistance facility (MFAF) of €12.5bn for member states outside the Euro Area, which had not been used since 1993 and had largely been forgotten about.[113] The ECB, as seen in chapter 3, had no plan in place either and took almost a week to decide on the terms of the credit line to Hungary.

During the first days after the Hungarian market collapse on October 9th 2008 several initiatives to assemble an assistance package were set in motion. Initially, the Hungarian central bank (MNB) had only reached out to the IMF for assistance, but the European Commission quickly intervened by stating that the Hungarian government should have requested support from the EU first (Blustein, 2015, p. 8). Yet, shortly after asserting its role, the Commission was forced to concede that it lacked the resources to run a BoP programme and that it would need to cooperate with the Fund (Király, 2020, p. 57). Coincidentally, many of the key players were at the IMF's Annual Meeting in Washington at the time. Negotiations between the Hungarian central bank, the IMF, and the Commission could already begin a day after the financial market collapse. It was quickly agreed that the IMF and the Commission would dispatch a joint mission to Budapest, but the ECB did not join in (Blustein, 2015).

Despite the need for additional financial resources, no central bank made any contribution that was counted towards the Hungarian bailout. At the start of the negotiations, an IMF official contacted the deputy governor of the Austrian National Bank (OeNB) suggesting that the OeNB contribute to the bailout with about €1bn.[114] But that proposal fell on deaf ears – the OeNB never formally participated in the IMF's missions to Hungary, even though Austrian banks had

[112] Interviews IMF 1, IMF 2, IMF 3, Kiraly, Nagy, Wieser

[113] The facility had been kept in place after the euro's creation precisely because of the possibility of a BoP crisis in an accession state (EU Council, 2002)

[114] Interview IMF 2

strong linkages with the country. Besides, from the IMF's perspective, neither of the two credit lines, that the Hungarian central bank had received, helped resolve the BoP problem. The assessment of the IMF was that the ECB's repo 'was not counted toward filling the financing gap, because it was viewed as largely a domestic monetary operation' (Kincaid, 2016, p. 51). The swap line from their Swiss colleagues (a EUR/CHF swap line) did not feature as a capital inflow, because it only exchanged one foreign asset for another (International Monetary Fund, 2009b, p. 28). No IMF official interviewed recalls contacts with the Swiss National Bank.[115]

For over a year the ECB did not send its own representative on the joint Commission-IMF missions to Hungary, but it was involved in discussions through other channels. First, it took part in the discussion on the EU's MoU through the Economic and Financial Committee (EFC) where it argued for the of removal monetary policy issues (the monitoring of foreign reserves) from the text to avoid negative financial market reactions (Thissen et al., 2013, p. 19). Second, though the negotiations of the terms of the repo line between the ECB and the MNB took place separately from the MoU negotiations, an IMF official visited Frankfurt to meet with Klaus Masuch of the ECB's Economics Department[116] to discuss 'the workings of this repo line, including its collateral requirements' (Kincaid, 2016, p. 51). The IMF persuaded the ECB to accept a broader range of collateral a week after the original agreement with the MNB had been concluded.[117]

[115] Interviews IMF 1, IMF 2, IMF 3

[116] Interview IMF 3

[117] Under the original agreement, the MNB was only allowed to repo German, French, and Italian bonds. After the change, the ECB allowed public sector securities from all EU member states, as well as the European Investment Bank and the KfW (European Central Bank, 2008f).

Whereas the ECB was thus hardly involved in programme design, it nevertheless interfered with monetary policy conduct in Hungary. After the market for Hungarian government bonds had completely collapsed, the MNB a week later struck an agreement with the banks that usually bought government bonds (primary dealers). The primary dealers agreed again to participate in government bond auctions and the MNB would buy the same amount of bonds on the secondary market (Király, 2020, p. 62). Under this policy, the MNB intervened in the secondary markets seven times, until the return of confidence following the arrival of IMF funds (Magyar Nemzeti Bank, 2009, p. 22). Even though the measure thus proved successful in reviving the government bond market, it led the ECB to write an angry letter to the MNB in which it argued that such bond purchases violated the EU's monetary financing prohibition under Article 123, TFEU.[118] The MNB apologized, but ECB President Trichet refused to accept that the measure was necessary for this emergency (Király, 2020, p. 62). Even if the ECB insisted that it did not want to set programme conditions, it was unforgiving when it came to enforcing the EU Treaty provisions.[119]

Overall, the Hungarian BoP programme was the first attempt at establishing a task division between the three institutions that would become the troika during the Euro Area crisis. Yet, neither the ECB nor other central banks with exposure to Hungary participated in the programme negotiations or supported the MNB's efforts to stabilize financial markets. If the Hungarian crisis had established a precedent, one would expect that central banks would indeed

[118] In retrospect this point is highly ironic

[119] The ECB produced several similar opinions on central banks' crisis measures after October 2008 that show its lack of appreciation for the situation. In Denmark, for instance, the ECB at first argued that liquidity support to a nationalized bank would constitute monetary financing (European Central Bank, 2008b), Interview Berg (DNB). In Sweden, it made a similar point around the newly set-up financial stability fund (European Central Bank, 2008c)

play a subordinate role in BoP programmes. The experience of Latvia just a few weeks later, however, shows that in other circumstances, central banks were far more proactive.

4.1.2 The ECB and the Latvian programme

The negotiations for a BoP programme in Latvia started in late October 2008. This time, however, the ECB participated in the negotiations from the start when it sent Rasmus Rüffer, another German official from the Economics Department, as an observer to the missions (Blustein, 2015, pp. 10–11; Kincaid, 2016, p. 53). The ECB's representative played, however, only a limited role in the lead-up to the programme. One IMF official recalls him just attending the meetings and quietly reporting back.[120] Compared with the ECB's refusal to participate in the Hungarian missions, however, the fact that it sent somebody to Latvia at all is remarkable.

One of the most central issues during the negotiations of the Latvian BoP programme was the fixed exchange rate. The question of whether Latvia should devalue its currency created a deep divide between the IMF and all other parties involved in the bailout negotiations. The IMF initially drew largely on its previous experience with BoP programmes in emerging markets to justify its advocacy of devaluation (Blustein, 2015). Some staff members also found the degree of internal devaluation that Latvia would have to undergo to maintain the currency peg impossible.[121] But the IMF faced a broad opposition composed of the the European Commission, the ECB, and the Nordic governments (Åslund & Dombrovskis, 2011, p. 42). The Latvian government itself was adamant in ruling out devaluation in order to stay on course for Euro Area entry In the end, the European side prevailed, as the IMF acknowledged not just the technical merits of their case against devaluation, but also stressed the importance of 'country

[120] Interview IMF 1

[121] Interview IMF 1

ownership' of the programme conditions (Rosenberg, 2009). In return, however, the shares in the financing arrangement had to be adjusted to what was dubbed a 'reverse Hungary' (Blustein, 2015).[122] After the MFAF had been increased to a volume of €25bn, the EU had the necessary resources to cover €3.1bn out of the official programme financing of €5.3bn.

The ECB's motivation to get involved in the negotiations in Latvia seems above all to have been linked to Latvia's participation in the Exchange Rate Mechanism (ERM) II (Kincaid, 2016, p. 53). The Latvian lats was at risk of crashing out of the mechanism and under the operating procedures of the ERM II, the ECB was tasked with monitoring the sustainability of exchange rates of participating currencies (Lütz & Kranke, 2014). Since in these reports the had consistently emphasised the need for equal treatment (see e.g. European Central Bank, 2008a, p. 7),[123] it now saw that there 'was a risk that IMF surveillance might call into question aspects of the peer review conducted by EU institutions' (Kincaid, 2016, p. 53).

The ECB took a somewhat paradoxical position on the BoP programme in Latvia. Though it opposed a devaluation of the Latvian lats, the ECB was unwilling to contribute to the programme. The ECB had various reasons to oppose the devaluation. First, it assessed that 'the strategy of pegging and the de facto euroisation the Baltics have created a very difficult situation in which no ideal policy option exists' (European Central Bank, 2008h). Nevertheless, it argued that Latvia's economy would do better if the peg was maintained (European Central Bank, 2008h).[124] Second, it saw a risk of contagion if the currency was devalued. It was reasoned that

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[122] This distribution reflected not just the Europeans' emphasis on maintaining the exchange rate but also the size of Latvia's financing gap (Interview Nauschnigg, OeNB). The IMF's share was about 1000% of Latvia's quote, similar to the share in the Hungarian programme; the overall programme size was almost a third of Latvia's GDP.

[123] I am grateful to one committee member for this suggestion

[124] Interview Bini Smaghi

currency speculators might target other fixed currency arrangements in CEE if the lats could not be defended anymore. Jürgen Stark, the ECB's Chief Economist, was among those who feared a potential domino effect that could hit not only the Baltic states.[125]

These worries brought both reputational and material interests to the fore. From a reputational standpoint, financial contagion which would have necessitated bailouts for more ERM II participants would have reflected negatively on the EU.[126] But if contagion spread to countries in Central Europe, it could also hurt the interests of banks from Euro Area states. At a meeting of the Belgo-Austrian IMF constituency, all states present agreed that Latvia should not devalue because contagion might spread to Croatia or Bulgaria, where other banks were more exposed. As one OeNB official recalls: 'The Balts were not so much our priority, but we wanted to protect them to protect ourselves.'[127]

Yet the ECB did not want to play any role itself in the defence of the Latvian currency peg and thus also not in the BoP programme. Curiously, the IMF's report on the programme request does not even mention the repo agreement that the Latvian central bank had received from the ECB (International Monetary Fund, 2008b). For the ECB it was clear that while devaluation should be avoided, the responsibility for that would lie with the Latvian government. An internal document in November 2008 restated that '[t]he ECB's policy line has always been that currency board or unilateral pegs by third countries are not backed in any way by policy

[125] Interview IMF 1

[126] Interview IMF 1

[127] Interview Nauschnigg (OeNB), translated from German

commitments from the ECB' (European Central Bank, 2008h). Additional resources to defend the currency peg would have to come from fiscal sources, not the central bank.[128]

With devaluation ruled out, the IMF floated another pragmatic, but unorthodox proposal. If the Latvian government did not want to adjust, it could simply adopt the euro as its official currency and thereby eliminate both the risk of devaluation and potentially gain access to the ECB's liquidity facilities (International Monetary Fund, 2008b, p. 27, 2009f). However, the ECB and the Commission were unforgiving about changing the exchange rate regime. In public, the ECB argued on economic grounds that

> '[…] entering the euro area prematurely – that is before reaching a sufficient degree of convergence and economic flexibility – would not be a panacea for the CEE countries to overcome the crisis impact. On the contrary, a premature entry into the euro area would deprive the countries from [*sic*] important adjustment tools and would therefore not be in the interest of the country joining' (Tumpel-Gugerell, 2009, pp. 4–5).

However, this technical argument has some glaring weaknesses. After all, if Latvia had committed itself to a narrow exchange rate peg, there were no adjustment tools left for it inside the ERM II framework. The IMF staff, having accepted that devaluation was no option, argued that adopting the euro was the 'technically more attractive' option than maintaining the peg (Kincaid, 2016, p. 53). But the ECB was immovable. The summary of the IMF Executive Board meeting on Latvia, for instance, records that while Directors from other constituencies contemplated the idea, 'in practice immediate euroisation has been ruled out by the EU authorities as inconsistent with the Maastricht Treaty' (International Monetary Fund, 2009f, p. 2). The ECB's economic case against euro adoption may have been unconvincing, but 'the Europeans insisted, and they were in a position to get their way, given their voting power on

[128] Interview Nauschnigg (OeNB)

the IMF board' (Blustein, 2015, p. 11). The real concern seems to have been to avoid setting a precedent for a looser application of the convergence criteria.

During the programme, another conflict between the EU and the IMF erupted on the issue of devaluation. Ahead of the first programme review in June 2009, the economic prospects worsened and the question of a potential devaluation returned (Åslund & Dombrovskis, 2011, pp. 75–81). At its core was a disagreement between the IMF and the EU side over the fiscal austerity package that the Latvian parliament had passed. The IMF considered the wide-ranging social spending cuts too harsh, but the EU side insisted that they were necessary to keep the country on track for euro adoption in 2014 (Lütz & Hilgers, 2018, p. 9). Though in this situation, again, the ECB still refused to offer material support, it weighed in on the debate when President Trichet (2009) expressed his 'full confidence that the Government of Latvia will take the decisions that are appropriate for the domestic context without a change in the currency.' In the end, the Europeans outmanoeuvred the IMF by releasing the next financing tranche without waiting for IMF Board approval, which replenished Latvian foreign reserves and brought the speculation against the exchange rate to an end (Åslund & Dombrovskis, 2011, pp. 75–81).

The ECB thus got involved in the Latvian crisis from the start because the question of devaluation concerned one of its competencies as an EU institution. Both its uncompromising stance on the exchange rate and its reluctance to provide direct financial support were related to its interpretation of what was appropriate within the ERM II framework. Closing the financing gap, from this perspective, had to be done through fiscal means. Its more active role in Latvia was, however, an exception. During the next programme, in Romania, the ECB would once more stand by idly.

4.1.3 The ECB and the BoP programme in Romania

The Romanian BoP programme came somewhat later than the first two programmes and was agreed upon in May 2009. The financing shares between the Commission and the IMF were again reversed. The IMF covered €13bn out of €20bn; the Commission provided €5bn after the volume of the MFAF had now been raised to €50bn (Darvas, 2009). Most of the programme negotiations took place within the context of the Vienna Initiative, which the ECB attended as an observer (Franks & Tuladhar, 2012, p. 150). Especially the West European parent banks' commitment letters in March 2009 were seen as integral to the success of the programme (Kincaid, 2016, p. 57).

Unlike in Hungary and Latvia, the ECB has not provided a credit line to the National Bank of Romania (NBR). Again, it played a very limited role in programme design. The possibility of a credit line for the NBR is first mentioned as part of an IMF mission in mid-2010 (International Monetary Fund, 2010). Before that, the ECB had weighed in on the programme rather selectively. Several of the Romanian programme conditions concerned monetary policy issues, such as the exchange rate and stress testing. These issues were however only covered in the Memoranda of Understanding (MoU) with the IMF and not those with the European Commission[129] (Kincaid, 2016, pp. 57–58). The EU's reluctance to interfere with monetary policy resembles the decision on the programme in Hungary, where the ECB had argued against including monetary policy in the programme conditions.

In one regard, however, the ECB quickly came to the aid of the NBR: in early 2010, the government pushed through a sweeping round of fiscal austerity measures and cut all public

[129] The IMF memorandum included several quantitative performance criteria for foreign assets and inflation (International Monetary Fund, 2009e, pp. 12–14). These conditions are missing in the EU's MoU (*Memorandum of Understanding Between The European Community And Romania*, 2009).

employees' salaries by 25% (Åslund, 2010, p. 39). After a protest from the ECB that this measure not just infringed on the financial independence of the central bank, but also constituted monetary financing of the state if the savings were added to the fiscal budget (European Central Bank, 2010b), the government quickly moved to withdraw the measure again (International Monetary Fund, 2010). In Hungary, the newly-instated Orbán government took a similar measure around the same time, capping the central bank Governor's salary (Király, 2020, p. 100) which led to a similar response from the ECB (European Central Bank, 2010a).

4.1.4 Taking stock of the early 'troika'

The BoP programmes in Hungary, Latvia, and Romania were the first instances in which the ECB had to define its role in providing external financial assistance, not just vis-à-vis the IMF as another creditor, but also the European Commission. As shown in this section, the ECB succeeded in bracketing out monetary policy from the EU's MoUs in Hungary and Romania. Its input to crisis measures seems, however, limited to safeguarding the integrity of the EU principles by taking a strict line on the monetary financing prohibition and central bank independence, even if these decisions at times interfered with financial crisis management or rolled back austerity measures.

In Latvia, a similarly principled stance led the ECB to veto plans to adjust the exchange rate or accelerate euro accession. Its proactive involvement both in the IMF missions and the design of the programme conditions seems largely driven by the ECB's institutional role in the euro adoption procedure. However, as in the other two cases, the ECB insisted it avoid a role in programme financing, which was left to the Commission and the IMF.

Considered against the backdrop of material interests, the ECB's course of action is somewhat puzzling. In the two countries that saw a strong involvement of Euro Area banks, the ECB initially refrained from interfering with programme design. But in Latvia, it was strongly

involved from the beginning, despite the virtual absence of financial linkages with the Euro Area. Even in Latvia, the ECB's actions ran counter to its desired consequences; the ECB aimed to avoid currency devaluation. However, unlike the Nordic central banks, the ECB did not make a financial contribution to tide the Bank of Latvia over.

The ECB's particular interpretation of its policy mandate and the EU's principles for central banking provides more clarity. There was a consensus inside the ECB that it had no role in BoP crises outside the Euro Area.

> 'While the ECB was very much involved in Greece, with the IMF, was very close with the IMF on Ireland, on Portugal, Spain […] in the non-Eurozone countries, frankly, I don't think we had a possible role. […] Because the […] responsibility for monetary policy was in the national central bank, fiscal policy was in the country. So, it would have been interference on the ECB's role.'[130]

A similar stance was taken by Luxembourgish central bank governor Yves Mersch who emphasized that the ECB's Governing Council's agreed stance was to focus on price stability in the Euro Area and that the ECB could not be 'a regional IMF' (Atkins, 2009).

Moreover, whenever EU laws and agreements provided clear prescriptions, the ECB was ready to enforce them. Both the ECB's dogged insistence on Latvia's original euro accession schedule and the refusal to support the exchange rate were firmly rooted in its narrow reading of the ERM II principles. In Hungary and Romania, the ECB interfered with crisis management when it feared the transgression of the monetary financing prohibition or central bank independence. Strikingly all these measures appeared largely unrelated to the practical requirements of crisis management.

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[130] Interview Bini Smaghi

Besides the ECB's role perception, another concern seems to have been the ECB's limited expertise in BoP crises at the time. Lorenzo Bini Smaghi argued that 'the ECB didn't want to get too much involved […] not only because of the availability of staff and knowledge but also because it was not responsible.'[131] Another former ECB Board Member mused that the ECB could, if it all, be involved when it came to monetary policy (which, as seen, was largely left out of the EU's MoUs), but not be part of the programmes.[132] In other words, the ECB deferred to the IMF on questions of conditionality not just because it avoided responsibility for financial crises outside the Euro Area, but also because it could not design a programme itself. It is worth adding though that several interviewees have indicated that the ECB after the Hungarian crisis improved its capacities for structural adjustment programmes, as will be discussed at the end of the chapter. However, one can only speculate whether it would have responded differently to the East European crises if it had had better staff capacities.

The last explanation that several interviewees from outside the ECB mentioned is that the ECB generally had little trust in the EU's new member states. Hungarian central banker Julia Király, for instance, recalled that for '[ECB President] Trichet, [CEE] was dangerous, unreliable, unpredictable […] For him, Romania, Bulgaria, Hungary, Czech, is all the same.'[133] While EU officials still considered the stigma of an IMF programme off limits for a member of the Euro Area, 'its loans were fine for poor ex-Communist nations' (Walker, Forelle, & Blackstone, 2010).

[131] Interview Bini Smaghi, Nauschnigg (OeNB)

[132] Interview ECB 1

[133] Interview Király (MNB)

The ECB thus justified its aloof stance on adjustment programmes in CEE on two principles. Acting as a central bank, it insisted on a very narrow interpretation of its mandate, but in its role as an EU institution, it aimed to uphold treaty principles. All in all, these conclusions suggest that its attitude followed considerations of appropriate action with relative disregard for the expected consequences.

4.2 Nordic cooperation on BoP programmes

The Nordic central banks contributed, to differing degrees, to the two BoP assistance programmes in the Nordic/Baltic IMF constituency. This section will discuss how both swap lines were conditional acceptance of IMF criteria and how the Riksbank played a leading role in defining the principled quid pro quo approach towards financial assistance in the region. Though central banks' measures were closely coordinated with the IMF, their cooperation was separate from the negotiations between finance ministries.

4.2.1 Contributions to negotiations and programme financing

The Riksbank took a leading role in shaping the Nordic central banks' approaches to financial assistance in 2008. In the early days of both the Icelandic and the Latvian crises, the Riksbank conducted its own analyses of the situation and coordinated with the IMF. In the case of the Icelandic crisis, it is noteworthy that the Riksbank was the only major central bank that sent officials to Reykjavik to assess the situation, while the Fed and the ECB relied instead on an assessment of the IMF (Gissurarson, 2018, pp. 41–42).

Though the IMF only officially sent a mission to Iceland in October 2008, it nevertheless played an important role in influencing the terms of the swap. The previous chapter has discussed the

stringent conditionality that the Nordic central banks – especially the Riksbank[134] – demanded in return for the Icelandic swap. As it turns out, these conditions had been negotiated during the IMF spring meeting in April 2008 (Ingves, 2018, p. 10). One official remembers asking the IMF's country desk for Iceland for which policies to demand.[135] The Riksbank took a hard-handed approach: at one point in the negotiations, CBI Governor Oddson handed over his phone so that Ingves could speak directly to the Icelandic prime minister (Gissurarson, 2018, p. 43). In the end, three Icelandic ministers had to sign up to the conditions for the swap line.

Though the Riksbank initially refused the CBI access to the swap line, as discussed in the previous chapter, the Nordic swap lines were maintained once the Icelandic government had signed its IMF agreement (Sveriges Riksbank, 2009c). By that point, all the Nordic governments, plus the Polish one, had all committed additional financing to the programme (Ibison, 2008). The swap lines remained in place until June 2009.

The Riksbank's approach to the crisis in the Baltic states was a bit more conciliatory but no less proactive. When the Latvian government requested IMF assistance, Ingves immediately signalled his readiness to provide a swap but on the condition that the Latvian government agreed to an IMF programme. According to the summary of one Riksbank official Ingves told the Latvian side 'We know that the IMF will take some time. But as soon as we are certain that the IMF will recommend to its board a set of programs […] on that very day, we will have a swap line with you.'[136] In this case, the Riksbank explicitly linked its support to the conclusion of an IMF programme.

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[134] Interview Riksbank officials, Berg (DNB)

[135] Interview Riksbank officials

[136] Interview Riksbank officials

The Riksbank also assisted in the resolution of the Latvian crisis directly. Already in October 2008, Ingves sent his advisor Göran Lind to report on the progress of the bailout negotiations. Lind recalled travelling to Riga and back about ten times during that period.[137] In November 2008, he participated in the negotiations on the takeover of the bank Parex, one of the most crucial issues of the programme (Åslund & Dombrovskis, 2011), alongside IMF and European Commission representatives (FCMC, 2009, pp. 6–7). But Lind's role in the bank resolution went beyond that: subsequently, he co-drafted the piece of emergency legislation that would pass the Latvian parliament to enable the takeover.[138] Though the Riksbank was no creditor institution itself, it had directly influenced some terms of the Latvian programme.

