Faustian Bargaining in a Regime Complex: IMF-RFA Cooperation in Europe (2008-2012)

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Abstract

What explains IMF behavior in Europe between 2008 and 2012? Harshly criticized in Greece, yet tentatively praised in Hungary, the institution found itself playing different roles as it responded to a string of financial crises. Its programs varied substantially in terms of conditionality, financing, and private sector involvement. This thesis explores why, highlighting the changing global financial safety net, which is both expanding and becoming more decentralized due to the spectacular rise of regional financing arrangements (RFAs).

Existing theories of IMF behavior assume the Fund to be a stand-alone institution and analyze financial assistance as the outcome from the interplay between creditors, borrowers, and staff. By focusing on dynamics *within* the IMF, however, they miss how developments *outside* the institution are increasingly shaping its behavior.

This thesis brings in the role of changes in the institutional environment by drawing on the literature on regime complexity. The proliferation of RFAs alters the outside options of all actors, which affects their bargaining power. This opens the way for new strategies, through which creditors can *entangle* institutions by creating overlaps, borrowers can engage in *confrontation* between alternative financing institutions, and the IMF can find means to *co-work* with RFAs. These in turn affect whose preferences shape program design.

This argument is tested empirically through process-tracing and comparing three cases of IMF-RFA cooperation in Europe. In Hungary, the IMF led the way in shaping a surprisingly 'generous' program with little constraint from the EU. However, in Latvia, the Fund found itself a 'junior partner' in a program driven by local authorities with the support of an European RFA. In Greece, the interests of creditors were paramount, securing IMF acquiescence through the threat of exclusion.

These findings point to significant challenges for the Fund going forward. As RFAs continue to proliferate around the world, the IMF needs to avoid the temptation of striking even more Faustian bargains that keep it at the table of financial assistance at the cost of becoming a junior partner.

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Glossary of acronyms

AMF: Arab Monetary Fund

AMRO: ASEAN+3 Macroeconomic Research Office

BIS: Bank of International Settlements

BRICS CRA: BRICS Contingent Reserve Arrangement

CMIM: Chiang Mai Initiative Multilateralization

EB: Executive Board (of the IMF)

EBRD: European Bank for Reconstruction and Development

EC: European Commission

ECB: European Central Bank

ED: Executive Director (of the IMF)

EDP: Excessive Deficit Procedure

EFSD: Eurasian Fund for Stabilization and Development

EFSF: European Financial Stability Facility

EFSM: European Financial Stabilization Mechanism

EMF: European Monetary Fund

ERM: Exchange Rate Mechanism

ESM: European Stability Mechanism

EU BoPA: European Union Balance-of-Payments Arrangement

FLAR: Fondo Latinoamericano de Reservas (Latin American Reserve Fund)

G20: Group of Twenty

GAB: General Arrangements to Borrow

GFSN: Global Financial Safety Net

GLF: Greek Loan Facility

IEO: Independent Evaluation Office

IMF: International Monetary Fund

IO: International Organization

MNB: Magyar Nemzeti Bank (Hungarian National Bank)

MoU: Memorandum of Understanding

NAB: New Arrangements to Borrow

NAFA: North American Framework Agreement

OECD: Organization for Economic Cooperation and Development

PSI: Private Sector Involvement

RFA: Regional Financing Arrangement

SBA: Stand-By Arrangement

SDR: Special Drawing Rights

SGP: Stability and Growth Pact

SMP: Securities Markets Programme

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I. Introduction

When officials from the International Monetary Fund enter the room, local government representatives generally know what to expect. For them, this is often a last resort after all other measures to deal with a severe financial crisis battering their country have failed. For IMF staff, negotiating crisis programs that help countries deal with balance of payments difficulties drawing on the Fund's wide-ranging previous experience is their 'bread and butter' activity. What typically follows are tense discussions over program strategy, modalities of financing, and reforms that country officials promise to undertake in exchange. With the outcome of talks often affecting the daily lives of millions, the stakes are high and all sides seek to deploy bargaining strategies to their advantage. Just between 2002 and 2013, the IMF negotiated 71 such programs with 44 different countries across four continents.

Yet, there was something different about this common scene in November 2008, when Hungary asked the IMF for financial assistance. In addition to all the usual protagonists, now representatives of the European Commission, which had its own financial assistance vehicle, were seated side-to-side with IMF staff. Initially, this appeared to be a no-brainer – the Fund could benefit from both the additional financing and knowledge of the Commission, where the Europeans could draw on the extensive crisis-fighting experience of IMF staff. However, when this arrangement was replicated several weeks later in Latvia it proved far more controversial. Local authorities, supported by the Europeans, managed to largely push through their preferred policies, which left Fund staff feeling outmaneuvered and constrained to go with a strategy they considered doomed to fail. Yet, this was just a foretaste of the even more acrimonious experience that was to come in May 2010, when the IMF broke its own rules to go ahead with a Greek program close to the preferences of large creditor states that would soon after go significantly off-track.

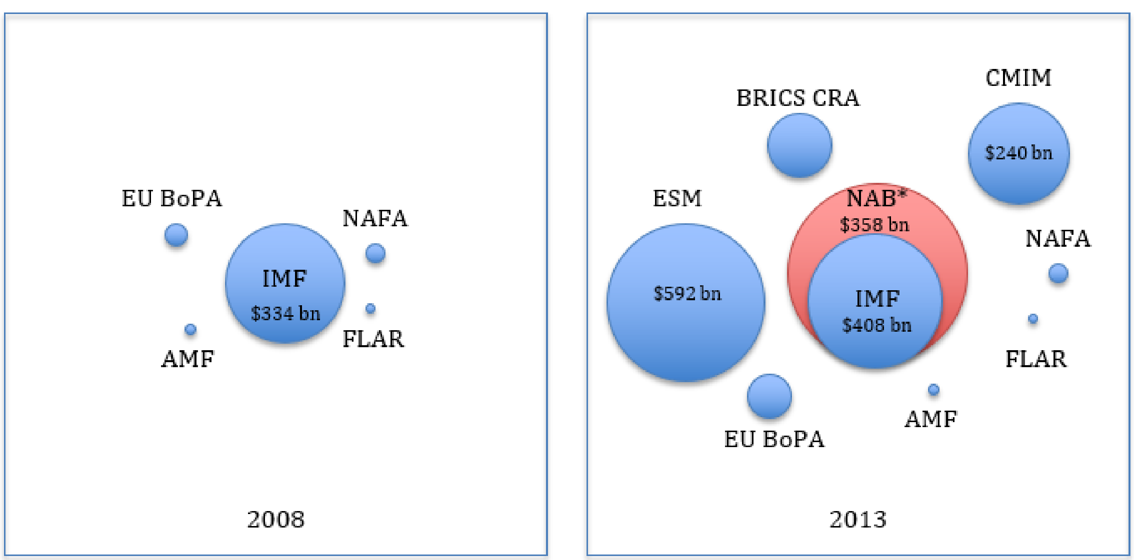
The experience of the IMF in Europe in the aftermath of the global financial crisis raises several puzzles. Between 2008 and 2013, the Fund disbursed some of the largest and most controversial loans in its history. In some cases, the presence of alternative institutions appeared to help the IMF to achieve its goals. In others, however, a similar configuration appeared to favor creditors or borrowers, leaving the Fund with little choice but to support programs that it believed destined to failure. Within a period of just several months and across countries facing comparable crises, the Fund went on to offer programs that varied significantly on several key measures such as levels of conditionality, modalities of financing, and bail-in of foreign banks (private sector involvement). During this time, the role of the Fund itself also varied dramatically, from being in the ‘driving seat’ to being relegated to a ‘junior’ partner.

IMF behavior in terms of outcomes in program design is often explained as the result of bargaining processes during program design negotiations between creditors, borrowers, and IMF staff. Traditionally, such processes unfolded within the confines of the Fund, with actors mobilizing different sources of leverage. The resulting program design reflected the relative bargaining power of these three sets of actors within the specific context of a particular county at a particular point in time. While this has been well-studied and documented, cases such as Hungary, Latvia, and Greece, as well as others in Europe, suggest a significant change in the institutional environment which affects both the process and outcome of such bargaining.

A changing institutional environment

Understanding the reasons for these varying outcomes has a relevance that is broader than the Fund's 'European crisis'. Regional financing arrangements (RFAs) similar to the ones in Europe have proliferated over the past decade and now cover 81 different countries across Europe, the Middle East, East and Central Asia, and Latin America (IMF 2017a, p. 8). Between 2008 and 2013, their total lending resources skyrocketed from around $18 bn to over $873 bn, which meant they jumped from barely 5% of IMF resources to 114%, overtaking its total lending capacity (IMF 2013a). Whereas before 2008 the Fund could be considered as 'the only game in town' when it came to financing arrangements, now the global financial safety net has become significantly more diverse and decentralized. The IMF therefore finds itself simultaneously competing and cooperating with an array of overlapping institutions and alternative source of financing. The goal of this thesis is to understand how this profoundly altered institutional environment affects the negotiating strategies and bargaining power of the various actors that comprise the Fund.

Figure 1: IMF and RFA lending capacity, 2008 and 2013 (USD, bn)



Source: IMF (2013a); * NAB – New Arrangements to Borrow (see Chapter 2)

How does the presence of such alternatives to financial assistance affect IMF behavior? On the one hand, RFAs can be immensely helpful in overcoming some of the biggest constraints the Fund faces. First, they are generally considerably closer in their economic surveillance to crisis countries that the IMF, and therefore have knowledge about the local financial challenges that allows to better target and streamline conditionality on macro-critical tasks. Second, RFA resources are now significant enough to complement the IMF 'war chest', which has been consistently signaled out as insufficient given the scale of capital flows between countries. Third, given that RFAs are not associated with the IMF 'stigma', they have a dense network of relationships on which they could draw, which can enhance the level of country ownership and provide contacts directly with private market actors, both of which are crucial to fighting financial crises. These dynamics were evident in certain cases, such as in Hungary in 2008-2011, where the IMF and European institutions were perceived as partnering effectively and efficiently according to a division of labor that corresponded to their relative advantages. The resulting financial assistance program was larger than what the IMF would have been able to mobilize on its own and relied on a 'soft' form of foreign bank bail-in to prevent capital outflows, allowing for a reduction in the need of country adjustment measures and thus in conditionality requirements.

On the other hand, RFAs are at best a mixed blessing for the IMF given the potential 'threat of exclusion' as their functions overlap, opening the way for creditors and borrowers to 'play them off' against each other. This appears to have been the case with Latvia, which successfully resisted pressure by the Fund to devalue its currency largely because it was able to draw on support from the EU *in lieu* of the IMF, consciously pushing the Washington-based institution into the role of a 'junior partner'. In the absence of RFAs and given previous experience with similar countries, it is likely that the Latvian authorities would have had little choice but to acquiesce to the Fund's 'advice' as the IMF would have been their last line of defense against the financial crisis. Therefore, in this case at least, the presence of an alternative institution increased the bargaining leverage for the 'weak' debtor country at the expense of what traditionally has been seen as a 'powerful' IMF in such circumstances.

Similar dynamics, based on the 'threat of exclusion', occur when the IMF steps on the toes of its most powerful creditors. Even more than borrowers, creditors have the financial resources to *create* overlapping institutions consciously to increase their leverage. In Greece, for example, European creditors preferred to channel most of their assistance through a brand new RFA created over endless 'crisis summits' and only reluctantly brought it the Fund late in the process to satisfy key domestic constituents. This meant that the IMF went through a process of breaking procedures and safeguards it had developed after previous bitter experiences without *direct* pressure from creditors through formal or informal channels. This adds a potentially new source of influence for creditors over program design negotiations that goes beyond previously identified mechanisms, further increasing the bargaining power of the already powerful.

Existing explanations and the challenge of RFAs

Given its central role in global financial governance, the Fund has attracted much scholarly attention. Researchers have advanced a number of theories that seek to explain precisely such variation in the design of its programs, most commonly focusing on conditionality or financing modalities that are shown to differ greatly among countries even when controlling for economic factors. A large body of literature has established that political drivers often have a determining effect on IMF decision-making. However, while such studies generally rely on long-term historical or large-scale statistical approaches, the experience of the Fund in co-lending with regional financing arrangements (RFAs) is much more recent.

The Fund has attracted sustained attention, particularly when it comes to shaping the policies of countries facing financial crisis through its lending facilities. Creditor-centric explanations of IMF behavior focus on the interests of key creditors and shareholders, such as the United States and few other advanced economies that together make up the G5 (Japan, United Kingdom, France, and Germany). Such perspectives suggest that powerful states will use their voting power at the Fund's Executive Board, as well as other, 'behind-the-scenes' means, to influence programs in cases where their financial institutions risk facing steep losses or where larger geopolitical considerations are at stake (Stone 2011). Borrower-centric explanations, meanwhile, point out that successful Fund programs require domestic actors that are willing and able to implement the necessary measures. This means that IMF can be swayed by the need to support 'sympathetic interlocutors' against more antagonistic opposition actors, or, alternatively, can be used by the borrower government as an external commitment device to push through domestic reforms (Vreeland 2003; Woods 2006a). Meanwhile, bureaucratic approaches point to the expertise, resources, and agenda-setting power of staff within the institution. In particular, variables such as narrow material self-interest or more normative considerations such as shared ideational worldviews become central (Chwieroth 2013; Vaubel 2004).

Despite their relative success in explaining IMF behavior, such perspectives are likely to yield biased predictions in the new institutional environment in which the IMF operates side-by-side with RFAs. Existing accounts focus on explaining who wins in conflicts between borrowers, creditors, and staff *within* the Fund based on implicit assumption that the alternative to IMF involvement is a painful adjustment without financial assistance. However, with the rise of RFAs the Fund now finds itself operating alongside a set of overlapping institutions that can also provide crisis lending. Therefore, maintaining the implicit assumption of 'splendid isolation' is no longer warranted as borrowers or creditors can approach alternative institutions to receive financial assistance. In turn, this suggests that moves *outside* of the Fund can have an important effect on its behavior.

To understand the impact of RFAs on IMF program design, this study draws on a relatively recent but rapidly increasing theoretical literature concerning 'regime complexity'. This refers to the presence of alternative institutions with at least partially overlapping mandates, a development that has been well noted in a number of issue areas in world politics such as environmental or trade governance (Keohane and Victor 2011). The resulting studies have largely focused on understanding the reasons for institutional proliferation as a dependent variable, or studying the effects of such complexity in enabling cross-institutional strategies for states (Alter and Meunier 2009). Nevertheless, the regime complexity literature, while advancing quickly, has not so far paid enough specific attention to IOs. Therefore, the goal of this thesis is to bring together the insights of regime complexity regarding the impact of proliferating institutions and the recent advances in studies of IO behavior.

Whose preferences? Regime complexity and IMF program design

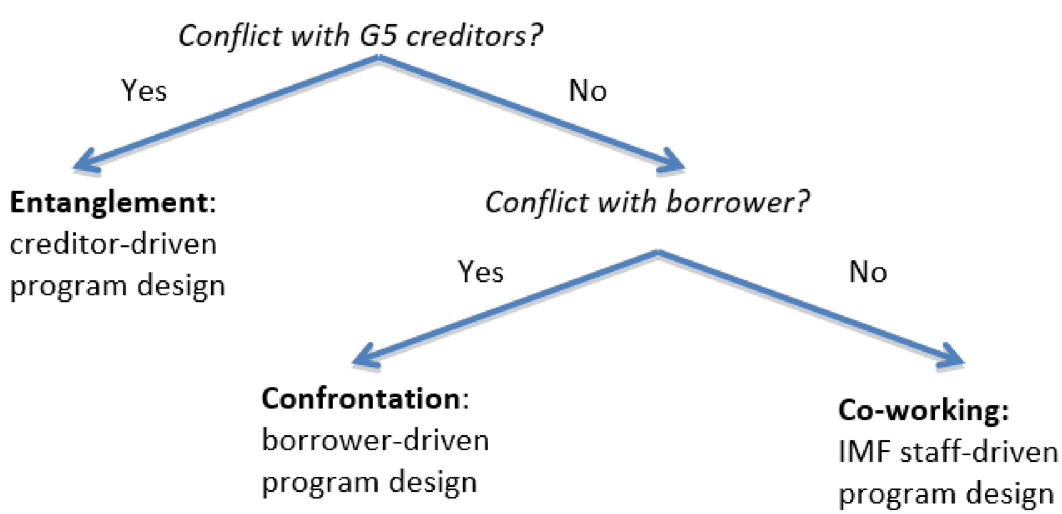
How does regime complexity impact IMF behavior? The presence of overlapping institutions creates the potential for exclusion if states decide to use alternative RFAs. This can be problematic for the Fund as it could diminish its resources and influence in the future. Alternatively, having more institutions involved can provide additional resources, knowledge, and contacts that can improve the effectiveness of the IMF. The institutional environment therefore is a priori neither a constraint nor an enabler – instead, its impact can vary depending on the strategies of states and IOs involved in the regime complex. In Hirschmanian terms, RFAs create a potential exit option for actors other than the IMF, which can increase their voice in bargaining with the Fund. Depending on the extent of preference divergence and the characteristics of alternative institutions, this can result in three different scenarios when it comes to program design.

First, in cases where the interests of the G5 creditor countries are intense and their preferences are in conflict with those of staff and/or borrowers, they can strategically channel financial assistance through RFAs that they are able to control directly. As with the existing literature, such interests stem from either the exposure of 'their' financial institutions to the crisis country, with losses potentially ricocheting on sovereign balance sheets, or from geopolitical interests. However, these motivations result in significantly different behavior under conditions of regime complexity. Instead of using their formal voting power or informal 'behind-the-scenes' means for influence, powerful states threaten or indeed engage in 'competitive regime creation' (Morse and Keohane 2014). They then use those alternative institutions to align IMF behavior with their preferences over program design without needing to directly engage in battles within the Fund itself. Instead, they rely on the incentives of management to remain involved in crisis lending for short-term financial benefits, but especially for the longer term organizational goal of maintain the focality and relevance of the IMF within an increasingly decentralized regime. In these cases, G5 creditors make sure their preferences are closely reflected in final program design through a strategy of *entanglement* (Henning 2017a).

Cases of intense G5 interests are likely to be high profile, but many other lending decisions occur in a context without large-scale exposure of powerful creditors. In these situations, borrower preferences within the regime complex become salient. If the borrower government has sharp disagreements with the crisis resolution strategy put forward by the Fund, it will look to receive financial assistance from other institutions such as RFAs that are more closely aligned to its preferences. However, unlike powerful creditors, they are restricted to choosing from a 'fixed menu' of options that are already available at the moment of the dispute. If an alternative RFA that is more closely aligned to their preferences does exist within the regime complex, borrowers use the threat of exclusion to bring the IMF closer to their own preferred strategy. This differs significantly from existing accounts that suggest that the power of borrowers stems from playing 'two level games' with the Fund in pointing out their constrained domestic win set and the danger of being replaced by more 'radical' opponents. A regime complex with availability of a suitable RFA thus gives such 'weak' actors leverage vis-à-vis the Fund even in the absence of domestic constraints. The result is that borrower preferences over program strategy can take precedence based on a strategy of *confrontation*.

Finally, there are also situations in which not only G5 interests are relatively limited, but also borrowers do not have significant disagreements over strategy with the Fund. Left to its own devices, IMF staff relies on resources from its institutional environment to increase the chances of 'success' of financial assistance programs. Thus, the Fund can draw on the additional money, local knowledge, and contacts with private actors that an RFA might bring to a crisis country. Both institutions are motivated by the desire to achieve their goals and seek to mutually complement their capabilities based on the logic of division of labor that allows for specialization according to areas of expertise. This differs in important ways from existing explanations, notably by suggesting that 'turf wars' between IOs are less likely to occur than previously thought and that shared ideational worldviews with local authorities are not the only possible driver for more 'generous' programs. Instead, the IMF can draw on the presence of RFAs to achieve a program that is larger in size and better targeted in terms of conditionality than it would have been able to put forward otherwise if relying solely on its constrained resources. In these cases, therefore, regime complexity allows staff to better realize their program design preferences through a strategy of *co-working* with RFAs.

Figure 2: Impact of regime complexity on IMF program design



Research design: IMF-EU programs in Hungary, Latvia, and Greece

In selecting the cases for testing the theoretical claims the thesis seeks to balance methodological considerations against data constraints. At the time of writing, IMF experience with lending in cooperation with RFAs is unfortunately limited to just seven cases, all of which are within the EU[1]: Hungary (2008-10), Latvia (2008-11), Romania's successive programs[2] (2009-2015), the three Greek programs (2010-2018), Ireland (2010-2013), Portugal (2011-2014), and Cyprus (2013-2016). Among these cases, the research focuses on three in particular which allow for variance on the independent variable, namely the degree of preference divergence between staff and creditor/borrowers in a regime complex. The first program under study is Hungary in November 2008, where G5 creditors had limited financial and geopolitical interests and the borrowing country was relatively aligned with IMF strategy from the outset. The second case, Latvia in December 2008, keeps the condition of low intensity of G5 preferences, but introduces a significant degree of divergence between the borrower government and IMF staff. Finally, a third case, the financial assistance program for Greece in 2010, exhibits high intensity of G5 creditor preferences due to financial exposure and potential contagion worries. The relatively small number of cases of IMF-RFA interaction so far is a key reason why a case study approach is preferred over a statistical analysis for which there are yet insufficient observations.

This case selection strategy also allows holding some key potentially confounding factors constant. By picking cases within a very limited time period of around 18 months, it controls

[1] Spain is a borderline case as IMF participation was restricted to technical assistance.
[2] Romania had a classic SBA arrangement between 2009 and 2011, which was followed by two considerably smaller arrangements agreed in 2011 and 2013 that were treated as precautionary.

to an extent for changes in the global financial environment as well as potential large-scale shifts in personnel or ideas within the IMF and globally. At the same time, despite some differences among the three countries, which are discussed in the thesis, they are all high-income countries (according to the World Bank) and EU members with comparable institutional and legal setup. Nevertheless, to mitigate the possibility of selection bias, country programs are also evaluated against other cases of IMF lending within the same period where possible as well as in the context of a larger sample of IMF lending programs from 2002 to 2013.