When it came to the question of whether Latvia should devalue, the Riksbank's opposition to the IMF was above all motivated by the effect on financial markets. Though Swedish banks appeared sufficiently well capitalized to withstand the expected loan losses if the Latvian lats was devalued, it was expected that Swedish banks might lose critical access to market funding.[139] During the Riksbank's Executive Board meeting in December 2008, Deputy Governor Lars Nyberg pointed out that

> '[…] the Baltic states […] are experiencing considerable problems and the situation in Latvia is particularly worrisome. We cannot rule out the possibility of a deterioration in the Baltic countries leading to problems for the Swedish banks, too, and for Sweden as a nation in obtaining funding in the international financial markets' (Sveriges Riksbank, 2008).

Other members of the Nordic IMF constituency took similar views. Andres Sutt of the Bank of Estonia recalled the feeling that 'if Latvia go [*sic*] under we have also an issue.'[140] But besides

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[137] Interview Riksbank officials, IMF 2

[138] Interview Riksbank officials

[139] Interview Riksbank officials

[140] Interview Sutt (Bank of Estonia)

that, there was also a consensus that devaluation would not be the appropriate course of action from a Latvian perspective. According to Per Callesen, then of the Danish Finance Ministry,

> '[…] [t]he Nordic view was if [Latvia had devalued], then they would have had an unprecedented inflationary spiral. Latvia didn't have a particularly strong export sector. It could have boosted inflation; they would have been compensating wage demands. So, they would have entered the vicious circle where they had to devalue once again and again. So better stop that from the outset.'[141]

Arguably, their IMF constituency offered the Nordic/Baltic states another channel through which they could influence the terms of the Latvian programme. The Nordic/Baltic Monetary Financial Committee (NBMFC), which was composed of one finance ministry and one central bank representative per state, was 'central' to the work done by the Nordic/Baltic IMF constituency.[142] Jens Henriksson, the IMF constituency's Executive Director, was in that respect an important player.[143] The Nordic and Baltic states also formed a working group together with the European Commission to discuss the programme terms.[144] Officials from the constituency have emphasised that avoiding devaluation required not just having the necessary votes, but also making a technically convincing case that internal devaluation could work.[145] Indeed Callesen argues that 'we won the argument [about devaluation] in practice, and intellectually.' The joint IMF constituency was thus not just a source of voting power, but also a way for the Nordic and Baltic states to influence the terms of the discussion inside the IMF.

The Swedish side played a central role during the formal negotiations of the Latvian programme, but there was a clear division in responsibilities between the political level and

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[141] Interview Callesen (Danish MoF)

[142] Interview Callesen (Danish MoF), Ross (Bank of Estonia)

[143] Interviews IMF 1, Kivine (Estonian MoF), Riksbank officials

[144] Interviews Callesen (Danish MoF), Kivine (Estonian MoF)

[145] Interview Kivine (Estonian MoF)

central banks. When it came to negotiating the programme, Sweden's finance minister Anders Borg was the leading figure.[146] It was he who summoned the finance ministers from across the region to Arlanda airport shortly before the agreement of the IMF programme (Åslund & Dombrovskis, 2011, p. 46). At the meeting, the governments of the four Nordic countries, plus the Czech Republic, Poland, and Estonia committed a total of €2.2bn in bilateral loans to close the financing gap for the Latvian programme. In these political negotiations, the central bank did not play a visible role,[147] though the IMF report acknowledges the input of both the Swedish finance ministry and the Riksbank (International Monetary Fund, 2008b).

The Riksbank also made clear that it would provide similar loans to the other two Baltic states. Its precautionary swap with the Bank of Estonia, as seen, was not related to an IMF programme. And even the Lithuanian prime minister at one point visited the Riksbank to discuss a potential swap agreement, though, in the end, his country managed without a loan and an IMF programme.[148]

Despite the formal separation between fiscal and monetary support during the negotiations, the central bank swap was counted towards the programme financing for Latvia (International Monetary Fund, 2008b, pp. 13, 20). The loan fulfilled its purpose of tiding over the Bank of Latvia between the conclusion of the BoP programme negotiations and the IMF board approval three weeks later. The swap line also provided additional resources during a government crisis in Latvia in February 2009, but the Bank of Latvia did not draw it anymore during the height of the June crisis.

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[146] Interview IMF 1, Kivine (Estonian MoF)

[147] Interview IMF 1

[148] Interview Riksbank officials

4.2.2 Understanding the Riksbank's role in the BoP programmes

Whereas it may be tempting to link the Riksbank's involvement in the Baltic region to the large exposure of Swedish banks, its leading role with the Icelandic swap lines illustrates that its relationship with the IMF was more multifaceted. The IMF served the Riksbank both as a commitment device and by helping the Riksbank ensure the Icelandic loan conditions were equivalent to an IMF programme. To appreciate this strategy fully, once more, the specific role understanding of what is appropriate to do for central banks during a crisis played an important role, as well as the agents inside the Riksbank that were ready to assume this form of leadership.

The Riksbank stands out for its confidence in responding to financial crises. Stefan Ingves himself had strong credentials. He had led the Swedish bank resolution authority after the Nordic banking crisis and published on the Swedish approach to banking resolution (Ingves, 1998; Ingves & Lind, 2008). Until he became Riksbank governor in 2006 he headed the IMF's Financial Stability Department, where he had been involved with the Indonesian BoP programme.[149] Several IMF officials stressed Ingves' linkages to the Fund as a factor that facilitated the cooperation.[150] Göran Lind, the Riksbank's representative to the Latvian missions, was a financial stability specialist who had been a long-time member of the Basel Committee on Banking Supervision. Early into the crisis, Ingves and Lind even co-authored an article in which they advocated other countries follow the Swedish approach to banking crises (Ingves & Lind, 2008). In short, the Riksbank could draw on considerable experience when the crisis erupted (cf. Mayes, 2009).

[149] Interview Riksbank officials

[150] Interviews IMF 1, IMF 2

These prior experiences also informed how the Riksbank defined its contribution to BoP programmes. There had been a longstanding awareness that central bank credit lines could serve as a bridge or a supplement to IMF programmes.[151] After all, since the financial crisis in Mexico in 1982, leading central banks had provided syndicated loans to distressed emerging markets, usually through the BIS (Cooper, 2006). Lind recalls even an informal quota scheme for such occasions at the BIS, where the Riksbank's share amounted to about 2%.[152] In this sense, the Riksbank had a template for its role in international financial rescues and Ingves knew from personal experience that some time could elapse between the agreement and approval of an IMF programme.[153]

The Riksbank's proactive involvement in both Iceland and Latvia before the conclusion of their programmes suggests that the Riksbank was confident in its expertise in financial stability issues. But the Riksbank made a clear distinction between central bank cooperation and BoP assistance and acknowledged the IMF's expertise by linking the swap to programme approval. Slightly understating his handling of the Icelandic government Ingves (2010, p. 3) argued that 'the Riksbank neither can nor should become involved in assessing whether or not the country is making the necessary economic adjustments.' Another issue was the Riksbank's weak mandate for financial stability even in Sweden, not to mention internationally (C. Goodhart & Rochet, 2011; Riksrevisionen, 2011).[154] For such considerations of institutional legitimacy, the

[151] Interview Riksbank officials

[152] Interview Riksbank officials

[153] Interview Riksbank officials

[154] Interview Riksbank officials

matter of ensuring that the programme came together was officially left to the political actors (Ingves, 2018, p. 13).

Many facets of the Nordic central banks' involvement with BoP support strengthen the conclusion that central banks chose to play a rather narrow and specific role by providing credit lines. Callesen's explanation of the relationship between the two suggests that this relationship between the two is rooted in a broader understanding of the significance of central bank loans compared to IMF programmes.

> '[A] swap line is something very narrow, specific, it's related to liquidity back and forth, you shouldn't interpret that as a lending arrangement. […] What it took to manage the financial crisis was much more than that […] When you accept an IMF programme […] it comes with heavy strings attached.'[155]

The IMF constituencies offered another setting where central banks and finance ministries could coordinate and affect programme design. Nevertheless, there existed a clear segmentation between what would be discussed at the political level and what would be done by central banks.

4.3 Reforming the financial assistance architecture during the crisis

This section turns to the question of whether central banks changed their approach to BoP crises based on their experiences during the GFC. The ECB's involvement on the EU level suggests that it reformed after its weak response to the crisis in CEE; the reforms at the IMF level highlight both the surprising role of CEE in reforming the IMF, but also central banks' general willingness to channel financial support through the IMF, rather than bilaterally.

[155] Interview Callesen (Danish MoF)

4.3.1 The EU's bailout system

Almost as soon as the Hungarian crisis exposed the EU's limited capacity for handling BoP crises in member states, work started on the issue of being better prepared next time. One relatively straightforward way of increasing the EU's crisis-handling capacity consisted in ramping up the volume of the MFAF. From initially €12.5bn, the EU Council increased the facility in November 2008 and March 2009 to €50bn.[156] This increase took place largely in response to the escalating crises, as especially Hungary and Romania required considerable EU funding (Kincaid, 2016). In the context of the second Romanian programme in 2011, the MFAF was also broadened to include also precautionary financing arrangements (which allowed the EU to continue demanding reforms without disbursing funds).

Growing the MFAF was however only the bare minimum that the EU could do, as the facility could only be used by member states outside the Euro Area. The Hungarian crisis also served as a wake-up call for the Commission and the ECB that something similar could befall a member of the Euro Area and that the EU had no instruments to cope with that. As soon as November 2008, a secret task force was formed to discuss the options for such a scenario, composed of high-level representatives from the Commission, the ECB, the Eurogroup, and the French and German governments (Walker et al., 2010). Soon thereafter, reports about potential Euro Area bailout scenarios became public, though the ECB, at least in public, was at first opposed to the idea (Bastasin, 2015, pp. 86–88; Reiermann, 2009).

[156] The ECB opposed the idea of giving the Commission the power to raise the ceiling of the facility unilaterally. Some voices from the OeNB had even demanded an increase to €100bn (Nauschnigg, 2009).

The ECB also had to concede that it lacked the internal capacities to run adjustment programmes.[157] An evaluation report of the ECB's Research Department, for instance, criticised that the ECB had focused its activities too much on monetary policy and econometric modelling, at the expense of financial stability. 'DG Research will have to expand its research capabilities in the areas of financial-real linkages, financial stability [and] global and intra-European imbalances' (Freedman, Lane, Repullo, & Schmidt-Hebbel, 2011, pp. 10, 13). But several interviewees noted that, while the ECB may initially have been hapless, the institution quickly learned, not least thanks to its cooperation with the Fund.[158] Klaus Masuch, the ECB person assigned to the Hungarian programme, would in 2009 head a new ECB team working on special tasks 'related to vulnerable countries and the sovereign debt crisis in the euro area.'[159] He would later head the ECB's troika delegation to Greece and Ireland in 2010. Mr. Rüffer, the ECB representative on the Latvian mission, was similarly relocated to work on the sovereign debt crisis and headed the ECB's team for Portugal in 2011 (Henning, 2017, p. 104). The crisis in Eastern Europe proved a valuable learning experience for the ECB to develop its capacities for structural adjustment programmes.

4.3.2 Central banks in the IMF reform

The reforms of the global financial safety net after 2008 provide further evidence for the clear task division between central banks and IMF loans. The funding of the IMF holds important lessons in that regard. At the G20 summit in London in April 2009, the IMF's resources were

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[157] Interview Bini Smaghi

[158] Interview ECB 1, IMF 1

[159] Interview ECB 1. Klaus Masuch | Bruegel Masuch had previously worked as Issing's assistant professor at Würzburg University and was among the German officials that Issing had brought with him to the ECB's Economics Department, Interview Berg (DNB, ex-ECB).

increased from $250bn to $750bn (Blustein, 2015, p. 9). Though some authors dispute the necessity of the measure at the time (Helleiner, 2014, pp. 35–38), the increased IMF lending capacity became necessary to finance the Fund's share in the Euro Area bailouts and was raised once more in late 2010 after the onset of the Greek crisis (Henning, 2017, pp. 158–159).

The financial crisis in Europe had a catalysing effect on the IMF quota increase because most IMF lending in late 2008 and early 2009 went to European countries. The programmes for Iceland, Hungary, and Ukraine were being negotiated during the G20 Washington summit, where the increase of IMF resources was agreed to in principle (Helleiner, 2014, p. 34); programmes for Latvia, Serbia, Belarus, Romania, and Bosnia and Herzegovina followed soon (Bakker & Klingen, 2012). Most new IMF lending by volume around that time, accordingly, went to European countries. This fact was not lost on US officials who took the view that 'Eastern Europe, it's a European problem, and the Europeans should pay for it.'[160]

Until the Obama Administration took office, European efforts to increase the IMF's firepower ran into resistance from the US that opposed changes to the IMF quotas to maintain its veto on the Fund's Executive Board. But the European constituencies and Japan moved ahead by offering bilateral credits to the IMF, which would later be converted into New Arrangements to Borrow (NAB) (Henning, 2009). The decision on the EU level was taken during the European Council in March 2009 which agreed that '[f]or specific crisis support, EU Member States are ready to provide on a voluntary basis a fast temporary support of IMF lending capacity in the form of a loan to a total amount of EUR 75 billion' (Council of the European

[160] Interview Nauschnigg (OeNB)

Union, 2009, p. 15). This contribution at once exceeded the top-up of the MFAF to €50bn agreed upon at the same meeting.

Several central bankers interviewed for this research have emphasized that the IMF is funded from central bank resources (Murau et al., 2021) and that, consequently, the bilateral credits came straight from central banks.[161] Lending to the IMF is even explicitly exempted from the EU's monetary financing prohibition of public bodies.[162] In other words, by increasing the IMF resources, the EU's central banks could ensure that the necessary funds were available without getting directly involved, but this mechanism was not 'entirely transparent' – the OeNB could sell it as a measure to strengthen the IMF to gain parliamentary approval.[163] In fact, central banks' commitments to the IMF were far larger than the bilateral credit lines that they concluded.[164] Going via the IMF was attractive for central banks since the Fund would not just set the lending conditions, but also bear the credit risk and the political responsibility for the programmes.

Another topic of international financial reform was to clarify the relationship between central bank swap lines and IMF lending. The South Korean government at the G20 summit in Seoul in 2010 pushed for a structured system for central bank swap lines instead of the ad hoc approach in 2008 (Helleiner, 2014, p. 45). Several proposals were circulated for establishing conditions for countries to be eligible for swap lines in coordination with the IMF's

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[161] Interviews Callesen (DNB), Nowotny, Naunschigg (both OeNB)

[162] Council Regulation (EC) No 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b (1) of the Treaty - Publications Office of the EU (europa.eu), Art 7. This did, however, not stop Bundesbank President Axel Weber (2009) from decrying it as monetary financing and encouraging moral hazard.

[163] Interview Nowotny (OeNB), author's translation from German

[164] Interviews Callesen (DNB), Nauschnigg, Nowotny (both OeNB)

precautionary credit line (e.g. Henning, 2015; Truman, 2011). However, the institutionalization of central bank swap lines was uneven. On the one hand, the world's leading central banks – the Fed, the ECB, the Bank of England, the Bank of Canada, the Bank of Japan, and the Swiss National Bank – set up a standing network of swap lines in 2013. But on the other hand, both the Fed (Kim & Chey, 2012) and the ECB (Dorucci & McKay, 2011, pp. 37–38) insisted on maintaining 'constructive ambiguity' as to the question of lending to other central banks, ostensibly to prevent moral hazard. After the Cannes G20 Summit concluded that 'central banks play a major role in addressing liquidity shocks at a global and regional level,' (G7, quoted in Kim & Chey, 2012) the issue ran aground.

If the reforms at the EU level have thus spurred the ECB to prepare for a more active role in future BoP crises, the reforms at the global level support the conclusion that central banks have aimed to avoid a too visible role in financial rescues or commitments to provide support. The finding that central banks saw the bilateral credits to the IMF as a substitute for additional credit lines to central banks can be interpreted as reflecting both material and normative concerns. On the one hand, lending to the IMF reduced the credit risk for central banks and ensured the enforcement of policy conditionality. On the other hand, central banks seemed generally reluctant to get officially involved in political questions of policy conditionality.

Conclusion

In financial terms, central bank credit lines and BoP assistance programmes are similar because they work by increasing the recipient's access to foreign exchange reserves. However, this chapter has found that this similarity was seldom reflected in the way that central banks related to official BoP programmes. Central banks tried to ensure that BoP programmes would be the principal way of providing financial support to distressed countries in CEE. The ECB initially abstained from participating in two out of three BoP programmes; the Riksbank made its swap

line to Latvia conditional on programme approval; and the OeNB preferred to channel funds to CEE through credits to the IMF, rather than bilaterally. Curiously, central banks often bypassed or paralleled IMF credit lines, offering credit lines that served rather narrowly defined purposes. They argued that the IMF should provide medium-term financial assistance to peripheral countries in Europe.

The argument advanced here is that this course of action was often the result of strategic choices that were often informed by norms, rather than interests. Perhaps the clearest case in this regard is the OeNB's refusal to contribute to the BoP programme in Hungary when asked to do so, despite Austrian banks' financial stakes in the country. The ECB's choice to participate only in the Latvian programme missions, but did so because of the euro adoption process, rather than any immediate threat to Euro Area stability. Lastly, the Riksbank pursued a consequent approach of asking for policy commitments in return for financial support. The resulting arrangement for Iceland was an 'IMF loan without the IMF' (Ingves, 2018, p. 10); the Latvian government had to agree to its BoP programme to receive the swap.

Conflicting institutional mandates weighed on the ECB which initially struggled to define a clear role for itself. On the one hand, it insisted on a restrictive interpretation of its primary mandate for price stability in the Euro Area, rather than taking a more expansive definition that included financial stability in the entire EU. It did not feel responsible for events outside the Euro Area. On the other hand, its role as an EU institution led it to interfere with other central banks' crisis measures and even programme design in the case of Latvia. Its stance to avoid both devaluation and euroization was at least in part motivated by its insistence on the rules of the EU's euro adoption schedule.

The Riksbank pursued a proactive approach towards financial stability in the Nordic/Baltic region. Crucial components were not just strong financial linkages, but also a consistent

strategic approach informed by Ingves' personal experience at the IMF and a role understanding of the Riksbank from its previous participation in financial rescues.[165] Both the linkage between credit lines and acceptance of conditionality and the Riksbank's efforts to co-opt their Danish and Norwegian colleagues for the Latvian loan were deliberate choices, not financial necessities.

Financial risks and the IMF's stronger expertise in BoP programmes both provided reasons for central banks to defer to the IMF instead of acting more proactively. The ECB clearly lacked expertise and the IMF was seen as adding credibility and expertise to the programmes that the central banks lacked themselves. This theme would repeat itself during the Euro Area crisis (Henning, 2017). The decision to make far more resources available to the IMF than through bilateral loans seems to have been motivated by the 'elegant'[166] idea of avoiding financial liability.

Yet, as the last section of this chapter has shown, while the crisis in CEE started new efforts at reforming the global and the European financial stability architecture, they failed to lead to a more profound change in the institutional relationship between central banks and BoP programmes. The ECB would soon involve itself far more proactively in the design of BoP programmes for Euro Area countries (Henning, 2017), but a standing network of central bank swap lines would only be set up between the leading Western central banks and remain separate from the IMF. Compared with the governance arrangements that were set up in Europe to coordinate central banks' crisis measures, central banks' involvement in IMF programmes was

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[165] One could add here the Riksbank choice to send a financial stability expert to the missions, whereas the ECB dispatched economists.

[166] Interview Nauschnigg (OeNB)

however limited. The following chapter will begin the study of central banks' collective actions by studying how they coordinated the provision of liquidity to cross-national banking groups.

Chapter 5 – Cross-border crisis management

Abstract

This chapter turns to central banks' collective actions and tackles the creation and operation of two regional arrangements for managing cross-border financial stability: the Vienna Initiative and the Nordic/Baltic Stability Group. Both these arrangements were based on flexible and inclusive institutional settings that offered space for learning. The chapter, therefore, argues that these regional crisis management settings need to be understood not just as an effort to maintain regional stability, but also as redefining various actors' responsibilities and perceptions of appropriate action. Both ideational changes and institutional leadership were required to enable this resolution of the crisis.

Introduction

Cross-border banking is a longstanding concern of central banks' international cooperation. Since the 1970s, central banks have elaborated rules and principles regarding the regulation of internationally operating banks, for instance in the framework of the Basel Committee (C. Goodhart, 2011; Helleiner, 1994; Kapstein, 1992). The crucial challenge of international crisis management consists in coordinating regulatory responsibilities towards cross-border banks to ensure that all parts of the group have sufficient resources or are resolved in an orderly fashion (Claessens, Herring, & Schoenmaker, 2010). As this chapter shows, though this is traditionally a matter for central banks, in practice the resolution of the crisis in Europe required the coordination of many other actors besides them.

The context of the GFC in Central and Eastern Europe (CEE) is particularly instructive for learning about international crisis management. The successful resolution of the crisis there came as a surprise to many observers (Krugman, 2008; The Economist, 2009). Many feared that foreign banks would withdraw from peripheral countries and that regional financial contagion could ensue as a result, leading to a regional financial breakdown. But none of these doom scenarios materialized. Regional policymakers managed to ensure that banks maintained their exposure, that national 'ringfencing' was reined in to allow liquidity to be distributed

across the region, and that a clear distribution of responsibilities between home and host authorities was agreed upon. This coordination between national authorities and cross-border banks is hailed as a rare success story (Bakker & Klingen, 2012; Kudrna & Gabor, 2013; Mabbett & Schelkle, 2015).

In the patchy financial supervisory context of Europe at the time, none of these successes was a foregone conclusion. Cross-border crisis management revolved around the Vienna Initiative (VI), a newly created public-private forum for supervisory cooperation, and informal cooperation in the Nordic/Baltic region which resulted in the creation of the Nordic/Baltic Stability Group (NBSG). For the first time, these formats brought together central banks and financial supervisors to coordinate on the issue of regional financial stability, as opposed to previous cooperation on bilateral financial linkages.

Many accounts attribute the resolution of the crisis to material interests and successful bargaining in the VI which compelled foreign banks to maintain exposure (Åslund, 2010; Bakker & Klingen, 2012; Blyth, 2013; R. De Haas et al., 2012; Kudrna & Gabor, 2013; Mitra et al., 2009; Pistor, 2011, 2015). Rachel Epstein (2017) has, contrarily, argued that the VI was largely the derivative of banks' business models, intended to send a signal to markets and obtain public support. Both these accounts interpret VI based on its consequences, primarily as a setting that served to elicit policy commitments, from both the banks and national authorities.

The argument advanced in this chapter argues, by contrast, that successful crisis management reflected changing perceptions of appropriateness. The VI marked the culmination of a shift in perceptions that had led exposed central banks to recast their national interest in regional terms. Cooperation between policymakers happened mostly outside official institutional channels and relied instead on informality and collective problem-solving. The formulation of new regulatory principles and the coordination between banks and national authorities reflected changing

norms for international crisis management. Overall, the findings in this chapter support the theoretical argument that cross-border crisis management can best be understood as based on deliberation and collective learning, rather than bargaining.

In the remainder of the chapter, the following empirical points are developed. Section 5.1 provides the requisite background about financial market integration in CEE before the GFC and central bank cooperation before the crisis and highlights the gaps in the EU's institutional architecture. Section 5.2 takes three sub-sections to review the formation that led to the VI. Section 5.3 then provides the comparison of central bank cooperation in the Nordic/Baltic region that led up to the formation of the NBSG. The final section offers some preliminary conclusions.

5.1 Background

5.1.1 Financial market integration in CEE

Two broad trends characterized financial markets across CEE before the GFC. First, the region stood out for its high level of foreign bank ownership. In the late 1990s and early 2000s, West European banking groups had bought up many regional banks in the context of privatization and financial crises during the economic transition (Iwanicz-Drozdowska, Bongini, Smaga, & Witkowski, 2018). By 2008, about two-thirds of all financial assets in the EU's new member states, between 29% and 98% in individual countries, were owned by foreign banking groups (EBRD, 2009). Second, a high share of loans to households and businesses was denominated in foreign currencies. As a result, banks would often obtain funding from abroad for their overall liquidity management and local monetary policy would be less effective. In combination, foreign bank ownership and foreign currency lending meant that West European parent banks and their home authorities would have considerable control over liquidity conditions across CEE.

Foreign bank ownership in the Baltic states was highly concentrated among Swedish banks. Skandinaviska Enskilda Banken (SEB) and Swedbank controlled an 80% market share in Estonia, 60% in Latvia, and 55% in Lithuania (Ingves, 2010, p. 1). Much of the remaining market shares were controlled by Danish Danske Bank, Norwegian DNB, and Sweden's Nordea. For SEB and Swedbank, the Baltic states had become part of their core business, and their exposures accounted for 13% and 16% of total group assets. In Central Europe, foreign bank ownership was more dispersed. Relative to national GDP, Austrian banks had the largest exposure (Ong & Maechler, 2009) but Belgian, French, German, and Italian banks also had operations (R. de Haas & Naaborg, 2005, p. 4; Naaborg, 2007).[167] Often individual banks operated only in a few countries, though Austrian banks had diversified their activities across the region (Árvai et al., 2009; Ong & Maechler, 2009).

The position of the East European central banks was additionally weakened because of their monetary policy frameworks and banks' lending practices. In the Baltic states, the central banks' narrow currency pegs prevented them from providing great amounts of additional liquidity. In Central Europe, the wide use of foreign currency loans eroded local central banks' room for action, especially in Hungary where they accounted for 45% of all loans. Poland and Romania had lower, but still considerable levels of foreign currency loans, at 16% and 22%, respectively.

Banks' business models suggested that they had a long-term commitment to the region. Their business strategies were dubbed the 'second home market' (R. A. Epstein, 2014, p. 862) and focused on retail business, which has far longer time horizons than corporate loans, and their

[167] Bonin and Louie (2017) single out Erste, Intesa Sanpaolo, KBC, Raiffeisen, Société Générale, and UniCredit (which took over Bayerische Landesbank and CreditAnstalt together with their Central European portfolios) as the 'big six' banks who had set up a 'second home market.'

funds were tied up in illiquid loans which they could not call quickly during a crisis (Mitra et al., 2009). When Erste Bank, for instance, expanded to CEE with its retail banking model, this was perceived as a larger commitment than Raiffeisen's investment banking because retail banking had a longer time horizon.[168] The by far prevalent business structure was that foreign banks operated through subsidiaries, that is self-standing legal units, rather than branches. However, the parent groups often allocated capital and liquidity (especially in foreign currency) through a central treasury and most subsidiaries relied heavily on funding from the parent banks which meant that they practically operated akin to branches (R. de Haas & Naaborg, 2005; R. de Haas & van Lelyveld, 2010).[169]

This degree of financial integration and banks' business models were at odds with the neat task division between home and host authorities envisaged under EU legislation (Dermine, 2006; Persaud, 2010; Schoenmaker, 2013). Under EU rules, the host authority would be responsible for liquidity provision to subsidiaries whereas branches would still have been considered as part of the parent's operations, putting the home authorities in charge (Pistor, 2010). With banks' hybrid business models, it was unclear which central bank would ultimately be responsible for maintaining stability. An IMF report concluded, for instance, that 'the lender-of-last-resort function in Europe cannot be disentangled from the overall architecture for financial stability' (Teixeira & Schinasi, 2006, p. 17). A working group of Nordic central bank officials concluded that some core issues of home-host coordination were not resolved on the eve of the GFC:

> 'How should the authorities approach a request for either liquidity or capital support to a group in a crisis situation? And were the subsidiaries stand-alone entities that could be ringfenced from the group and solved domestically in a crisis?' (RCG for Europe, 2016, p. 8).

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[168] Interview Wohlmuth (Erste)

[169] Though some banks, for instance Erste Bank, strove to maintain a 100% loan-to-deposit ratio in their subsidiaries, which meant that those would in principle self-standing. Interview Wohlmuth (Erste Bank).

Somewhat surprisingly, the central banks in CEE did not perceive their loss of control over funding conditions as a weakness. Already in the years before the crisis, they were confident that the parent banks would remain committed to their subsidiaries in a crisis. Parent banks had often signed 'Patronatserklärungen' (letters of confidence) in which they promised to stand by their subsidiaries (Altmann, 2006; R. De Haas & Naaborg, 2006). Furthermore, there existed strong reputational incentives not to abandon a subsidiary because that would reflect negatively on the parent group. The exceptional case of Bayerische Landesbank abandoning Rijecka Bank in Croatia is widely quoted as a cautionary tale (Barisitz, 2005; R. De Haas & Naaborg, 2006).

Though the local central banks would formally be responsible to act as lenders of last resort for subsidiary banks, the policymakers assumed that the parent banks would take over that role. Indeed, some central banks, for instance, the Polish and the Czech ones, expressed already before the crisis that they expected the parent banks to maintain exposure (R. de Haas & Naaborg, 2005). Hungarian policymakers were similarly sanguine. As late as June 2008, MNB Governor Andras Simor (2008) cautioned his colleagues of the risks that foreign banks might re-allocate their funds across the group but did not even mention the possibility of foreign banks abandoning their operations. His deputy governor Julia Kiraly recalled that 'we have not assumed at all those foreign banks would reduce their exposure.'[170] Estonian policymakers perhaps went farthest by officially acknowledging that they saw outsourcing bank ownership as a way to ensure domestic stability.[171]

On balance, the high degree of financial market integration posed some problems about which central bank would have the legal responsibility and the financial wherewithal to provide

[170] Interview Király (former deputy Governor MNB)

[171] Interviews Kivine (Estonian MoF), Ross, Sutt (all Bank of Estonia)

emergency liquidity during a crisis. Concretely, the EU's regulatory principle of home authority primacy was at odds with the operational practice of financial integration and left considerable uncertainty about what would happen in the event of a liquidity crisis (Dermine, 2006). Though technically the host authorities would be responsible for subsidiaries, in practice, external funding for most banks, especially in foreign currencies came from foreign parents. Implicitly it was assumed that to support their 'second home market,' the parent banks would ultimately rely on their home central banks – the ECB or the Riksbank – as a liquidity backstop.[172]

5.1.2 Cross-border cooperation in Europe before the crisis

Central bank cooperation before the crisis did little to resolve the ambiguities that resulted from the dense integration of financial markets. The most pressing issue when it came to cross-border banks was to ensure a smooth and regular exchange of supervisory information to be able to monitor risks in different parts of a group and coordinate crisis measures.

Work towards a European framework for crisis cooperation had progressed slowly and was largely based on soft law agreements, so-called Memoranda of Understanding (MoU). National banking supervisors had often signed bilateral MoUs on crisis management for specific banks (Altmann, 2006), but this would be insufficient for regionally operating banks. In 2003 the first EU-level 'Memorandum of Understanding on High-Level Principles on Co-operation between the Banking Supervisors and Central Banks of the EU in Crisis Management Situations' was signed (European Central Bank, 2006b). The same year, the Nordic central banks who had a keen awareness of cross-border risks (Evanoff, Kaufman, & LaBrosse, 2007) concluded an

[172] Interview ECB 1

MoU on the 'Management of a financial crisis with cross-border establishments' (Danmarks Nationalbank, 2003; RCG for Europe, 2016, p. 22).

Crisis exercises were used to test the robustness of these frameworks. But these efforts left however many disagreements over public recapitalization and the desirability of ringfencing subsidiaries unresolved (RCG for Europe, 2016, p. 22). During a Nordic/Baltic crisis exercise in 2007 for instance, the Icelandic central bank refused to reveal whether it would act as lender of last resort for its banks (Gissurarson, 2018). After an EU-level crisis exercise in late 2007 an MoU on cross-border financial stability with no less than 113 signatory parties (central banks, finance ministries, financial supervisors, and others) was signed in June 2008 (Berglöf, Gulde-Wolff, Nagy-Mohasci, & Wieser, 2019, p. 58; European Central Bank, 2008e).

However, there are few indications that the preparatory work done at the EU and Nordic/Baltic levels played any role during the crisis. Several interviewees agreed that the procedures outlined in the MoUs proved all but irrelevant in practice.[173] MoUs are voluntary, non-binding agreements and the texts remained vague on details regarding information sharing. MNB deputy governor Kiraly recollects that 'nobody read, ever, the MoU.'[174] Baltic and Nordic policymakers granted that the MoUs were at least helpful for creating trust and personal relationships between officials.[175]

Central banks' limited statutory competencies for financial stability represented one impediment to more effective cooperation. They were often tasked with maintaining systemic financial stability but lacked access to individual banks' supervisory data. The ECB's mandate

[173] Interviews Callesen (Danish MoF), Király (MNB), Papadia (ECB), Wieser (Austrian MoF)

[174] Interview Király (MNB)

[175] Interviews Callesen, Sutt (Bank of Estonia)

only requires it to '*contribute* to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system' (European Central Bank, 2002). Within the European System of Central Banks, each national central bank, such as the Bundesbank or the Banque de France, would be responsible for emergency liquidity provision to banks within its jurisdiction. Sveriges Riksbank did not even have an explicit mandate for financial stability – the Riksbank subsumed this responsibility under its task for the operation of the payment system (C. Goodhart & Rochet, 2011). Similar to the ECB, the Riksbank and Danmarks Nationalbank (the Danish central bank; DNB) also lacked official access to individual banks' balance sheets (C. Goodhart & Rochet, 2011, p. 30; Rangvid, 2013, p. 172). The authorities charged with liquidity provision thus had a blind spot for financial supervision and lacked detailed data and the formal responsibilities and instruments to assess risks.

A second impediment was more intellectual and consisted in grappling with the supervisory challenges of cross-border banks. The 2008 EU-level MoU 'prepared for the wrong crisis' because it foresaw the failure of an individual bank but underestimated systemic financial stresses.[176] Other important considerations only appeared on the agenda briefly before the crisis. The Nordic central bankers (RCG for Europe, 2016, p. 22) acknowledge that the issue of cross-border burden-sharing was only brought onto the agenda after the economists Charles Goodhart and Dirk Schoenmaker (2006) presented an academic paper at the Riksbank in 2006 (RCG for Europe, 2016, p. 22). Despite banks' regional expansion, most crisis preparation focused on bilateral cooperation.

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[176] Interview Callesen (Danish MoF)

Among the 'very few'[177] European policymakers who identified the risks related to cross-border banking ahead of the GFC were Klaus Regling, the Director General at the European Commission's DG Economics, and his advisor Max Watson. Both had worked at the IMF during the Latin American and East Asian financial crises and had first-hand experience with financial contagion. In Mr Regling's telling,[178] they saw the credit risks building up in Eastern Europe in 2006 and visited Stockholm and Vienna to warn of banks' overextension. In Sweden, Mr Regling's intervention aligned with warnings that the Riksbank had issued about banks' exposure to the Baltic states since 2005 (Johansson et al., 2018), but brushed up against Finansinspektionen's (the financial supervisor) approach of assessing risks based on individual loan data (C. Goodhart & Rochet, 2011, p. 18; Riksrevisionen, 2011). Among Austrian policymakers, Mr Regling's intervention created an acute sense of awareness of the risks related to regional exposure. Previous Austrian stress tests had taken a 'silo approach'[179] to their international exposure and assessed country risks based on bilateral exposures, without possible regional effects. Shortly after Mr Regling's visit, in late 2007, the OeNB published the results of its first stress test that assumed a correlation between country shocks across all of Eastern Europe (Boss, Krenn, Puhr, & Schwaiger, 2007). After the OeNB had long been cavalier about Austrian banks' activities in CEE, it now took Austrian banks' regional exposure more seriously.[180]

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[177] Interview Wieser (Austrian MoF)

[178] Interview Klaus Regling (former Director General, DG ECFIN, European Commission)

[179] Interview Wieser (Austrian MoF). Wieser listed three concrete beliefs that Regling challenged: 'First, everything is regarded as sitting in a silo; there is no correlation. Second, there is no cross-border effect. Third, the Euro Area is the Euro Area and everything outside it will only be transmitted via the exchange rate and the rest is up to the member states.' (author's translation from German)

[180] Interviews Nauschnigg (OeNB), Wieser (Austrian MoF), IMF 2

Yet, it took some time until policymakers linked their assumption that parent banks would not simply let their CEE subsidiaries fail to the possibility that they might be on the hook for regional crises. These incremental intellectual changes towards acknowledging regional financial risks were soon overtaken by events when the crisis erupted in October 2008.

5.2 The Vienna Initiative

The VI, created in 2009, was an ambitious new governance body aimed at reshaping the institutional norms that underpinned regional financial governance. It offered a framework where various actors, including banks, national authorities, and supranational institutions could coordinate their approaches to the financial crisis in CEE. This section argues that the VI was ultimately driven by public actors and that it had as its main concern the provision of cross-border liquidity. After the understanding that Austrian banks were regionally exposed had taken hold, the OeNB and other Austrian authorities pushed Austrian parent banks to take the lead and coordinate with their competitors. This account challenges prior work by Pistor (Pistor, 2011) who has identified the European Bank for Reconstruction and Development (EBRD) as an 'anchor tenant' and Epstein (Deuber & Epstein, 2019; R. A. Epstein, 2017) who stresses West European banks' own interest and agency in setting up the Vienna Initiative as a signal to other financial market participants, rather than each other, that CEE would remain stable. According to the interpretation proposed here, the VI functioned as a forum for collective learning and trust-building between national authorities (facilitated by the EBRD and the IMF's expertise), rather than a commitment device for banks. Lastly, the limited engagement of the ECB and the initial refusal to participate by several national authorities highlight that the VI framework struggled to gain acceptance, not least because it was seen as serving Austrian interests.

5.2.1 The parent banks' initiative

When the financial market panic spread to CEE in October 2008, there existed no multilateral framework for coordination between regionally operating banks and home and host authorities. Indeed, the first set of crisis responses were ad hoc measures with a national scope. It took the initiative of both public and private actors from Austria to set up what would eventually become the Vienna Initiative.

The first instance when foreign banks signalled their commitment to a host jurisdiction was in October 2008. After Hungarian money markets had collapsed on October 10, central bank governor Simor summoned the local representatives of the seven largest banks – local OTP and six foreign bank subsidiaries[181] – who on October 17 expressed their confidence and promised they would maintain lending (Magyar Nemzeti Bank, 2008). Just a week after the outbreak of the crisis, the Hungarian authorities were publicly assured that the foreign banks would maintain their exposure and this promise is also referred to in its Letter of Intent (LOI) to the IMF (International Monetary Fund, 2008a, p. 4).

The quick pronouncements of the parent banks were facilitated by the prior understanding that they would remain committed to the region. The largest West European parent banks in the region had already in September started to 'liaise' to support financial market conditions in CEE (Stepic, 2019, p. 100). The coordination among the banks was led by the Austrian bank Directors Herbert Stepic of Raiffeisen, and Andreas Treichl of Erste. But several sources have confirmed that the OeNB had put considerable informal pressure on the Austrian banks to initiate this coordination and ensure that all major parent banks maintain support for their

[181] The parent banks of the subsidiaries were Bayerische Landesbank Erste, Intesa, KBC, Raiffeisen, and Unicredit

subsidiaries (Stepic, 2019, p. 100).[182] This response to the crisis reflects how much the OeNB had come to accept the warnings about banks' regional exposure. One OeNB official provided three reasons for why the OeNB would encourage its banks to initiate this cooperation: ‘self-interest, stability of the parent banks, and [preventing] contagion.’[183]

Several participants and observers of the VI have argued that the initial objective was to prevent commitment problems and ‘prisoner dilemmas’ where whoever cut their exposure first would have to bear the smallest losses.[184] But given how quickly the banks agreed on joint action it seems that the commercial banks had taken little time to assure one another that they would all remain.[185] Instead, the banks soon coordinated actions in their collective interest by signalling to their home authorities that they would remain committed and to other market participants that foreign parents would behave responsibly in CEE, in line with Rachel Epstein’s (2017) findings.[186] In early November Raiffeisen hosted a meeting where the parent banks, together with the EBRD and the European Investment Bank (EIB), agreed on further steps to contribute to financial stability in CEE. The banks pursued several shared objectives, including ensuring sufficient support for local liquidity conditions from host central banks and liquidity support from the ECB and International Financial Institutions (IFI), including the EBRD and the EIB (Stepic, 2019, p. 101).

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[182] Interviews IMF 2, Nauschnigg (OeNB), Piroska Nagy-Mohásci (EBRD), Wieser (Austrian MoF), Wohlmuth (Erste Bank)

[183] Interview Nauschnigg (OeNB), translated from German

[184] Interviews Nagy-Mohásci (EBRD), Nowotny (OeNB), Wieser (Austrian MoF)

[185] Interview Wohlmuth (Erste Bank)

[186] Interview Wohlmuth (Erste Bank)

The result of this coordination was a letter, dated 27 November, that the CEO's of Erste, Intesa, KBC, Raiffeisen, Société Générale, and Unicredit sent to the European Commission and Christine Lagarde, the French Finance Minister chairing the ECOFIN Council (Treichl et al., 2008). This letter, which was largely drafted by Stepic and Treichl,[187] focused on banks' grievances regarding access to foreign currency liquidity in CEE. The core passage reads:

> 'Therefore, we, European banks operating in NMS [New Member States] and CC [Candidate Countries], call "to act together" with the European Central Bank and national authorities (governments and central banks) to take the lead to implement measures which provide additional sources of funding so that stable credit is provided to the economy' (Treichl et al., 2008, p. 3).

Yet the response from the Commission was only lukewarm (Berglöf et al., 2019, p. 59). Though the letter raised awareness of the problem, policymakers were unsure of what to do and at first, did not take up the initiative.[188]

In the following weeks, the initiators raised the profile of their coordination, and several other banks joined the initiative. In January 2009, a total of nine banks, the original six, plus SEB and Swedbank, as well as Greece's Eurobank, sent out another joint letter to secure more liquidity support, this time to the ECB and their home and host central banks (Würfel & Atroszczak, 2019, p. 226). Concretely, the banks proposed in that letter that the ECB provide swap lines to CEE central banks, accept local currency bonds as collateral, and open direct credit lines for Euro Area banks' subsidiaries.[189] But on the same day the banks sent their letter, Yves Mersch, Luxembourg's central bank governor and a member of the ECB's Governing Council[190] gave an interview with the Financial Times in which he insisted that banks' financial risks in Eastern

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[187] Interview Wohlmuth (Erste Bank)

[188] Interview Wieser (Austrian MoF)

[189] The letter is reproduced in EIB, 2019, p. 238.

[190] The ECB's Governing Council is composed of the six members of the Executive Board and the Governors of the National Central Banks.

Europe were an issue for financial supervision, not the ECB (Atkins, 2009). It could provide liquidity to the parent banks, but it would not backstop capital risks from foreign operations.[191] The banks' initiative may have increased awareness of the financial problems in CEE and signalled that the banks had no intention of leaving (R. A. Epstein, 2017, pp. 71–76), but on its own it failed to elicit additional support for regional coordination from either the Commission or the ECB.

5.2.2 The VI as an institution-building effort

Whereas the banks' efforts to mobilise support from EU institutions ran aground, other efforts at cooperation among public actors took place in parallel and led up to the first meeting of the VI in January 2009. After Thomas Wieser, the Austrian deputy finance minister and vice-president of the EU's Economic and Financial Committee (EFC), had unsuccessfully attempted to convince the European Commission to coordinate with banks and public authorities, he found more support from Piroska Nagy-Mohácsi, the Director for Policy at the EBRD when they met at a conference in early December 2008 (Vienna Initiative, 2012). Ms Nagy-Mohácsi and Mr Wieser discussed that 'the banks raised the problem […] that there was not, not enough foreign liquidity, but of course that was only part of the problem.'[192] The bigger, systemic threat they both mentioned was that the banks would withdraw from the region.[193] They agreed to organise a 'coordination conference.'[194] Mr Wieser used the 'convening power' of the Austrian Finance

[191] Interview ECB 1, Nauschnigg (OeNB)

[192] Interviews Nagy-Mohásci (EBRD),

[193] Interviews Nagy-Mohásci (EBRD), Wieser (Austrian MoF)

[194] Interviews Nagy-Mohásci (EBRD)

Ministry[195] to set up a meeting and the EBRD, and soon also the IMF, used their standing to gain support for coordination from national authorities.[196] The first meeting in Vienna involved the finance ministries, central banks, and sometimes financial supervisors from six home and seven host countries.[197] The EBRD, ECB, EIB, European Commission, IMF, and the World Bank also participated.