To operationalize the approach, this study focuses on the influence of regime complexity on the process of IMF negotiations with borrower countries in the context of the presence of alternative RFAs. In order to establish the point of departure, it examines documents related to the initial positions of creditors, borrowers, and IMF staff at the outset of the negotiations and traces how they evolve and are reflected into the final program. In order to ensure that programs across countries are comparable, it considers three dimensions related to the dependent variable of program design: fiscal and structural conditionality, level and frontloading of financing, and extent of private sector involvement (bail-in). Together, they indicate how the burden of adjustment in covering the 'financing gap' is distributed among creditors, borrowers, and the Fund. Moreover, these are the same dependent variables that the existing IMF literature explicitly attempts to explain. By focusing on them, the research provides a 'level playing field' for assessing the value of a regime complexity argument relative to state-centric and bureaucratic accounts.

To test the empirical validity of such arguments, this thesis draws on a wide and diverse evidence base. It includes primary sources such as official documents, minutes of meetings, and correspondence between parties, as well as a large number of ex-post assessments and evaluation reports carried out by the IMF and the EU (Independent Evaluation Office 2016). Such documents are complemented by and checked against a large and growing secondary literature that provides an in-depth account on the crisis in Europe as well as against contemporaneous press accounts and memoirs of key actors (for example, Bastasin 2012; Blustein 2016; Papaconstantinou 2016; Pisani-Ferry 2014). Finally, these sources are triangulated via a set of 34 interviews carried out by the researcher with officials from borrowing countries, the IMF, and EU institutions. When carefully considered against each other, this rich set of data provide a picture of the sequence of decisions that is sufficiently detailed to fulfill the 'informational requirements' of process-tracing models, even if some omissions are impossible to avoid.

It is necessary to be clear about the scope and limits of the thesis and what it is *not* attempting to cover. First, the study does not seek to explain the origin of preferences among IMF staff, creditors, or borrowers, which are taken as a starting point; instead, it seeks to account for the interplay between those different actors during the course of program negotiations. Second, it does not seek to provide an assessment of the effects of regime complexity on economic outcomes. Therefore, it does not directly tackle the question of whether having overlapping institutions in crisis lending is 'better' or 'worse' for macroeconomic outcomes. Third, it does not purport to explain the origins of regime complexes and instead takes the presence of such overlapping institutions as an independent variable affecting IMF behavior and program design.

Thesis roadmap

The rest of this thesis is structured in three main parts. Chapter 2 and 3 present the theoretical underpinning of the work. Chapter 2 reviews the existing literature and situates the current study within broader debates about IO behavior. It therefore presents explanations for IO behavior, outlines the main contributions of regime complexity studies, and provides a short introduction to the role of the IMF and the growth of RFAs.

Chapter 3 develops the main argument about the impact of regime complexity on IMF behavior at length. It first outlines existing explanations and examines the extent to which they are likely to hold under emerging conditions of overlapping institutions. It then draws on regime complexity to examine how the presence of alternative RFAs opens up new cross-institutional strategies for creditors, borrowers, and Fund staff. Finally, it distills some observable implications that stem from this argument and presents the research design through which these are to be tested against data and alternative explanations.

Together, chapters 4 to 6 form the empirical core of the thesis. They present a process-tracing analysis of three cases chosen to vary in terms of preference divergence between creditors, borrowers, and Fund staff. Chapter 4 focuses on Hungary, where in November 2008 the IMF found itself compelled to cooperate with the EU for the first time. Yet, despite large-scale vulnerabilities, the resulting IMF-EU program for financial assistance was surprisingly 'generous' compared to other IMF programs. In this case, there were no significant major disagreements with borrower authorities, nor any significant direct exposure of G5 creditors.

Chapter 5 presents the case of Latvia in late 2008, where G5 interests are equally limited, but discussions with country officials were dominated by a sharp conflict over program strategy. On the IMF side, staff preferred a strategy based on devaluation; however, this was strongly opposed by local government officials. Yet, in this case, the tiny Baltic nation managed to achieve a program that corresponded to its preferences, with the Fund grudgingly going along as a junior partner.

Chapter 6 tackles the case of Greece, a country where G5 creditors, and especially Germany and France, had significant interests at stake mainly due to concerns over potential spillover effects on other euro area countries. In particular, they strongly resisted proposals for debt restructuring, despite significant misgivings about this strategy among most Fund staff. This thesis presents a detailed analysis of IMF decision-making during this period, noting how creditors relied not on their usual formal or informal governance mechanisms, but rather on the threat of exclusion as a strategy for control.

Finally, chapters 7 and 8 present a discussion of the empirical findings in light of the theoretical expectations. Chapter 7 adds a cross-case comparison to the within-case process-tracing analysis carried out in preceding chapters. It also ‘zooms out’ to discuss the current state of affairs and prospects for IMF-RFA cooperation in the future, including by assessing recent policy proposals by the Fund. Chapter 8 provides concluding comments to the study by summarizing the main messages, discussing the limits of the research, and distilling policy implications for the IMF.

II. Explaining the behavior of international organizations

We live in a world densely populated by numerous international organizations. The most prominent of them, such as the IMF, are household names. Yet, while such organizations are perhaps the most classic of international actors beyond the state, their study has been curiously limited until recently. There is still an ongoing vibrant debate over how and when such institutions matter, which has begun to carefully open the 'black box' of what happens within global institutions. As scholars have sought to deepen their understanding of such organizations, a number of anomalies have become apparent in what was initially presumed to be relative predictable behavior. Meanwhile, research has increasingly noted and investigated a secular trend towards the creation of multiple and potentially overlapping organizations. The goal here is to investigate the impact of such institutional proliferation on the outputs of international organizations through its effect on the relative position and bargaining power of various actors, including different state representatives and staff.

Before proceeding, it is necessary to clarify that the scope of this thesis is restricted to international organizations (IOs). Such organizations share several characteristics. First, they are *formal*, in that they have a treaty basis and a specific mandate and therefore represent a type of structured cooperation rather than informal coordination (Abbott and Snidal 1998). Second, they are *institutionalized* in the sense that they are endowed with specific features such as secretariats, budgets, and other material endowments that make their functioning possible. Finally, they are *intergovernmental*, that is, they are created by states and their core membership is reserved for states. Following from this, such organizations are *multilateral* as they are composed of several member states. Thus, international organizations are a subset of a larger phenomenon, namely international institutions or regimes, which can vary in their levels of formality, institutionalization, and membership.

The goal of this chapter is to outline briefly what are the main approaches to IOs in order to situate the contributions this study aims to make to the academic field. It begins by briefly outlining some current debates about the role of IOs in world politics, focusing on state-centric and bureaucratic approaches. The chapter then introduces the concept of 'regime complexity', which captures important changes in the environment in which such IOs operate, and discusses some open questions and gaps in that literature. Finally, it turns to the IMF in particular and provides an introduction to its role and the changing institutional landscape in which it finds itself operating, with a focus on Europe.

The role(s) of international organizations

There is an extensive literature in International Relations on the role of IOs, which is of relatively recent vintage. Initial debates focused on the question whether IOs *mattered* at all for world politics. From a realist perspective that prioritized the role of states and the distribution of power, such institutions were often seen as 'epiphenomenal' as they simply reflected the state interests that give rise to them in the first place (Mearsheimer 1995). Meanwhile, cooperation is also clearly possible outside of institutionalized organizations (Axelrod 1984). One response was that, even within this realist framework, IOs can have an impact on global affairs by reducing the transaction cost of negotiations, by supplying information, and by providing some monitoring capacity (Keohane 1984; Snidal 1985). Another was that IOs help states coordinate their expectations and therefore sustain the development of international regimes in specific issue areas (Krasner 1983; Ruggie 1982).

This naturally spilled over into a discussion about why and when states choose to create new institutions in the first place. A functional approach focuses on the 'rational design' of international institutions to help states overcome collective action problems. Thus, the design of institutions is influenced by the characteristics of the cooperation problem, such as distribution issues, enforcement, the number of actors, and uncertainty (Koremenos et al. 2001; Martin 1992). Another topic is the extent of formalization of international organizations and the role of informal institutions (Abbott and Snidal 1998; Vabulas and Snidal 2013). Others, however, emphasize power politics explanations, highlighting the primacy of states in institutional creation. Such IOs are therefore seen as an expression of state power and a case of 'redistributive cooperation', generating gains for their creators but possibly leaving little choice for less powerful others than to join them (Gruber 2000; Oatley and Nabors 1998).

Most recently, the literature on IOs have moved from these general questions to discussions over what drives the actual observed behavior of such organizations. Scholars have begun to open the 'black box' of IOs to analyze their governance arrangements, organizational culture, and performance (among others, Broome and Seabrooke 2012; Gutner and Thompson 2010; Johnson 2014; Lall 2017; Park and Vetterlein 2010). Generalizing somewhat, two main approaches can be identified: a state-centric and a bureaucratic view. Both of these come with specific nuances and particular variants, but the goal here is to parsimoniously outline key causal factors and mechanisms common to many of the different strands of the two approaches.

State-centric approaches

IOs by definition are created by states and for states, so a useful starting point to consider is the role of their founders in shaping behavior. State-centric approaches focus on the preferences of states, and especially those of powerful states, and how they realize such preferences through the formal or informal mechanisms of IOs. If states create IOs to further their goals and to reap gains from cooperation, then the resulting organizations are likely to be under their control. Therefore, in such approaches the distribution of interests among states is seen to ultimately account for IO behavior. This does not necessarily make organizations epiphenomenal as they can still allow states to achieve goals they otherwise might not be able to realize through reducing transaction costs or providing information. However, ultimately IOs cannot move too far from state preferences without being 'reined back' by their shareholders.

One version of this argument focuses on the formal governance mechanisms of IOs as the key means for control by states. In this view, IOs are the agents of their political principals, who have chosen to delegate certain tasks in the first place (Koremenos 2008). Such delegation is conditional and limited in scope, and always potentially revocable by the principal. States delegate in order to reap gains from the division of labor and specialization, to solve coordination problems, to overcome deadlock in collective decision-making, to provide third-party arbitration of likely future conflicts, or to reduce credibility problems arising from time-inconsistent preferences. On the other hand, principals also weigh the drawbacks related to some loss of control, particularly when preference heterogeneity is high or there is a divergence between institutional rules and the distribution of power (Hawkins et al. 2006, pp. 13–22). Therefore, the extent of delegation is likely to depend on the characteristics of principals, such as their preferences, need for information, and structure (such as multiple or collective principals), as well as on the properties of agents.

The main insight in such models is that any contract between a principal and an agent is incomplete and hence there is always some risk of 'agency slack', or actions by the agent that deviate from the wishes of the principals. To avoid this, "principals attempt to structure the incentives of agents ex ante so that it is in the interests of those agents to carry out their principals' desires faithfully ex post" (Hawkins et al. 2006, p. 26). Such mechanisms can take several forms – rules-based delegation at the cost of discretion and specialization, close monitoring and reporting requirements, screening and selection procedures that choose 'sympathetic agents', intra-institutional checks and balances, and direct sanctions, usually through budgetary means, but also including ultimately the threat of rescinding delegation (Nielson and Tierney 2003). Such mechanisms are usually carefully weighted at the negotiation and institutional design stage in relation to the specific problems that the organization is supposed to address (Koremenos et al. 2001).

While formal attributes of IOs are undoubtedly important, recently scholars have started to highlight the importance of various aspects of *informal* governance in explaining actual behavior (Christiansen and Neuhold 2012). In 'normal' times, IO actions might correspond to formal treaty provisions, but at times of crisis their behavior can deviate substantially from written procedures. Such informal governance can be defined as "the systematic influence of unwritten rules, shared expectations or norms within international organizations that substantially modify or substitute for formal treaty provisions" (Stone 2013, p. 123). In power-based views on informal governance, the key variable of interest is the outside options of powerful states, which generate credibility problems for their participation in cases in which following the formal rules will severely hurt their interests (Stone 2011). In other, liberal approaches, informal governance is seen as a disruption to formal rules that is a result of domestic political problems of certain governments that avoids breaking directly formal rules (Kleine 2013a). Finally, informal governance can also be exercised by states in strategic positions to arbitrate conflicts *between* institutions, giving those states extra leverage on the IOs involved (Henning 2017a, pp. 24–26).

Focusing on informal governance also yields insights over when and how such influence is likely to be exercised. Powerful states are likely to engage in 'behind the scenes' maneuvers such as directly lobbying key management and staff officials, providing or withholding crucial information, and other activities whenever issues they consider of vital importance come up for discussion. Exercising such informal power, however, is costly for powerful states, usually through bad publicity, which prevents it from becoming routine. Equally, smaller states face their own participation constraints and they are in turn likely to disengage if the package of formal benefits and informal costs is not seen to be superior to leaving (Stone 2011). Another source of informal governance might be political uncertainty over the domestic political costs of adherence to formal rules. When such uncertainty is high, other actors are likely to defer to this state in order to avoid pushing it too far. However, states have incentives to misrepresent their domestic difficulties in respecting the formal rules, which requires that there is a mechanism or an agent to adjudicate the legitimacy of such claims (Kleine 2013b).

Bureaucratic approaches

In contrast to state-driven approaches, others put the emphasis not on *international*, but on *organizations* (Ness and Brechin 1988). In this view, IOs can be seen as bureaucratic institutions with their own set of incentives, conflicts, and resources. Focusing on staff allows for studying where IO preferences originate and how the actual 'agents' perceive their role and the instruments at their disposal. Organizations therefore are not simply the functional result of states seeking to reap gains of cooperation or the outcome of a power struggle between key actors; instead, they have a life of their own. Bureaucratic approaches thus focus on how such organizational pressures translate into actual IO behavior and often highlight that IOs can be thought of as self-directed actors (Oestreich 2012). This has stimulated extensive study of the inner workings of IOs and their secretariats (Biermann and Siebenhüner 2009; Jinnah and Young 2014; Mathiason 2007).

This approach can take either rationalist or ideational forms. In a rationalist setting, IOs can be seen as bureaucracies with their own interests that seek to ensure their survival and resources (Vaubel 1986). Particularly when international forums do not supply mechanisms for engagement and transparency and when the public demand is limited, this can give rise to regulatory capture of global forums (Mattli and Woods 2009). This 'public choice' perspective is suspicious of the motives of civil servants, who often have their own agendas and could end up more responsive to vested interests than to vague appeals to the 'public good' (Vaubel and Willett 1991). Thus, "bureaucracies are interested in power, prestige and amenities. To achieve these objectives, they try to maximize their budget, their staff, and their independence" (Vaubel 1996, p. 195). This leads to outcomes that deviate from what the general public would consider desirable and given that IOs are further removed from democratic control than other public institutions, they are particularly at risk of becoming 'runaway bureaucracies' and going 'rogue' (Vaubel 2006). Generally, such public choice perspectives have a bleak view of the incentives of international civil servants, often highlighting tendencies towards 'rent-seeking' and private profit at the expense of organizational goals.

Other rationalist approaches however focus on the strategies IO staff employ to increase their ability to realize their organizational preferences. One such strategy has been to enlist intermediary actors to achieve goals through an indirect and soft mode of governance that can be labeled 'orchestration' (Abbott and Snidal 2010; Hale and Roger 2014). This allows IOs to tap into the governance capabilities of such intermediaries such as information, expertise, enforcement, resources, legitimacy, or access to targets. IO staff can rely on several techniques, from convening and agenda-setting to assistance and endorsement to enlisting the help of intermediaries to target or bypass reluctant states. In general, orchestration approaches showcase that IOs can strategically take advantage of their organizational environment in order to enhance their autonomy (Abbott et al. 2015, pp. 3–36). Another example of rationalist but self-interested behavior is related to the action of secretariats in the design of new IOs. Indeed, IO personnel often plays a crucial role at the design stage of new institutions, and, when given the chance, pushes for introducing mechanisms that isolate the new organizations from state pressure. This is subject to specific scope conditions, but when state interests are not particularly salient and the demand for expertise is high, the increasing involvement of such bureaucrats leads to increased insulation of the newly created IOs from state control (Johnson 2014).

A different bureaucratic approach is to treat IOs as organizations that generate ideas that reshape the social reality for other actors. Such ideational theories see IOs as actors drawing authority from their status as bureaucracies that regulate and constitute the social world through new categories, interests, tasks, and other actions (Barnett and Finnemore 1999). Their authority is derived from their socially desirable mission and the impartial, technocratic, and rational façade for their actions. A key driver of their behavior is their mandate, but such mandates are ambiguous and require interpretation by IO staff, particularly when circumstances evolve. The key to staff power is social construction as "IOs use their knowledge to help create social reality" (Barnett and Finnemore 2004, p. 7). In this context, the organizational culture becomes an important explanatory factor for IO behavior as it directs and structures staff behavior, giving it 'content' (Barnett and Coleman 2005).

Ideational bureaucratic accounts focus on several causal mechanisms, which should be observable when such influence is present. A key requirement is evidence of 'interpretation' undertaken by staff that resulted in redefining forms of knowledge. In this case, 'seeing like an IO' requires that staff makes states 'legible' in a way in which it allows them to construct cognitive authority, which then filters into indirect influence on the states (Broome and Seabrooke 2012). Some focus on how such bureaucratic behavior can lead IOs to a preoccupation with rules at the expense of their social purpose, thus generating 'pathologies' (Barnett and Finnemore 2004). Another often used technique by some organizations is to rely on indicators to 'govern' a given issue area, nudging states into actions indirectly through benchmarks and other rankings (Broome and Quirk 2015; Davis et al. 2012). A final mechanism through which IOs can have an impact, which is however more diffuse, is by increasing socialization among states (Checkel 2005). These approaches generally push back against the self-aggrandizing assumptions of IO behavior in the public choice literature, but are also highly critical of IO behavior, often highlighting hypocrisy or dysfunction (Weaver 2008).

Overall, this section presented the main approaches in the current academic literature towards understanding IO behavior. After briefly discussing initial debates over whether such IOs matter at all, it presented two broad 'families' of approaches. State-centric approaches explain IO behavior as a function of state preferences and focus on formal mechanisms to reduce 'agency slack' or informal behind-the-scenes interventions by powerful states. In contrast, bureaucratic approaches focus on the role of international civil servants either in rationally pursuing strategies that increase their leverage vis-à-vis states or in constructing authority through interpretation and categorization. Despite their differences, such approaches generally make use of a common analytical shortcut by treating IOs as self-standing institutions and focusing on the staff-state interaction – a shortcut that is increasingly likely to bias their conclusions due to the rise of regime complexes.

Table 1: Summary of existing approaches to IO behavior

Accounts of IOs	Type	Key causal mechanisms
State-centric	Formal governance	• Distribution of voting rights among members • Principal-agent model of delegation
	Informal governance	• 'Behind the scenes' control for powerful members • Operates within and between institutions
Bureaucratic	Rationalist	• Public choice rent-seeking through agency slack • Orchestration of intermediaries
	Ideational	• Legal-rational authority from mandates • Constructing social reality through interpretation

Regime complexes

In parallel to evolving discussions of who and how drives IO behavior, scholars have increasingly taken note of the proliferation of 'overlapping' or 'nested' institutions (Aggarwal

1998). Crucially, this goes beyond the simple and oft-observed increase in the number of IOs in world politics. Instead, in recent years there appears to be a secular trend towards the creation of multiple IOs operating in a similar issue area. In turn, this has opened a new line of inquiry, focused on the strategies of states that now should also choose *between* institutional settings in pursuing their objectives. This section traces the resulting 'regime complexity', outlines some gaps in the research agenda, and demonstrates how this study seeks to contribute to this literature.

Overview of the literature

The notion of 'regime complex' adapts existing regime theory to contemporary trends in global governance. Building on the foundational work in the field from the 1980s (Keohane 1982; Krasner 1983; Ruggie 1982), researchers in the 1990s and early 2000s pointed to the rising 'density' of such regimes and the proliferation of 'international interaction' and 'linkages' (Aggarwal 1996; Oberthür and Gehring 2006; Stokke 2000; Young 1996). As proliferation became a clear trend, worries emerged that this is leading to a 'fragmentation' of regimes, which is undermining their coherence, rules, and effectiveness, especially in areas such as trade, human rights, and the environment (Aggarwal 1998; Biermann and Siebenhüner 2009; Raustiala and Victor 2004). However, recently scholars have taken a more nuanced view of this phenomenon. Some have pointed out that if an integrated regime is unlikely to emerge, then actors should embrace the advantages of regime complexes such as adaptability and flexibility and seek to steer them in a normatively desirable direction (Keohane and Victor 2011). Others have noted that regime complexes can also provide opportunities and resources for IOs that might actually allow them to achieve goals for which they would otherwise lack capabilities (Abbott et al. 2015).

In attempting to get to grips with the implications of proliferating and expanding regimes, scholars have coined and extended the concept of ‘regime complex’. Such a complex represents “loosely coupled sets of specific regimes” somewhere in the middle on “the continuum between comprehensive international regulatory institutions, which are usually focused on a single integrated legal instrument, at one end of a spectrum and highly fragmented arrangements at the other” (Keohane and Victor 2011, p. 7). A regime complex can therefore be defined as “an array of partially overlapping and nonhierarchical institutions governing a particular issue area” (Raustiala and Victor 2004, p. 279). More precisely, it constitutes a set of different elemental regimes with some degree of divergence in norms or goals, but with at least some overlapping interactions, which makes such activities potentially problematic (Orsini et al. 2013).

Where do regime complexes come from and how do they differ from their constituent regimes? Such complexes usually arise through increasing interaction between a variety of different regimes that begin to encroach on each other’s issue areas – such as trade and environmental governance for example, or refugee protection and international travel. These interactions are often spontaneous and unplanned, and aggregate in ways that go beyond simply the sum of all actions. Therefore, drawing on complexity theory, the resulting ‘regime complex’ can be described as an ‘emergent property’ at the level of the system of international regimes rather than simply a ‘meta-regime’ or a ‘hierarchical regime’. One of the key features of an aggregation of regimes covering different issue areas in one regime complex is the lack of purposefully designed instruments to coordinate activities and resolve potential conflicts. In that sense, “regime complexes reflect the patterns of spontaneously evolving institutions, although they are composed of sets of negotiated elemental institutions" (Gehring and Faude 2013, p. 121).

Given this, what are the consequences of international regime complexity for the politics of international cooperation? To put it differently, is increased competition within overlapping regimes "causally important in how it affects the strategies and dynamics of actors" (Alter and Meunier 2009, p. 15)? Most clearly, institutional proliferation creates openings for "chessboard politics" and various cross-institutional political strategies for states in the complex. In turn, these strategies can lead to outcomes that might be different compared to cases in which states are constrained to act through one particular institution rather than through a complex of IOs. Crucially, this suggests that moves beyond a specific organization can sometimes be key in explaining behavior inside it as they alter the outside options for states.