During the meeting, the participants agreed to further steps. At first, they made a deliberate decision to maintain an informal structure for the VI meetings. The initial idea of forming a creditors' group modelled on the Paris Club[198] was dismissed because, as Ms Nagy-Mohásci remembers 'we realised that that was too formalised and […] carrying an involuntary nature, […] the obligatory part of engagement.'[199] Participation in the VI would have to be voluntary and non-binding.

For the next meeting, it was decided that the VI would need to clarify institutional responsibilities for ensuring financial stability. The initial objectives, according to the EBRD, were not just to send a signal to market participants, but also to overcome collective action problems ensuring that national authorities and banks would act in the interest of regional stability (Nitsche, 2010). The IMF, which was seen as the primary authority regarding international financial crises, assumed the responsibility for proposing a revised task division

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[195] Interview Nagy-Mohásci (EBRD)

[196] Interviews IMF 2, Nagy-Mohásci (EBRD)

[197] Albania, Bulgaria, Croatia, Hungary, Romania, Serbia, and Ukraine; Austria, Belgium, France, Germany, Greece and Italy (Nitsche, 2010)

[198] A global institution where officials from creditor countries help overburdened debtor countries: Club de Paris.

[199] Interview Nagy-Mohásci (EBRD)

between home and host authorities.[200] The ‘Vienna principles’, for liquidity provision and stress testing were presented at the second VI meeting in March 2009 (Hardy, 2009).[201] He proposed that the host authorities had to conduct responsible macroeconomic policies and ensure local currency liquidity for local and foreign banks without discrimination, whereas the home authorities and the parent banks would have to ensure foreign currency liquidity and the solvency of subsidiaries (Berglöf et al., 2019, p. 63). These Vienna principles represented a clear departure from the EU’s official pre-crisis framework.

A second concern was to consider liquidity distribution across CEE, rather than individual countries. After Austrian policymakers had recast financial stability in regional, rather than bilateral terms, they needed to ensure that these efforts would be supported by the host authorities, too.[202] Foreign banks had already bilaterally committed to their subsidiaries in Hungary, but it was still possible that they might reallocate intra-group resources to meet these commitments and thereby destabilise operations elsewhere.[203] In February 2009, a delegation of senior Austrian policy-makers visited Bulgaria, Croatia, Romania, and Ukraine to communicate that they would put pressure on Austrian banks to maintain exposure, but urged the host authorities to behave responsibly, too.[204] Their objective was to raise awareness of the regional scope of the crisis and prevent liquidity ringfencing that could undermine effective liquidity distribution across the region (Nitsche, 2010).

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[200] Interview Nagy-Mohásci (EBRD)

[201] Interview Daniel Hardy (IMF)

[202] Learning effects among Austrian policymakers were emphasized by Wieser (Austrian MoF), IMF 2

[203] Interview Nagy-Mohásci (EBRD)

[204] Interview Wieser (Austrian MoF)

When it came to coordination between the IFIs, the EBRD, the EIB, and the World Bank Group, on 17 February announced the Joint IFI Action Plan (JIFIAP), under which they promised to disburse €24.5bn over the next two years to 'support foreign banks maintain their exposure' (M. Allen, 2019, p. 16).[205] Over the spring of 2009, they held meetings with West European banking groups to assess their funding needs and subsequently provided both liquidity and capital support to parents and subsidiaries. Unlike the ECB, the EIB was ready to support both parent banks and their subsidiaries directly and accept collateral in local currency.

While the VI had some success in facilitating cooperation among its participants, these were, however, not uniform. Though the European Commission eventually became a supporter of the initiative, its efforts in the field of banking resolution (which was back then still handled as part of competition policy) were not always supportive.[206] For instance, Bayerische LB could not commit the exposure to its Hungarian subsidiary because of the Commission's state aid investigation into its recapitalization by the German state (R. A. Epstein, 2017, p. 52).[207] The VI also had relatively limited input from the two central banks that issued the most important foreign currencies in the region. After the ECB had brushed off the banks' call for support, it insisted it would only participate in the VI as an observer. ECB representatives at the first meetings showed understanding of the problems in CEE,[208] but they signalled readiness to act

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[205] They ended up providing €33bn, both as capital and liquidity, to 17 banking groups by end-2010 (M. Allen, 2019, p. 16).

[206] Interview Nagy-Mohásci (EBRD)

[207] However, a representative of Bayerische LB did take part in the discussions on commitment letters to Hungary and signed the letter with a disclaimer, Interview Király (MNB), European Banking Group Coordination Meeting for Hungary, Concluding Statement by Participating Parent Banks (imf.org)

[208] Interview Király (MNB)

only to the degree that the financial stability of the Euro Area was at stake.[209] The SNB was not invited to participate,[210] even though most foreign currency loans in Hungary and Poland (as well as smaller shares in Croatia and Romania) were denominated in Swiss francs (Yesin, 2013). This limited participation suggests that the VI was indeed more focused on financial supervisory issues than monetary policy cooperation.

On the other hand, participation among the CEE countries was also limited in the beginning and various countries participated only partially or not at all in the VI despite a high share of foreign bank ownership (M. Allen, 2019, p. 13). Host countries without a serious financial crisis would sometimes prefer to maintain national policy autonomy rather than enter commitments in the regional interest. The Czech National Bank and the Polish financial supervisor both preferred to be able to act against foreign banks (Cerutti et al., 2010).[211] While these central banks informally told their colleagues in advance that they would ringfence[212] their decisions went against the idea that parent banks should be free to allocate resources across the region.[213]

Some interviewees also expressed scepticism towards the VI because they saw it as mostly serving the interests of Austrian banks. The Polish authorities viewed the VI with suspicion and feared that it aimed to 'increase the influence of Austria in the region.'[214] According to an Estonian policymaker, the VI 'seemed to be a moral hazard. […] [W]e think […] the IFIs are

[209] Interview Wieser (Austrian MoF)

[210] Interview Brown (University of St.Gallen), Nagy-Mohásci (EBRD)

[211] Interview Kluza (KNF)

[212] Interview Király (MNB)

[213] Erste Bank's Czech subsidiary Sporitelna had been the group's 'cash cow' before the crisis, thus the Czech decision to limit the payout of dividends proved a setback, Interview Wohlmuth (Erste Bank).

[214] Interview Kluza (KNF)

vehicles of the EU to be used to bail out the Austrians or the other interests in the crisis.'[215] Though most host countries would eventually participate in the VI,[216] in the beginning, the VI struggled to gain broader recognition as serving regional interests.

5.2.3 The VI as a model of norm-based governance

The VI's success consisted not so much in the formal commitments that it elicited, but rather in providing a forum for deliberation and collective learning among various actors. It was constantly re-defined by its participants and resulted in an informal and non-hierarchical structure.

Observers (Pistor, 2011, 2015) and participants[217] of the VI link its success to its informal character. The VI was from the onset open to public and private actors and to host authorities from within and outside the EU. After it had started with the participation of six parent banking groups, by mid-2009 seventeen banks took part. The presidency of the VI was passed on between different institutions: after Austria's Thomas Wieser chaired the meeting in January 2009, the first full forum in May was presided over by EBRD president Philip Mirow, and Sean Berrigan of the European Commission led the second full forum in September.[218] While the EBRD hosted the VI's secretariat, this rotation mechanism suggests that the broad ownership

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[215] Interview Kivine (Estonian MoF)

[216] In fact, Polish central bank governor Marek Belka in 2012 became the first Chairman of the VI Steering Board

[217] Interview Nagy-Mohásci (EBRD), IMF 2, Wieser (Austrian MoF)

[218] The eventual location was also contested as the European Commission argued the forum should take place in Brussels and insisted it be renamed the 'European Bank Coordination Initiative' or EBCI; IMF Managing Director Strauss Kahn would have liked it to be in Paris. In the end, the name Vienna Initiative prevailed, though the location still changes every year. Interview IMF 2

of the VI was reflected in its governance from the beginning, rather than revolving around an anchor tenant.

The eclectic participation in the VI overcame some rigors of the EU's institutional framework, which separated central banks' and financial regulators' meetings and foresaw no formal role for private banks. The VI format, both with its full-forum meetings and the country-specific meetings, was therefore innovative in several regards. First, the full forum served as a multilateral platform that brought together various actors that would not have sat around the same table in the EU's committee structure. Participation in the VI was from the start open to non-EU member states. There had previously not been a format where home and host policymakers and cross-national banks could coordinate (Stepic, 2019, p. 102). The objective of the full forum was expressly to look at financial stability as a regional issue and establish a common reference framework among all actors with the input of the EBRD and the IMF.

Second, five 'country meetings' were held for some countries with IMF programmes. In three instances, namely the meetings for Romania and Serbia in March 2009, and Bosnia and Herzegovina in June, banks' commitment letters were part of the negotiations for a BoP programme. Whether banks observed their exposure commitments was monitored as part of the programmes. By contrast, the parent banks' commitment letters to Hungary in May and Latvia in September were signed as the situation was already improving. After late 2009, the exposure limits were lowered to allow banks to adjust to falling credit demand (Bakker & Klingen, 2012, pp. 85–86).

Whereas the formal commitments made under the VI helped reassure host governments, they did not impose obligations on them that went beyond the terms of the IMF agreements. Indeed, parent banks' continued exposure was made contingent on governments' compliance with the

bailout terms.[219] Overall, however, the added value of the early VI likely cannot be found in the formal commitments that it elicited from the banks or host authorities. Host authorities only needed to comply with their financial assistance programmes, even if Nitsche (2010) argues that banks were co-opted as enforcers because their exposure was contingent on compliance with the bailout terms. Conversely, almost all banks lived up to their commitments even though those were informal and did not include any sanction mechanism for defectors.

The VI was thus not just a bargaining arena – it provided a platform for discussion and deliberation that allowed stakeholders to formulate, and act in, the interest of regional financial stability. Its 'ground rules were simple but powerful: open discussion among all relevant stakeholders; publicity about commitments made; and trust and authority bestowed to the IFIs' (Berglöf et al., 2019, p. 63). The VI helped create trust between banks and central banks and supervisors;[220] it helped establish a broadly accepted framework for home/host task divisions and stress-testing exposures of cross-national banks; and finally, it helped its participants recast financial stability in CEE as a regional, rather than a bilateral issue. To illustrate, when VI participants bargained over whether parent banks should maintain 95% or 97% of pre-crisis exposure, they had already accepted that such agreements would be made with an eye to regional stability. Regular monitoring created both reputational and financial incentives for banks and host countries to act in a wider regional interest.

In sum, whereas the VI was initiated out of pressing concerns over regional financial stability, it laid the foundation for an adaptive regional financial crisis management framework that went beyond national interests. But the VI outlasted the financial crisis and both its objectives and

[219] Thus, when Hungary's newly elected government in 2010 decided to exit its IMF/EU programme prematurely, this also set foreign banks free to reduce their exposure faster (Király, 2019, p. 122, 2020).

[220] Interview Király (MNB)

its institutional structure were updated after 2009. Its successor, called VI 2.0, functioned as a framework for tackling wider issues of macroprudential policy coordination and is discussed in the next chapter.

5.3 Liquidity cooperation in the Nordic/Baltic region

In the Nordic/Baltic region, the functional challenge of providing cross-border liquidity was similar to what the VI had to tackle in Central and South-Eastern Europe. Yet, the structure of the regional financial markets was simpler, given that just two Swedish banks controlled most of the banking markets in the Baltic states, and fears of the Swedish banks abandoning their subsidiaries were less acute than in Central Europe. Nevertheless, the financial crisis required increased cooperation between central banks, which in 2010 was formalized in the Nordic/Baltic Stability Group, the first regional cross-border stability group in the EU (Keereman, Kosicki, & Weidinger Sosdean, 2019a; Riksbank, 2010).

The Swedish parent banks were indispensable for financial stability in the Baltic states. Owing to their hard currency peg or currency board arrangements, the local central banks would be all but unable to provide any liquidity to the local financial sector.[221] Yet, there was little doubt that the Swedish banks would backstop their subsidiaries instead. Both banks' CEOs had already in 2008 publicly expressed their long-term commitments to the Baltic region (Collier, 2008; SEB, 2008) and reiterated these commitments as part of the Latvian bailout package (International Monetary Fund, 2009d, p. 13). While the Baltic subsidiaries had already relied heavily on their parents before the crisis, throughout 2009, their parent banks ended up providing almost all their external funding. In Latvia, for instance, the Swedbank subsidiary

[221] However, Bank of Latvia did provide some liquidity to the failing local bank Parex

operated a ‘centralized external financing strategy’ and relied on its parent for 98.85% of total funding in 2009 (Swedbank, 2009, p. 21).

If financial stability in the Baltic states depended on Sweden, the inverse was also true. The Riksbank saw financial stability in the Baltics as critical for domestic stability (Ingves, 2010; Riksrevisionen, 2011). Whereas Sweden avoided a domestic banking crisis, negative rumours about SEB’s and Swedbank’s potential losses in the Baltics made it more difficult for these banks to obtain market funding. Swedish policymakers sought to reassure markets that they would stand behind their banks. In January 2009, Finance Minister Anders Borg stated for instance ‘[w]e have declared to our banks that they are supposed to behave responsibly — to perceive these Baltic countries as their home market’ (Dealbook, 2009). The Riksbank backed up these promises in February by providing medium-term dollar funding to allow its banks to support their Baltic operations(Leung, 2020, p. 21). The Riksbank had assumed a barely implicit responsibility for systemic liquidity in the Baltic states (Riksrevisionen, 2011, p. 11).

Cooperation between the central banks initially happened in a highly informal way. Though the existing MoU foresaw procedures for information-sharing, those soon proved too slow and unworkable. Instead, senior policymakers, kept each other up to date, often through direct phone calls (RCG for Europe, 2016, p. 23). Even if the MoUs had not established workable protocols, central bank officials had developed good personal contacts in the process of negotiating them that proved valuable for ad hoc responses (RCG for Europe, 2016, p. 28).[222] Estonia’s deputy central bank governor recalls how crucial it was that ‘we had a phone number, so we could call anytime in the day or night.’[223] Bilateral cooperation between the Riksbank

[222] Interviews Callesen (Danish MoF), Sutt (Bank of Estonia)

[223] Interview Sutt (Bank of Estonia)

and their Estonian counterparts on liquidity provision started in early 2008 (Eesti Pank, 2014, p. 152). Given the urgency of the situation, all actors saw an interest in facilitating the flow of information.

In parallel, banks and central banks in the Nordic/Baltic region were involved in the Vienna Initiative. The parent banks' joint letter to the ECB in January 2009 had been co-signed by SEB's and Swedbank's executives, and Swedbank and Norwegian DnB Nord participated in the JIFIAP. Both the Riksbank and the Bank of Latvia participated from the start. But the VI played no role in eliciting cooperation from the banks. Only in September 2009 at a meeting in Stockholm the four largest foreign banks in Latvia[224] signed a vague commitment letter in which they promised to continue exposure to the Baltic states (International Monetary Fund, 2009a). The Nordic banks were more reluctant to make any specific commitments than their peers in Central Europe and paid more attention to the interests of their stakeholders.[225] Besides, by that time they had already demonstrated their long-term commitment to the region. The success in the Baltic region can therefore mostly be attributed to direct communication between the banks and central banks.[226]

When the financial crisis calmed down in 2010, the Nordic and Baltic central banks decided to establish a more formal framework for crisis management. Again, the Riksbank, and especially Lars Nyberg, the deputy governor responsible for financial stability, played a central role.[227] In August 2010, the central banks, finance ministries, and financial supervisors of the eight Nordic

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[224] DnB Nord, Nordea, SEB, and Swedbank

[225] Interview IMF 2

[226] Interview IMF 2, Wieser (Austrian MoF)

[227] Interview Riksbank officials

and Baltic states concluded an agreement on cross-border financial stability, crisis management, and resolution (Riksbank, 2010). That agreement laid the foundation for the formation of the Nordic/Baltic Stability Group (NBSG). Representatives from the signatory institutions worked in several working groups to implement the provisions of the agreement, both regarding crisis management and prevention (RCG for Europe, 2016, pp. 24-26). In setting up a regional stability group, the Nordic and Baltic states were the first to establish a semi-formal regional financial stability body, something that had been suggested in the EU-level MoU in 2008.

The NBSG served in several respects as an inspiration for the further development of the Vienna Initiative after 2012.[228] Its structure of working towards regional principles for home/host burden-sharing in dedicated working groups has been emulated in the VI 2.0 framework. However, in some key respects, its institutional framework differed (Keereman et al., 2019a, p. 323). Participation in the NBSG is less inclusive than in the VI: only representatives from the Nordic and Baltic states can take part and the cross-border banks are not involved. The inclusion of Iceland, which had no cross-border banks left after 2010, illustrates however that the Nordic/Baltic identity and institutional affiliation with the IMF constituency, rather than financial linkages was the criterion for participation (RCG for Europe, 2016). The presidency of the NBSG rotates between participant institutions. Lastly, the NBSG has worked towards new, multilateral MoUs on financial crisis management (including a dedicated working group just on ex-ante burden-sharing rules for the Nordea group). The NBSG has remained focused on aspects of crisis management, and it held a large cross-border financial crisis exercise in

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[228] Interview Nagy-Mohásci (EBRD)

2019,[229] while the VI, as the next chapter shows, has mostly been concerned with creating a framework and also veered into regional macroprudential governance.

Conclusion

The processes leading up to the formalisation of the VI and the NBSG resembled each other. The pre-crisis institutional frameworks for financial crisis cooperation, both in Central Europe and the Nordic/Baltic region had not kept in step with the deep and lopsided financial market integration that effectively put the home authorities of cross-border banks in charge of liquidity conditions abroad. Around 2007, the Austrian and Swedish central banks became aware that a financial crisis in CEE could become a problem for domestic financial stability, and in late 2008, they worried that deteriorating market conditions in the host constituencies could leave the parent banks without market access.

The coordination between home and host central banks happened largely outside the established EU framework. Through informal and ad hoc cooperation, central banks redefined the principles of regional financial governance by agreeing to set aside formal home/host responsibilities for liquidity provision. Instead, they pragmatically put the home authorities all but officially in charge of banks' foreign subsidiaries' liquidity and, in the VI, included regional banks in discussions about regional liquidity distribution.

It is crucial to highlight the role of institutional entrepreneurs and contingent events in bringing about these new governance arrangements. Though initial efforts by Austrian banks to set up a public-private coordination initiative had run aground, the impetus for the VI came after a chance encounter between an Austrian deputy minister and an EBRD official. The EBRD and

[229] Interview Riksbank officials

the IMF did not just provide financial support, but also play a critical role in re-defining the objectives of regional financial governance and legitimising new task divisions between the actors involved. In the Nordic/Baltic region, cooperation happened informally, but later the Riksbank took the lead on the NBSG.

One cannot deny the importance of financial objectives in motivating the key actors behind the VI. All the exposed West European banks wanted to maintain exposure – the VI arguably grew out of their effort to obtain more public support given their unwillingness to leave. Likewise, the recognition by both the OeNB and the Riksbank that they needed to restore confidence in their banks' host jurisdictions was motivated by their worries about domestic stability. In this sense, all key players agreed that they wanted to avoid an uncontrolled financial crisis in CEE and their choices can be interpreted as pragmatic crisis measures.

But the NBSG and the VI also carry many attributes that are associated with processes of norm-formation (Finnemore & Sikkink, 1998) and institutional change (Battilana et al., 2009). At first, individual entrepreneurs aim to convince others to adopt their perspectives of the nature of the financial risks in the region and develop a vision for change. Once their efforts succeeded, they used resources, such as the Austrian government's standing or the EBRD's administrative capacities, to mobilise other actors until the new norms were more generally accepted and institutionalised. The resultant arrangements resembled 'experimentalist governance' (Sabel & Zeitlin, 2008) as they relied on deliberation, peer scrutiny, joint framework goals, and relative autonomy for individual actors. The early phase of the VI featured a great collective learning effort about the operational difficulties associated with regional liquidity distribution; in the Nordic/Baltic region, there was less uncertainty, but the Riksbank still left little doubt about its willingness to support the Baltics. The VI offered a platform for open discussion and expert input to develop and legitimise the new principles of regional crisis management, while

policymakers in the Nordic/Baltic region benefited from their existing close contacts for finding informal solutions. In the end, both initiatives have largely resulted in informal commitments and relied on banks' and central banks' reputational interests.

Acute crisis management was, however, not the only domain in which central banks needed to coordinate their activities. The GFC had also cast light on the need to prevent the build-up of systemic risks across regional financial systems in the first place. The regional macroprudential bodies that were created in Europe to accomplish this shared many of the features of the crisis management arrangements, as the next chapter discusses.

Chapter 6 – Establishing Regional Macroprudential Governance

Abstract

Macroprudential policy coordination has become a new domain of international central bank cooperation since the GFC. This chapter reviews the formation processes and the work of the first years of three regional macroprudential governance bodies that were established in Europe after the GFC: The European Systemic Risk Board (ESRB), Nordic/Baltic Macroprudential Forum (NBMF), and the Vienna Initiative 2.0. It finds that post-crisis macroprudential governance relies on principles that are elaborated in non-hierarchical, inclusive deliberations and enforced through soft mechanisms, such as peer review. Based on that the chapter concludes that collective actions in these bodies can best be understood as reflecting a norm-based mode of interaction.

Introduction

After the acute financial crisis had abated in late 2009, attention among European financial policymakers shifted to building a more resilient international financial governance structure. Central to post-crisis governance was the increased importance of macroprudential policy, that is, regulatory measures whose goal was 'to limit the risk of episodes of financial distress with significant losses in terms of the real output for the economy as a whole' (Borio, 2003, p. 183; see also Galati & Moessner, 2012). For central banks, coordinating on macroprudential policies presented a new challenge that was separate from – and less well understood than – acute international crisis management (Csajbók & Király, 2012, p. 71). Nevertheless, European policymakers' efforts at collective macroprudential governance went further than in other places (Edge & Liang, 2019; L. M. Goodhart, 2015; Lombardi & Moschella, 2017). They did not just introduce a new regulatory agenda on the national level, but they also turned to reform the contours of the regional financial system.

Between 2010 and 2012, three multilateral bodies were set up where central banks, financial supervisors, and various other actors coordinated on international systemic risks. The European Systemic Risk Board (ESRB) and the Nordic-Baltic Macroprudential Forum (NBMF) started

operating in 2011; a year later the Vienna Initiative (VI) 2.0 was launched. All three governance bodies share some characteristics: they facilitate information exchange, rely on joint frameworks for risk assessments, and their operations are based on peer scrutiny and norm-based governance. Moreover, they are specifically concerned with international aspects of macroprudential policy, such as ensuring a level playing field, limiting the risk of cross-country contagion, and counteracting the build-up of international systemic risks (Csajbók & Király, 2012, p. 69).

European macroprudential policy coordination (which also involved financial regulators, though central banks were more prominent) came to rest on a few shared principles. National authorities would remain central to the governance of systemic risks (McPhilemy, 2016), but their relative powers were adjusted. The previous mismatch between regulatory power and responsibility would be resolved by strengthening host authorities relative to home authorities by introducing the principle of macroprudential policy reciprocation. And lastly, a clear hierarchy between the ESRB and the two sub-regional governance formats was established, where the ESRB stood as the most important and binding venue, although it, too, relies on deliberations and soft governance.

In the overall context of the thesis, this chapter marks the last empirical chapter in the study of the financial crisis in Central and Eastern Europe (CEE). Its theoretical contribution consists in highlighting the additional insights about macroprudential governance in Europe if it is conceived of as a process based on norms, rather than national interests. It argues that many features that have been criticised about the ESRB, such as its broad composition (Sibert, 2009), a supposed inaction bias (Schammo, 2019; Thiemann et al., 2018), and its lack of coercive policy tools (Stellinga, 2021) are less problematic if it is interpreted as geared towards norm formation because they facilitate consensus-building. Indeed, the institutions of European

macroprudential governance were consciously set up to exchange information, deliberate ideas, and exercise peer pressure and participants appreciate these styles of interaction.

The remainder of the chapter is structured as follows. The next section will describe the build-up of systemic risks in CEE before the GFC and how central banks cooperated in that regard. After that, the formation of the ESRB, NBMF, and VI 2.0 will be discussed in that order. The analysis section will highlight both the commonalities between the three formats and their relationship to each other before the final section offers conclusions.

6.1 Macroprudential governance in Europe before the financial crisis

The European financial supervisory architecture before the crisis was based on a set of principles that left a blind spot for the international dimension of macroprudential risks. Financial regulation shifted the 'power-responsibility balance'[230] between home and host authorities in favour of the former. Home authorities had the responsibility for banking groups and the principle of mutual recognition implied that foreign banks' branches were not subject to host macroprudential policy at all (Alford, 2006, p. 394; Dermine, 2006; Persaud, 2010). Whereas home regulators' decisions could affect financial conditions abroad they had no prudential mandate for stability in the host jurisdictions.

The host authorities did try to contain credit growth and macroprudential risks (Pazarbasioglu, Johnsen, Hilbers, & Ötker, 2005). In 2006 the Bank of Estonia raised the risk weights for housing loans from 50% to 100% and imposed capital buffers of 12% and a 15% reserve requirement (Eesti Pank, 2014, Chapter 11). But as a Latvian regulator explains, such measures

[230] Interview Kluza (KNF)

did little to tighten banks' lending practices because they had 'almost unlimited' resources available from their Swedish parent banks (Rutkaste, 2007, p. 188). In Hungary, the central bank itself 'had no instrument to curb the bubble' (Király, 2020, p. 28) and did not succeed in getting the government to restrict foreign currency loans as had happened in Poland.[231]

Home authorities' limited actions compounded the problem. The Riksbank had consistently warned about the credit bubble in the Baltic states in its financial stability reports (C. Goodhart & Rochet, 2011; Johansson et al., 2018).[232] However, besides this form of moral suasion, the Riksbank lacked the policy instruments to act upon its warnings, and Finansinspektionen, the Swedish financial regulator, did not act because it considered the Swedish banks sufficiently capitalised (C. Goodhart & Rochet, 2011, pp. 30, 102–103). The OeNB and the Austrian authorities tackled the systemic risks from foreign currency lending at home (Csajbók & Király, 2012; Finanzmarktaufsicht, 2011), but they abstained from actions that could have constrained Austrian banks' profitable foreign operations.[233] By resorting to cross-border loans (Puhr, Schwaiger, & Sigmund, 2009) Austrian banks could circumvent restrictive national measures, especially in Hungary or Romania (Enoch & Ötker-Robe, 2007, p. 364).[234] As a result of such measures, attempts by the host authorities to tighten macroprudential regulation were often ineffective.

[231] Interview Kluza (KNF)

[232] In 2007 the Riksbank even took the unconventional step of calling out SEB and Swedbank, the two most exposed banks (Tett, 2007).

[233] Interviews Nauschnigg (OeNB), IMF 2

[234] Panel remarks by Cristian Popa (former deputy Governor NBR), (European Political Economy Project, 2020, 40:00-53:00 min)

The EU's macroprudential policy coordination framework did little to improve the situation. Since 2000, the ECB monitored macroprudential developments and the EU's central banks gathered at the Banking Supervision Committee (BSC) to monitor macroprudential developments.[235] In parallel, the Committee of European Banking Supervisors (CEBS) convened financial supervisors to discuss the regulation of individual banks, so-called microprudential regulation, as part of the broader committee structure that was part of the so-called Lamfalussy process (Alford, 2006). The challenge of coordinating national prudential policies in integrating financial markets was already recognised at the time. ECB President Trichet (2004, p. 3) cautioned that '"systemic risk" is […] no longer confined to one Member State but must be looked at from an EU-wide perspective.' Yet, the division between the CEBS and the BSC was not formalised[236] and even if macroprudential risks were identified, those diagnoses were not translated into supervisory measures (González-Parámo, 2010).

Though the BSC identified some systemic risks building up, it had no instruments to compel national action. Andres Sutt, former Deputy Governor for financial stability of the Bank of Estonia, remembers that the overheating Baltic economies were frequently mentioned. '[T]he topic of fast credit growth, fixed exchange rate, high current account deficit, these macro imbalances, […] it was almost every meeting. There was a lot of attention on us.'[237] But discussions about cross-border coordination of national macroprudential measures took place informally and bilaterally if they happened at all. In 2005, the Bank of Estonia sent a letter to

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[235] Interview Bini Smaghi

[236] Other ECB committees were of little help in facilitating coordination. When the Bank of Estonia raised its reserve requirements in 2006 to increase banks liquidity buffers, the ECB commented, for instance, that this measure would be interpreted as a departure from Estonia's convergence with the Euro Area (European Central Bank, 2006a).

[237] Interview Sutt (Bank of Estonia)

the Finnish, German, Latvian, and Swedish parent bank supervisors, asking them to raise capital requirements for the parents of Estonian subsidiaries.[238] But that letter did not result in any regulatory measures.

Mr Sutt provided a succinct summary of the institutional structure of macroprudential governance in Europe before the GFC: 'Industry was integrated, and supervision was fragmented – legally [and] functionally.'[239] The EU's regulatory framework and the high degree of financial market integration left host authorities' macroprudential policy relatively ineffective. Conversely, home authorities failed to tighten regulation for banks' foreign operations, not least because systemic stability abroad was outside their policy mandates (Riksrevisionen, 2011). Attempts at coordinating between home and host authorities only happened in an unstructured manner, despite the existence of EU-level committees. After the severity of the financial crisis had at once exposed the ineffectiveness of this regulatory framework, though, the issue of international systemic risks came to play a more important role, as the next sections will demonstrate.

6.2 The ESRB: Formalising macroprudential policy on the EU level

The creation of the ESRB was one of the first institutional responses at the EU level to the GFC. In October 2008, at the height of the crisis, the European Commission convened a 'High-Level Group' of senior central bankers chaired by former Banque de France Governor Jacques de Larosière. The group was tasked with making proposals to strengthen 'European cooperation on financial stability oversight, early warning mechanisms, and crisis management, including

[238] Interview Sutt (Bank of Estonia)

[239] Interview Sutt (Bank of Estonia)

the management of cross border and cross sectoral [*sic*] risks' (European Commission, 2008). The 'de Larosière report,' published in February 2009, concluded that '[m]acro-prudential supervision requires […] a judgement to be taken at EU level' (De Larosière et al., 2009, pp. 39–40). It thereby laid the foundation for the legislative process that resulted in the establishment of the ESRB. Henceforth, the ESRB was put in charge of the 'macroprudential oversight of the financial system within the EU.'[240]

Scholarly accounts of the creation of the ESRB and the way that it operates have largely portrayed it as a political bargain of limited usefulness. The ESRB has been described as a case of 'symbolic delegation' (Lombardi & Moschella, 2017). EU member states were reluctant to delegate legally binding powers to the ESRB (Stellinga, 2021) and national central banks influenced the negotiations to strengthen their institutional position (McPhilemy, 2016). The resulting institutional set-up of the ESRB has been heavily criticised. Sibert (Sibert, 2009, p. 6) has for instance argued that '[g]iven its size and composition, the ESRB is clearly a body that is designed for maximum inefficiency.' Research about the ESRB's work has argued that it has produced a convoluted and ineffective policy framework (Stellinga, 2021) as it struggled to overcome internal disagreements. From this perspective, the ESRB appears rather ineffective because it lacks binding policy instruments and suffers from internal decision-making problems.

This section advances two propositions that suggest that the ESRB be seen in a different light. It first argues that the ESRB was geared towards facilitating the deliberation of new principles for international macroprudential policy coordination. Many of the design features that

[240] Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Macro-Prudential Oversight of the Financial System and Establishing a European Systemic Risk Board, 2010

supposedly weaken its effectiveness as a bargaining arena are conducive to the development of a broadly accepted normative framework. Second, it refers to the ESRB's shift from mutual recognition to reciprocation of macroprudential policy as an example of how its approach to governing international systemic risks has starkly diverged from the pre-crisis set-up. The final section of this chapter will build on these contributions by highlighting how, despite its seemingly informal character, the ESRB is seen as the most binding regional macroprudential body, and how its work is informed by both the VI 2.0 and the NBMF.

6.2.1 The ESRB as a deliberative body

The ESRB was created as an agency rooted in EU law. This meant that ultimately, its institutional design was decided by the European Commission, the Council, and the European Parliament, whereas central banks themselves could only try to influence the negotiations from the outside. Though central banks succeeded in securing a strong position on the ESRB by controlling most votes (McPhilemy, 2016), several institutional choices by the co-legislators suggest that the ESRB was from the beginning intended to serve as a deliberative body.

De Larosière's initial proposal foresaw a relatively limited composition of what would later become the ESRB. It was supposed to consist only of the key actors in macroprudential policymaking the participation of just the ECB, national central banks, the European Commission, and the EU's financial supervisory committees (which would later become the EU's financial supervisory agencies). The report did not even foresee a formal role for national financial supervisors, but it proposed that they participate on an ad hoc basis (De Larosière et al., 2009, pp. 44–45)

Throughout the negotiations, ESRB's composition was, however, successively broadened to include more and more actors. First, the European Commission agreed to allow financial

supervisors to participate permanently, albeit as non-voting members.[241] Later, an Advisory Scientific Committee (ASC), which holds three of the Governing Board's 38 voting members, was added at the initiative of the European Parliament (Schieffer, 2010). The ASC is a body composed predominantly of academic experts (McPhilemy & Roche, 2013, pp. 23–24).[242] From its initial conception as a body confined to central banks, the ESRB had expanded to more than sixty members, with input from various national authorities and external experts.

The ESRB's composition went even further in ensuring a wide input of points of view. After its creation, it aimed to strike a balance between the Eurosystem and non-Euro Area central banks and put important proponents of macroprudential thinking in key positions. While the ESRB is chaired by the ECB President, its Vice Chair has so far been the Governor of a non-Euro Area central bank. The first two Vice Chairs were the Bank of England's (BoE) Governor Mervyn King and his successor Mark Carney; Mr Ingves took over the position in 2019. The BoE, and besides King, especially its Financial Stability Director Andrew Haldane had been among the most vocal advocates of the post-crisis macroprudential agenda (Baker, 2013; Engelen et al., 2012). This rationale is reflected in remarks by ESRB Secretary-General Francesco Mazzaferro, who mentioned that Brexit had been 'real shock for [the ESRB] because

[241] Regulation 1092/2010, Article 6

[242] Regulation 1092/2010, article 12 demands that '[t]he nominees […] shall be chosen on the basis of their general competence and their diverse experience in academic fields or other sectors, in particular in small and medium-sized enterprises or trade-unions, or as providers or consumers of financial services.'

However, as a European Parliament report notes, its initial composition was strongly leaning towards academia with 11 out of its 15 members being scholars of economics or finance (McPhilemy & Roche, 2013, p. 63)

the BoE has been one of the inventors of modern macroprudential policy' (European Political Economy Project, 2020, 18:30min).[243]

The ESRB's main preparatory body, called the Advisory Technical Committee (ATC), would also be chaired by a non-Euro Area governor. The ATC's tasks consisted in identifying and prioritizing risks and designing macroprudential policy instruments (McPhilemy & Roche, 2013, p. 56). It was led by Stefan Ingves, the Governor of the Riksbank and one of the key actors during the crisis, as seen in previous chapters. In this function, Mr Ingves also attended the meetings of the newly created ASC, whose first chair was the economist Martin Hellwig.

Whereas the number of participants in the ESRB grew over time, the idea that it should function as a deliberative body remained unchanged from the start. The Commission's original proposal already stated that the ESRB was 'conceived as a "reputational" [*quotation marks in original*] body with a high-level composition that should influence the actions of policymakers and supervisors by means of its moral authority' (European Commission, 2009, p. 5). The ESRB can only issue warnings and recommendations to its members, which respond on a comply-or-explain basis, these instruments are widely deemed sufficient to ensure compliance (McPhilemy & Roche, 2013, p. 4). However, the ESRB does not operate entirely by consensus: its decisions are taken by a single majority, or, when making recommendations public, a two-thirds majority.

Worries that so many participants could hold back the ESRB's decision-making capability have been refuted. Mr Ingves (Ingves, 2016, p. 2), for instance, insists that, despite its large membership, the ESRB 'actually works.' Though the Euro Area's national central banks form

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[243] Though the Bank of England does not participate in the ESRB anymore after Brexit, the EFTA states Iceland, Liechtenstein, and Norway have joined as non-voting members, see General Board (europa.eu).

a big voting bloc it is not uncommon that one of them gets outvoted (European Political Economy Project, 2020, 15:00-17:00min). Rather than leading to dysfunction the broad composition of the General Board has been referred to as a 'major asset'[244] of the ESRB.

This counterintuitive success appears plausible if the ESRB is thought of as a body whose goal is deliberation. First, the ESRB enjoys considerable authority in the field of macroprudential policy precisely thanks to its diverse composition, which has allowed it to base its discussions on a 'holistic' assessment of various factors (Ingves, 2016). The quality of its analyses is seen as one of the central elements of its authority (Gerlach, Gnan, & Ulbricht, 2012). The ASC specifically is credited with putting several important issues on the ESRB's, and thus the EU's, macroprudential regulatory agenda, including the treatment of sovereign debt and a Report on the 'Global Dimension of Macroprudential Policy' (Portes et al., 2020).

The ESRB's second strength is its role in fostering ideational convergence among its members. Despite the ESRB's large membership McPhilemy and Roche (2013, p. 59) report that 'there was broad agreement […] that the quality of discussion in the General Board has been better than might have been expected' (see also Ingves, 2012, p. 33). A great accomplishment of the ESRB was to increase general awareness of the importance of systemic risk. In this regard, it 'performs an educational function for members' (McPhilemy & Roche, 2013, p. 60). Mr Ingves (2016, p. 3) argues that the ESRB's work has been 'important for implementing a macroprudential culture in a broader sense.' While in the preparatory ATC, there are some suggestions that national, rather than European, interests played an important role, among

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[244] Regulation (EU) 2019/2176 of the European Parliament and of the Council of 18 December 2019 amending Regulation (EU) No 1092/2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (Text with EEA relevance) (europa.eu)

senior central bankers, the ESRB appears to have played an important function in building a set of macroprudential policy consensus (McPhilemy & Roche, 2013, p. 62).

Third, the ESRB, has, as intended, mostly relied on central banks' reputational interests, rather than material incentives. Participating central banks have buy-in for implementing measures because they can choose to participate in an ESRB workstream. They can sometimes decide not to implement a recommendation if they can justify this sufficiently (Ingves, 2016). Enforcement based on peer pressure and a comply-or-explain mechanism has, according to ECB President Mario Draghi (quoted in McPhilemy & Roche, 2013, p. 43) 'functioned smoothly.' Overall, the ESRB's reliance on soft governance tools and the collective perception of the appropriateness of the recommendations seem to be a source of its success – but they also represent a more stringent approach to macroprudential policy within the EU than before the crisis because the ESRB's recommendations establish concrete principles and follow up on their implementation.

Summing up, the institutional design and the functioning of the ESRB can be well understood as being underpinned by a logic of appropriate action. The ESRB seems highly conducive to facilitating effective deliberation. Rather than being a central banks-only setting like its predecessor, the ESRB brings together various viewpoints, including financial supervisors' input from external experts. Despite its lack of enforcement tools, its decisions are considered authoritative by its members because they reflect broadly shared consensus and expertise.

6.2.3 The ESRB's work on the regional dimension of macroprudential policy

The ESRB is charged with focusing on systemic risks from the perspective of the EU, as opposed to the national level. After the first meeting, ESRB Chair (and ECB President) Jean-Claude Trichet (Trichet, 2011), assured the European Parliament that 'the ESRB will focus on preventing and mitigating systemic risks [...] at the level of the European Union,' adding that

‘the ESRB will pay special attention to horizontal risks across Member States.’ In pursuit of that goal, it has upended one of the core principles of financial regulation in the EU, by providing a regular framework for the reciprocation of national macroprudential measures.

The ESRB’s approach to mitigating regional systemic risks rests on the core principle that macroprudential policy should be set at the national level. As McPhilemy (McPhilemy, 2016, p. 536) has argued, the ESRB has served as a platform for national central banks to advance this argument in EU regulatory politics. When, for instance, the EU transposed Basel III principles the ESRB rejected the ‘maximum harmonization’ approach to Countercyclical Capital Buffers (CCyB) that was favoured both by the banking industry and the European Commission. Instead, the central bankers’ argument that the CCyB should be set nationally prevailed and member states enjoy some constrained discretion over macroprudential instruments (McPhilemy, 2016, pp. 534–536). In other words, notwithstanding its EU-level outlook, the ESRB operates on the principle that macroprudential policy should be determined nationally rather than according to a set of supranational rules.

In the face of regionally integrated financial markets, however, the limitations of this approach soon became clear. After all, before the crisis, national macroprudential policies had been largely uncoordinated. Banks could often bypass them by operating through branches or issuing cross-border loans. The necessary corollary to the principle of nationally set macroprudential policy was to dispense with the principle of mutual recognition. That principle was replaced by the understanding that macroprudential policies in one country would be reciprocated by other jurisdictions. The ESRB (2016) has issued a ‘Recommendation on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures’ wherein it aims to ensure the effectiveness of national macroprudential policy, ensure a level playing field, and prevent regulatory arbitrage.

Ensuring the reciprocation of macroprudential measures has since become a core task of the ESRB. The ESRB's role consists in acting as an information hub. When national authorities implement macroprudential measures that can have cross-border effects, they need to inform the ESRB with a request for reciprocation. In some cases, reciprocity is mandatory, in other cases it is voluntary and there exists a *de minimis* exception that allows national macroprudential authorities to forego reciprocation of measures in jurisdictions with weak financial ties (ESRB, 2022). ESRB members insist that the practice of reciprocation is 'crucial' in an integrated financial system (European Political Economy Project, 2020, 14:45 - 18:00 min).[245]

Another way in which the ESRB has contributed to the resolution of regional systemic risks has been by suggesting changes in national policies. It is noteworthy that its first two recommendations concerned precisely those financial stability issues that had necessitated international central bank credit lines during the GFC: foreign currency loans (ESRB, 2011) and banks' reliance on dollar funding (ESRB, 2012). In substance, the recommendation on foreign currency loans echoes many of the same concerns as the BSC's report back in 2006, such as risks to borrowers with income in local currency, and liquidity and capital risks for banks (ESRB, 2011, pp. 2–3). However, with its specific recommendations for policy measures and peer review, it was more successful in triggering national actions than previous attempts. Overall, compliance with this recommendation has been fairly good[246] and foreign currency loans have declined considerably since the recommendation (Ehrmann & Schure, 2020).

[245] This reference links to a panel discussion to which both Mr Ingves and Francesco Mazzaferro, the Secretary General of the ESRB contributed.

[246] Bulgaria was only deemed partially compliant, but its government argued that foreign currency loans were unproblematic in the context of its currency board (ESRB, 2013)

Taking stock, the ESRB has become the principal platform for regional macroprudential governance in the EU since the GFC. This section has argued that it should be understood as a deliberative body where new ideas and principles are developed, rather than as a dysfunctional bargaining setting. When the ESRB takes decisions, it relies on the technical convincingness of its arguments and peer pressure to enforce them. The ESRB's work has specifically paid attention to governing not just national imbalances, but also ensuring the reciprocation of national measures and mitigating regional systemic risks. As the following two sections turn to macroprudential policy cooperation in the Nordic/Baltic region and Central Europe, however, it will become clear that many of these ideas had already been prepared in other, less formal settings. The ESRB, for all its deliberative features, reflects the most binding body in European macroprudential governance.

6.3 The Vienna Initiative 2.0: Relaunched with a different mission

Once the acute phase of the liquidity crisis in CEE had subsided, in late 2009, the participants of the VI agreed to maintain the format. However, its focus was broadened from acute crisis management to the governance of systemic risks. In 2012, the VI 2.0 was set up, which had a more formal organizational structure and a clearer mandate than its predecessor. It has maintained many of the deliberative and inclusive features of its predecessors and, besides crisis management, it has become an important forum for setting the European agenda for regional macroprudential governance.

6.3.1 The transformation of the VI

In early 2010, when it seemed as if the worst of the financial crisis in CEE had been overcome and that the VI had accomplished its goals of maintaining regional financial stability, the participants decided to maintain the VI. At the full forum meeting in Athens in March 2010, two working groups were set up to tackle deeper vulnerabilities, namely the absorption of EU funds and the development of local currency and capital markets (M. Allen, 2019, p. 20). Foreign currency loans had, after all, been the principal source of macro-financial vulnerability in many CEE countries during the crisis (Keereman, Kosicki, & Weidinger Sosdean, 2019b, p. 165).

Piroska Nagy-Mohásci, who had been one of the key officials of the EBRD behind the VI, explained that 'we started this local currency, local capital markets initiative back in 2009/10 and [it] was important to use the Vienna framework for […] systemic risk discussions. Not crisis management, but systemic discussions.'[247] The framework had proven effective enough during the crisis that the VI could now serve as a platform for developing a broader regional macroprudential agenda.