There are broadly two main categories of strategies states can pursue depending on the quality of their outside option. In the first category, states can choose to navigate with increasing levels of sophistication between a fixed set of regimes. At the most basic level, states can *forum shop* from a menu of institutions through which to potentially act and pick the one that is most likely to promote their interests (Hafner-Burton 2009; Kelley 2009; Busch 2007; Pekkanen et al. 2007; companies can also engage in venue-shopping, Jones and Macartney 2016). A more ambitious strategy is to try to restructure inconvenient rules by turning to parallel regimes with alternative priorities which align closer with the aims of the government, that is, *regime shifting* (Betts 2009; Helfer 2009). This can be defined as an "iterative long-term strategy that seeks to create outcomes that have feedback effects…by broadening the policy spaces within which relevant decisions are made" (Helfer 2009, p. 39). Finally, states might pursue *strategic ambiguity* by creating contradictory rules in parallel regimes to undermine existing rules, which in turn creates more leeway for state actions that otherwise might be constrained (Hofmann 2009; Raustiala and Victor 2004).

However, if one relaxes the assumption of 'fixed' regimes, this opens a way to think about a second set of strategies that involve the threat of the eventual establishment of an entirely new institution through *competitive regime creation* (Morse and Keohane 2014, pp. 398–403). This presupposes the ability of states to act upon an outside option, or at the least to credibly threaten to do so. In turn, this creates a challenge to the current institution and can result in a decrease of funding or authority in the given issue area. In that sense, it goes beyond notions of institutional choice that suggest states pick whether to select IOs based on the nature of the cooperation problem and its fit with the institutional status quo (Jupille et al. 2013). Instead, it emphasizes the key role of combining both 'voice' and 'exit' in contesting the institutional arrangement that the given state – with significantly good outside options – views as unsatisfactory (Morse and Keohane 2014, pp. 389–390).

The blind spot of regime complexity

The literature on regime complexity has moved from observing (and often lamenting) an important empirical phenomenon to increasingly theorizing about its origins and its consequences. One question, which it has consistently sought to address, is what explains changes in the levels of integration of a regime. In such studies, the degree of fragmentation of a regime among a multitude of actors, and IOs in particular, is often taken as the dependent variable. Such 'regime separation' is a challenge to functionalist accounts of rational design that find it hard to account for the apparent duplication of institutions to address the same issue. One explanation is related to the efficiency gains from a division of labor or the benefits of competing in areas with positive rather than negative spillovers (Gehring and Faude 2014; Johnson and Urpelainen 2012; Pratt forthcoming). Another approach to this topic is to focus on the interests of states in creating alternative organizations, usually as a result of finding their existing options limited or in response to domestic political pressures (Colgan et al. 2012; Henning 2017a; Morse and Keohane 2014).

However, the increasing sophistication and nuances of the new generation of regime complexity studies come at a cost. These advances in our understanding of what *causes* fragmentation and decentralization have much to recommend in advancing the research agenda, but for the sake of parsimony have often abstracted away from the concerns of the initial generation of scholars and policymakers. This study takes a different approach, focusing on regime complexity as an independent variable. In short, the aim here is *not* to explain why or how a regime becomes 'separated' or 'fragmented' among multiple IOs but rather to examine the consequences that arise from such developments. In this sense, this study is closer to the first wave of regime complexity scholarship in its formulation of a research question. However, it shares with newer approaches the aim for a carefully grounded investigation of the causal mechanisms through which such regime complexity leads to specific outcomes, as well as precise explanations that account for variance in observed outcomes.

More specifically, this study is interested in the effects of regime complexity on IO behavior. Intuitively, the proliferation of alternative IOs and partially overlapping regimes is likely to have an impact as it raises the competition for pre-existing institutions. The shift from a single regime to a 'regime complex' increases the opportunities for states to achieve their goals via new institutional strategies described above, from forum shopping to competitive regime creation. This leads IOs to "compete for support by their constituents, especially for governance functions and resources" (Gehring and Faude 2013, p. 124). Such competition can a priori have a positive or a negative effect on regime outcomes. On the one hand, it can keep institutions 'on their toes' and allow for a division of labor to emerge according to specialization. On the other, institutional relations can become a 'race to the bottom' with fragmentation and open conflict undermining effectiveness. As Alter and Meunier (2009, p. 20) put it, "competition can have negative effects—turf battles and a failure to coordinate efforts. Competition can also have positive effects—increasing total resources, spreading risk, allowing experimentation."

Overall, there is a growing recognition of the need to take the institutional environment into account when explaining institutional outcomes. However, there has been surprisingly little work done on the impact of institutional proliferation as an independent variable on the behavior of IOs themselves. As Betts (2013, p. 70) asks, what does a competitive environment "mean for IOs that previously held a relative monopoly as service provider, secretariat, and forum in a given issue area? How do they react strategically to states engaging in forum shopping and regime shifting, and how should they react?" This raises the further question of when competition can improve institutional outcomes and when is it instead likely to lead to fragmentation and undermine effectiveness of IOs. In short, "we still know little about how and under what conditions regime complexes move from open conflict among their elemental institutions to an institutionalized division of labor" (Gehring and Faude 2013, p. 128).

The literature on international regime complexity has made great strides in conceptualizing the phenomenon of overlapping and nested institutions, establishing that it is an increasingly important part of the study of world politics, and generating sophisticated explanations for the forces that give rise to 'separation' and 'fragmentation'. However, it has so far not addressed in depth the impact of these changes on IOs despite that intuitively one would expect increased competition to influence IO behavior. IOs have thus curiously remained so far the blind spot of a burgeoning regime complexity literature.

Situating the study

The contribution of this thesis is to bring the study of regime complexity, which seems to capture an increasingly important trend, to ongoing debates on IO behavior. Meanwhile, it also seeks to move in the opposite direction, bringing IOs to studies of regime complexity. Such studies have paralleled initial debates in the IO literature, which have often taken international institutions to be passive receivers of state preferences for analytical purposes. Yet, recent scholarship has increasingly acknowledged the sources of constrained autonomy that such IOs could enjoy under specific circumstances. It therefore appears pertinent to investigate the effects of the proliferation of competing institutions on IO behavior and outputs.

For that purpose, however, the study requires a working definition of regime complexity. A regime complex is thus understood to be *a set of international organizations with partially overlapping mandates*. This builds on previous studies, but is both narrower and broader in scope. There is still a lack of a generally accepted definition of regime complexes, probably due to the desire of authors to analyze a comprehensive phenomenon, which sometimes risks leading to concept-stretching (Collier and Mahon 1993; Sartori 1970). The proposed working definition is more specific as it focuses particularly on formal IOs and their environment rather than the more elusive concept of regimes and the broader notion of ‘institutions’. This is similar to Henning’s logic of excluding all other state and non-state actors from his definition of a regime complex. The resources, ideas, and preferences of other actors are analytically distinct from the complex itself and instead can be understood as factors influencing the behavior of the IOs in the complex (Henning 2017a, p. 20).

The definition advanced above is also narrower than other existing ones in that it avoids delimiting the set of institutions by a ‘common issue area’ and instead focuses on their mandates. This is a direct reference to the fact that the very idea of a ‘common issue area’ needs to be constructed, either by formal amendments to mandates (including the creation of new IOs), or through a reinterpretation of existing rules – both of which are actions that are constitutive of the regime complex and therefore part of the behavior of IOs within the complex itself. This process is part of the regime complex itself and is not a prior condition by which one can objectively recognize a regime complex that is ‘out there’.

Meanwhile, the proposed definition is broader than existing definitions due to the elements that it leaves out. It is descriptive and contains no prescriptive or normative judgment about the nature of regime separation. The definition is therefore agnostic about the actual dynamics that might take place, such as ‘fragmentation’, ‘integration’, ‘separation’, ‘decentralization’, or even the direction of travel. This broader approach therefore paves the way to drawing on existing theories and formulating new ones regarding the actual impact of such overlapping mandates on IO behavior, leaving also ultimately open the ‘null hypothesis’ of no causal effect. Finally, it also does not prejudge the actual outcome for global governance, in contrast with many early regime complexity studies, which often express direct concerns about the potential negative consequences on regime 'coherence'. While such concerns are understandable, they leave causal mechanisms underspecified.

At this stage, it is also useful to highlight how this study relates to some recent contributions that focus on topics that are similar to regime complexity. One such area is institutional choice, or how states pick from a variety of institutions at their disposal in the first place. In their study, Jupille, Mattli, and Snidal (2013) combine a rational design perspective with bounded rationality to present a sequential model of how and why states choose to use, select, change or create new institutions. Once states have decided to undertake institutionalized cooperation, they will move down the decision tree until they find a 'fit' between the institutional setup and the cooperation problem that is 'good enough'. While this study acknowledges the role of states in the process, it differs in at least one aspect by holding the IOs under study constant and analyzing instead how they respond to such state strategies. It is in this sense that the current thesis focuses on IO behavior and outputs rather than the strategies of states that perceive IOs as configurations of state interests.

Another study that is closely related is the recent investigation into 'contested multilateralism' by Morse and Keohane (2014). They point out that more and more often states that are not satisfied with the status quo resort not to unilateral strategies but rather to contestation of multilateral practices through regime shifting or regime creation. To achieve their goals, they use conflicts *between* institutions as a key instrument to advance their agenda, and their success depends on their outside options and credibility. The current study shares some common features with this approach. Morse and Keohane explicitly highlight how the threat of 'exit' can increase 'voice', an insight that is also central to the logic of regime complexes. Their focus on conflicts between institutions is also at the core of the study of overlapping and hence at least potentially conflicting mandates. However, the thesis departs from Morse and Keohane's focus on long-term institutional change and considers how competitive relations between organizations alter the bargaining environment among the constituents of an IO at a fixed point in time. Thus, the goal is not to explain challenges to the institutional status quo, but how regime complexes can be instrumentalized by states and IOs to increase or decrease control over institutional behavior, with implications about whose preferences are realized in practice. Consequently, the timescale is much more constrained and the level of analysis much more granular to allow for precise process-tracing as opposed to discussions over the drivers of institutional change over the *longue durée*.

In short, regime complexity is an increasingly important phenomenon in global affairs, which has attracted significant attention over the past several years. However, the literature has so far largely focused on judging the overall consequences for global governance or, more recently, explaining the origin and development of such regime complexes. What appears to be lacking from the discussion is a specific focus on its impact on IOs, as they have so far been treated analytically mostly as passive arenas for state strategies. This study seeks to correct for this blind spot by bringing IOs back in through a discussion of how regime complexity impacts IO behavior by altering the bargaining environment for its constituents. In this section, it has proposed a working definition of regime complexes, which connects to existing debates, but is more specifically focused on IOs. The next step is to consider which IOs can offer a good empirical subject for this research.

The International Monetary Fund

Where do the theoretical considerations outlined above meet empirical reality? This study proposes to focus on a specific institution – the International Monetary Fund (IMF). As a formal, institutionalized, and multilateral organization, which is made up of states and a secretariat of around 2000 economists mostly based in Washington, D.C. and governed by its own mandate in the form of Articles of Agreement, the IMF is a classic example of an IO. Furthermore, it is often perceived as one of the most consequential IOs in world politics due to its role in providing conditional lending to crisis-stricken countries. The rest of this section serves to first outline briefly the history, setup and activities of the Fund for non-specialist readers before then focusing on the emergence of a regime complex with the rise of alternative financing arrangements (RFAs) in global financial governance.

'The Fund': an overview

The IMF was set up in 1944 as part of the Bretton Woods institutions[3]. In the spirit of 'embedded liberalism' it was supposed to provide a pool of reserves that countries can use to support their pegged exchange rates in times of temporary current account deficits (Ruggie 1982; Vries 1987). However, with the collapse of the Bretton Woods arrangements in the 1970s, the Fund's role changed, and it increasingly focused on surveillance and on fighting financial crises. In the 1980s, it faced a protracted debt crisis in Latin America as a result of a surge of lending by commercial banks to countries in the region, which came to an abrupt stop when the

[3] For good accounts of the bargaining surrounding its setup, see Steil (2013) and Helleiner (2014).

US Federal Reserve began to raise its interest rates in 1979 (Boughton 2001). Later, in the 1990s and early 2000s it would face a series of aftershocks in Latin America, notably in Mexico, Argentina, and Brazil (Blustein 2006; IEO 2004). However, the defining event of the 1990s for the Fund was the East Asian financial crisis, when it was involved in a 'chastening' experience in lending to Thailand, Indonesia, and Korea (Blustein 2003; IEO 2003). This was followed by a period of reflection and change at the IMF, which led to significant amendments to its policies and approach. The first serious test of these policies would come, rather unexpectedly, in Europe from 2008 onwards.

At the core of the IMF's activities is conditional lending for countries that find themselves in a financial crisis, or, more precisely, in balance of payments difficulties. This is a key function which is central to its mandate as one of its purposes is "give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity" (IMF 2016a Articles of Agreement, Art I(v)). Usually, the negotiations over program design unfold in a series of steps. First, the crisis-stricken country will reach out formally to the IMF after some informal discussions. The Fund will then send a team of economists, headed by a mission chief, to the country and they will negotiate with a series of financial and political officials over the shape of the program. Ultimately, staff and country authorities present to the Executive Board of the IMF a series of documents that spell out the program and the obligations that the crisis country undertakes to fulfil in exchange for Fund money. Upon approval, the loan is then disbursed in a series of tranches over a certain period, usually between two and three years for the most common non-concessional loans[4]. Before each disbursement an IMF mission provides an assessment of country compliance with its agreed obligations and can propose amendments to the program.

Crisis lending has several goals from an IMF perspective. Its main purpose is to restore the crisis country to 'economic health' by providing financing at a reasonable rate for a short period of time to give it a chance to adjust. IMF programs thus help cover the 'financing gap' which emerges when private markets are no longer willing to provide funds to the country at a sustainable rate due to worries about its ability to repay loans. Fund resources provide the 'breathing space' for adjusting by temporarily substituting for private financing, but ultimately aim at returning countries to the market in a sustainable manner by the end of the program. This then will allow the country to continue growing, and will thus provide it with enough resources to pay back the Fund loans plus the accrued interest. In turn, the interest the Fund charges on its loans is the main way in which it finances its own operating expenses. Thus, crisis lending is IMF's 'bread and butter' and is central to the role it has played so far in global financial governance.

In addition to crisis lending, the IMF also undertakes a range of other activities. One that receives a lot of attention is surveillance of the economic policies of its member countries. Such monitoring is aimed at identifying risks to the international monetary system and country economies at the global, regional, or national level. It has a bilateral component through annual

[4] The IMF also engages in concessional lending to low income countries through its Poverty Reduction and Growth Trust. Such lending falls outside the scope of this study (see Hibben 2016; Lombardi 2005).

visits and reports on member states (so-called Article IV consultations) and a multilateral component through its regional and global reports such as *World Economic Outlook* and others. Such surveillance activity has increasingly been recognized as an important part of the IMF's toolkit even if it often depends crucially on the presence of necessary conditions for effective persuasion (Eichengreen and Woods 2016; Lombardi and Woods 2008; Moschella 2012). Another of the core activities of the IMF, and one which consumes a significant part of its time and budget, is technical assistance. Through its capacity development, the Fund advises countries on topics such as improving public revenues, tax administration, the quality of statistics, banking policies, or legal frameworks. This has received considerably less attention than crisis lending and surveillance, but recently scholars have become more and more interested in how the IMF constructs and develops 'sympathetic interlocutors' in crisis countries through such measures (Broome and Seabrooke 2015). However, for practical reasons, both surveillance and capacity development fall outsides the scope of this study, which instead focuses on the core function of conditional crisis lending.

The Fund fills its lending coffers in two main ways. First, there are quota resources, or the subscriptions, which each country makes to the Fund. These are the most stable part of IMF resources and are directly linked to the voting power of member-states. They are generally supposed to track the size of a country in the world economy, but the IMF has faced extensive criticism for how quotas have failed to keep up with changes in the relative size of member states (Cooper and Truman 2007; Truman 2006; Woods 2000). In addition, due to lack of quota increases from 1998 to 2010, a period of burgeoning and quickly rising private money flows, the IMF's main financing base was widely seen as inadequate in scale next to capital markets.

Second, since quota increases can be painstakingly slow and therefore not well suited to a crisis situation, the Fund has also agreed 'arrangements to borrow' from its wealthier members in an emergency[5]. The set of New and General Arrangements to Borrow (NAB/GAB) represents a preferred way of adding 'firepower' when demand for IMF resources rises in a crisis, and it can also be further augmented through bilateral borrowing. Crucially, this is exceptional borrowing, which does not affect voting power. In that sense, quota resources are at the core of the IMF and a key source of independence, while NAB/GAB borrowing tilts the IMF towards dependence on wealthy lenders (Woods 2010).

The governance structure of the IMF is focused around the work of an Executive Board, management, and staff. The ultimate authority for making strategic decisions lies with the Board of Governors, at which all member states are represented, and which meets annually. However, day-to-day work is steered by a resident Executive Board, which comprises a total of 24 members and meets several times a week. This means the Board plays a strongly political role in terms of representing member-states, even as it is less effective in some of its other duties (Martinez-Diaz 2008). On the Board, there are five appointed directors by the five countries with the largest voting power (United States, Japan, Germany, France and the UK), with the rest being elected and generally representing 'constituencies' of multiple countries. For all policy and strategy decisions such as quota increases or amendments to the Articles of Agreements, the Fund requires a majority of 85% of voting power that gives the US, which held 16.77% of votes in 2009, an effective veto. Voting weights and quotas changed minimally

[5] The New Arrangements to Borrow were agreed in 1995 and include 26 countries, going beyond the initial 11 that made up the General Arrangements to Borrow (Woods 2010, p. 54).

during the period of the study due to a governance reform that entered into force in 2010, but generally can be considered stable for analytical purposes[6].

The IMF itself is composed of what can be defined as management and staff. Management represents senior officials in key decision-making roles who serve as the 'transmission mechanism' between staff's economic analysis and the Executive Board. Key among them is the Managing Director, who also chairs sessions of the Executive Board and sets the general direction. By 'convention' this has always been an European, as a quid pro quo for the World Bank president always being an American. However, powerful member states exert influence in the management of the IMF through Deputy Directors, in particular the US-appointed First Deputy Managing Director. The rest of senior management is composed of directors of the departments of the IMF, especially those of the five regional area departments and several of the functional departments (Fiscal Affairs Department, Strategy, Policy and Review Department, Legal Department, Monetary and Capital Markets Department, and the Research Department). Of the remainder of the 2700 people who work in the IMF, around half are economists who work in these and other departments of the IMF. They tend to mostly hold PhDs from a limited number of top economic departments of US and UK universities, even though they might come from 149 different countries (Nelson 2014; Woods 2006a). Their main incentives are linked to career advancement and include negotiating large and successful loans, in addition to technical competency and years of service (Chwieroth 2013, pp. 269–274; Momani 2005).

[6] The voting power of the G5 in 2013, the final year under study here, was as follows (brackets indicate voting power in 2009): US – 16.75% (16.77%); Japan – 6.23% (6.02%); Germany – 5.81% (5.88%); France – 4.29% (4.86%); United Kingdom – 4.29% (4.86%). There were further changes with governance reforms that became effective in 2016, discussed in Chapter 7.

In relation to lending decisions, which are the focus of this study, all three levels – staff, management, and the Executive Board play a role. Staff, particularly from area departments that cover the region of the crisis country, have an important agenda setting role. Upon initial contact, it is staff that prepares a first-cut blueprint based on available data and knowledge that is then debated internally in the Fund across departments and with management. Then, it is staff that carries out the actual negotiation, identifies scope for compromises and drafts the letter of intent and the memorandum of understanding, the two key documents that form the basis of an IMF program, alongside a staff report on the program. Management has input at several critical stages of a lending decision. First, it is the point of contact for the official request and can indicate the broad parameters of what would be realistic expectations. Second, it evaluates and clears the initial blueprint prepared by staff and hands negotiators directions akin to a mandate. Third, it stays in touch with the mission team throughout the negotiation period, providing guidance. In theory, management also approves the final set of documents and can make amendments, although in practice this is very rare (Mussa and Savastano 1999, pp. 84–98).

Finally, the Executive Board plays a subtler role. According to formal rules, lending decisions require a simple majority of the Board to vote in favor; however, in practice a norm of consensus is observed, with exceptions such as abstentions being very rare. This arguably creates an incentive for management and staff to bring to the Board only programs which they expect will have the support of the Board as a whole and ensures that staff's agenda-setting power operates 'in the shadow' of the Board (Copelovitch 2010, p. 57). Instead of actual places for voting and debate, Board discussions are a chance for member states to signal concerns and priorities for the crisis country. Upon approval, the first tranche of the IMF loan is released. Subsequent tranches are subject to a similar process of (typically quarterly) reviews, which assess the level of compliance of the state with its promises and the evolution of the economic variables and can thus provide a chance for adjustments to the program (Houtven 2002; Martin 2006).

The rise of regional financing arrangements

As the discussion above suggests, the Fund was designed to be the central IO concerned with crisis lending to countries with balance of payments difficulties. In that sense, it was quasi-synonymous with the concept of *global financial safety net*, which comprises the instruments to assist countries facing a financial crisis. At its core, this provides some insurance against financial shocks resulting from 'bad luck'. Yet, this has to be balanced against the issue of inducing moral hazard on the part of borrowers through bailing out countries that followed 'bad policies'. Moral hazard can equally arise on the part of creditors, who are protected from the consequences of imprudent lending which itself can be motivated by the expectation of forthcoming external support. Thus, the GFSN, and the IMF as part of it, performs the function of an international lender of last resort (Kindleberger and Aliber 2011).

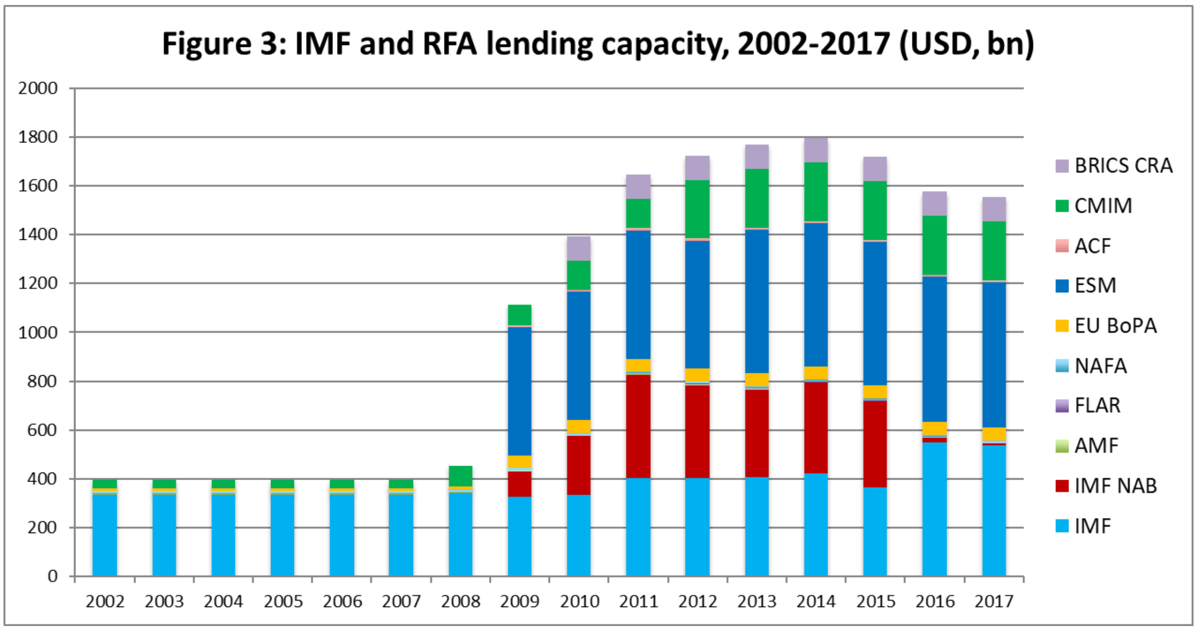
However, recently there has been a well-noted proliferation of alternative means of providing financial assistance, in particular through regional financing arrangements (RFAs). Before 2008, the IMF was at the center of the safety net, even if some countries were increasingly relying on costly self-insurance through accumulation of international reserves (Obstfeld 2011). The crisis also brought to the forefront in spectacular fashion the use of a network of bilateral swap lines between (mostly) advanced economies (Duran 2015; McDowell 2012). Regional financial arrangements (RFAs) played a particularly important role in underpinning the safety net, particularly in Europe. These transformations have engendered significant debate, much of which has focused on whether the GFSN is large enough given potential needs and whether it effectively covers everybody that might need it, especially developing countries (Denbee et al. 2016; IMF 2016b; Scheubel and Stracca 2016; Shafik 2015).

This thesis focuses on RFAs as the most direct challengers and competitors to the IMF. These can be defined as vehicles for financial assistance to regional member-states drawing on the resource of regional members. Such RFAs mostly fit the definition of IOs as formalized and institutionalized cooperation as they tend to be made of states, to have formal mandates, and to employ at least some staff. The other two levels of the GFSN fall outside the scope of this study. Currency swap lines are an example of cooperation, which however is carried out overwhelmingly bilaterally without the assistance of an IO and through independent central banks. Meanwhile, reserve currency accumulation is a strategy of *self*-insurance, which means it is not an instance of cooperation in the first place. While there is some elasticity in substituting between individual, bilateral, regional, and global arrangements, for analytical purposes this thesis will focus more specifically on RFAs as the alternative form of institutionalized cooperation that most clearly 'invades' the Fund's issue-space and is thus seen as primary competitor.

Such RFAs are not new, but they have proliferated in the short span from 2008 to 2013[7]. Some small-scale RFAs existed before the global financial crisis in Europe, North America, and Latin America. Notably, back in the 1990s, Japan floated a proposal for an Asian Monetary Fund,

[7] It is beyond the scope of this thesis to produce an exhaustive overview of the currently existing RFAs around the world; however, such overviews can be found in IMF (2013a), Weder di Mauro and Zettelmeyer (2017), and Henning (2017b). See Chapter 7 for a comparative discussion.

which was rejected by the US and others (Bergsten 1998). However, between 2008 and 2013 RFA total combined resources skyrocketed from around \$18 bn to \$873 bn, almost a 50-fold increase. Meanwhile, their weight in relation to the IMF also increased dramatically, from a total of only 5% to over 114% of the Fund's resources[8]. The European Stability Mechanism, whose size rivals that of the IMF despite its more limited regional mandate, led the growth but similar arrangements exist in East Asia, Central and Eastern Europe, Latin America, North America, the Arab countries, and Central Asia (IMF 2013a). Partly in response, the G20 issued a set of broad guiding principles about cooperation between IMF and RFAs (G20 2011).



Source: IMF (2013a, 2017a) and IMF financial account data

Yet, the decentralization of the GFSN also raises acute governance questions, nowhere more pointedly than when it comes to relations between the IMF and RFAs. The Fund itself has undertaken a stock-taking exercise in relation to RFAs and has been warning that the "current

[8] This takes into account IMF borrowing outside its quota resources, which it undertook in response to the global and European financial crises; if calculated solely as percentage of its quota, then in 2013 RFAs accounted for 214% of its subscribed quota resources.

GFSN has expanded but at the cost of more fragmentation" (IMF 2013a, 2016b, p. 6). The small but important academic literature in relation to RFAs comes to similar conclusions. Many have expressed doubts about how far the G20 principles for cooperation go, calling for more careful and ex-ante structuring of such interactions to avoid that the GFSN "decays into a fragmented set of regional equivalents to the IMF" (Henning 2011, p. 3; Volz 2012). Concerns over such fragmentation and the desire to prevent it motivate a number of existing studies (Henning 2017c; McKay et al. 2011). Some have also pointed that RFAs may be more responsive to political pressure as they are closer to regionally powerful states with high stakes in crisis countries (Eichengreen 2012; Weder di Mauro and Zettelmeyer 2017). Such studies have performed a key role in describing and calling forth attention to an increasingly important phenomenon and in making policy proposals, but have ventured little beyond the realm of description. In particular, they have generally not provided an analysis of the drivers of IMF behavior in this brave new world of overlapping institutions, nor have considered what are the specific variables and causal pathways, which might lead to fragmentation.

In short, since the outset of the financial crisis, the GFSN has changed profoundly by simultaneously increasing in size and becoming ever more decentralized. In the area of financial assistance, the 'glorious isolation' of the IMF has been substituted by the hustle-and-bustle of cooperating with an increasing number of RFAs with large resources and close political links to member states. Thus, the Fund has found itself in the presence of multiple IOs with overlapping mandates – a regime complex. The goal of this study is to use the toolkit of regime complexity to analyze the pressures that this new environment places on the IMF in order to better understand how it shapes its behavior in terms of program design.

IMF-RFA cooperation in Europe

A significant motivation for this study comes from the Fund's controversial European engagement with RFAs. There are three main reasons why focusing on this specific set of experiences for the IMF is useful analytically. This was the first time the Fund found itself entangled in a regime complex and it struggled to navigate this environment. Previously, it has been involved in programs that involved sometimes substantial co-lending and this has had an impact on its incentives (Gould 2006). However, it is in Europe that one can observe direct and structured co-lending between RFAs and the IMF, which makes it a natural subject of interest for any discussion about the impact of regime complexity on IO behavior. Second, the Fund's experience in Europe in 2008-2013 is likely to reverberate well beyond this region and time. In particular, it showed deficiencies in how the GFSN structure operates and demonstrated a number of governance gaps that both the IMF and other regions need to consider going forward (Darvas 2017; Henning 2017c; Volz 2013). Finally, focusing on one region and a relatively short period of time allows this study to hold analytically constant a number of alternative factors, which can influence observed outcomes. Most notably, all cases occurred in countries with broadly comparable legal frameworks and political institutions, and under identical external global economic conditions.

The IMF has received its fair share of criticism over its behavior in Europe. For some, the crisis demonstrated that the IMF has trouble standing up to its powerful shareholders whenever push comes to shove. This applies to emerging Europe as well as the euro area, and critics often highlight the skewed distribution of votes on the Executive Board that favours European countries and the European nationality of the Managing Director (Blustein 2016; Orphanides

2015; Subramanian and Kapur 2009). Others have pointed out that in addition the IMF faced significant difficulties in lending to countries within a monetary union in the case of Greece, Ireland, and Portugal that lacked a fundamental instrument to correct their debt problems, namely devaluation (Independent Evaluation Office 2016; Pisani-Ferry 2014). The Fund was additionally constrained in this view by its participation in the Troika, which was highly unusual and served to curtail significantly its freedom of maneuver (Henning 2017a; Pisani-Ferry et al. 2013). Much of the criticism on both counts has come from former high-level IMF staffers (Mandeng 2013; Mody 2015; Rajan 2011; Schadler 2012).

There have been several in-depth academic studies that focus specifically on the role of the IMF in Europe[9]. Lutz and Kranke (2014) investigate the relationship between the IMF and the EU in Latvia and Romania and find that the defender of “Washington consensus” policies was actually the Europeans and not Fund economists. They use a constructivist framework to explain this puzzling outcome, arguing that IMF staff interpreted their mandate as an opportunity to react flexibly, while EC and ECB staff interpreted their mandates narrowly as requiring adherence to orthodoxy. Schwarzer (2015) tackles the question of why the IMF was brought into euro area crisis management in the first place despite initial reluctance. Drawing on Hall’s (1993) learning framework and constructivist insights, she argues that this is due to the need to ‘learn under constraints’; such learning helped governments change their perception of the crisis and hence their response. Finally, Hodson (2015) tackles a similar question to Schwarzer about the reasons for IMF involvement in Europe, but takes a rationalist perspective

[9] For a more general discussion of the changes at the IMF since the global financial crisis, see Ban and Gallagher (2015) and articles included in this special issue, and Grabel (2011).

based on principal-agent models. Drawing on a multiple supervisor approach, he argues that EU delegated powers to the IMF as a credible monitoring mechanism as they did not trust the European Commission.

Such academic, policy, and public discussions however do not reveal much about the drivers of IMF behavior and program design in particular in the context of overlapping institutions. They certainly betray concern over the arrangements under which the Fund participated in Europe, and suggest some counterintuitive results. This study seeks to move this research agenda forward by focusing specifically on the role of the IMF as an IO in Europe (as opposed to examining in depth all the actors involved, including EU institutions). This requires going beyond questions of why Europeans 'commissioned' the IMF and analyzing how this affected the bargaining position of the various actors that are part of a Fund program. Furthermore, by focusing generally on the IMF in the euro area, many existing studies risk overemphasizing the financial constraints of a monetary union (Mabbett and Schelkle 2015). Instead, by considering the similarities and differences between cases on a spectrum of membership in the euro area, this study looks to address more general questions about the political economy of IOs. At the time of writing, the best empirical material for this topic remains the experience of the IMF in lending in emerging Europe and the euro area.

In short, this section has proposed focusing on the IMF as a suitable institution to consider the impact of regime complexity on IO behaviour. It sketched a brief introduction to the history, functions, governance, and structure of the Fund. The section then outlined the rising number of RFAs over the years since 2008, which have placed the IMF in a new situation of operating in a regime complex. Finally, it connected these broader discussions with more specific empirical observations of the Fund's behaviour in Europe, which have often been critical of the IMF, but have not yet explored in-depth the potential impact of 'sharing the stage' with other IOs.

Conclusion

This chapter situated the current research into the larger academic literature and introduced some of the core concepts and topics that the thesis attempts to address. It began by a brief overview of the main theoretical approaches to IO behavior, which can broadly be classified as state-centric and bureaucratic. The chapter then proceeded to introduce the concept of regime complex and to outline its increasing empirical and academic relevance, while nonetheless pointing to some gaps that justify a focus on such complexity as an independent variable for IO behavior. It then introduced the IMF as an IO that has increasingly been challenged by the proliferation of alternative RFAs, and particularly so in the case of Europe. With the brief discussion of the literature on IOs, the concept of regime complexity, and the specifics of the Fund, this chapter aimed to provide the building blocks and context for the specific arguments made in this study.

Overall, based on this brief literature review, this chapter argued three main points. First, studies of IOs have paid relatively little attention to an increasingly important empirical phenomenon, which is the proliferation of institutions with overlapping mandates. This is likely to affect the balance of bargaining power among and between states and staff, but to the best of this author's knowledge there has been no conceptualization of how precisely this in turn might affect IO outputs. Second, studies of regime complexes have documented the importance of this phenomenon and have provided increasingly sophisticated explanations for the reasons of its emergence. However, there are some open questions about the impact of regime complexity on IOs, which have so far been treated as generally passive ‘vessels’ for state interests – something that conflicts with recent analyses that have increasingly found some level of circumscribed autonomy for IOs. Third, in bringing the two sets of literature together, the study of the IMF can prove instructive and fruitful. A classic IO, the Fund has increasingly had to conduct its core business of financial assistance together with new RFAs with similar mandates. This has been particularly the case in Europe after the global financial crisis in a string of lending programs with mixed success. Therefore, this thesis proposes to contribute to the academic literature on IOs by focusing on the impact of rising regime complexity on IMF behavior in Europe. The goal of the next chapter is to outline precisely how and why these two variables are related.

III. IMF behavior in a regime complex

What explains IMF behavior? Given the prominence of the Fund in global financial governance, it has attracted substantial attention by both pundits and academics. Some focus on the IMF as a powerful institution that dictates the terms of loans to countries that have been brought to their knees by a financial crisis. Others dismiss it as nothing more than a plaything in the hands of powerful countries that use the Fund to further their narrow state interests. Scholarship has demonstrated that despite grains of truth in both of these perspectives, actual IMF behavior is often the result of a much more nuanced interplay of forces between creditors, borrowers, and the Fund itself.

Until now, no other IOs were part of this ‘push and pull’ as there were hardly any plausible alternatives in existence. However, with the rise of RFAs and other alternative channels the institutional environment in which the negotiations are carried out have been profoundly altered. How does this affect program design, if at all? This chapter seeks to develop a theoretically informed answer to this question by drawing on insights from a regime complexity perspective. To that end, it opens up the ‘black box’ of decision-making and bargaining within IMF negotiations and seeks to understand the pressures that institutional competition puts on different actors such as Fund staff, borrowers, and creditors. In particular, it argues that within regime complexes the ultimate drivers for IMF behavior can often be found outside of the IMF itself as the presence of RFAs rearranges outside options for all involved.

This chapter develops the key argument of the thesis in four parts. First, it outlines the state-of-the-art existing explanations for IMF behavior and argues they are likely to be misleading about the drivers of such behavior in the context of a regime complex. Second, it develops the new bargaining strategies for the Fund, borrowers, and creditors that the presence of overlapping institutions opens up and generates testable hypotheses about how they are likely to affect IMF program design. Third, it introduces the research design of this study, including the methodology, case selection, and data sources through which the argument presented here will be examined in the empirical chapters.

Existing approaches and their limits

What shapes the bargaining power of creditors, debtors, and IMF staff in the process of program negotiations? Given the apex position of the IMF within global financial governance, the question has received extensive attention. The goal of this section is to outline existing explanations in order to demonstrate where such actors draw their negotiating leverage from. After presenting the traditional understanding of bargaining within the IMF, it then critically assesses its limits in explaining bargaining in regime complexes.

The power of the strong: State-centric approaches

Many of the traditional explanations for IMF behavior have focused on the preferences and interests of states. After all, the Fund is made up of states as creditors and lends to members as borrowers; in that sense, it is an organization by states for (other) states. It gets its resources from interactions with states and ultimate decision-making power on most operational topics – including financial assistance - is vested in state representatives at the Executive Board. Given different quotas and voting power, state-centric approaches highlight the key role of the G5 (US, Japan, Germany, France, and UK) shareholders, who in 2008 held together 38.4% of votes at the Executive Board and had the right to appoint their own Executive Directors. In addition, the next four biggest constituencies were also led by European executive directors from Belgium, Italy, Spain, and Netherlands. As Copelovitch points out, G5 directors only need three more EDs to vote with them to gain formal control over lending decisions that require a simple majority (Copelovitch 2010, p. 56). This study therefore follows recent studies in focusing on the role of G5 as a reasonable proxy for the interests of powerful IMF stakeholders.

Unsurprisingly, some of the most prominent approaches to IMF lending emphasize the role of large state shareholders and their interests conceived in terms of power (Broz and Hawes 2006; Copelovitch 2010; Dreher and Jensen 2007; Oatley and Yackee 2004; Stone 2004; Stone 2002; Thacker 1999). G5 creditors are generally motivated to act by two factors. In some cases, they have specific geopolitical interests in particular countries such as Russia or Pakistan that they might wish to support financially. In others, financial institutions headquartered in the G5 countries might have significant exposure to the crisis country, which motivates their state representatives to resist measures that might lead to losses that could in turn rebound on the government itself. Regardless of the specific source of their preferences, powerful states look to secure more generous IMF programs for their 'client' countries, which therefore receive help beyond what they would otherwise get from the Fund.

To achieve this, large shareholders use both (the threat of) their formal power as principals, particularly in budgetary matters, and various more informal governance mechanisms (Stone 2011). Formal decision-making power, as expressed by voting shares on the Executive Board, gives G5 creditors a disproportionate measure of control over the IMF relative to their weight in the global economy. This should therefore give them a leverage in negotiations as any program needs their ultimate approval. In addition, the G5 also have more informal means of influencing behavior. Notably, they have their own Executive Director and most key personnel such as the Managing Director and Deputy Managing Directors come from these countries. This gives them a measure of behind-the-scenes influence even outside of formal channels which can subtly provide 'guidance' to unfolding negotiations before they reach the Executive Board. In both cases, G5 countries ‘re-purpose’ the Fund as a tool of their foreign or economic policy.

The power of the weak: Borrower-driven approaches

Ultimately, IMF programs are negotiated with borrowing countries for borrowing countries. Such countries often face dire prospects and an IMF loan is their last resort, usually after all other avenues have been exhausted. This is because signing a loan arrangement with the Fund entails significant sovereignty costs, but also because of the 'IMF stigma' that the institution carries from the Asian crisis. Therefore, at first such borrowers appear to lack any viable bargaining leverage given that their outside option - adjusting without a financial assistance program - implies such large costs that they are willing to call in the IMF in the first place. Given their financial problems, it would appear that at first sight the 'weak' have little power over a 'take-it-or-leave-it' offer from the Fund, particularly in reducing the stringency of conditions and unlocking larger financing packages.

Yet, studies of IMF programs have revealed that under specific conditions domestic policymakers can influence program design. The main insight here is that the success of IMF programs hinges on political support within crisis countries (Ivanova 2006). Thus, the IMF needs to take into account the potential impact of its measures on domestic politics, and particularly on the influence of ‘reformers’ that support its policies within the government (Pop-Eleches 2009; Woods 2006a). Such reformers are aware of this and can use the IMF as an external ‘commitment device’ to overcome domestic blockage and push through their preferred policies (Vreeland 2003). In such cases, local reformers might call in the IMF to 'tie their hands' on certain policy commitments that they would prefer anyway, but are unable to pass given staunch opposition. They can therefore push the IMF to introduce some conditions beyond what Fund staff considers 'macro-critical' and can therefore sometimes account for larger observed conditionality.

Alternatively, local policymakers can also exploit two-level games to their advantage, extracting more concessions from the IMF by pointing out that they are likely to lose political support if pushed too far by the Fund (Dreher and Vaubel 2004; Fang and Owen 2011; Vreeland 2002; Vreeland 2003). In this case, reformers or their political parties can derive strength from their domestic weakness if they can convince the Fund that stringent conditions will undermine their position and bring to power a more antagonistic administration or personnel (Woods 2006a). This can sway IMF staff, who, after all, need programs to be 'successful', including for their own promotion prospect. That said, in their interactions with the IMF, governments can be constrained by partisan competition, institutional legacies, or interest groups (Caraway et al. 2012; Mukherjee and Singer 2010; Pop-Eleches 2009). Nevertheless, in such cases the IMF can be seen as moving closer to the preferences of its 'weak' borrowers that use various strategies different from traditional formal voting power to achieve their goals.

The power of bureaucracy: Staff-driven approaches

Even if the IMF is largely a classic inter-governmental organization, it still boasts an impressively large, well-educated, and well-paid staff. This has led some to articulate more bureaucratic accounts of Fund behavior, focusing not on the role of member-states, but on that of IMF economists as agents and actors. In particular, they point out to the technical expertise of staff, their key role in the negotiation of the program and the norms of voting that have emerged at the Executive Board. First, IMF staff is relatively big, endowed with resources and technically sophisticated. In 2008, the Fund had a total of over 1800 professional and managerial employees and an operating budget of about 1 bn USD, of which over 70% were spent on personnel (IMF 2009a, pp. 64–68). Moreover, its top staff is generally made of PhD economists trained at elite (mostly American) institutions (Nelson 2014, p. 309).

Second, it is staff, under the guidance of management, who generates the initial program draft and conducts the direct negotiations with the borrowing country. In theory, there is no intervention from Executive Directors at this stage, although it has been observed in cases of particular importance for some of its G5 principals. Staff therefore has potentially strong agenda-setting power, as the Board cannot approve a financial assistance program without their prior proposal.

Third, the Board itself does not take formal votes on programs; instead programs are approved by consensus basis while taking into account the relative voting power of member states (Mussa and Savastano 1999). As Gould points out, "'there are only a few instances in the Fund's entire history of the Board turning down or even modifying a request for a conditional loan arrangement'' (Gould 2006, p. 286). In sum, therefore, the Board can change the parameters of the program submitted by staff or even vote it down, but in practice this is extremely unlikely to happen given the ensuing economic consequences for the crisis country.

These considerations have led some to emphasize the role of staff in shaping IMF lending programs. One set of theories draws on principal-agent framework and find that staff enjoys large degrees of 'agency slack' that it exploits to further its own bureaucratic interests and extract 'rents'. In this perspective, staff makes use of information asymmetries and knowledge production to push through its preferred policies as derived by material interests such as increased budget or control (Dreher and Vaubel 2004; Willett 2000). Thus, it is factors such as an impending quota review or availability of resources that affect staff decision-making and push them for example to increase the size of loans (Dreher and Vaubel 2004; Vaubel 1996). In this perspective, therefore, 'agency slack' gives discretion and thus leverage for Fund staff in program design.

However, while 'public choice' approaches explain when staff might have discretion, they are less enlightening when it comes to how staff uses such discretion. Another approach thus accentuates the role of the IMF as a bureaucratic organization with its own norms, rules, and culture. From that perspective, staff behavior represents the construction of social knowledge and cognitive authority based on how they interpret their uncertain and incomplete mandates (Barnett and Finnemore 2004; Broome and Seabrooke 2012). These perspectives often accentuate the role of the Fund as a 'runaway bureaucracy', but can also be seen in a narrower sense as suggesting that IMF staff preferences are likely to matter and could even sometimes be more consequential in shaping program design than state preferences. In this case, it is the bureaucratic-legal authority that economists can claim that helps them construct 'cognitive authority' over program design.