Still, at a meeting in Brussels in early 2011, the question was discussed whether the VI had served its purpose and should be closed (Nagy, 2011). While some actors advocated 'declaring victory' and moving on, the European Commission expressed a strong interest in continuing the cooperation 'because we don't have too many successful crisis management mechanisms.'[248] It was decided to continue the VI and broaden its outlook to focus on regional macroprudential issues. After the first two working group reports had been presented at the

[247] Interview Nagy-Mohásci (EBRD)

[248] Interview Nagy-Mohásci (EBRD)

same meeting, two more working groups were set up to work on the issues of non-performing loans (NPL) and the transposition of Basel III principles for the VI participants. The composition of these working groups was, perhaps characteristically for the VI, very broad: they involved home and host representatives and regional banks and were coordinated by the EBRD, World Bank, or IMF (European Bank Coordination ("Vienna") Initiative, 2011). As before, the ECB participated as an observer, but it also gathered survey data that informed the work of the NPL working group (M. Allen, 2019, p. 25). Despite the continued participation of the banks, the VI moved increasingly towards the coordination of public policies.

Another driver for the intensification of the cooperation at the VI was the resurfacing of problems of home/host coordination in cross-border banking related to macroprudential supervision. The Austrian authorities reminded the host constituencies of regulatory spillovers when they took a series of measures aimed at improving the resilience of Austrian banks. In 2008 and 2010, Finanzmarktaufsicht (the financial supervisor) issued supervisory recommendations to Austrian banks to discontinue foreign currency lending (Finanzmarktaufsicht, n.d.). The Austrian authorities had hardly coordinated this measure with their banks' host authorities.[249] In 2011, the OeNB and Finanzmarktaufsicht required Austrian banks to increase their capital and change the funding model of their CEE subsidiaries so that those would be almost entirely self-funded (Finanzmarktaufsicht, 2011). As Kudrna and Gabor (Kudrna & Gabor, 2013, p. 560) note 'the measures did reflect the VI's recommendations.' But host authorities perceived them as a unilateral measure and the Austrian authorities had to explain their decision in many subsequent bilateral meetings (M. Allen, 2019, p. 22).

[249] Interview Nowotny (OeNB)

Against this backdrop, in March 2012, finally, the VI was officially given a new purpose. The public sector participants agreed that, in contrast with the original purpose of the VI, it would now be necessary to ensure an orderly deleveraging process without cross-border disruptions (M. Allen, 2019, p. 22). This goal implied no less than a reform of the contours of the regional financial system. It meant that two financial stability risks, the level of foreign currency loans and the degree of cross-border banking, would have to be tackled as regional concerns. Banks would have to revise their business models, home and host authorities would have to agree on principles to reduce spillovers of policy measures, and International Financial Institutions, though reluctant to promise anything, were expected to provide financial support if needed. The VI 2.0, as it came to be known, would pursue a medium-term agenda for financial system reform.

6.3.2 The operating structure of the VI 2.0

The VI 2.0 received a more hierarchical organisational structure than its predecessor by moving from a rotating presidency to establishing a permanent Steering Committee. That Committee was chaired by NBP Governor Marek Belka, who was also the only East European member of the ESRB's Steering Committee. The other members were one home and one host supervisor, two EU institutions (the European Commission and the Council's EFC), and the IFIs (EBRD, EIB, IMF, and World Bank). A year later, a non-EU seat and a representative of the banking groups were added (M. Allen, 2019, pp. 26–27). While the VI 2.0 now had a formal structure, its composition remained very broad and overcame both the gaps between public and private actors and between EU and non-EU countries.

Another major change in the VI 2.0 was that it had a clearly formulated mission that covered three workstreams. First, it was now specifically directed at the joint governance of the regional financial system. Its mission clearly stated its focus on macroprudential concerns. It aims to '1.

avoid disorderly deleveraging […]; 2. Ensure that potential cross-border financial stability issues are resolved; [and] 3. achieve policy actions, notably in the supervisory area, that are taken in the best joint interest of home and host countries' (Vienna Initiative, n.d.). In July 2012, the VI 2.0 furthermore adopted eight basic principles that would guide its efforts (M. Allen, 2019, p. 24). Notably principles two ('matching the supervisory framework with the cross-border integration of financial markets') and four ('considering spillovers from national actions') mirror some of the regional macroprudential concerns that would later be discussed in the ESRB. Principle five ('the central role of European institutions') explicitly acknowledged the ESRB as playing the leading role in macroprudential governance.

A second concern of the VI 2.0 was the improvement of home/host cooperation in banking supervision. A note containing 'observations on supervisory practices' was drawn up by Lars Nyberg, the Riksbank's former Financial Stability Director who was now at the EBRD (M. Allen, 2019, p. 28). Mr Nyberg's input to the VI 2.0 was solicited to learn from the work on supervisory cooperation that had taken place among the Nordic countries when they had formed the NBSG in 2010 (Keereman et al., 2019a).[250] The most important observations pertained to potential conflicts of interest between home and host authorities and the need to include non-EU host countries in the supervisory architecture. In the end, the recommendations were forwarded to the European Banking Authority (EBA), ECB, and European Commission, as part of the ongoing reform process of financial supervision in the EU and the creation of the Banking Union (European Commission, 2012). The role of the VI in the reform of the EU's financial supervision was acknowledged by Commissioner for Economic and Financial Affairs Olli

[250] Interview Nagy-Mohásci (EBRD)

Rehn, who stated that 'the Vienna Initiative provides support – by offering a coordination platform and strengthening the voice of host countries' (NBP, 2011).

The third organizational stream that the VI 2.0 set up consisted of a new system of regional macroprudential monitoring. The analytical work was distributed between the IFIs. The IMF, with the assistance of the BIS, provided a Deleveraging and Credit Monitor, to follow up on BoP developments and subsidiaries' reduced reliance on parent bank funding. The EIB complemented this work with a Central Eastern and Southeastern (CESEE) Bank Lending Survey, and from 2016 on, the EBRD contributed a semi-annual NPL Monitor. Boris Vujčić, the Croatian central bank Governor and since 2016 the Chairman of the VI 2.0 Steering Committee, stresses that

> '[t]hese reports and discussions have allowed participants to gain valuable insight into cross-border funding flows, bank lending, and asset quality developments. They also enable central banks of host countries to understand better the funding and lending strategies of foreign banking groups, which in turn allows them to make well-informed monetary and macroprudential policy decisions' (Vujčić, 2019, p. 9).

The VI 2.0 has tackled a wide range of topics in dedicated meeting formats. Besides the Full Forum, it includes several dedicated working groups with varying participation both on permanent topics, such as NPLs, and issues currently on the regulatory agenda. Meetings could be dedicated to reviewing monitoring reports to discussing the situations in specific countries, such as Greece or, in 2014, Ukraine. Overall, the VI 2.0 has maintained both the breadth of its predecessor and the informal, deliberative style of its gatherings.

Taken together, when the VI 2.0 was turned into a permanent arrangement to tackle legacy risks from the crisis, it expanded its work from coordinating cross-border banking developments to monitoring regional macroprudential risks, charting a reform agenda, and providing input in EU legislative processes on behalf of host countries. Its composition has remained eclectic and has even been broadened to more countries. Full Forum meetings now attract about 100

participants. Still, its internal work has remained relatively flexible. Though it is officially outside the EU framework, the VI 2.0 has formal roles for various EU institutions[251] and acknowledges their formal authority in its basic principles.

6.3.3 The macroprudential work of the VI 2.0

The substance of the macroprudential work done at the VI 2.0 has so far received very limited attention. Kudrna and Gabor (2013, p. 562) have argued that the VI 2.0's first recommendations largely internalised the interests of transnational banks, while Shields (Shields, 2020) argues that the VI 2.0 perpetuates neoliberal policies. When it comes to regional macroprudential governance the work done at the VI 2.0 can be credited with preparing the ground for many of the principles that would later officially be recommended by the ESRB.

To begin with, the working group on local currency and capital markets started its work when the ESRB was still under negotiation. The report agrees with the ESRB's recommendations on some principles, such as that a bespoke national approach would be needed and that foreign currency loans to unhedged borrowers (who had incomes in local currency) could become a systemic risk. Unsurprisingly, there is a great substantive overlap between the two reports, regarding the degree to which central banks should monitor systemic liquidity risks and the reduction of credit growth. The ESRB's recommendations, which came half a year after the working group report and explicitly acknowledge the groundwork done at the VI 2.0, focused largely on short-term measures to contain foreign currency lending, such as increased risk weights or stricter borrower requirements (ESRB, 2011, pp. 29–30). By contrast, the VI 2.0 also

[251] The EBA, ECB, European Commission, and the EIB. It is worth mentioning that the ECB still insists it participates as an observer and that the European Commission and the EIB need to recuse themselves from the conclusions of working groups that provide input to EU reform processes. This was for instance the case with the VI 2.0's Working Group on Banking Union.

made medium-term recommendations such as changing government debt management strategies or legal frameworks (European Bank Coordination (“Vienna”) Initiative, 2011, pp. 4–5). From the beginning, it seems that the VI 2.0 took an expansive view of systemic risk management.

Similarly, the VI 2.0’s work on deleveraging foreshadowed some of the later EU initiatives. The NPL Initiative, started in 2012 and formalised in 2014, contributed to the ongoing international debate on this issue and provided technical assistance to several countries (including non-CESEE countries, such as Greece and Cyprus) on how to deal with NPLs (Marković, Cloutier, & Jerić, 2019, pp. 200–208). EU-level action on NPLs followed only in 2017 when the Council of the EU issued an NPL action plan (Council of the European Union, 2017). The same year, an ATC expert working group published a report on resolving NPLs (ESRB, 2017) which presented them as a macroprudential – as opposed to individual banks’ – risk. Again, the work of the NPL Initiative is credited with informing the work of the ESRB and the European Commission on the same issue (M. Allen, 2019, p. 40; see ESRB, 2017, p. 17).

Besides NPLs, the issues of reducing cross-border exposures and subsidiaries’ reliance on parent banks were a central concern to the VI 2.0’s deleveraging agenda. Arguably, the ambition expressed in the 2011 report to establish local currency capital markets and ensure subsidiaries were self-funded was a bold one, though the objective of promoting a more decentralised funding model was shared by the IMF (2013), too. The VI 2.0 framework has in this regard stood out for combining the analytical work in the EIB-run Deleveraging Reports with technical support for host authorities and programmes by the EBRD, the EIB, and the World Bank to issue local currency bonds themselves to deepen capital markets (M. Allen, 2019, p. 40). After Austrian regulators had unilaterally moved to reduce intra-group lending in

2011, the ESRB in a 2013 recommendation on bank funding warned that the geographical concentration of funding, especially within a group, could pose a risk if capital flows were interrupted by regulatory ringfencing (International Monetary Fund, 2013, p. 39). Even if both the VI 2.0's and the ESRB's recommendations insist that they want to safeguard the principle of the free flow of capital (basic principle 1 of the VI 2.0), the obvious friction with the macroprudential paradigm that cross-border flows can be destabilizing has not been resolved yet (Schelkle, 2017, p. 221).

In summary, after the liquidity crisis, the VI was transformed from an improvised response to a gap in the EU's financial supervisory system into a regular forum for regional financial market governance. The VI 2.0's adapted mission after 2012 establishes it not just as an important lobby for the interests of host countries in the EU's financial regulatory reform, but also as an extremely inclusive forum that aims to develop a regional macroprudential agenda for financial markets in CESEE. It engages in regular data reporting, brings together various stakeholders to agree on recommendations, and it coordinates support for host authorities in the implementation, especially through IFIs. While the work of the VI 2.0 on macroprudential policy has informed similar initiatives at the level of the ESRB, the VI 2.0 has maintained a less official character and acknowledges the ESRB as the ultimate authority. The VI 2.0's regional focus on host countries in CESEE had, however, bracketed out home/host cooperation in the Nordic/Baltic region. As the next section shows, those countries had established their own informal forum for macroprudential policy coordination.

6.4 The NBMF: Keeping it informal

Cooperation on macroprudential policy among the Nordic and Baltic authorities was set up in parallel with the ESRB. In 2011, the NBMF was created, which would bring together the central bank governors and the heads of the financial supervisors of the eight Nordic and Baltic states.

The NBMF (and the NBSG) represented a new form of regulatory cooperation even in the already tightly networked Nordic/Baltic region. Although various meeting formats existed exclusively for the central banks there had previously not been a forum where they would meet their financial stability colleagues (RCG for Europe, 2016, p. 17). The instigator behind the NBMF had once more been Riksbank Governor Ingves, who also took over the chairmanship.[252] The Riksbank provided the secretariat for the meetings, but in 2012 a preparatory sub-group was created, which was led by their colleagues from the financial supervision authority (Farelius, 2015, p. 43). Besides facilitating macroprudential policy cooperation between national authorities, the NBMF also served to coordinate Nordic/Baltic views ahead of ESRB meetings (European Political Economy Project, 2020, 8:30-10:00min; RCG for Europe, 2016, p. 17).

The NBMF itself has remained a rather informal set-up. Its meetings were held at Arlanda airport in Stockholm, to allow all participants to return home the same day (RCG for Europe, 2016, p. 17). Its mandate is to 'discuss financial stability in the Nordic-Baltic countries and the implementation of macroprudential measures,' but the forum itself has no decision-making power (Farelius & Billborn, 2016). Indeed, participants have characterised it as a 'forum for discussion'[253] or 'an information exchange for where you explain what you're doing in this area. An exchange […] of views and advice.'[254] As the VI 2.0, the NBMF recognises the ESRB as

[252] Interview Riksbank officials

[253] Interview Riksbank officials

[254] Interview Berg (Head of the Danish FSA)

the ‘more important’ body, not least because the ESRB alone issues formal recommendations.[255]

The added value of the NBMF consists rather in the quality of its deliberations. Given its limited size (the NBMF consists of sixteen participants, two per country) the exchanges could also go a bit more into depth than in larger configurations, such as the ESRB (European Political Economy Project, 2020, 8:30-10:00 min; Farelius & Billborn, 2016). The composition of the NBMF suggests that its objective is arriving at an intellectual consensus, rather than the coordination of regulatory measures. Specifically, not all NBMF participants set the macroprudential policies in their countries. In Denmark and Norway, the designated macroprudential authority is the government, rather than the financial supervisor or the central bank (RCG for Europe, 2016, p. 16). But these institutional divisions do not matter for the discussion. Mr Ingves’ account of the technical, consensus-oriented exchanges is telling:

> ‘The institutional set-up is quite different for all these countries, but that does not really matter at all when you talk about the plumbers. Because plumbers like to talk to plumbers and we like to talk about the plumbing, that’s what we do. […] We don’t talk about the politics of it […] The domestic setup is completely, all across the place. And still, it is possible for us to talk about all of the technical details and how this works. And in that respect, it is not too different from what you call the Vienna Initiative because there is, we have a common interest in talking about these things’ (European Political Economy Project, 2020, 11:00-12:30min)

On substance, the NBMF’s work mirrors the activities of the ESRB very closely. Since 2013, the forum follows the ESRB’s practice of collecting and comparing macroprudential information from all participants through a survey, which is forwarded to the ESRB secretariat after an NBMF meeting. After the ESRB’s recommendation on foreign currency lending, the NBMF also was used to coordinate a joint response from the Nordic and Baltic countries (Farelius, 2015, pp. 42–43). But despite the overlap with the ESRB and a general agreement that the ESRB framework worked well, the NBMF’s members still saw an added value in the

[255] Interview Callesen (Governor DNB)

discussions in their regional setting and decided to continue the format in 2018 (European Political Economy Project, 2020, 11:00-12:30min).

The substantive work of the NBMF has sometimes been ahead of initiatives at the EU level. Given the high degree of financial integration in the Nordic/Baltic region, the NBMF has, for instance, been at the forefront of working on the issue of reciprocation and the exchange of supervisory information for cross-border banks. Its work on the topic, which started in 2013, fed into the ESRB's recommendation two years later. One important principle was that exposure-based measures (such as risk weights for mortgages) should be reciprocated whereas institution-based measures should not (RCG for Europe, 2016, p. 21). The ESRB's work on the macroprudential role of foreign bank branches presents the NBMF as a 'benchmark' for supervisory cooperation (ESRB, 2019b, p. 3, 2019a, p. 46).

The NBMF, in brief, reflects some trends in post-GFC macroprudential governance in Europe. It provides a venue for the regular exchange of macroprudential information and policy intentions in a highly informal and consensus-based format. Its composition aims at overcoming institutional differences by bringing together central bankers and financial supervisors for peer scrutiny. The NBMF was established in parallel with the ESRB (and Riksbank Governor Ingves played a key role in both from the start), but it has worked not just on translating EU rules and recommendations into the Nordic context but also contributed to the debate on regional macroprudential policy at the EU level.

Conclusion

After the GFC, macroprudential policy cooperation in Europe has come to be organised into three new governance bodies, the ESRB, the NBMF, and the VI 2.0. These three formats represent a qualitatively new approach to international systemic risks, both regarding their

substance and the organizational form. This chapter has argued that the emergence of regional macroprudential governance in Europe can best be understood as a process aimed at changing actors' perceptions of appropriateness. This interpretation deviates considerably from the predominant view in the literature that casts these multilateral settings as dysfunctional bargaining arenas. It suggests that the effectiveness of regional macroprudential governance does not necessarily lie in their ability to implement new policies, but rather in facilitating the formation of consensus and a new regulatory agenda in a new and uncertain policy field.

The chapter started by outlining the institutional shortcomings of the pre-crisis institutions, especially the lack of inclusive institutions for policy coordination and the shortcomings of the regulatory approach centred on banks' home authorities. Since the crisis, the principle of mutual recognition has been superseded by a regular framework for macroprudential policy reciprocation. Additionally, potential restrictions on the free movement of capital have been accepted, for instance, to reduce the reliance of subsidiary banks on their parents. The VI 2.0 has perhaps been most ambitious in this regard by setting out a roadmap for region-wide deleveraging in CESEE. In other words, the new macroprudential framework has changed some of the core norms of financial governance in Europe.

Macroprudential policy coordination came to take place in more inclusive formats than before the crisis. The NBMF, as the smallest setting, brings together sixteen central banks and financial supervisors; the ESRB has over 60 members; the VI Full Forum comprises about 100. In the cases of the ESRB and the NBMF, inclusivity was a deliberate design feature because macroprudential policy was recognised as a cross-cutting issue and because different national authorities would be in charge of implementing it. But in the case of the VI 2.0, its inclusivity represents a historical contingency, as it grew out of the improvised initiative formed during the crisis.

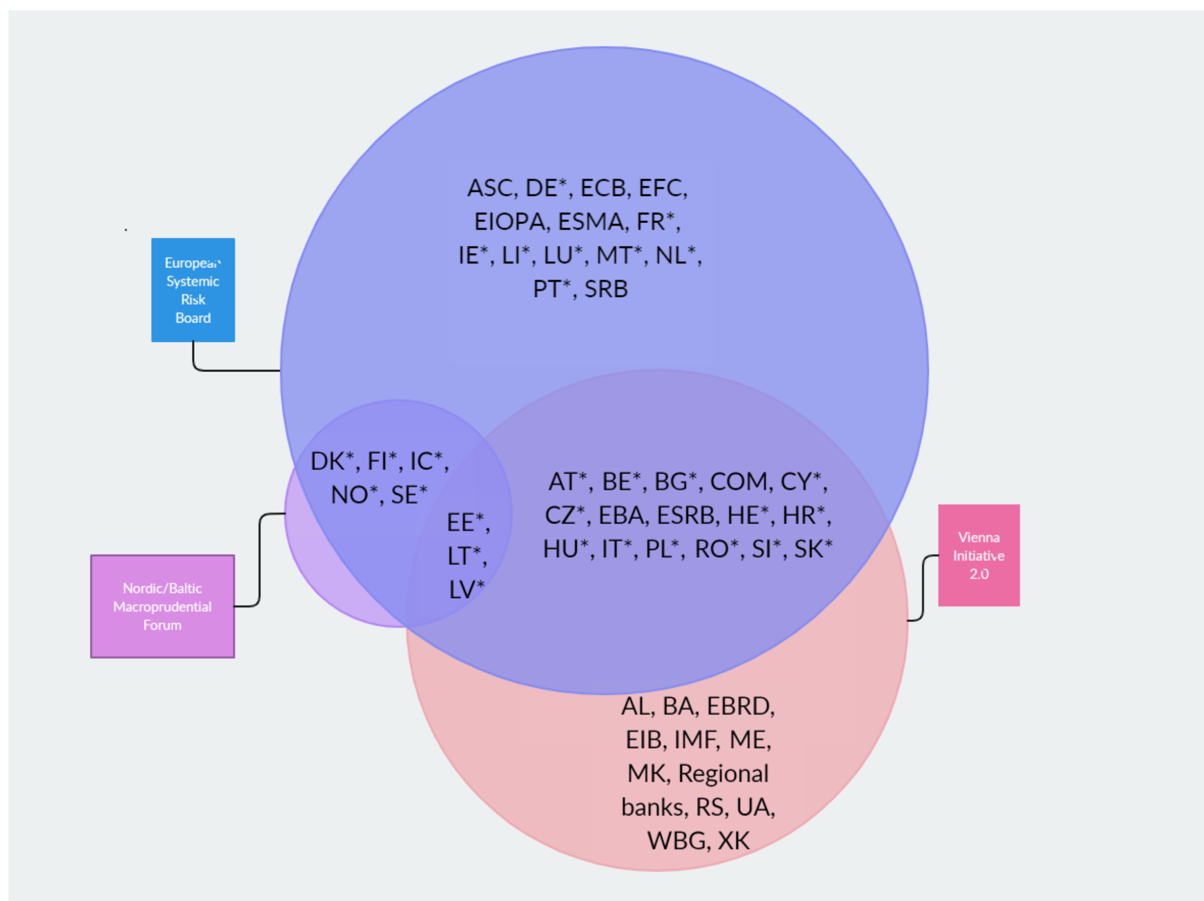
With so many actors around the table, international macroprudential policy coordination has developed an increasingly deliberative character. All three formats rely on the structured monitoring of systemic risks and the peer review of national measures. Assembling a variety of actors, including academic experts in the ESRB and four IFIs in the VI 2.0, ensures a great range of viewpoints represented in the discussion and increases the authority of the principles that are developed. None of these bodies aims to formulate binding rules. Macroprudential policy coordination can instead be seen as a collective endeavour to formulate new, generally accepted norms for appropriate policy conduct and the convergence towards a shared understanding of systemic risks. It aims, as Mr Ingves put it, to establish a 'macroprudential culture' and create joint responsibility for international financial stability.