In addition, scholars have underlined how the normative orientations of staff can lead to systematic bias in lending decisions. The main insight here refers to staff incentives to be less ‘stringent’ on “sympathetic interlocutors” with whom they share a common background (Chwieroth 2013, 2015; Nelson 2014). These studies often blend rationalist and ideational insights. On a rationalist side, encountering such ‘partners’ in borrower country teams increases the confidence of Fund staff that the government is genuinely committed to implement tough adjustment measures because they consider them in their own benefit and the ‘right’ thing to do. In turn, this reduces the need for tight monitoring and oversight by the Fund itself, which translates into ‘looser’ programs. From an ideational perspective, such ‘sympathetic interlocutors’ might lead to a normative bias by IMF staff. In particular, despite their geographical diversity, Fund economists tend to be overwhelmingly graduates of a number of elite American and British universities, in which the general curriculum follows a relatively ‘neoliberal’ perspective (Nelson 2017). Given that, they are likely to feel less ‘policy distance’ from their negotiating counterparts in the borrowing country when such counterparts have similar economic training or are known to the Fund from previous lending programs. In turn, this might affect how staff perceives the political feasibility of the program and other projections for future behavior, which are key to assessing the likelihood of program success. If this is the case, informal staff motivations and their source become an important variable in explaining overall program design (Chwieroth 2013, pp. 269–274).

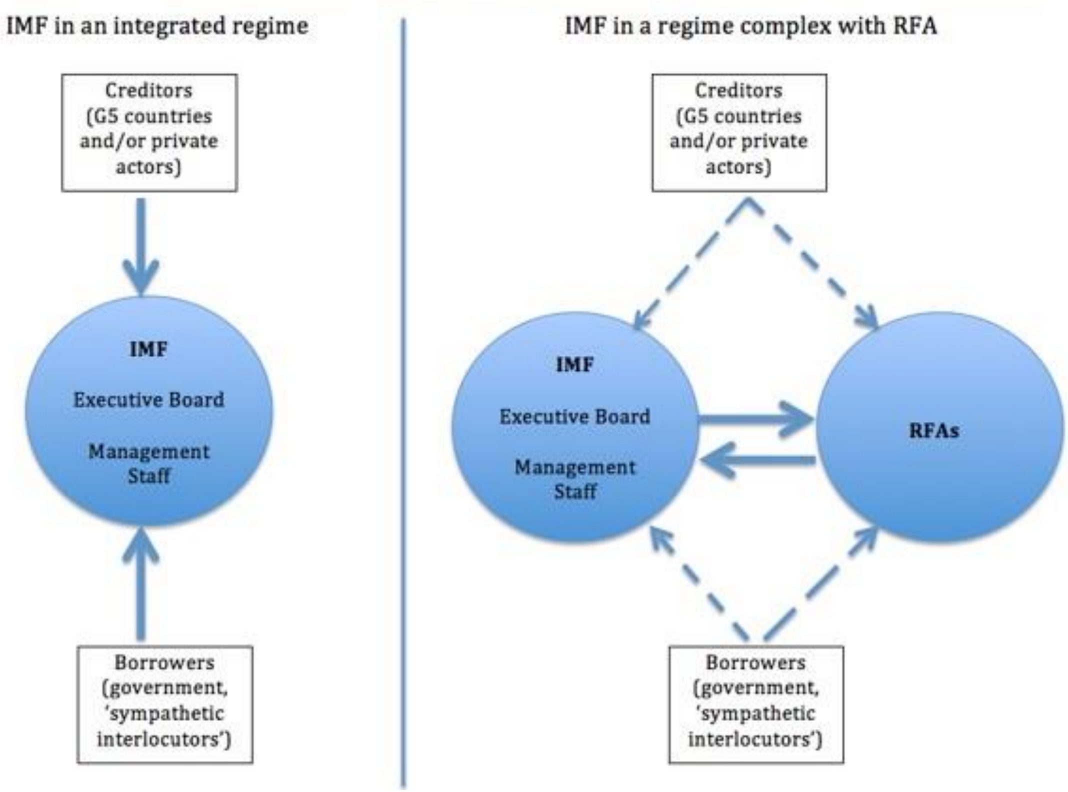
Limitations of existing literature

Despite their merits and differences, the state-of-the-art existing theories all focus on how conflict *within* the IMF drives institutional outcomes. Regardless of whether it is creditors, borrowers, or IMF staff that is seen as driving behavior, they all assume that the important moves are made within the IO, either at the Executive Board or in staff negotiations with borrowers. In the case of creditor-driven theories, the key variation is the interests of G5 countries, which are filtered through the Fund machinery. If one focuses on borrower countries, then the key is their direct bargaining power vis-à-vis a potentially powerful IO. Staff searches for sympathetic interlocutors, with variations in the relationship between borrowers and the Fund seen as key to program design. In more visual terms, existing theories all assume some level of '*vertical'* negotiations between creditors, staff, and borrowers.

Such theories therefore implicitly rely on the assumption of the IMF as the sole provider of crisis lending to countries in difficulties. This was reasonable approximation of reality before the global financial crisis. However, the rise of RFAs across large parts of the world alters the institutional environment in which the IMF operates by providing alternative channels for the provision of financial assistance. In light of these changes in the outside options of actors, maintaining the assumption of IMF exclusivity is likely to yield misleading inferences, particularly where issues of equifinality arise. Therefore, now '*horizontal'* relations between the IMF and RFAs become salient as they open up new strategies for all actors in the regime complex.

The key difference between a regime complexity approach and existing accounts of IMF behavior is that whereas they focus on the interaction of actors *within* the IMF, in this account the main determinants can sometimes be found *outside* the IMF. This means that its behavior is likely to be shaped in important ways by the regime complex in which it operates, rather than just by the internal interplay of powerful shareholders, borrowing countries, or its own staff ideas and expertise. To understand the actions of the Fund as part of an expanding but also increasingly decentralized contemporary global financial safety net one needs to situate the analysis at the level of the regime complex itself. In turn, the IMF behavior is the result of its strategic response to exogenous developments as the outside options of all actors are different given the existence of an alternative institution for crisis lending (in this case, an RFA).

Figure 4: Traditional and Regime Complexity Approaches to IMF Behavior



It may also be useful at that point to delineate more clearly what this study is *not* attempting to cover. First, it does not address the question of where regime complexes come from. The presence of a regime complex in crisis finance is taken as a starting point and an independent variable. What it does consider instead is how its presence affects IMF behavior, in terms of program design in crisis lending, the dependent variable. Second, it does not purport to explain the sources of preferences among creditors, borrowers, and staff, which are also taken as given. The question it seeks to address is *whose* interests are reflected in the final program at the end of a process of bargaining and negotiation. Finally, this framework is not addressing directly the question of whether the shift to regime complexity is improving or hindering the effectiveness of crisis lending. Instead, it seeks to develop a positive understanding of the phenomenon before addressing the normative and practical implications for the IMF in Chapter 7.

IOs and regime complexes: Why does the institutional environment matter?

How can one integrate the impact of a changing institutional environment on program negotiations? This section builds the main argument in two steps by drawing on regime complexity concepts. First, it considers how IO motivations and preferences differ when it operates in an environment of overlapping institutions. This serves to explain why IOs can and indeed often do respond to developments taking place outside of the particular institution. Second, this section applies such general arguments to the case of the IMF and the pressures that influence decision-making within the Fund. In particular, it demonstrates why potential exclusion from crisis lending can be problematic for the IMF.

IO behavior in a regime complex

Why does the presence of a regime complex affects IO behavior in the first place? As the outside options change, this has an impact on the decisions taken by the IO itself through their effect on the bargaining environment facing all actors, including member-state representatives, management, and staff. In short, IOs *also* behave strategically in a regime complex. In their relations with states, therefore, IOs will behave purposefully to *adapt* to changing circumstances in their institutional environment in order to preserve their advantages. This moves IOs beyond the rather passive arenas envisaged in most regime complexity scholarship to actors participating in dynamic interactions with states, other IOs, and other non-state actors.

The motivation for such behavior is likely to be a string of interrelated bureaucratic and ideational incentives. On the bureaucratic side, IOs that are losing their centrality in performing certain tasks are likely to seek to regain their status since it comes with associated material endowments for the organization, and therefore for its staff. As the relevance of an IO declines, it is likely to face reductions in its budget and staffing, as well as in other intangible variables such as 'prestige'. Therefore, in order to survive and thrive, the IO needs to adopt strategies that guarantee that they will have the necessary resources going further. This in particular means the required material means to carry out their tasks as defined by states at the delegation stage. As they accrue general resources, they are likely to receive funding for their 'operating costs', allowing IOs to increase or maintain staffing and salaries.

Concerns within the IO about regime complexes can go beyond the "selfish" public choice rationale and instead highlight broader accountability concerns. The proliferation of overlapping institutions can lead IOs to worry about the effectiveness in delivering on their mandate. Specifically, the presence of other actors means that the process of reaching decisions is considerably more complicated and potentially slower in the absence of explicit coordination. Moreover, from the perspective of the previously single IO their involvement creates 'intervening organizations', which have some influence on the final result. This increases the uncertainty and muddles the accountability for outcomes for which the IO itself is ostensibly singularly responsible. These worries are complementary to the narrower bureaucratic concerns as performing effectively is likely to increase the chances of receiving more resources from states (Lall 2017, p. 251).

This mix of motivations leads IOs to take into account the changes in their operating environment. The effects of such competition can be seen as more and less 'benign'. Ideally, competition is supposed to provide a stimulus to improving the 'service' such IOs are offering as otherwise states might choose to 'vote with their feet' and switch to alternative institutions. In this case, the strategic response by IOs is assumed to be functional. In particular, this is intended to stimulate improvements in performance through either efficiency gains, further specialization, or some form of institutional innovation that gives an edge in terms of output production. This can certainly be a powerful driver of internal change in the absence of state interests and could push IOs, which have had little competitive pressure before, to adapt to changing demands.

However, competition can also take less 'benign' forms. Instead of focusing on their outputs, such institutions can also maintain their centrality by moving closer to the preferences of their state principals. This can be seen as a more political form of adaptation that maintains the role of the IO by aligning it with state preferences even sometimes at the expense of what IO staff or external experts consider to be the 'right' thing to do. To the extent that the long-run success of an IO is related to its output legitimacy, this can therefore solve the problem of exclusion in the short term at the expense of the long-term interests of the institution. This approach is likely to result in a 'race to the bottom' in terms of standards or outputs as states play off organizations against one another. Given the presence of overlapping institutions the question remains about which strategy is likely to dominate. In particular, the important consideration is what mix of strategies will IOs pick if left to competitive pressures and whether there might be ways of designing institutional interaction that make it more likely for this to result in a 'virtuous' rather than a 'vicious' cycle.

Drivers of IMF behavior in a regime complex

How do these more general arguments about the incentives created by the presence of a regime complex 'translate' into the case of the IMF? In the context of overlapping institutions, the Fund is likely to be motivated by the mix of bureaucratic and ideational concerns noted above. More prosaically, sharing the stage or even being excluded implies financial consequences for staff and management, who need to deal with the repercussions for the institution. The IMF derives significant proportion of its operating income from the interest it charges its borrowers; therefore, missing out on a large program is potentially costly, particularly so at times when the IMF has a relatively small portfolio of loans. This is also related to the financial cornerstone of the IMF – it's 'preferred creditor status', which means its loans are the first in line to be repaid (above other sovereign or private loans) and which has ensured an exceptionally low rate of default so far[10]. This can be challenged if other IOs, also sponsored by states, are co-lending with the Fund, with their creditors being unwilling to take a ‘hit’ to their loans before the Fund.

In addition, operating in a regime complex also motivates strategic behavior from the IMF through more ideational concerns. Crisis lending is at the core of the Fund’s raison d’etre and hence any channeling of such assistance through other institutions can undermine the rationale for its existence. In short, if RFAs have the resources and the capacity to do conditional lending, what is the role left for the IMF? Furthermore, even the engagement of other RFAs in parallel to the Fund is likely to be problematic by muddling accountability and implicitly challenging the Fund’s authority, and thus focality, in the area of financial assistance. Such ideational, or professional, concerns are likely to intensify when a particular program it is perceived as a precedent for a whole particular set of similar countries, which may otherwise require assistance from the Fund in the future. Exclusion from high profile or novel cases is particularly damaging as it casts a shadow that suggests that future similar crises would also be addressed without the IMF. In short, a regime complex motivates strategic responses from the Fund and its management for both financial and professional reasons.

How does a more competitive landscape then affect IMF behavior? In a world with a single integrated regime around the Fund, actors have stark choices. On the borrower side, the alternative to agreeing financial assistance is to adjust unilaterally by quickly addressing vulnerabilities and returning to private financing. Yet, this often implies especially painful and

[10] Some countries fall in arrears, but generally clear them within a delay of several years; the only countries still in arrears as of late 2017 are Sudan, Somalia, and Zimbabwe.

wrenching measures, which could undermine the potential economic recovery, and can lead to sovereign default and capital controls. On the creditor side, channeling lending through the IMF is considerably more efficient both because of the IMF lending 'machinery' but also because creditors can count on mobilizing a larger package than they would be able to mobilize bilaterally. Therefore, given painful alternatives for adjustment or credit mobilization outside the Fund, the battle has traditionally been fought *within* the IMF, with various interests seeking to shift the Fund closer to their preferred outcome.

The proliferation of RFAs significantly changes the outside options of all actors even as formal rules inside the IMF change little. Now, the alternative to IMF involvement is no longer 'no financial assistance', but lending from other sources[11]. Such RFAs can enhance the IMF response by providing supplementary financing, access to key non-state actors, or in-depth local knowledge in *addition* to the Fund's own resources. However, states can also use RFAs to strategically *substitute* IMF funding when their preferences diverge significantly from those of the Fund. This in turn puts the IMF itself in a much more defensive position as it recognizes that it could be 'played off' against other institutions, or even potentially replaced in its core functions. Such threats are always present implicitly even in a world with the IMF as the sole provider of financial assistance. However, once alternative channels go from a hypothesis to reality, this significantly constrains the room of maneuver for the Fund. That in turn makes it increasingly hard for the IMF to exercise influence over the terms of its conditional lending programs.

[11] The focus here is on RFAs, but other sources of financing can include bilateral central bank swaps, foreign exchange reserves, or private financial markets when liquidity is plentiful.

Complex bargaining: The IMF in a regime complex for financial assistance

The previous two sections outlined existing theories of bargaining within the IMF and the reasons why a regime complex introduces a new set of incentives that affects the process of program design and negotiation. The goal of this section is to build on these insights to generate a set of observable hypotheses about the process and outcome of such bargaining under conditions of regime complexity. It therefore first analyzes how specifically such conditions alter the incentives of IMF staff, borrowers, and creditors. In particular, it presents three possible outcomes from such bargaining processes. Then, it proceeds to offer some observable implications about whose interests are more likely to be reflected in final program design.

Whose interests? Overlapping institutions and the threat of exclusion

The presence of institutions with overlapping mandates affects the incentives of all the actors in the regime complex and opens the way to new strategies, which, even when not exercised, have an effect on decisions and bargaining power. For the Fund itself, the presence of other IOs in the same issue area can mean more capabilities. This logic draws on recent advances in understanding IO behavior that highlight that a dense institutional environment can serve "as a source of IGO autonomy" as such organizations "enlist the assistance of transnational actors…or other IGOs, increasing their effectiveness and their autonomy from member states" (Abbott et al. 2015, p. 6). Unless imposed by states, such cooperation is likely to be soft and rely on informal networks and contacts, but can be effective when institutional capabilities are complementary and can help all IOs involved to achieve their goals. RFAs generally fall in this category, providing in particular additional financing, more fine-grained local knowledge, and deeper relationships with important state and non-state actors in the region. On the other hand, the IMF is the 'go to' focal institution when it comes to crisis lending, has extensive crosscountry experience, and, until recently, had a considerably larger ‘war chest’ than the RFAs. In that sense, from a functional and bureaucratic perspective, the IMF can benefit by cooperating with other institutions, and vice versa, which can help both actors achieve their objectives. In turn, this is likely to affect how they approach the process and task of crisis lending.

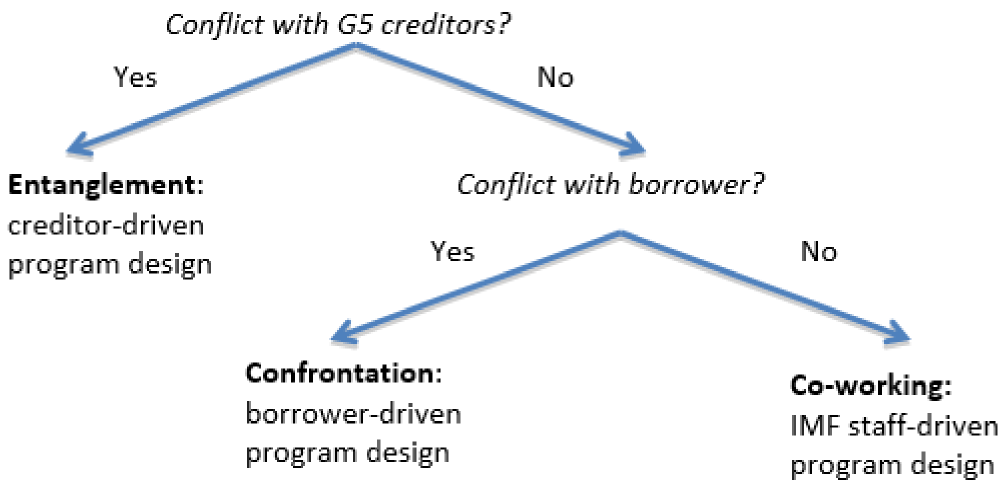
Overlapping institutions also present strategies for states, as it has been extensively studied. Where this thesis goes beyond existing scholarship is by suggesting that such strategies can be *deliberately* used by states specifically to enhance their bargaining power vis-a-vis the IMF when the Fund's preferences come into conflict with their immediate objectives. This is substantially different from most existing accounts of state behavior in regime complexes, which focus instead on cross-institutional strategies vis-à-vis other states (with the exception of notions of ‘contested multilateralism’ and ‘tangled governance’, discussed below). Notably, a key difference in observed behavior is that rather than shift actions decisively through various strategies to a most preferred forum, states might choose to channel activities through two or more IOs *as a strategy of control* vis-à-vis the IO itself. Such logic makes an assumption that states will care for their short-term interest and discount the long-term effects on the IO in question of such actions. However, this appears as a realistic assumption in the case of crisis lending, which is a highly salient topic for borrowers domestically and, when their interests are at stake, for G5 countries which are the Fund’s primary creditors.

For borrowers, which are usually states facing a financial crisis, overlapping institutions present alternative avenues for help, which, crucially, are not mutually exclusive. Blending insights from forum shopping and contested multilateralism, their behavior can be understood as a type of hedging (Busch 2007; Morse and Keohane 2014). While the logic appears similar to 'shopping' between alternatives for the venue most likely to advance the borrower's interests, this is analytically different as the options are additive rather than exclusive. Borrowers prefer to borrow from all possible sources for both functional and political reasons. Functionally, this allows them to achieve potentially a larger loan package, which reduces the necessary internal adjustment measures and associate sovereignty costs. Politically, however, it allows borrowers to rely on the IO that most closely reflects their interests should a conflict arise. This is also different from contested multilateralism, which focuses on actions by powerful states with potential outside options to achieve institutional change. Borrowers are generally in a weak position and therefore cannot create outside options; instead, they have to choose from a fixed menu set for them exogenously.

For creditors, overlapping institutions present alternative channels through which to provide the means for financial assistance to a borrower state. When their interests are not directly impacted, creditors are likely to let IOs deal with the financial crisis in accordance to their own best practices. However, if IO behavior lead it to suggest a course of action that conflicts with strongly-held preferences, G5 creditors are likely to actively use the threat to switch to an alternative institution, which is closer to their own preferences. Ultimately, given that they are the source of financial means, they are also able to engage in what contested multilateralism calls 'competitive regime creation', or the actual establishment of alternative IOs with characteristics that favor them directly. This logic is similar to what Henning terms 'tangled governance' (Henning 2017a). In his view, "by selecting multiple institutions rather than a single institution, creditor states in the euro area could better control the terms and conditions of country programs” and could arbitrate conflicts in order to restrain the ‘drifting’ of institutions beyond their preferences (Henning 2017a, p. 14). Thus, he highlights how creditor states deliberately involve overlapping institutions in order to realize their preferences. However fruitful, his argument remains limited. By restricting his case studies to the euro area, where creditor interests were intense, he does not discuss the strategies of staff and borrowers in other situations as described above.

Understanding IMF behavior in a regime complex involving the IMF, an RFA, a set of creditors, and a borrowing country requires putting these three incentive structures together. When powerful creditor interests are intense they are likely to seek to *entangle* institutions by creating overlaps that they can exploit to bring recalcitrant IOs 'in line' through the threat of exclusion. Therefore, when G5 interests are intense, IMF program design in a regime complex is likely to closely follow their broad preferences regardless of its own staff or borrower preferences. However, when G5 creditor interests are not so intense, then program design is likely to depend on the strategies of the borrower. In these cases, borrowers that disagree with the IMF but have a recourse to a RFA that is closer to their own preferences will seek to play institutions off each other through a strategy of *confrontation*. Finally, when neither creditors nor borrowers have an incentive to pit institutions against each other, then the IMF will be able to weave partnerships and generate networks with other IOs, which allow both the Fund and the RFAs in the complex to achieve their goals by enhancing their joint capabilities through *co-working*. This logic can be represented graphically in a decision tree:

Figure 5: Impact of regime complexity on IMF program design



Observable implications

This section seeks to draw some observable implications that allow testing the above propositions about IMF behavior in a regime complex. Such hypotheses need to accomplish two interrelated goals. First, they should be detailed enough to allow testing the framework against empirical reality in order to judge the internal validity of the study. Second, they need to be specific in order to differentiate the predictions of a regime complexity perspective from those of existing IMF theories. This should allow adjudicating between the validity of alternative hypotheses by explicitly focusing on points on which different theories would lead to different predictions. Given that the perspective presented in this thesis expects IMF behavior, understood in terms of program design, *within the same regime complex* to be different depending on the intensity and divergence of interests of borrowers and creditors, this generates three sets of such observations.

First, the section above proposed that when G5 creditor interests are intense, they would move to use the threat of exclusion to ‘align’ the IMF with their preferences over general strategy. In particular, they would do so by proposing to channel financial assistance through alternative institutions, which would then *entangle* the Fund into a regime complex. In these cases, there would be disagreements between some or all of G5 creditors and IMF staff over the initial blueprint for financial assistance at the outset of program negotiations. Based on these, creditors would make strategic moves towards channeling financing through an overlapping RFA, thus consciously *entangling* the regime complex. Such alternative RFA can be created if needed, and is likely to come with tight control mechanisms in order to guarantee it sticks closely to the creditors' preferences. Following this threat of exclusion, IMF management pushes to adjust initial program suggestions in ways that align program proposals better with G5 preferences. In turn, this reduces IMF staff to influence over some lower-level details of the financing package.

The broad outline of the strategy and key parameters of the subsequent program are likely to come close to creditor preferences. In that sense, the final outcome is similar to what existing theories would suggest is the case when G5 interests are intense, namely, policies biased towards G5 preferences. However, the *process* through which this occurs is fundamentally different. Most notably, such influence occurs by moves powerful states make outside of the Fund; therefore, in such cases one would *not* expect to observe a significant role for the Executive Board either directly through their voting power or indirectly through behind-the-scenes interventions and lobbying. Instead, IMF management will ‘adjust’ Fund policies out of its own desire to remain involved in crisis lending, without necessarily needing any *direct* pressure from the creditors. This allows for the formulation of a testable hypothesis for IMF behavior in cases of intense creditor interests as an alternative to existing state-centric accounts that prioritize formal voting power or informal mechanisms.

H1: If G5 creditors have intense interests in a particular crisis country, under regime complexity their preferences will shape program design.

> *H1.1: In a regime complex, creditors make strategic moves to channel financial assistance through alternative institutions.*
>
> *H1.2: In a regime complex, the Executive Board is marginalized in decision-making despite its formal vote on the program.*
>
> *H1.3: In a regime complex, IMF management takes key decisions in line with creditors' interests without the direct intervention of Executive Directors in the process.*

Second, when no significant G5 interests are necessarily on the line, borrowers dissatisfied with IMF proposals will make use of the 'threat of exclusion' to align the Fund with their own preferences over program strategy. To achieve this, borrowers need to have an alternative institution to which they can turn in case of disagreement with the Fund. Moreover, the preferences of this exogenously given RFA need to be considerably closer to the borrower than the IMF. At that point, they can engage in *confrontation* by playing the two institutions off each other when a disagreement arises. As a prerequisite, the borrower is motivated to engage in such strategies due to fundamental disagreements with IMF staff proposals for crisis resolution. Such preference conflict triggers moves by the borrower to switch financial assistance to an alternative institution with sufficient resources and closer preferences. Faced with threat of exclusion, IMF management adjusts program design to align itself closer with borrower preferences. IMF staff then exercise some influence on the means of achieving the policy objectives set by borrower.

The key expected outcome when borrowers disagree with the Fund within a regime complex is increased reflection of borrower preferences in the strategy and design of the financial assistance program. Therefore, whenever there is a disagreement, the IMF finds itself pitted not only against the borrower government, as usual, but also against an alternative RFA. This gives particular leverage to smaller countries that have so far been seen are having limited bargaining power vis-à-vis the IMF. In fact, in a regime complex they could even be particularly empowered as the smaller the size, the more easily they might be accommodated by an alternative institution. However, given the lack of capabilities for competitive regime creation, this means that such countries are 'shopping' from a 'fixed menu' and alternative institutions might not necessarily align with their preferences.

Nonetheless, the outcome – moving closer to borrower preferences – is also predicted by other existing theories of IMF behavior that highlight either rational or normative explanations. One potential example of the former would be state officials that engage in two level games in either direction (i.e. pointing to constrained win sets at home to extract concessions for the Fund, or using the political cover of IMF conditionality to push through politically controversial reforms at home). However, in the case of RFAs, they can achieve similar outcomes even in the *absence* of such domestic constraints. Meanwhile, staff can also find its autonomy constrained if it fears that pushing 'sympathetic interlocutors' too far might lead to arrival of less cooperative decision-makers. Similarly, however, even in the absence of concerns about the domestic position of their interlocutors – or indeed in the presence of strong domestic partners, the Fund can once again see its bargaining power, which is substantial in theory, constrained in practice. Thus, the following set of observable implications can be formulated to adjudicate between alternative explanations:

H2: If G5 creditors do not have intense interests and the borrowing country has diverging preferences over program strategy, under regime complexity borrower preferences will shape program design.

> *H2.1: In a regime complex, borrowers will make strategic moves to channel financial assistance through alternative institutions, which leads IMF management to align its policies with them.*
>
> *H2.2: In a regime complex, borrowers will be able to shift the IMF closer to their preferences in the absence of domestic political constraints.*
>
> *H2.3: In a regime complex, interlocutors will use the threat of using an alternative institution rather than the threat to their own position within domestic decision-making structures.*

Finally, when neither creditor interests are intense, nor borrowers experience any significant disagreement with the IMF, the Fund will draw on the institutional environment in order to increase its capabilities. This in particular allows the IMF to get some benefits, such as better local knowledge, access to key non-state actors, or simply more resources, which are likely to increase the chances of making the financial assistance program a success. In this case, there will be extensive contacts between the IMF and the RFA at both everyday staff level and management level, which provide the coordination and steering. Such *co-working* does not need to be formalized, but is based on an idea of division of labor according to relative comparative strengths of the relevant institution. Through these, both reap gains from increased specialization which result in improved effectiveness. The final program also contains a number of interlinkages and aspects of program design which are mutually related, and potentially mutually dependent.

The expected outcome from this situation would be an increase in the ability of the IMF to shape the terms of the crisis lending package. In particular, motivated by the presence of additional capabilities, the Fund faces fewer restrictions over realizing its preferences than when it acts alone. In that sense, this perspective shares some affinity with theories of IMF behavior that focus on the role of staff. However, it again emphasizes the role of strategically adapting to the international environment over ideational or bureaucratic concerns. Thus, this thesis argues that staff will relax conditions over lending terms not because of shared neoliberal ideas, but because it can mobilize larger packages and mitigate risks better through cross-institutional strategies than alone. IMF behavior in a regime complex also differs from the one often described in public choice approaches focused on self-serving bureaucrats that seek to increase their budgets, mandates or prestige. Notably, such bureaucrats are likely to engage in 'turf-wars' between institutions with overlapping mandates in order to claim as much of the associated resources for themselves. Such frictions would not be completely absent in regime complexes, but in contrast the overall pattern should be one of cooperation and division of labor as both institutions benefit from being better able to realize their mandates through their complementary capabilities.

H3: When G5 creditors do not have intense interests and the borrower country has no disagreements with the Fund, regime complexity increases the ability of the IMF to shape program design.

> *H3.1: In a regime complex, IMF staff will use cross-institutional strategies to augment its capabilities and reduce risks to the program.*
>
> *H3.2: In a regime complex, ideological affinity with the negotiating team or government of the borrower country is not necessary for relaxing loan conditions.*
>
> *H3.3: In a regime complex, IMF-RFA interaction leads to division of labor rather than inter-institutional conflicts.*

Table 2: Summary of alternative approaches to IMF behavior		
	Determinant of IMF behavior	Observable implications
Creditor-centric approaches	• Formal voting power • Informal governance	• Staff anticipates Executive Board alliance that most closely corresponds to their preferences. • Involvement of state representatives ‘behind the scenes’ exploiting information asymmetry and lack of transparency.
Borrower-centric approaches	• IMF as external commitment device • Supporting 'sympathetic interlocutors'	• Domestic government shapes program design to push reforms past recalcitrant opposition. • Changes in program design to accommodate preferred domestic political partners in weak domestic position.
Bureaucratic approaches	• Bureaucratic rent-seeking • Shared 'neoliberal' beliefs	• IMF staff exploits 'agency slack' to pursue narrow rational bureaucratic incentives (larger budget, more authority, etc.) • Support for partners on ideational grounds and limited concern over implementation due to assumed commitment to reforms.
Regime complexity	• Fear of missing out	• Moves by actors outside the IMF lead management to incorporate policy positions that keep the Fund within the regime complex. • Can result in *entanglement, confrontation,* or *co-working.*

Research design

How can the theoretical claims made above regarding IMF behavior in a regime complex be tested? This section presents the research design that seeks to provide an empirical challenge to the argument above. It therefore focuses first on selecting the most relevant methods for this study, laying out the reasoning behind combining a process tracing approach with comparative case studies and how this allows for testing existing explanations against the regime complexity perspective. It then discusses the case selection strategy, nothing carefully what factors are held constant and which ones are varying between cases, as well as the data sources that underpin the study.

Process-tracing IMF program design

Given the nature of the observable implications that flow from the argument presented above, this study relies on a combination of case study methods. Within-case analysis is conducted through process tracing, supported by congruence testing and counterfactual analysis (George and Bennett 2005). As a first step, initial values of the relevant independent variables proposed by the present and alternative theories of IMF behavior are considered against final IMF program design to test whether they are 'congruent' with the observations. This is useful to potentially narrow down the set of alternative hypotheses or to better specify what causal mechanisms alternative theories would expect to observe in this particular case. Second, the core of the empirical tests is conducted through process tracing. As Bennett explains, "the goal is to establish which of several possible explanations is consistent with an uninterrupted chain of evidence from hypothesized cause to observed effect" (Bennett 2004, p. 22).

Process tracing methods are particularly apt for two reasons. First, the causal mechanisms proposed in this study relate to how IMF decision-making is influenced through bargaining between the initial formulations of actors' preferences and the observed final program design. Process tracing therefore is the most suitable method for testing the validity of this type of argument against the empirical record. Second, the contention of this thesis is that IMF behavior is different under regime complexity from what existing theories might suggest. However, the outcomes in terms of program design are plagued by potential equifinality, which means congruence analysis is likely to be insufficient to assess the relative validity of alternative hypotheses. Instead, process tracing, which involves 'digging' into the causal chain, will be more suitable for adjudicating between possible explanations.

Finally, counterfactual analysis is used throughout the case studies when actors need to make a choice between several alternative pathways (Fearon 1991; Tetlock and Belkin 1996). The goal is to strengthen process tracing analysis by establishing insofar as possible the alternative options which were 'on the table' when the decision to go with particular strategy was made. Reconstructing the choiceset actors faced in this way can suggest what were the plausible counterfactual scenarios and can help to identify the pressures that led to the choice of a particular course of action over its perceived alternatives.

Operationalizing the dependent variable: Conditionality, financing, bail-in

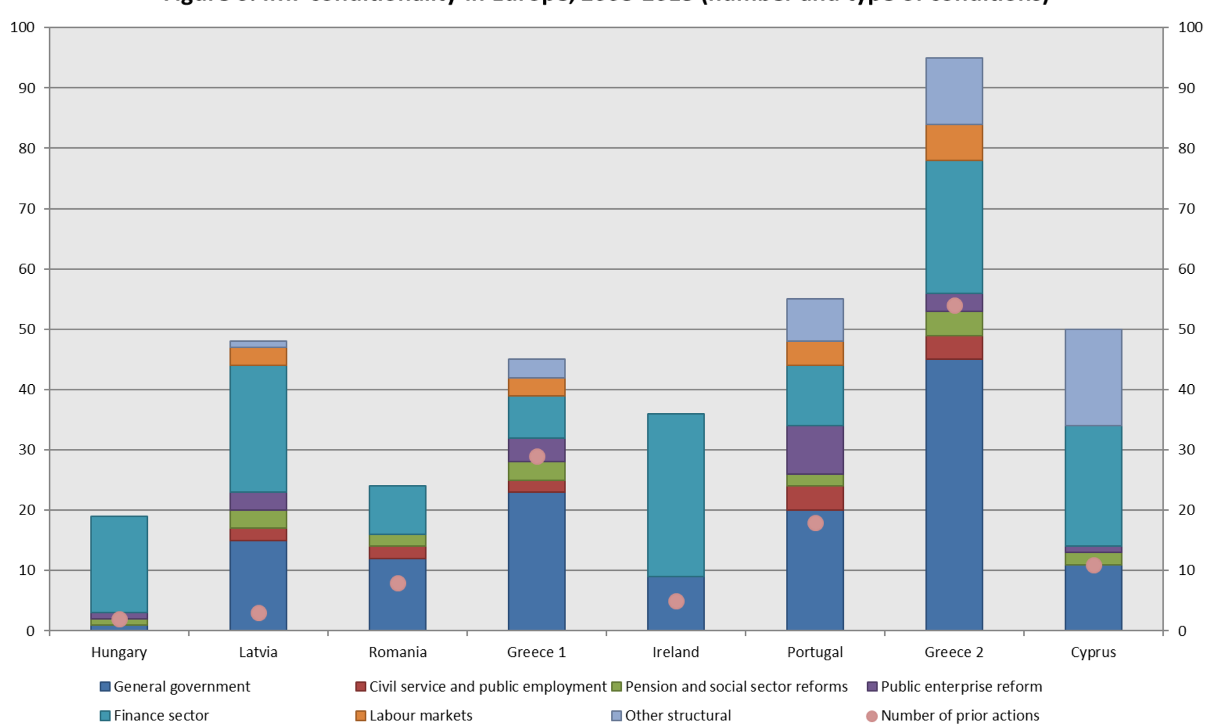
To operationalize such considerations, case studies are structured around three key aspects of program design: conditionality, financing, and bail-in. As explained in the previous chapter, IMF programs aim to fill in a 'financing gap' for a limited period of time to give a crisis country some breathing space for a more controlled adjustment than in the absence of external support.

The crucial question then becomes how is the burden of ‘filling the gap’ spread between the different actors. Together, these three parameters determine the extent of burden sharing among borrowers, creditors, and the private sector. They are thus interrelated - for example, a higher amount of adjustment through conditionality in the borrower country reduces the financing needed from official and private creditors. Therefore, for analytical purposes, these are the three main dimensions along which IMF programs vary, with important consequences for borrower countries.

Focusing on these three aspects is also necessary from a research design perspective. Existing theories of IMF behavior have been particularly focused on these aspects of program design and have devised sophisticated explanations for the observed variance among these characteristics. In particular, various features of conditionality such as its scope or its enforcement have received extensive attention (for example, Dreher and Jensen 2007; Gould 2006; Oatley and Yackee 2004; Stone 2002, 2008; Vreeland 2003). Others have focused also on the size of financing packages (for example, Broz and Hawes 2006; Copelovitch 2010; Vaubel 1996). There have been somewhat less studies on the political factors in relation to bail-ins in IMF programs, or what is known as catalytic lending, but it has recently began to attract more attention (see Bauer et al. 2012; Chapman et al. 2015; Edwards 2006; Jensen 2004). Thus, these are the typical features of programs that existing explanations have sought to explain, often through statistical analysis, and therefore provide a robust test for the relative validity of the regime complexity argument.

IMF conditionality comes in two main types. First, fiscal conditionality refers to the budgetary targets, and especially the path of the size of the fiscal deficit, to which the country agrees in exchange for Fund money. This is done in order to reduce ‘overspending’, but also serves to improve the debt-repayment capacity of the country, which would then allow it to both repay the IMF and regain market access. Second, structural conditionality refers to a variety of non-quantifiable reforms related to mid-term and long-term policies, such as labor market rules, financial regulation, pensions, privatization, and others (for a review, see Dreher 2009). This arguably serves to make sure the underlying macroeconomic weaknesses are addressed, and that the country can repay the Fund. Over time, the IMF has faced significant criticisms of exceeding its mandate regarding the imposition of conditionality on countries in difficulties and has been seen as previously promoting a ‘Washington consensus’ (Radelet and Sachs 1998; Stiglitz 2002; Williamson 1993).

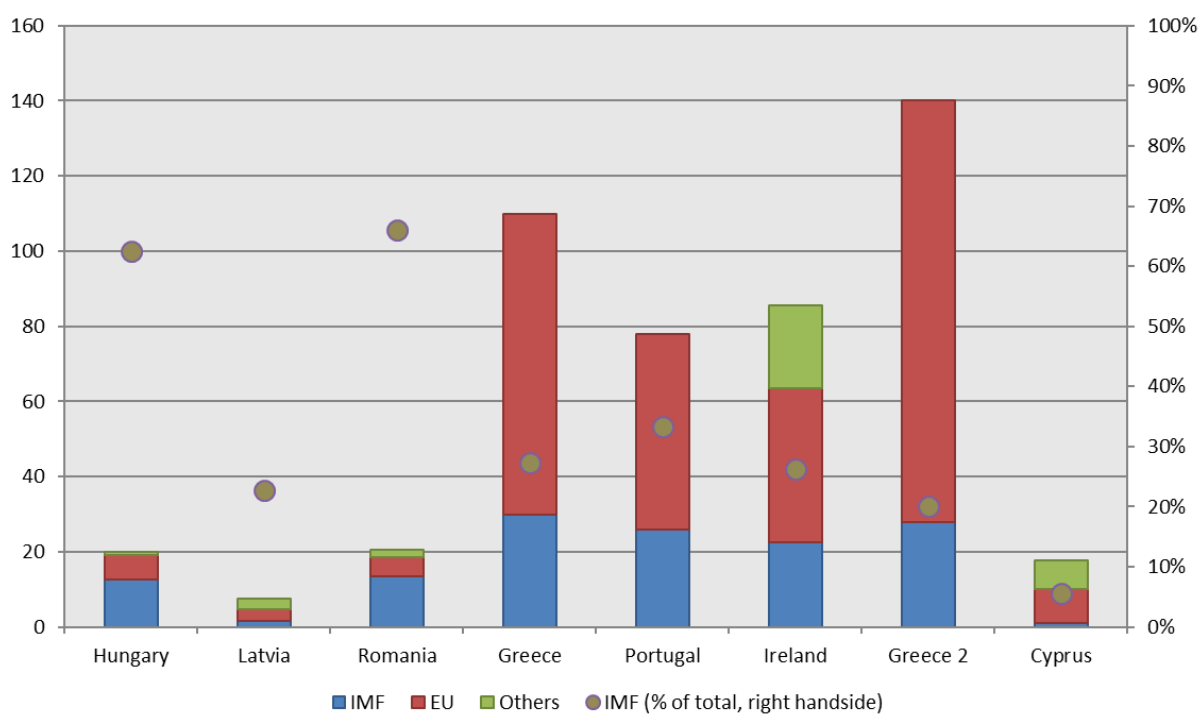
Figure 6: IMF conditionality in Europe, 2008-2013 (number and type of conditions)



Source: IMF MONA database

If conditionality is the 'stick', the 'carrot' is the financing package offered by multilateral institutions to a country in crisis. Traditionally, this was only IMF money, but a host of other actors have become involved in various ways over the years as "supplementary financiers" (Gould 2003, 2006). The overall size of the IMF portion of the package is determined as a certain multiple of the country's IMF quota. Particularly large loans (over 300%, and later, 600% of quota) need to satisfy 'exceptional access criteria' meant to provide clarity and protect the IMF from political influence in lending to countries that require debt restructurings (Schadler 2016). Money is disbursed only after the staff proposal for a program is officially approved by the Executive Board, and is released in tranches, which keeps the incentives for countries to implement agreed conditionality. Therefore, beyond size, key questions relate to the speed and 'frontloading' of disbursements, as well as any restrictions on their use.

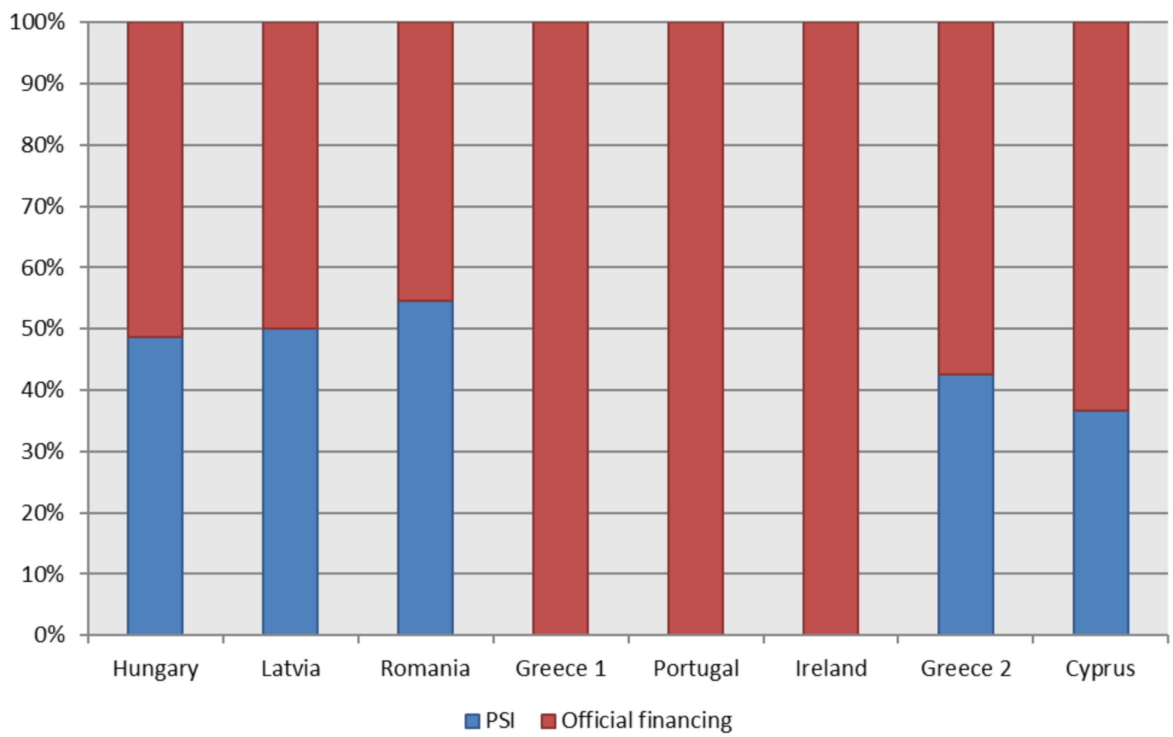
Figure 7: IMF-EU financial asssistance in Europe and burden-sharing (bn of euros)



Source: IMF MONA database, IMF and EU requests for financial assistance

Finally, a third feature of IMF programs is private sector involvement (PSI), or bail-in of private creditors. It can take many different forms, from informal rollover agreements to public debt write-offs and restructuring, with various degrees of Fund involvement. As financial globalization has largely outpaced increases in IMF resources, the behavior of private actors and their reactions to taking potential losses has started to feature prominently in discussions at the IMF about resolving financial crises (Roubini and Setser 2004). Yet, despite worries about contagion to other countries, the IMF has increasingly recognized that putting money 'in' that immediately simply goes 'out' to pay foreign creditors simply substitutes private for official sector debt, essentially solving the creditors' problem by making it one for the Fund.