The interaction between the ESRB, the NBMF, and the VI 2.0 underlines the importance of norms and ideas for macroprudential cooperation. On the one hand, there is a commonly acknowledged hierarchy between them, where the ESRB is seen as the ultimate authority for macroprudential policy recommendations. Figure 1 below presents the overlapping compositions of the three institutional settings. But overlaps in the memberships and responsibilities of the three formats are considered unproblematic: the participants of the VI2.0 and the NBMF decided to keep these formats in addition to the ESRB. The NBMF and the VI 2.0 have even contributed policy ideas to the ESRB's reform agenda, respectively on reciprocity and cross-border banking and foreign currency loans and deleveraging. Moreover, some key officials occupied leading roles in both formats: Riksbank Governor Ingves chaired the NBMF and the ESRB's ATC;[256] NBP Governor Belka led the VI 2.0 Steering Committee and was the only ESRB Steering Committee member from a CEE central bank. These overlaps ensured not

[256] Mr Ingves has remained a key player at the ESRB and in 2019 became its first Vice Chair.

just coherence between the agendas, but also put key proponents of macroprudential policy in charge.

Figure 1: Membership of Regional Macroprudential Institutions[257]



[257] AL: Albania; ASC: Advisory Scientific Committee; AT: Austria; BA: Bosnia and Herzegovina; BE: Belgium; BG; Bulgaria; COM: European Commission; CY: Cyprus; CZ: Czechia; DE: Germany; DK: Denmark; EBA: European Banking Authority; EBRD: European Bank for Reconstruction and Development; ECB: European Central Bank; EFC: Economic and Financial Committee; EE: Estonia; EIB: European Investment Bank; EIOPA: European Insurance and Occupational Pension Authority; ESMA: European Securities and Market Authority; ESRB: European Systemic Risk Board; FI: Finland; FR: France; HE: Greece; HR: Croatia; IC: Iceland; IE: Ireland; IMF: International Monetary Fund; IT: Italy; LI: Liechtenstein; LT: Lithuania; LU: Luxembourg; LV: Latvia; ME: Montenegro; MK: North Macedonia; MT: Malta; NL: the Netherlands; NO: Norway; PL: Poland; PT: Portugal; RO: Romania; RS: Serbia; SE: Sweden; SI: Slovenia; SK: Slovakia: SRB: Single Resolution Board; UA: Ukraine; WBG: World Bank Group; XK: Kosovo.

Asterisks indicate the participation of more than one national institution.

VI 2.0 Full Forum membership has changed over time, this compilation is based on the 2018 Full Forum meeting in London, available here: Vienna Initiative (vienna-initiative.com); ESRB General Forum composition is based on General Board (europa.eu).

Returning to the question of what macroprudential policy cooperation reveals about central bank's collective agency, this chapter supports the conclusion that the developments of the past ten years can well be understood as underpinned by a logic of appropriateness. Macroprudential policy coordination is predominantly based on norms that are collectively developed, passed on through non-binding recommendations, and, in the case of the ESRB, enforced through peer pressure or on a comply-or-explain basis. The governance of international systemic risks thus seems to rely mostly on the perceived legitimacy and authority of community norms. Without disputing the importance of national interests for individual decisions (Thiemann & Stellinga, 2022), one needs to note that deliberation and peer learning have become characteristic features of regional macroprudential governance in Europe.

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; Sahasrabuddhe, 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 reciprocation 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

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[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 reciprocation. 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.

Chapter 8 – Conclusion

Abstract

The main finding of this study is that central bank cooperation can often best be understood as following normative, as well as material considerations. This final chapter outlines the contributions of this study to the academic literature by demonstrating how the thesis advances the debate on international central bank cooperation. It begins by summarising the major empirical and theoretical contributions established throughout this thesis. Second, it offers some theoretical and methodological implications for future work on central bank cooperation. Lastly, it proposes how the insights developed here could fruitfully be applied to the study of recent and current developments in international central bank cooperation.

Introduction

This study of central bank cooperation in Europe during and after the GFC has proposed a new theoretical understanding of why cooperation happens in the international financial system. It has contested the prevalent approach of studying international monetary cooperation which is based on an analysis of national material interests. Instead, it has argued that central banks should be studied as agents in the international system in their own right. Furthermore, it has found that central banks' actions during the crisis often reflected non-material judgments of appropriateness.

Central banks cooperated closely throughout the financial crisis in Europe and took various individual and collective decisions. Often their choices could be better understood as informed by normative considerations and joint identities rather than by material interests. While these findings shed light on a so far neglected aspect of central banks’ international agency, they should, however, not be read as a full repudiation of materialist approaches. Rather they should be read as a call to broaden the terms of the theoretical debate. In studying explicitly how both material and normative considerations informed central banks’ actions, this study departs from mainstream approaches that concentrate on material aspects. No single framework could

account for the variety of outcomes; to understand their decisions it was necessary to reconstruct the decision-making processes in detail.

The European experience with central bank cooperation is a particularly interesting case to study. Based on the research of its new landscape and experiences, some conclusions can be drawn to advance the broader debate in International Political Economy (IPE) in three ways. First, the empirical contributions speak in favour of a more fine-grained understanding of how central banks cooperate in practice. Central banks' individual decisions reconciled conflicting concerns and varied based on contextual factors; collective decisions reflected unfolding processes of entrepreneurship and collective norm formation. To study how cooperation takes place and changes over time, one needs to appreciate these nuances and contingencies.

Second, this study proposes a methodological approach that is different from those typically adopted in IPE so as to account for central banks' international agency. To arrive at a conceptually refined understanding of central banks' agency, future studies may wish to apply and develop ideal types to understand instances of cooperation, rather than infer their interests based on their structural position alone.

Third, the conceptual framework developed here underscores how important it is to account for different facets of central banks' agency. Individual decisions and institutional developments were often crucially informed by ideas and normative considerations, not just national self-interest. On this abstract level, these insights are useful to advance the debate on central bank cooperation in other contexts, too.

8.1 Empirical contributions

The context of the GFC in Europe provided a suitable setting for making an empirical contribution to the literature on central bank cooperation. It has offered a rich selection of hitherto neglected instances which broaden our understanding of the variegated ways in which cooperation may take place. Moreover, the GFC has arguably been a watershed moment for central bank cooperation around the world (W. A. Allen, 2013; Destais, 2014), and the principal forms of central bank cooperation considered here, multilateral cooperation for crisis prevention and management and credit lines, can be found in various other regional settings (Eichengreen et al., 2018; L. M. Goodhart, 2015; Kawai et al., 2015). The empirical findings in this study, therefore, hold important lessons for studying central bank cooperation more generally.

The first empirical insight concerns the question of what counts as central bank cooperation and how much empirical detail is needed to study it. Notwithstanding prior efforts at developing exhaustive lists of the ways how central banks can cooperate (Cooper, 2006; Simmons, 2008), in practice, the possibilities escape these categories. Central banks provided credit lines on a variety of terms, at times only in return for collateral or explicit policy commitments; and though regulatory cooperation has long been common among central banks (C. Goodhart, 2011), in the European context, various other actors, including commercial banks, IFIs and academics became involved in governing traditional central banking issues such as liquidity management and macroprudential policy on a regional scale. Studying the origins of these features in-depth is necessary, not only to understand the empirical forms of central bank cooperation sufficiently but also to be able to identify the interests and processes that shaped them.

Teasing out detailed features of cooperation is essential because central banks had considerable scope for discretionary decisions. Unlike the Fed, central banks in Europe only rarely face strong structural imperatives to act in a certain way. Even when they did, as the Swedish

approach to the crisis in the Baltic states illustrates, they could make strategic decisions on how to respond to material risks. Often, however, material considerations were ambiguous or uncertain. Even to central bank officials themselves, it was sometimes unclear how conflicts between different considerations would be resolved. Central banks' perceptions of where their interests lay in such cases were informed by the ideas and perceptions that prevailed inside the organisations and the norms and identities to which they were beholden.

8.1.1 The debate on the GFC in Europe

This study has made concrete contributions to discussions on the GFC in Europe. The most controversial issue was probably the approach of the ECB towards international central bank cooperation (Tooze, 2018; Vallee, 2010). The interpretation advanced in this thesis is that while the ECB had no prior plan for responding to crises in EU member states, its decision to define its interest narrowly in terms of its Euro Area mandate reflected some 'German' ideas (which were in fact more broadly shared) regarding the international role of the euro, the importance of credit risk, and the obligations that the ERM II framework placed on participants. These findings align with other work on the ideational politics inside the ECB (Mugnai, 2022; Schulz, 2017) and extend these findings to the international dimension of the ECB's policy conduct.

The higher degree of cooperation in the Nordic/Baltic region has been linked to two factors. First, the shared regional identity was in itself an important driver of central bank cooperation, even in the cases of Iceland and Latvia, where clear financial risks mattered, too. It also influenced the composition of the two sub-regional arrangements that were set up after the crisis, the NBMF and the NBSG. While the special character of cooperation between the Nordic states is well-studied (Strang, 2015), these findings demonstrate in detail how they mattered for financial supervisory and central bank cooperation. A second, idiosyncratic factor concerns the leadership role of the Swedish Riksbank, notably the role of its governor, Stefan Ingves. He

was instrumental in providing a lead role during the crisis and initiated closer cooperation afterwards. While all Nordic countries had experiences with financial crises (Mayes, 2009), it seems that actors inside the Riksbank were especially adept at applying their insights to the crisis at hand.

A last empirical addition concerns the dispute of the motivations behind the VI. The interpretation of its creation proposed here challenges both the notion that the VI resolved a prisoner's dilemma (Pistor, 2011) and that it reflected banks' prior interests in coordinating national policies and sending a signal to markets (Deuber & Epstein, 2019). On their own, the banks had little success in convincing the ECB to provide more liquidity assistance. Instead, the VI reflected a new institutional approach to regional financial governance, spearheaded by the Austrian Finance Ministry, the EBRD, and the IMF, in which new norms for both public and private actors were developed. Over time the VI developed its own dynamic and moved on from acute crisis coordination. It has charted a reform agenda for the regional financial system in CESEE and developed institutional resources to assist its implementation.

These and other empirical findings throughout the thesis may contribute to both, a new interpretation of the resolution of the GFC in the European periphery, and a different understanding of post-crisis governance. Central banks in Europe faced meaningful choices over how they would cooperate; their decisions reflected various, often conflicting considerations. As such cooperation was not a mere derivative of prevalent market structures and relative weights of national interests. Instead, they were shaped decisively by policymakers' ideas and normative judgments. Thus, to understand central bank cooperation in the context studied here, it is imperative to account for the ideational climate and the social agents that operated in it.

8.1.2 The debate on the international financial system

Some of the empirical findings presented in this thesis are also relevant for contextualizing and interpreting central bank cooperation wider construed. Many insights about the importance of norms within the international central banking community can indeed be applied more broadly. Central bank cooperation during the GFC took place within a context where there were certain normative expectations about who would provide or receive credit lines. Among G10 central banks, the norm of cooperation during crises was already institutionalized and central banks had draft swap agreements prepared in case of a calamity. The opprobrium that critics have heaped on the ECB, for its handling of the crisis, illustrates that such self-centred behaviour could not only put material interests at risk but also damaged its international reputation as it violated shared norms of appropriateness.

The importance of contextual and normative judgments should also serve as a caution against interpreting the relationship between central bank credit lines and formal BoP programmes purely based on the formal hierarchy between the financial instruments (McDowell, 2017; Murau et al., 2021). There was an implicit understanding that central bank credit lines could serve as bridging loans to IMF programmes (Cooper, 2006), and the Riksbank's decision to make its swap conditional on Latvia's approval of its programme illustrates how this idea could be applied. Yet in the Icelandic context, the Nordic central banks themselves imposed policy conditions before the IMF was formally involved; and conversely, the OeNB refused a direct role in the Hungarian bailout even when the IMF asked it to do so. Central banks' contribution to BoP programme is not just a reflection of their material capabilities and national interests (Awrey, 2017; Henning, 2015; Volz, 2012) but is inherently tied up with their self-understanding in a given situation.

Lastly, when regional governance bodies are interpreted as being geared at collective norm formation, rather than as bargaining arenas, some of their design features appear more plausible. The ESRB, NBMF, and VI 2.0 all bring a variety of actors together, their competences and fields of action overlap, and none of them has any hard enforcement tools to ensure compliance. In turn, this lack of a stick has led some observers to question the effectiveness of these frameworks in tackling macroprudential risks (Stellinga, 2021; Thiemann et al., 2018). And yet, these inclusive settings have offered opportunities to deliberate what the implications of macroprudential ideas are for regional financial governance. It also serves as a venue where to elaborate on and provide broad input on jointly accepted principles for governing interdependent financial systems. While it may therefore no longer be the case that central banks on their own form epistemic communities for macroprudential policy (Johnson, 2016; McPhilemy, 2016; Verdun, 1999), collective institutions nevertheless serve to foster ideational convergence within policy communities.

In recent discussions on the programmatic direction for IPE, several scholars have argued that the discipline should tackle more big, systemic questions. Drezner and McNamara (2013, p. 156) called on IPE to 'explain the generation and transformation of global financial orders' and Cohen (2017, p. 19) asked: '[h]ow are monetary relations to be governed in a world of globalized finance?' The empirical contributions in this study, summarising broadly, leave the impression that central banks have cooperated in various, inherently contingent ways. They occupy a special role in the international financial system, which has allowed them to act with some autonomy, responding not just to material considerations, but also to normative considerations. The following section sketches the theoretical implications for the wider debate on central bank cooperation.

8.2 Theoretical implications

While this study speaks to broader issues of international monetary relations, it refrains from making any sweeping claims about why central banks cooperate around the world. Each instance of central bank cooperation is different. It is the result of how central banks as creative agents interpret specific situations. This study has argued that the terms of central bank cooperation do not conform to broad patterns but reflect discretionary choices. While the theoretical insights drawn from this research remain fairly abstract and even still somewhat tentative, they inform a wider understanding of the factors that drive central bank cooperation as well as the role that central banks play in the international financial architecture.

8.2.1 Insights gained through the ideal types

The overarching theoretical objective of this thesis is to develop a richer conceptual understanding of how central banks cooperate. Having studied a range of contextually linked cases of central bank cooperation, one can conclude that both ideal-typical logics of action considered here, based on consequences and appropriateness, provide intriguing insights. While the ideal types are highly abstract, they serve as useful analytical tools to study central bank cooperation more broadly.

Some of the findings associated with the logic of consequences (and thus financial market conditions) resonate with claims that have been made in other contexts about the drivers of central bank cooperation. Somewhat unsurprisingly, when central banks regard situations abroad as threatening domestic financial stability, they are often ready to help resolve the problem. Similarly, considerations about domestic policy objectives and the international role of the currency matter, especially for the SNB and the ECB, which both issue widely used international currencies.

Besides financial exposures, considerations around sovereign credit risk are prominent in the European context. These concerns influenced, for instance, the decision during the GFC of both the ECB and SNB to demand hard-currency collateral. Credit risk seems to have featured more prominently in Europe than it did in the United States: in 2008, the Fed ruled out requiring collateral from emerging market economies because doing so 'would "stigmatise" and "insult" these countries' (McDowell, 2017, p. 172). However, when it comes to the relationship between central banks and BoP assistance, this study diverges from others, such as McDowell (2017), who argue that the Fed provided swap lines if the IMF was seen as too slow or insufficiently funded. Especially the Riksbank was adept at using access to liquidity as leverage to get recipient countries to sign up for policy reforms.

The three most important findings associated with a logic of appropriateness are the importance of joint identities, international rules, and governance based on behavioural norms. First, joint identities inspire a sense of moral obligation to support central banks that are considered relatively close peers. Social prestige in professional networks also plays a role (Seabrooke & Tsingou, 2014): the ECB, the Riksbank, and the SNB were all members of the G10, and the DNB is seen as a shadow member of the Euro Area. Membership in the same IMF constituencies is another salient identity, which played a role in the cooperation in the Nordic/Baltic region. But while shared identities may inspire cooperation out of solidarity, treating them as 'heuristics' in the decision-making process (Marple, 2021) may be cutting a corner: the pressure from joint identities was strong enough to lead the Nordic central banks to provide support to Iceland and Latvia – two countries that other central banks had shunned. As such, joint identities may very well be considered drivers of cooperation in their own right.

Second, international agreements can influence cooperation in various ways. A more surprising finding, from a normative perspective, is that the existence of a fixed exchange rate agreement,

the ERM II, has led the ECB to impose stiffer borrowing terms for the central banks of Denmark and Latvia. While these decisions unequivocally speak to a normative interpretation, they show that the very existence of joint institutions does not inevitably lead to more cooperation (Schulz & Verdun, 2022). If rules are interpreted as requiring a degree of self-discipline, they may accomplish the opposite.

Third, the norm-based governance of regional financial risks during and after the GFC suggests that international regulatory developments should not just be considered from the perspective of coordinating policies, but also creating a shared framework of acceptable policy actions. Policy ideas are diffused across different institutional settings, sometimes by the same norm entrepreneurs. And although the rules of those arrangements are not formally binding, they carry perceptible moral weight for those actors that participate in them, precisely because they are formulated through lengthy deliberations and with the input of various actors.

Summing up, this thesis has proposed to study central bank cooperation by taking their perceptions of legitimacy and appropriateness seriously. Considering the importance of normative considerations across various instances and forms of central bank cooperation, one can conclude here that the study provides empirical evidence and analytical tools for a richer conceptual understanding of international monetary cooperation. Material considerations should not be dismissed, however as they surely did matter. These two perspectives should therefore be treated as complementary ways of analysing individual instances of central bank cooperation that are not in competition with one another.

8.2.2 Wider applications

The European context of central bank cooperation might be seen as idiosyncratic or sui generis – much in line with the EU itself. Indeed, many explanations that are developed here are likely to remain specific to individual outcomes. These caveats are not per se problematic. This study

has not aimed at any form of a controlled comparison between the cases. Instead, it emphasises the contextual and contingent characteristics of central bank cooperation. It also provides food for thought about processes of central bank cooperation in an integrated region characterised by close linkages.

To transfer the insights to other contexts, such as other cases of regional financial cooperation, they must be referred to a high level of abstraction. The features and interpretations of, say the ERM II, or the state of macroprudential thinking in Europe around the GFC were transient; other institutions or emerging policy norms may very well foster different forms of cooperation. However, it is part of the broader theoretical point advanced here that central bank cooperation needs to be seen as a contextual phenomenon, rather than following universal principles. The factors outlined above should not be read as a general explanation of international cooperation, but as concrete ways in which the ideal-typical logics of actions have manifested themselves across cases in this one specific context. In other contexts, things are bound to be different as other ideas, interests, and identities matter but there may be elements of similarity.

To make these theoretical points, one could of course have zoomed in on fewer instances of central bank cooperation to gain an even more profound and fine-grained understanding than has been attempted here. Such a setup would, however, have had two drawbacks for this study. First, trading off breadth against depth would have shifted the primary contribution from theoretical to empirical knowledge. Yet the objective here is to formulate widely applicable insights about central bank cooperation. The focus lies on technocratic cooperation more broadly not on formulating an exhaustive account of a single event. Second, by studying several synchronous instances of central bank cooperation, this study has been able to account for interdependencies and contingencies between them and acknowledge the messiness of real-world cooperation. The conceptual understanding that stands at the end of this study represents

but one way to interpret what happened using systematic categorisation. The added value of this study is to suggest, at a rather abstract level, that there is something to be gained by studying central bank cooperation in line with the approach outlined here. The following section proposes how the insights gleaned throughout this study can inform how future scholars may approach central bank cooperation.

8.3 Methodological implications

The theoretical argument outlined so far implies that future studies can benefit from treating central banks as responding to normative as well as material considerations. The relationship between national interests and identities, and the norms prevailing within the international central banking community should be problematised explicitly. To follow such an approach implies that future studies should apply methods that allow them to treat central banks as creative agents who possess scope for discretionary actions. Studies should account for how policymakers puzzle in uncertain situations, resolve conflicting considerations and adapt their behaviour over time. It is therefore not enough to try and explain individual events merely by reference to some form of material national interest. One has to reconstruct the decision-making processes as they unfolded and examine policymakers' perceptions of certain situations. The result ought then not to be a parsimonious predictive framework that explains cooperation, but empirically rich accounts that elucidate the factors that shaped specific decisions.

To structure such analyses, this study has proposed to use an 'analyticist' (Jackson, 2011) approach, using ideal-typical conceptions of how central banks might conceive of their actions. The framework employed here, drawing on March and Olsen's (1998) two logics of action, has remained relatively broad to ensure that it may be applied to many instances. Future studies could aim to refine it more situationally to increase its analytical leverage and precision. Spielberger (2022) has, for instance, contrasted a 'technocratic' and a 'politicised' logic of

action to distinguish the ECB's divergent approaches to credit line provisions to central banks from CEE in 2008 and 2020 and highlight a process of politicisation.

Future studies might also consider central bank cooperation more explicitly as a contingent process. Studies of central bank cooperation over time (McDowell, 2017; Pape, 2022) have based their analyses on snapshot views of individual instances, without acknowledging potential interdependencies between them. The findings of this study suggest, however, that the norms governing central bank cooperation are contested and may evolve as the result of norm entrepreneurship (Finnemore & Sikkink, 1998) or through processes such as lessons-drawing and organizational learning (Deverell, 2009; Dunlop & Radaelli, 2013; Levitt & March, 1988; Quaglia & Verdun, 2022). These processes may take a dynamic of their own that should be considered explicitly. To provide one illustration, central bank credit lines during the COVID-19 crisis (discussed in more detail at the end of this chapter) could be related to central banks' prior experience during the GFC and the institutionalization of standing swap arrangements in 2011.

Despite this study's emphasis on interpreting central banks' actions as following a logic of appropriateness, the methodological approach proposed here is open to materialist approaches. It is worth restating that materialist expectations have served as a helpful baseline. The findings of this study should then be read as a plea to include normative considerations systematically in future analyses, as a complementary approach to interpreting specific outcomes. Both perspectives can provide helpful insights into central banks' motivations.