Figure 8: Contribution of private sector involvement (% of financing gap)



Source: IMF program documents, Kincaid (2016)

Case selection and data sources

The second plank of the research strategy is the between-case analysis based on a comparative design around three case studies. These were chosen by focusing on the key independent variables as hypothesized by the argument presented above, namely the degree of preference divergence between creditors, borrowers, and IMF staff. Therefore, the first program under study is that of Hungary, where G5 countries had limited financial and geopolitical interests, and the borrowing country was reasonably aligned with IMF staff. The second program involves Latvia, a country with relatively low intensity G5 preferences but with a borrowing government that is at odds with IMF's preferred strategy. Finally, the third program features intense G5 interests and preferences, as was the case during the negotiation of the first Greek program.

Case study design can be plagued by problems of selection bias (King et al. 1994). This study acknowledges this, but seeks to mitigate them in several ways. The population of possible observations – that is, countries with IMF programs that also had recourse to potential alternative sources of financing – is for now severely limited in practice. At this stage, such experience is restricted to a total of seven cases, all in the EU[12], but is very likely to become increasingly common going forward. This thesis focuses in particular on three cases, Hungary, Latvia, and the first Greek program. This ensures variance among cases in terms of their size, political makeup and euro area membership (with Hungary having a flexible exchange rate, and Latvia – a currency peg to the euro). The second and the third Greek programs are not subject

[12] At the time of writing, Hungary (2008-10), Latvia (2008-11), Romania (2009-2015), the three Greek programs (2010-2018), Ireland (2010-2013), Portugal (2011-2014), and Cyprus (2013-2016). Spain is a borderline case as IMF participation was restricted to technical assistance.

to analysis here given that they were significantly impacted by the initial decisions taken during the first program. Romania can be categorized as similar to Hungary in terms of limited G5 interests and low divergence of preferences with the borrower, but Hungary presents a clearer test from the outset of the crisis before a pattern of cooperation has become established. Latvia and Cyprus both are examples of relatively small economies, but given the extent to which Cyprus was a collateral victim of the Greek debt restructuring, Latvia once again presents a case with less potential confounding factors. The first Greek program shared a number of features with other mid-sized euro area countries such as Ireland and Portugal, but also set precedents and shaped the institutional environment for the next two country programs. In short, Hungary, Latvia, and Greece were preferred over alternative cases as they provide for more robust tests of alternative theories by minimizing potential confounding factors.

In addition to cross-case variance, in keeping with a most-similar case study design, this selection also ensures a number of relevant factors are kept constant across the cases. All three countries are EU members, which means they largely share a general institutional setup and legal framework, despite some important differences in the case of full euro area membership elaborated in the respective chapters. The study is also restricted in time, covering a period of under three years between the beginning of the Hungary program in late 2008 and the later stages of the first Greek program in mid-2011 (from which point onwards actors anticipated and negotiated a debt restructuring). This marks it out from alternative approaches that seek to map out changes in bargaining outcomes over long periods of time or study variance in bargaining success among a cross-section of IOs at a given moment. Instead the goal here is to understand why and how the 'output' of an IMF with fixed governance arrangements and facing a comparable institutional context and crisis vulnerabilities in program countries still varies in response to the pressures of a regime complex. Finally, this aim also explains why the selected cases study how IMF behavior varies *within* a regime complex rather than *between* being outside and within such an institutional context. The latter is likely to yield trivial results without the necessary nuances to understand the conditional factors that lead to differences in program outputs. Moreover, these are the cases for which existing theories have been initially developed and for which there is a large amount of knowledge already accumulated.

In carrying out the proposed within-case and between-case analysis, the current study relies on a rich set of data sources. First, there are a number of primary sources, such as official IMF, EU and country documents released publicly during the discussions. They have been complemented recently by the expiry of five-year embargoes on several key documents such as Executive Board minutes and internal IMF memos and background notes. Second, the IMF has carried out a number of assessments, including ex-post evaluations and audit reports from its Independent Evaluation Office, which have uncovered crucial behind-the-scenes details. Third, by now there is also a large and growing secondary literature that tackles the crises in Europe, which, in addition to contemporaneous press reports, can provide a way to triangulate key debates and decisions. In some cases, important participants have released their memoirs, which can also be illustrative of their thinking. Finally, this set of documents is complemented by a series of interviews conducted by the researcher with officials from the borrowing country governments, IMF management level officials, Fund staffers (including participants in negotiating teams), and officials from EU institutions. Taken together and considered carefully against each other, they paint most of the time a sufficiently clear picture of the sequence of decisions to fulfill the rich ‘informational requirements’ of process tracing methods.

Overall, this section presented the research design of the study, which combines within-case analysis reliant in particular on a process tracing approach with cross-case comparison that allows testing the predictions made regarding variance in the independent variables. This strategy was chosen as a way to ‘pin’ the argument in this chapter against both the empirical record and against alternative state-centric or bureaucratic explanations. To do so, the empirical chapters focus on attributes of program design that have received a lot of attention in existing studies, such as conditionality, financing, and bail-in arrangements. This allows for both organizing the discussion and testing the regime complexity argument on a ‘level playing field’ against the predictions about causal mechanisms made by current theories of IMF behavior.

Conclusion and roadmap

In summary, this chapter presented a theoretically-informed argument about how the IMF behaves in the presence of other institutions with overlapping mandates. It first outlined existing explanations of Fund behavior and the sources of bargaining power for creditors, borrowers, and staff that they identify. However, it argued that such explanations are implicitly presumed on the IMF standing alone as the single institution for channeling financial assistance, which is increasingly misleading in a world with proliferating RFAs. Then, it began to unpack how regime complexity affects the behavior of IOs by considering how IO incentives differ when it operates in an environment of overlapping institutions, by focusing in particular on why potential exclusion from programs of financial assistance might be costly for the Fund.

This led to the core argument of this chapter that the presence of overlapping institutions opens up the potential for cross-institutional strategies that creditors, borrowers, and staff can use to achieve their goals. When no intense G5 preferences are at stake and borrowers do not have general disagreements with IMF staff, the Fund is likely to draw on the presence of complementary partner IOs in order to increase the chance of program success, resulting a *co-working* outcome. However, in the absence of formal coordination mechanisms borrowers and creditors can equally make recourse to alternative institutions as part of a deliberate bargaining strategy by brandishing the threat of exclusion. If borrowers can find an alternative RFA within the regime complex that is closer to their preferences, they can engage in *confrontation* with the IMF, and ultimately can even shape program design and strategy from an apparent position of weakness. However, if G5 creditor interests are intense due to financial or geopolitical concerns, they can engage in competitive regime creation, leading to the strategic *entanglement* of the IMF with alternative institutions. Variations in IO behavior within a regime complex are therefore attributable to moves *outside* of the Fund, in contrast to existing theories that stress battles *within* the IMF.

The argument here is tested through a combination of case study methods against the financial assistance programs negotiated for Hungary, Latvia, and Greece in the aftermath of the global financial crisis. This draws on extensive documentary base in order to address problems such as equifinality and adjudicate between alternative explanations. The goal ultimately is to gain insights that go beyond existing theories and help to account for empirical puzzles. Therefore, the next chapter is dedicated to the case of Hungary, which received a surprisingly 'lenient' loan from the Fund in November 2008. It is followed up by a study of the Latvian program of

December 2008, in which a small country managed to resist successfully pressure from the Fund to devalue its currency. The final case study focuses on the case of the first Greek program of March 2010 and the agreement by the IMF to be a 'junior partner' in a program about which staff and management were skeptical at best. The next three chapters therefore seek to assess to what extent variance in IMF program design in each of these cases can be attributed to traditional creditor-centric, borrower-centric, or bureaucratic accounts, or the new regime complex explanation, before then drawing some implications for the role of the Fund and the future of the global financial safety net.

IV. The IMF in Hungary (2008-2010): Doing it the IMF way

On 9 October 2008, the governor of the Hungarian central bank called the IMF with a simple message: "all hell has broken loose" (Bakker and Klingen 2012, p. 93). A government bond auction had just fallen through, convincing the Hungarian government that it has little choice but to seek official assistance. This was not a surprise for the Fund given the high external and sovereign debt of Hungary as well as their well-known problems in addressing their fiscal deficit and large-scale foreign currency borrowing. The IMF was quick to organize a mission, negotiate a set of adjustment measures, and approve the program and the immediate first disbursement by 6 November 2008. The total program financing reached 20 bn euros, of which 12.5 bn were to be provided by the Fund, with the European Commission (EC) providing up to 6.5 bn and the World Bank pledging an additional 1 bn euros.

All this ranks the Hungary IMF-EU program as one of the most 'generous' packages that the Fund has ever offered to a crisis country. Despite a history of persistent fiscal deficits, the program initially only envisaged a fiscal adjustment worth just 1% of GDP. While being aware of structural problems, the IMF was satisfied with very limited structural conditionality focused mostly on the financial sector and was ready to leave the design of such measures to the government. These conditions were complemented with generous funding, marking the program as one of the highest relative to the country's quota in IMF history and on par with previous high-profile cases. Moreover, money was disbursed quickly and was highly frontloaded. Finally, the IMF recommended and supported an effective bail-in of foreign creditors, mainly banks, thus reducing the need for adjustment and risks to its own balance sheet and reputation.

What were the forces that shaped the process and led to such outcomes? Existing theories highlight the role of creditor or borrower states or the bureaucratic or ideational incentives of IMF staff. This chapter tests their explanatory power vis-à-vis the hypotheses regarding IMF behavior in a regime complex presented the previous chapter. To adjudicate between competing explanations, it relies primarily on process tracing, focusing on the causal chain through which independent variables are assumed to condition outcomes. It first analyzes the congruence between explanatory variables and the observed outcomes before then engaging in detailed tracing of the causal chain that resulted in the observed conditionality, financing, and bail-in arrangements.

The IMF program for financial assistance to Hungary

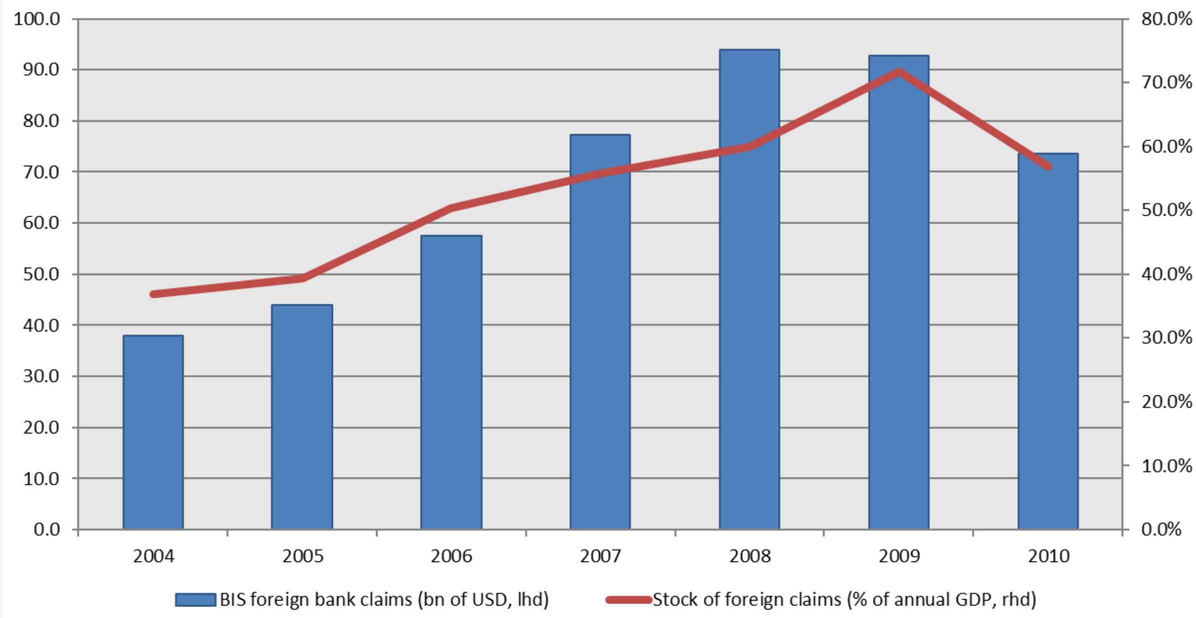
This section serves to introduce briefly the Hungarian crisis and to provide an outline of the key elements of the financial assistance package that was provided to Hungary in November 2008. It sets the scene and examines the key program design outputs in terms of fiscal and structural conditionality, size and speed of financing, and cross-border bank bail-in. Taken together, it demonstrates that given the severity and sources of the crisis, the program that was struck with the IMF appears to be relatively generous, even when considered in the context of other programs the Fund agreed during the same period.

Hungary's boom and bust

From a technocratic point of view, in the presence of liquidity rather than a solvency crisis the IMF should be willing to act more like a lender of last resort and offer larger packages at lower conditionality. At first, this appears to somewhat fit Hungary's case. An early and eager reformer, the country has often been seen as the standard-setter for the other transition countries in the 1990s by pursuing austerity, stabilization, and privatization policies. It joined the EU in 2004 along with most other Eastern European countries, and it grew strongly afterwards. Early financial inflows were largely FDI, but as European integration progressed, they shifted more and more towards debt and banking flows. Foreign banks entered the Hungarian market early on and expanded aggressively, driving up rapid credit growth as in other emerging European countries (Enoch and Ötker-Robe 2007).

By the end of 2008, foreign banks owned 67% of banking assets and 87% of Hungarian banks, while their claims increased 2.5 times compared to barely four years earlier. Meanwhile, the biggest bank, OTP, remained largely Hungarian, but itself expanded in adjacent countries. Foreign-owned banks fueled their growth through foreign currency funding channeled through their banking groups and hedged their risks by extending loans in the same currency in Hungary. Households and corporates took advantage of the significantly lower rates on foreign currency loans under the assumption of rapid euro area entry. The result was that on the eve of the crisis two thirds of all bank loans was denominated in foreign currency to unhedged borrowers, while loan to value ratios hit 150 (Bakker and Klingen 2012, p. 93).

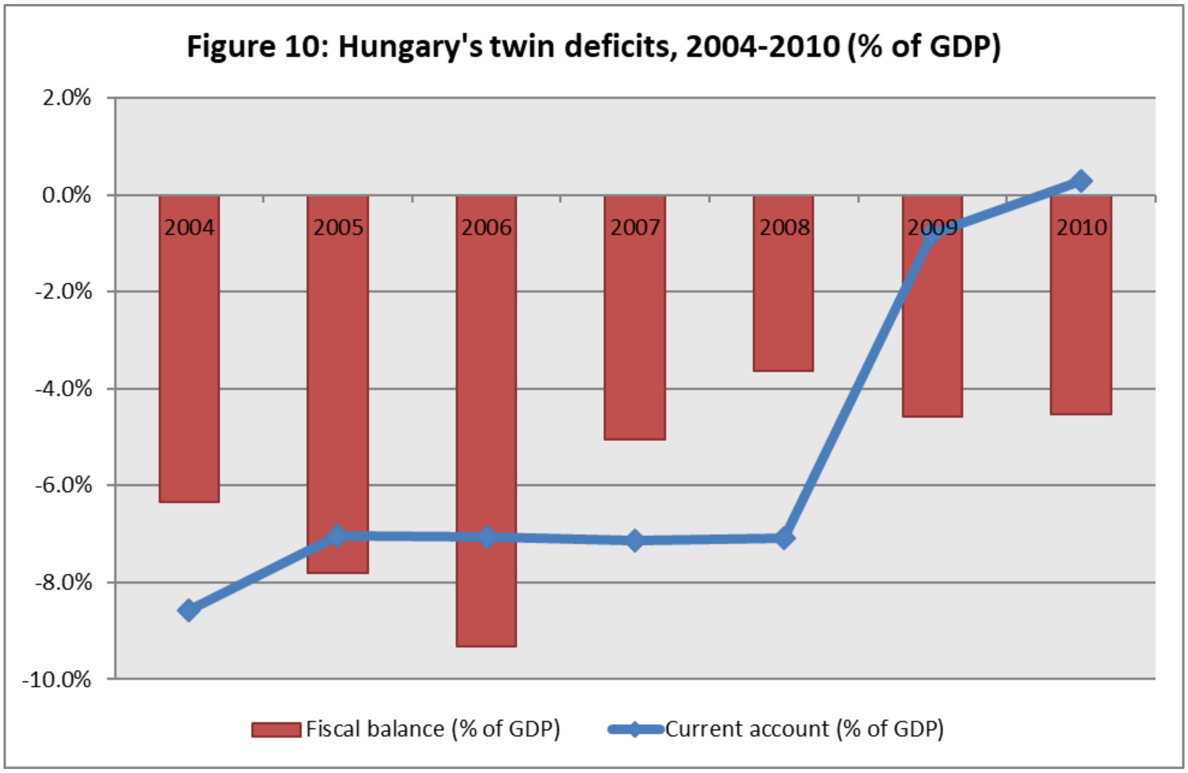
Figure 9: Foreign bank inflows in Hungary, 2004-2010, (USD, bn, and % of GDP)



Source: BIS Consolidated Statistics, IMF WEO

Whereas such financial sector problems can be attributed to spillovers from the global financial crisis, Hungary also faced clear structural and solvency problems. On the fiscal side, Hungary had a public debt of 66% of GDP in 2007, which would be considered large by the regional and emerging market standards that applied to the country (Reinhart and Rogoff 2009). This reflected both the initial starting point – Hungary entered the post-communist transition period with a higher debt load – and, crucially, the accumulation of fiscal deficits over the years. Between 2002 and 2006, the government deficit was on average larger than 8% of GDP, and exhibited significant increases on the eve of elections (IMF 2008a). In 2006, a month after leading the Socialists to reelection, the Prime Minister Ferenc Gyurcsany was caught on tape suggesting the party lied to the electorate about the size of the fiscal problems. This led to significant protests, but also marked the beginning of fiscal consolidation attempts by his government, which reduced the deficit from just above 9% of GDP in 2006 to 5% of GDP in

2007. However, even if stabilized, sovereign debt remained at high levels, with around a third of it held by non-residents, increasing rollover and interest-rate risk.



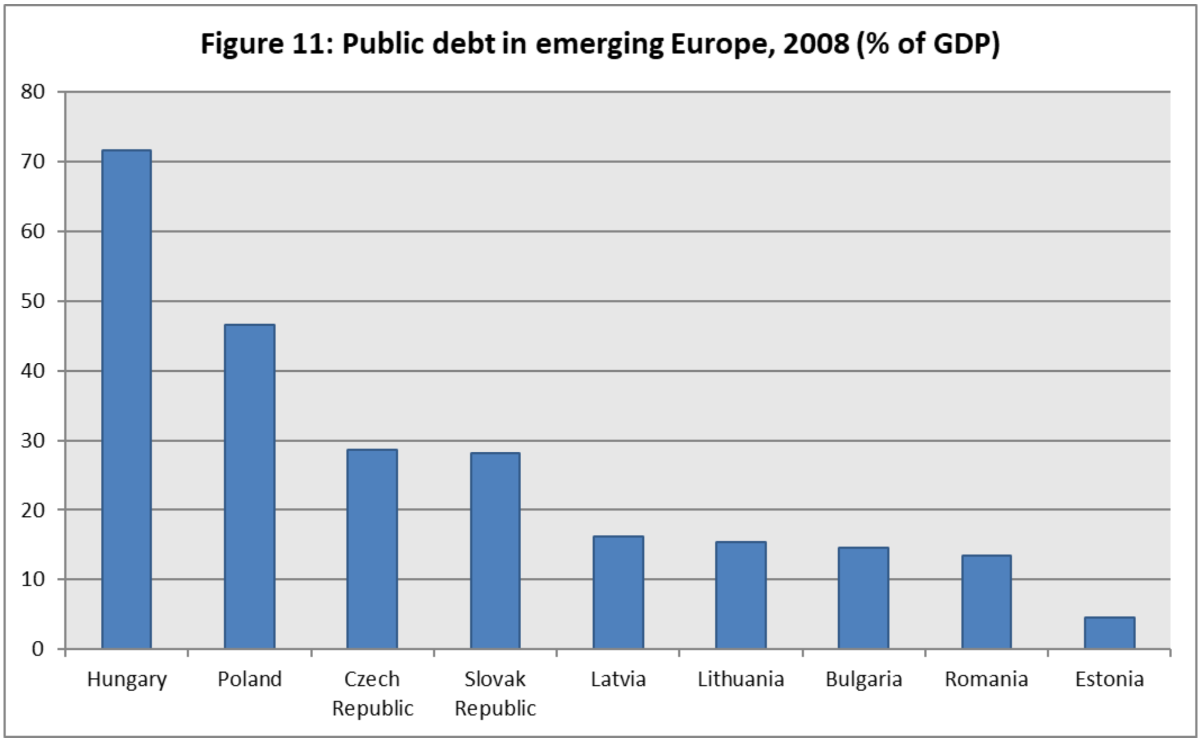
Source: IMF WEO

Program design: Conditionality, financing, bail-in

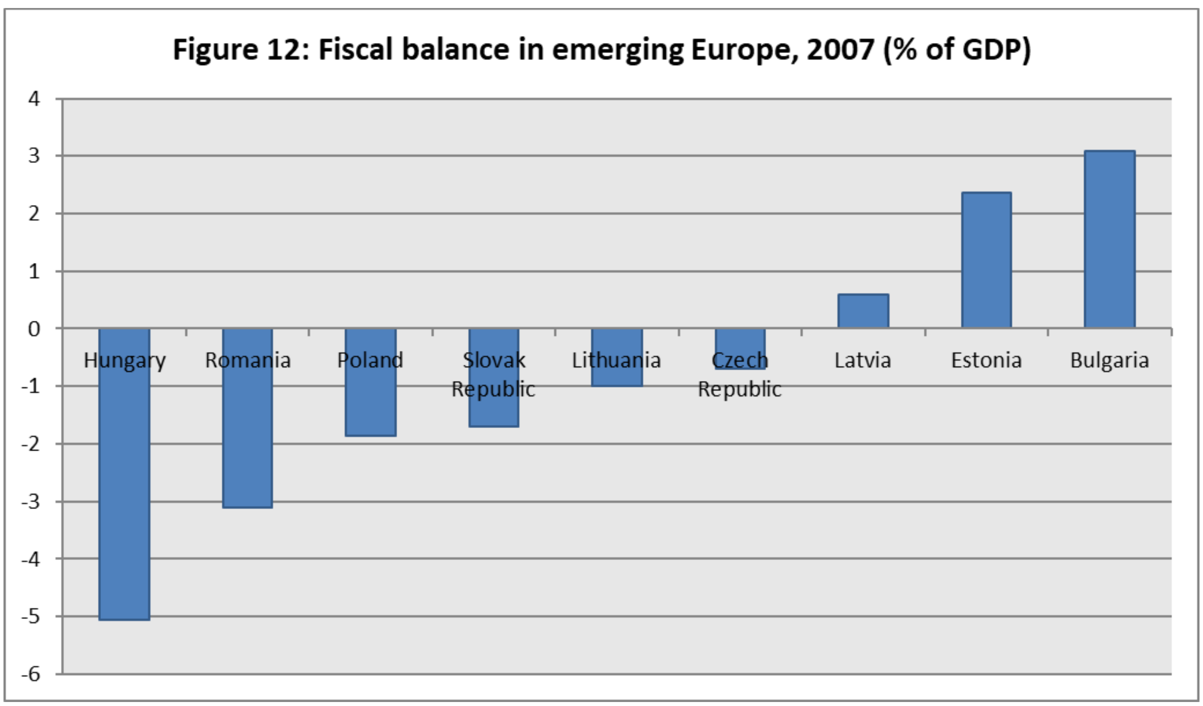
Given relatively higher levels of government expenditure due to a number of years with fiscal deficits, reducing fiscal weaknesses was perceived as key if Hungary was to return to capital markets within a reasonably short amount of time. At the end of 2008, Hungary's public debt stood at 71% of GDP, significantly higher than other countries in the region. The fiscal deficit for 2008 was projected at around 3.4% of GDP, down from 9.3% two years earlier due to the austerity program already pursued by the Gyursceny government. The government initially aimed to bring it to 2.9% of GDP in 2009, but the crisis changed their plans. Assuming a 1%

contraction in 2009, the government and the IMF agreed to target instead a 2.5% fiscal deficit for 2009, which required a structural adjustment of 2.5% of GDP (IMF 2008a, p. 10).