Future studies may, however, pay more attention to the question of how agents resolve conflicts between competing logics of action to explain specific instances of cooperation. One might thus probe why normative understandings of appropriate action sometimes prevailed over considerations of expected consequences. This theoretical question has not been settled and

many possibilities exist (March & Olsen, 2011). The swap lines in the Nordic/Baltic region considered here suggest a hierarchy between the two logics of action – identities might come to the fore in materially ambiguous situations. Conversely, the ECB's credit lines show how specific ideas shape perceptions of where material interests lie and what actions might be appropriate to take. By and large, this study has found that policymakers resolve such conflicting pressures based on their specific ideas and experiences.

Central bank cooperation, especially during international financial crises is a messy affair. Appealing as it may be to explain decisions based on some readily available economic indicators and imputed interests, truly understanding them requires a reconstruction of the decision-making processes, aware that human agency matters for cooperation in the international financial system (cf. Hudson, 2005). Developing and refining a conceptual framework for analysing the different ways in which central banks could reconcile conflicting demands is one fruitful way of going forward with this agenda.

8.4 Looking ahead

The importance of central bank cooperation to the international financial system has, if anything, only increased since the GFC. The issue is therefore likely to remain an important one for IPE scholarship. Recent developments include for instance the creation of the Network for Greening the Financial System (NGFS) and the provision of central bank credit lines during the COVID-19 crisis. Though venturing into comprehensive accounts of these events requires new, dedicated studies, this section can at least outline how the concepts and understandings developed here might inform analyses of these kinds of events. It suggests how these developments can be interpreted as reflecting not only material calculations, but also the creation, development, and expression of international norms. Going forward, this thesis

proposes a research agenda that puts central banks' social agency at the centre of the analysis from the outset.

8.4.1 Collective action: The Network for Greening the Financial System

The foundation of the NGFS in 2017 brought the issue of climate-related risks onto the international central banking agenda. The purpose of the NGFS is to support the global climate agenda and specifically 'to enhance the role of the financial system to manage risks and to mobilize capital for green and low-carbon investments.'[261] As of 2022, it brings together 116 central banks and prudential supervisors to define and share best practices for measuring and regulating climate-related risks in the financial system. The NGFS advocates a proactive approach to tackling these risks which has been hailed as part of a wider paradigm shift towards more interventionist regulatory approaches (van 't Klooster, 2021).

Initially, the rationale for setting up the NGFS was presented clearly in line with the logic of consequences. For instance, when then-Bank of England Governor Mark Carney (2015) put the issue on the agenda in his 'Tragedy of the Horizon' speech, he urged central banks to act because of the risks that climate change might pose to financial stability, rather than the general need to protect the environment. From this perspective, regulating climate risks was necessary for central banks as a means to an end, that is, a partial strategy to fulfil a component of their policy mandates. However, more recent work has cast the issue of sustainability in more normative terms, suggesting that 'central banks can […] proactively promote long-termism by supporting the *values* or *ideals* of sustainable finance' (Bolton et al., 2020, p. 48, emphasis in original). Thus, tackling climate risks may be understood as either an additional policy objective

[261] Origin and Purpose | Banque de France (ngfs.net)

that central banks need to attend to or an emerging social norm within the central banking community, depending on which logic of action is invoked.

The organizational form of the NGFS supports this interpretation and shares many features with the initiatives studied here. The focus of its activities lies in developing a generally accepted framework for measuring and tackling climate-related risks, both by developing a more refined conceptual understanding of these risks (NGFS, 2021) and by sharing national experiences and best practices (NGFS, 2022a). As a voluntary initiative, the NGFS can only issue non-binding recommendations. It needs to rely on the authoritativeness of its policy advice, rather than any formal authority.

In short, the NGFS serves as a platform for norm development. The concrete payoffs for the participants remain uncertain: many NGFS publications acknowledge that the policy concepts it aims to introduce are as of yet still underdeveloped. A generally accepted measure of risks is still lacking (NGFS, 2022b). Studying the NGFS not as a policy hub, but also as a setting for socialization, deliberation, and learning is necessary to stress central banks' active role in shaping how to deal with climate risks.

8.4.2 Central bank credit lines during the COVID-19 crisis

Central bank credit lines made a comeback during the early months of the COVID-19 crisis in March 2020. When financial markets erupted in a 'dash for cash' (FSB, 2020), the US Fed, the ECB, and the BoJ quickly set up credit facilities to allow central banks to step in as lenders of last resort in foreign currencies once more (W. A. Allen & Moessner, 2020). This smooth and bold response to a major shock to the global financial system is widely considered crucial for preventing a complete collapse of global financial markets (Cetorelli, Goldberg, & Ravazzola, 2020).

That central banks were able to respond so boldly to an unprecedented shock is commonly linked to their experience with swap line provision during the GFC. Adam Tooze's (2020) account in March 2020 was emblematic of this assessment:

> 'There has not been as much international coordination among the central banks as there eventually was in fighting the 2008 global financial crisis. But explicit coordination may not be necessary. We have spent enough time digesting the experience of the global financial crisis. Everyone knows the playbook.'

Unlike financial market analysts, economists' accounts of these events so far have interpreted the COVID-19 credit lines as following material imperatives (Aizenman et al., 2022; Pape, 2022). Yet one may doubt whether these factors alone account for the most relevant factors that impacted the Fed's decisions. For instance, Aizenman et al. (2022) note that the Fed simply re-activated all the swap lines that it had set up during the GFC, but explain that these were based on financial and trade linkages, rather than on the recent precedent of cooperation with these central banks.

The ECB's actions also suggest that central banks' responses to the COVID-19 crisis additionally offer a context to map changes in their approaches towards credit lines over time. In three ways, the ECB broke new ground in 2020. First, it offered swap lines to two CEE central banks, the Croatian and Bulgarian ones, but repos to two others, despite similarly weak financial linkages, apparently out of considerations surrounding these countries' plans to adopt the euro (Spielberger, 2022). Second, it extended repo lines to non-EU central banks from South-Eastern Europe.[262] Third, the ECB copied the Fed's decision to complement its bilateral credit lines with new repo facilities that would be open to more central banks (Murau et al., 2021; Panetta & Schnabel, 2020).

[262] See Appendix 1

Central bank credit lines during the COVID-19 crisis were not just an indispensable tool to preserve international financial stability, but they also seem suitable to apply and develop the framework that this thesis has proposed. Future studies could investigate more systematically how central banks' perceptions of when it is appropriate to provide which sort of credit line. Building on that, one can trace how these norms have developed over time. This requires reconstructing the decision-making process and considering both actors and contexts. Understanding what exactly underpinned these decisions is not just a matter of setting the empirical record straight. It may also have implications for the developing character of the international monetary system and central banks' strategies for shielding their financial sectors against international crises.

Concluding thoughts

International financial stability is a precious public good that is usually taken for granted. Indeed, financial stability is commonly defined as the absence of its opposite (W. A. Allen & Wood, 2006). The reasons are obvious: financial crises can crash economies (Reinhart & Rogoff, 2009), wipe out people's lifetime savings (Chwieroth & Walter, 2019), and strain democracies (Funke et al., 2016). Financial crises are, in Charles Kindleberger's words, 'hardy perennials' (Kindleberger & Aliber, 2005) as they return regularly in different guises.

Over the past two decades, central banks have been critical in ensuring the operation of international financial markets. Many of the decisions that they took during the GFC were essential not only to withstand that crisis but also for developing new, internationally accepted approaches towards systemic risks. Today, central banks use macroprudential instruments to prevent systemic risks from emerging. Moreover, they have established agreements to coordinate their policies and assist each other in moments of crisis. This intensified cooperation has been successful, it seems, during the COVID-19 crisis. A recent article in the Financial

Times even wondered whether technocrats had become 'too effective for their own good' (Ganesh, 2022). But at the time of writing in 2022, central banks across the world are once again struggling to maintain stability as they confront rapidly accelerating inflation. This may be cause for concern. 'The evolution of central bank cooperation and coordination […] has closely followed the evolution of central bank credibility' (Bordo, 2021, p. 608). One must hope that central bankers will find ways – both new and established ones – to overcome the current challenges, too.

This thesis has argued that if one is to understand how institutions cooperate, one needs to unearth the motivations and considerations that drive the people working inside central banks. The latter are actors on the international stage. Their ideas and perceptions matter in the decisions that they take. Resolving international financial crises is therefore not only a matter of know-how – many books have been written on what ought to be done to handle crises – but a matter of practical knowledge and applied ethics (Flyvbjerg, 2004).

This actor-centred approach has cast a different light on central bank cooperation. Central banks reflect on which course of action would be appropriate based on their beliefs and identities. Considering these findings, it may appear reductive to think that 'central banks feel partly responsible for […] the stability and efficiency of the international monetary and financial system, at least *insofar as it affects their own domestic economy*' (Borio & Toniolo, 2006, p. 1). Central banks base their decisions on how they think about themselves and how they relate to each other. Maintaining international financial stability may therefore not merely be a matter of ensuring the operation of international markets. It may also be the result of the dynamics, norms, and beliefs inside the transnational community of central bankers. The hope is that IPE scholarship of the international financial order, therefore, takes note of the role of the logic of appropriateness in understanding what may be driving central bank cooperation.

Appendix

Appendix 1 : Overview of central bank credit lines in Europe 2001-2022

Date	Lender	Borrower	Remarks
13/09/01	*Federal Reserve*	*European Central Bank (ECB)*	*USD/EUR swap, EUR 50bn*
28/01/03	*ECB*	*Swiss National Bank*	*EUR/CHF bilateral swap*
n/a	*ECB*	*Bank of Japan*	*EUR/JPY swap*
12/12/07	*Federal Reserve*	*ECB*	*EUR/ USD swap, USD 20bn*
12/12/07	*Federal Reserve*	*Swiss National Bank*	*EUR/CHF swap, USD 4bn*
20/12/07	ECB	Sveriges Riksbank	SEK/ EUR swap, EUR 10bn
15/05/08	Denmark's National Bank, Central Bank of Norway, Sveriges Riksbank,	Central Bank of Iceland	ISK/EUR swap, EUR 500m each
18/09/08	*Federal Reserve*	*Bank of England*	*USD/GBP swap, USD 40bn*
24/09/08/	*Federal Reserve*	*Danish National Bank, Central Bank of Norway, Sveriges Riksbank*	*USD/DKK swap and USD/NOK swap, USD 5bn each; USD SEK swap, USD 10bn*
13/10/08	*Federal Reserve*	*ECB*	*USD/EUR swap, unlimited*
15/10/08	Swiss National Bank	ECB	CHF EUR swap, EUR 25 bn, expired in 2010
16/10/08	ECB	Hungarian National Bank	EUR 5bn repo; informally converted into swap from late 2009 until early 2010
26/10/08	ECB	Denmark's National Bank	EUR/DKK 12bn swap
11/11/08	ECB	Bank of Latvia	EUR 1bn repo
17/11/08	Swiss National Bank	National Bank of Poland	CHF/EUR swap
28/01/09	Swiss National Bank	Hungarian National Bank	CHF/EUR swap

21/11/08	ECB	National Bank of Poland	EUR 10bn repo
16/12/08	Denmark's National Bank, Sveriges Riksbank	Bank of Latvia	EUR/LVL swap, EUR 500m in total (EUR 375m by Sveriges Riksbank; EUR 125m by Denmark's National Bank); after March 2009 only Sveriges Riksbank
18/02/09	Sveriges Riksbank	Bank of Estonia	SEK/EEK swap, SEK 200m
09/05/10	*Federal Reserve*	*ECB*	*USD/EUR unlimited swap*
17/12/10	*Bank of England*	*ECB*	*GBP/EUR swap, GBP 10 bn*
25/6/12	*Swiss National Bank*	*National Bank of Poland*	*CHF/PLN swap, size undisclosed*
10/10/13	*ECB*	*People's Bank of China*	*EUR /RMB swap, EUR 45 bn*
31/10/13	*ECB*	*Bank of Canada, Bank of England, Bank of Japan, Federal Reserve, Swiss National Bank*	*Unlimited bilateral swap network*
21/07/14	*People's Bank of China*	*Swiss National Bank*	*RMB/CHF swap, RMB 150bn*
19/05/15	*People's Bank of China*	*National Bank of Ukraine*	*RMB/UAH swap, RMB 15bn*
16/09/15	Sveriges Riksbank	National Bank of Ukraine	USD/UAH swap, USD 500m
23/12/15	*National Bank of Poland*	*National Bank of Ukraine*	*PLN/UAH swap, USD 1bn*
16/04/2016	*Swiss National Bank*	*National Bank of Ukraine*	*USD/UAH swap, USD 200m; guaranteed by the Swiss government*
19/03/20	*Federal Reserve Bank*	*Denmark's National Bank, Central Bank of Norway, Sveriges Riksbank*	*USD/DKK, USD/NOK, and USD/SEK swaps, USD 30bn each*
20/03/20	*ECB*	*Denmark's National Bank*	*EUR 24 bn swap*
15/04/20	*ECB*	*Croatian National Bank*	*EUR/HRK swap, EUR 2bn*

22/04/20	*ECB*	*Bulgarian National Bank*	*EUR/BGN swap, EUR 2bn*
05/05/20	*EBRD*	*National Bank of Ukraine*	*USD/UAH swap, USD 500m*
05/06/20	*ECB*	*National Bank of Romania*	*EUR 4.5 bn repo*
25/06/20	*ECB*	*"a broad set of central banks"*	*Creation of EUREP facility, unlimited, repo*
17/07/20	*ECB*	*National Bank of Serbia*	*EUR 1bn repo*
17/07/20	*ECB*	*Bank of Albania*	*EUR 400m repo*
23/07/20	*ECB*	*Hungarian National Bank*	*EUR 4 bn repo*
12/11/20	*Central Bank of Norway*	*Denmark's National Bank; Sveriges Riksbank*	*NOK/DKK and NOK/SEK swap, size undisclosed*
22/03/22	*National Bank of Poland*	*National Bank of Ukraine*	*USD/UAH swap, USD 1bn*
28/03/22	*ECB*	*National Bank of Poland*	*EUR/PLN swap, EUR 10bn*

Sources: Albrizio et al., 2021; European Central Bank, 2007, 2014, central banks' websites

Appendix 2: Participant consent form

Participant Consent Form

Central Bank cooperation in Central and Eastern Europe

You are invited to participate in a study entitled **Central Bank cooperation in Central and Eastern Europe** conducted by Lukas Spielberger.

Lukas Spielberger is a PhD candidate at the Institute of Political Science at Leiden University. If you have further questions you can contact him at l.spielberger@fsw.leidenuniv.nl or reach him under his mobile phone number +49 157 32399525.

His doctoral research is supervised by Prof Amy Verdun. This research receives no funding from external sources.

Purpose and Objectives

This research project seeks to investigate cooperation between central banks in Western/Northern Europe and Central and Eastern Europe. The project's aim is to understand why central banks decided to cooperate before, during, and after the financial crisis in 2008/09 and how cooperation took place. The study seeks to contribute to the debate in international political economy on central bank swap lines and international financial markets. It also aims to contribute to the literature on financial and monetary integration in Europe.

Importance of this Research

Most publications on central bank cooperation have focused on the provision of swap lines by the US Federal Reserve, rather than the wider phenomenon. The case of Central and Eastern Europe contributes to a better understanding of the interests and concerns that central banks have when cooperating in the international financial system.

Participants Selection

You are asked to participate in this study because of your knowledge of financial markets and monetary policy in Central and Eastern Europe. In addition, you have been chosen based on the position you currently hold or have held in the past.

What is involved

If you agree voluntarily to participate in this research, your participation will involve answering questions during an interview, which will take approximately 60-90 minutes (list of questions attached). The interviews would normally be audiotaped, unless you indicate that you do not want that. On some occasions, if it is impossible to meet in person, an interview could be held by telephone.

Inconvenience

Participation in this study takes 60-90 minutes of your time for the purpose of the interview, as well as any preparations you might want to make before the interview takes place.

Risks

The research is conducted in accordance with the Code of Ethics for the Social and Behavioural Sciences for Dutch universities and has been approved by the thesis supervisor.

The Code of Ethics requires that I point some potential risks to you by participating in this research if the researcher were to misuse the information provided by the participant—i.e. the loss of reputation within or outside your organization. Should you at any moment, choose not to take part in research, you would be free to let me know you no longer want to participate. In that case we will not include insights obtained through you in the final publications.

To avoid any misunderstandings, and to enable you to choose your level of confidentiality, we have the following options indicated below under confidentiality.

Benefits

The potential benefits of your participation in this research include: if you are interested, you may obtain a copy of the research report and a link to the final dissertation. This study may have potential benefits to society, as it will provide a better understanding of the governance of international financial markets and the resolution of the financial crisis in 2008/09.

Compensation

There is no monetary compensation for participating in the research.

Voluntary Participation

Your participation in this research must be completely voluntary. If you decide to participate, you may withdraw at any time without any consequences or any explanation. If you do withdraw from the study, your data will not be used or only if you give explicit permission.

At your request you can obtain a recording or a transcript of the interview to review.

Confidentiality

Your confidentiality and the confidentiality of the data will be protected. I will let you know who referred you so you know that this person has a good guess that we may be speaking to you. In the event that this reference is problematic to you, please let us know. We can discontinue the conversation at any point and you may ask to be removed from participating in the project. Alternatively, I can promise not to inform the referee that I have spoken to you.

Unless individual participants agree I will not mention names. If you do not want your name mentioned in the report I would ask if you would allow me to include your general job description in the report in general terms (e.g. official at the European Central Bank). Here are your options:

Confidentiality. We offer to protect your identity. We will not mention your name or detailed function in the research report unless you chose to reveal your identity.

I agree to reveal my identity (my personal name) yes ______ no ______

I agree to reveal the institution that I work for (e.g. European Central Bank) yes ______ no ______

Literal quotation. You may give me the right to quote you literally or not. (If you do agree that I may quote you, you may still decide at any given point during the interview that you would not want a particular phrase/comment you made to be quoted).

I agree to be quoted literally yes ______ no ______

If yes, please show me the quote in advance yes ______ no ______

Dissemination of Results

It is anticipated that the results of this study will be shared with others in the following ways: published articles and book chapters and a thesis manuscript; presentation at conferences; some materials may be

disseminated on website; and research summary may be distributed to those who participated in the research.

Disposal of Data

The data will be used for academic purposes, i.e. the writing of academic books, book chapters and journal articles by the researcher. They will respect the rules of confidentiality set out above.

Interview audio files and transcripts will remain on the password protected server for research data provided by Leiden University. They will only be accessed by the researcher and the thesis supervisor. Data will be stored for 20 years.

Contacts

The person to contact regarding this study is Lukas Spielberger (l.spielberger@fsw.leidenuniv.nl). In addition, you may verify the ethical approval of this study, or raise any concerns you might have, by contacting the Ethics Review Committee of the Social Sciences at Leiden University.

Your signature below indicates that you understand the above conditions of participation in this study and that you have had the opportunity to have your questions answered by the researcher.

Name of Participant Signature *Date*

A copy of this consent will be left with you, and a copy will be taken by the researcher.

Appendix 3: Sample interview outline

Question list

Research Project: Central bank cooperation in Central and Eastern Europe

Primary **Researcher:** Lukas Spielberger, PhD Candidate, Leiden University

Thesis supervisor: Prof Amy Verdun, Leiden University

Funding: Leiden University internal Funds

General Information about the Interview

This research project focuses on lending arrangements between central banks in Central and Eastern Europe during the financial crisis in 2008/09. In my research project I aim to inform the debate in international political economy on central bank cooperation in the international monetary system in two ways: First, I want to discover Western and Northern European central banks' motivations to conclude cooperative arrangements with the central banks of Poland and Hungary, and Latvia and Estonia, respectively. Second, I hope to show how these arrangements related to regional efforts at financial stabilisation.

The objective for this interview is to find out more about the international cooperation of the OeNB both in its role as part of the Eurosystem and in banking supervision.

Before we start the conversation I would like to ask what you consider your organization's official written position on the financial crisis. I shall ask you to tell me when I may interpret your opinion as the policy, strategy, or view of the organization for which you work, and to indicate when you are providing me with your personal opinion. After asking you about your function within your organization and how long you have been working there, and your professional background, I would start asking the following questions:

List of questions

1. Before the onset of the crisis in 2007, how would you describe the attitude of [your organisation] towards financial markets in Central and Eastern Europe (CEE)?
2. How did [your organisation]'s assessment of financial markets in Central and Eastern Europe change after 2007? What was your personal assessment?
3. What, from your perspective, were the steps that led to central bank lending agreements (swap or repo)?
4. Which factors do you think shaped the terms of the lending agreements?
5. Which other forms of central bank cooperation besides lending arrangements would you highlight during the financial crisis?
6. Which role did other sources of foreign exchange liquidity, such as parent banks or EU funds, play in the resolution of the financial crisis? How would you describe the impact of the Vienna Initiative?
7. Overall, how would you evaluate the role of central bank cooperation in resolving the financial crisis in CEE between 2007 and 2010?

8. Is there anything you would like to tell me about for my research which I haven't thought to ask you?
9. Could you recommend any further potential informants or any documents I might want to refer to for my research?

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Curriculum Vitae

Lukas Spielberger was born in Mainz, Germany, on July 19 1993. In 2011, he obtained his Allgemeine Hochschulreife at the Rabanus-Maurus Gymnasium Mainz. He first studied French and Linguistics at the Johannes-Gutenberg Universität Mainz, but in 2013 he instead matriculated at the University of Twente, the Netherlands, to pursue a B.Sc. in European Public Administration which he completed *cum laude* in 2016. In 2017, he graduated from the London School of Economics and Political Science with an M.Sc. in Political Economy of Europe. His M.A. in European Political and Administrative Studies, with a specialization in European Public Policy Analysis, from the College of Europe in Bruges, Belgium, in 2018 received the distinction *excellent*.

During his studies, Lukas volunteered for the Bringing Europeans Together Association (BETA), both as an organizer of EU simulation games and as President of BETA France. In the second half of 2018, he worked as a supply teacher at the Rheingrafen Realschule Plus, in Wörrstadt, Germany.

In January 2019, Lukas began his doctoral research at the Institute of Political Science, Leiden University, under the supervision of Prof. Amy Verdun and Dr. Matthew diGiuseppe, with Prof. David Howarth (University of Luxembourg), as external supervisor. Lukas' work has been published in the *Journal of European Public Policy* and *Comparative European Politics.*

Besides his PhD, Lukas completed the Europeaum Scholars Programme 2020-2021. Since September 2022, Lukas works at the University of Luxembourg as a Postdoctoral researcher in European Integration Studies/ Political Science on the project 'Banking in Europe.'