Participants at the time and after the program perceived this fiscal adjustment to be significantly lower than what might have been expected from the IMF given the size of the vulnerabilities. Indeed, as the Fund puts it itself, in terms of fiscal adjustment in the midst of the crisis, "Hungary's program (1% of GDP) is at the low end of the range of planned overall balance adjustments" in IMF-supported programs in capital account crises, such as Mexico, Korea, and Turkey (IMF 2008a, p. 11). Thus, the IMF opted for a fairly limited retrenchment, which represented a 'new' approach compared to its fiscal policy advice before 2008 (Ban 2015). This was particularly notable when the Hungarian situation is considered in its regional context. Even in the 'good' times, Hungary ran a large fiscal deficit of over 9% of GDP for 2006 and on the eve of the crisis in 2007 it was still above 5% of GDP. This meant that in terms of fiscal performance, Hungary was among the worst in the region both before the crisis and at the time of the IMF program negotiations. Similarly, this was reflected in the country's public debt. Again, on the eve of the crisis, it stood at 71%, considerably higher than all the rest of the Eastern European EU members that mostly tended to have their public debts below 30% of GDP. Therefore, Hungary was the only country in the region, which was significantly beyond the limits of the EU SGP framework that prescribed public debt levels at up to 60% of GDP and fiscal deficits of no more than 3% of GDP annually.



Source: IMF WEO database



Source: IMF WEO database

In addition to the relative limited fiscal adjustment, the Hungary program was also light on structural conditionality, at least at the outset. The key condition was the approval of a fiscal responsibility law. The package imposed rules preventing public debt from increasing in real terms, introduced rolling three-year expenditure ceilings, and created an independent Fiscal Council. Other structural benchmarks included the submission of a bank support package law and granting the Hungarian Financial Supervisory Authority special resolution powers (IMF 2008a). Equally interesting, however, is what did not make it into the structural conditions. Some have noted that at least some of the structural weaknesses of the Hungarian economy had to do with relatively generous social provisions and, in particular, the large scale of the public sector in which salaries often exceeded those in the private sphere. This explains why observers were surprised that when the program was unveiled it did not include conditions such as changes to the pension regimes or privatization, a previous staple of the IMF (Blustein 2016, p. 64). This was also well-noted at the time: even the Bretton Woods Project, often critical of the Fund, came to the conclusion that “the IMF seems to be modestly improving its flexibility and conditionality compared to its dreadful practices in previous decades” (Boda 2009).

The overall funding package of the joint IMF-EU program for Hungary eventually came up to 20 bn euros, or around 16.4% of GDP for 2008. Of this, the IMF provided 12.5 bn euros, the EC – 6.5, and the World Bank - 1 bn euros[13]. In addition, the ECB played a minor role through a swap facility, which however functioned more as a repo line with limited use for Budapest. This was not the first time the IMF was disbursing with other institutions, but marked a precedent in including them in the negotiation and monitoring of a program. Therefore, it is not

[13] As the World Bank tranche was never fully negotiated in terms of conditionality, neither drawn upon, it is not subject to analysis here.

surprising that given the lack of previous experience, the structure of the loan was contentious, both within the IMF and across the institutions involved.

The IMF program was set at an exceptionally high level of 1015% of Hungary's quota. As staff noted, "at the time of the request, access at SDR 10.5 billion placed the Hungary program as the largest Fund arrangement since Turkey in 2002 and Korea in 1997" (IMF 2011, p. 8). The loan was highly front-loaded, with 40% of total IMF funding available to Hungary upon approval. Publicly, this was justified by reference to the nature of capital account crises, which require large and quick financing to 'shock and awe' market participants into resuming lending, and to prevent spillovers (Ecorys 2013, p. 82). Therefore, at the time of making the loan, it was perceived by all actors to provide a very high level of financing that was comparable to the heyday of IMF activity in late 1990s and early 2000s.

Finally, the extent to which the Hungarian economy has become dependent on bank inflows required at least considering some form of bail-in. As described above, the credit boom before 2008 was based on channeling foreign currency lending to households and corporates. Around 2/3rd of all banking assets in Hungary were held by foreign banks, a comparatively lower level than most other emerging European countries (Claessens and van Horen 2014). Part of this is related to the fact that the biggest bank – OTP – is Hungarian and holds over 20% of all assets in the country. Foreign banks however could raise cheap financing on international markets and channel it to Hungarian borrowers in foreign currency loans at lower interest rates than forint-denominated loans. The result was that banks thus hedged their foreign currency exposure, but effectively passed the exchange risk to borrowers. Thus more than half of all non-financial borrowing was denominated in euros and Swiss francs, pushing up both external debt and credit risk for banks (IMF 2008a, p. 4).

In this context, the Hungarian program relied on measures to secure rollover commitments, particularly from foreign banks, to reduce the financing gap facing the country. This was also important to guarantee that official liquidity would not just 'leak out' of the country through repayments to foreign creditors, resulting in a shift of private debt into official loans that are harder to restructure if the need arises. Ultimately, the IMF managed to secure an 80% rollover commitment through a series of confidential letters from banks, which were crucially underpinned by the European Bank Coordination Initiative, better known as the Vienna Initiative. This cooperative effort between the IMF, the EBRD, the World Bank and several EU institutions ensured a region-wide solution to the potential coordination problem faced by foreign banks, which was directly underpinned by a threat to suspend IMF programs in case of non-compliance by financial institutions. Thus, the final program therefore relied on this institutional architecture to ensure a soft form of private sector involvement that covered around half of the financing gap (IMF 2008a).

The Hungary program in comparative perspective

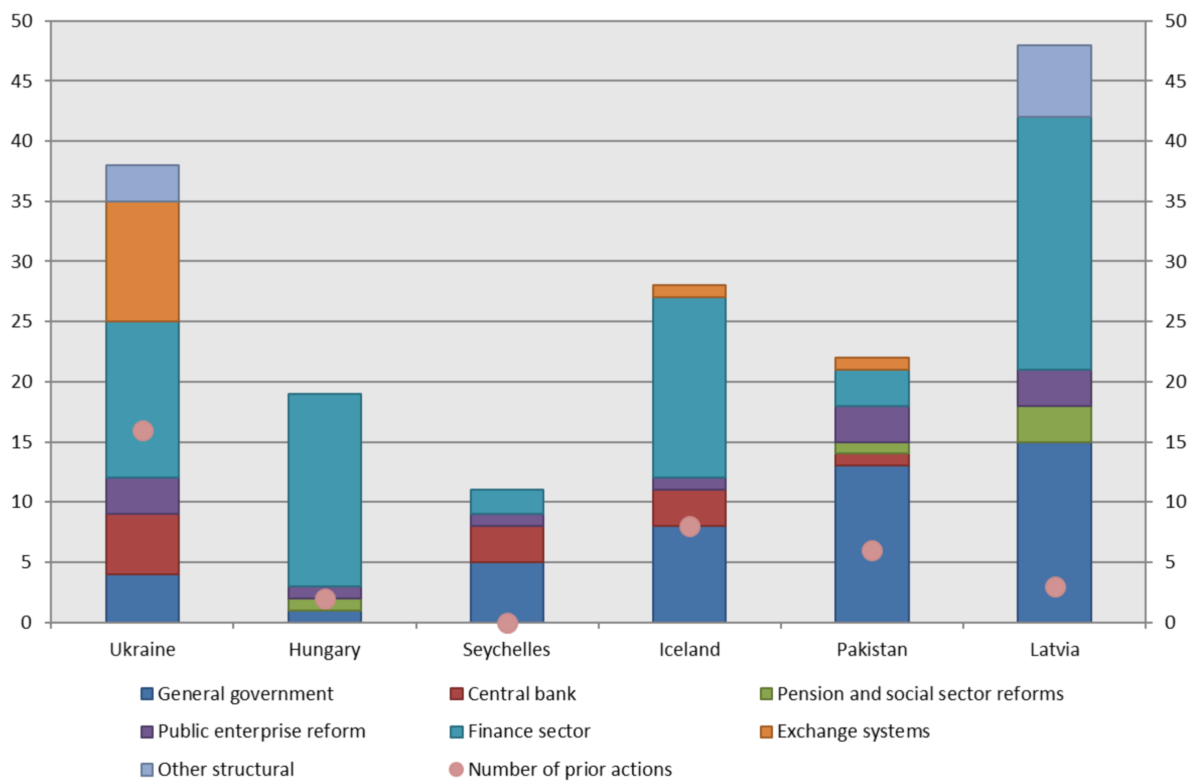
The Hungary IMF-EU program announced in November 2008 was therefore considered to be generally low in terms of fiscal adjustment and structural conditionality, fairly large in terms of financing, and to include a rather sizable element of private sector involvement. Such relatively 'generous' terms are particularly striking given the country's history of fiscal problems and high public debt, even if more recently it has also been a target for large-scale cross-border bank inflows. Another way to assess the Hungary program is to compare it to other programs that the IMF approved in the same period. In November and December 2008, the Fund agreed five new lending arrangements with Ukraine, Hungary, the Seychelles, Iceland, Pakistan, and Latvia (in that order)[14]. This allows for a comparison of the Hungary program that holds constant the resources and thinking of the IMF as well as global financial conditions.

In this comparison, Hungary again stands out due to its combination of low conditionality and large financing. In terms of structural conditions, the Hungary IMF program had a lower number of conditions than all other programs, except the Seychelles arrangement. Similarly, it had a particularly low number of prior actions, the most binding type of Fund structural conditionality, and very limited conditionality beyond financial sector issues. Moreover, the number of 'general government' and 'pension and social sector' conditions, which refer to painful public spending adjustments, is low, especially considering the country's history of fiscal problems. In terms of financing, again Hungary stands out as the second largest program in absolute terms, and as one of the three programs that go above 10 times of the quota resources of the country – something which was previously an extremely rare occurrence reserved for 'special' cases of global geopolitical and financial importance. Meanwhile, Hungary's loan is by far the most frontloaded of all the loans the IMF approved over this short span.

[14] It also approved a loan to Georgia in September 2008, but as this was related to the conflict with Russia rather than the global financial crisis, this is not subject to analysis here.

Table 3: Key characteristics of IMF programs approved in November-December 2008				
Country	Approval date	Amount (bn of USD)	Percent of quota	Percent of total loan for immediate release
Ukraine	Nov 2008	16.4	802 %	64 %
Hungary	Nov 2008	15.7	1015 %	72 %
Seychelles	Nov 2008	0.03	200 %	45 %
Iceland	Nov 2008	2.1	1190 %	40 %
Pakistan	Nov 2008	7.6	700 %	47 %
Latvia	Dec 2008	2.4	1200 %	47 %
				Source: IMF MONA database, Woods (2010)

Figure 13: IMF conditionality in 2008 programs (number and type)



Source: IMF MONA database

In summary, this section presented the outlines of the Hungary programs and its key variables – levels of conditionality, financing, and bail-in. In terms of pre-crisis experience, the perceived and persistent large-scale vulnerabilities are notable in relation to other countries in the Central and Eastern European region. However, in terms of program design, fiscal and structural conditionality were perceived to be relatively mild, financing was considered particularly large and frontloaded, and bail-in ensured a considerable level of private sector involvement. These characteristics also stand out when Hungary is compared to other programs approved by the IMF in the same limited time window. This therefore justifies considering the program to be relatively 'generous' to Hungary. The question then becomes what might be the factors that explain this outcome.

The IMF context of the Hungary program

The existing literature has provided several potential explanations about why some countries might receive this type of 'generous' package. This section therefore first considers what existing state-centric and staff-driven approaches would suggest as outcomes given the values of the key independent variables they emphasize in the case of Hungary and relates this to the actually observed aspects of program design. Finding that this congruence analysis reveals limits to their explanatory power, it then begins to unpack decision-making within the Fund in order to understand what were the drivers in this particular program. Finally, it introduces the overlapping European RFA to which Hungarian authorities had recourse in the crisis as non-euro EU members.

State-centric and bureaucratic explanations

What would be some of the existing political explanations for IMF behavior? One state-centric approach is premised on the direct intervention of G5 creditor states for geopolitical or financial reasons, as in Mexico or Korea in the 1990s. In terms of geopolitics, Hungary was an Eastern European state, which by 2008 it was firmly rooted in EU and NATO structures as a full member. Moreover, its location had limited strategic value for facing the global challenges of the mid-2000s such as terrorism. There is potentially a different mechanism, which might motivate G5 involvement, namely financial exposure through their banks or other financial institutions that stand to make losses if the crisis escalates. The most exposed home country in late 2008 was clearly Austria with 36.8 bn USD worth of cross-border bank claims, amounting to 8% of Austrian GDP, according to BIS data. Other exposed countries were Germany (32 bn USD), and Italy (around 30 bn USD[15]), but given their much larger size, their exposure relative to GDP was lower – at about 0.8% and 1.2%, respectively. Contagion worries were restricted only to emerging Europe and at that point the euro area was perceived as an anchor of stability to the extent that there were calls for speedy euroization in order to help emerging European countries (Darvas 2009).

This pattern of exposure suggests relatively limited G5 interests. Out of the G5 IMF creditors, only Germany had some exposure. However, Germany (and the rest of the G5) had at that time larger problems to address at home such as the situation with Hypo Real Estate (Bastasin 2012, pp. 29–36). Meanwhile, there was a very real interest from Austria in dealing with problems in Hungary. It is certainly an important member of the Executive Board through participation in the then-biggest multi-member constituency. However, its own voting power on the Board is limited to 0.85%, and the dominating country in the constituency is actually Belgium, with about 2.5 times more votes than Austria. In short, whereas the outcome – a relatively 'generous'

[15] This is an estimate, given in 2008 Italian bank flows were recorded under 'Other' in BIS data. By 2010, most of Italian flows are recorded separately, indicating 20.8 bn USD banking claims after deleveraging. Austrian claims had been reduced slightly to 35 bn USD, while German claims were down to 20.5 bn USD

program – could be consistent with special intervention from G5 creditors, they appear to lack such motivations as measured by the country's financial or geopolitical exposure.

Another possible explanation is that the borrower government successfully played a 'two-level game' suggesting that other domestic political interlocutors are less likely to implement the agreed upon program with the IMF. In previous cases this has infamously pushed the Fund to provide 'generous' conditions to support an incumbent against an impalpable alternative, such as in Russia in the 1990s. Yet, at the time of the Hungary program, the IMF also interacted with the main opposition party, which also expressed support for austerity measures. Five months into the program, the prime minister was forced to resign given his unpopularity due to protests in relation to comments he made about 'lying' to Hungarians about the fiscal deficit that were caught on tape; he also lost the support of a crucial smaller party in mid-2008 (Stratfor 2009). According to the Economist (2009), "Years of mismanagement and the Socialists' failure to trim public spending enough, or to reduce a huge pension burden, have left Hungary's economy on the edge of meltdown", which suggests the reasons for his resignation predate the IMF program. Gyursceny then handed the government over to a technocratic administration headed by his finance minister until the next scheduled elections. Under such conditions one would expect the IMF to be less 'generous' given doubts about political support and continuity. Nonetheless, domestic factors may have some explanatory power as at that stage the leader of the opposition Victor Orban was beginning to develop his nationalist rhetoric in which he was highlighting large foreign bank ownership as a problem in contrast with IMF's view (Economist 2009).

Finally, bureaucratic explanations focus on the rational or ideational biases in the decision-making of the IMF. Staff is often considered to offer generous conditions to country officials that share an ideological background described as ‘neoliberal’. Such shared background can arguably reassure staff in the reform commitment of borrower governments. However, in Budapest they faced a Socialist government in which key decision-makers were all educated in Hungarian universities under communism and have not been part of the IMF or other international institutions. This was true of the two prime ministers during the financial assistance program, Ferenc Gyurscany and the independent Gordon Bajnai, who was Gyurscany’s finance minister before stepping up to replace him, as well as to the central bank governor, Andras Simor. Therefore, it is unclear why their presence should motivate IMF staff to ‘water down’ the stringency of its program requirements. It is however true that they all did have a previous career in the private financial sector in Hungary before entering politics, which might have shaped neoliberal beliefs. In particular, both Simor and Bajnai were part of the management of an Austrian-owned securities trading company in Hungary in the 1990s. Following this, Simor worked for the Budapest Stock Exchange before joining the central bank in 2007, while Bajnai worked for a private holding company before becoming part of Gyurscany’s government. Yet, such professional experience is not the focus of currently existing theories of IMF behavior, which emphasize shared educational or institutional experience that were both absent in the case of the top economic decision-makers.

In summary, in late 2008 Hungary was on the verge of a severe financial crisis. The immediate trigger were banking difficulties in the aftermath of the collapse of Lehman Brothers, but it was underpinned by what were perceived as persistent problems with fiscal management and public debt. However, it received a program from the IMF that was light on conditionality, large on financing, and included significant bail-in provisions. There are a number of variables that the existing literature associates with such an outcome, such as geopolitical position, the pattern of financial exposure, the nature of domestic politics in the country, or the normative orientation of local policymakers, which could bias IMF decision-making towards 'lighter' programs such as the one observed here. However, none of these factors appears to be initially present in Hungary in late 2008. Therefore, what is needed is to proceed to unpack decision-making within the Fund that led to such an outcome.

The IMF before 2008: An existential crisis

Before the global financial crisis erupted, the IMF was facing a challenge to its own relevance within the global financial safety net. First, a prolonged period of 'great moderation' has reduced the frequency of crises and high commodity prices supported growth in many former Fund clients, particularly in Latin America. Second, countries were also taking advantage of favorable conditions to build up their reserves, essentially preferring to incur the high costs of unilateral insurance over potentially relying on the Fund's multilateral pooling capacity. This led to widespread calls to wind down or reorient Fund activities away from financial assistance. As the Economist (2006) put it, there was "Not Even a Cat to Rescue", leading it to pose the question, "if the IMF were to wither away – its money untapped, its advice unheeded – should anyone care?" The Fund therefore risked, in the words of the Governor of the Bank of England, to "slip into obscurity" as a new institution is instead created to assess the spillover effects of national policies (Giles and Balls 2006).

In turn, this challenge to the IMF had consequences for its financial situation. Despite accelerating financial globalization, members had not increased the quota resources available to the Fund since the middle of the Asian financial crisis in 1998. As Brau and Stedman (Brau and Stedman 2014, p. 1) put it, “In June 2008, Fund credit outstanding…in the amount of SDR 8.7 billion was at a several decades’ low point relative to total quotas, and the Fund’s Forward Commitment Capacity was at its highest-ever absolute level of SDR 127 billion”[16]. As the only major loan being repaid in that period was from an earlier program in Turkey, one IMF staff member joked about the perception of a “Turkish Monetary Fund”[17]. Further questions lingered over its income stream, as evidenced by the commissioning and production of a high-level report, suggesting a more active investment role and some sales from its gold reserves (Committee to Study Sustainable Long-Term Financing of the IMF 2007).

Financial troubles directly affected IMF capacity and led to a downsizing of its staff. This was a demand by advanced country shareholders due to both widespread doubts about the need for a large crisis lender and declining income from loans. In 2007, the Managing Director Strauss-Kahn announced the need for $100 million in savings over three years, kicking off a process of staff layoffs through voluntary separation. As a result, “nearly 500 staff, including…24% of senior managers exited the IMF between May 2008 and May 2009 […] the IMF lost some of its most experienced staff, just when it was needed for a rapid response to the crisis” (Independent Evaluation Office 2014, p. 31). In total, more than 20% of staff left the Fund in a period of just 12 months.

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[16] The Forward Commitment Capacity (FCC) refers to the amount of resources readily available for non-concessional lending.
[17] Interview no. 33, February 2017.

Overall, the period of relative idleness between 2002 and 2007 demonstrates in practice how exclusion from financial assistance programs can directly lead to negative outcomes for staff and management at the IMF. In late 2008, the IMF had large resources that were not being utilized, as measured by its forward commitment capacity. Furthermore, Hungary was seen to set a precedent for the future of the IMF in two key ways. First, it could establish for a first time in recent history a role for the Fund in lending to EU member-states, bringing it into new and profitable territory closer to the core of the financial system. Second, Hungary could turn out to be just the first in a string of emerging European countries that might need help soon. Therefore, it had an important signaling function for other potential soon-to-be borrowers.

An RFA for emerging Europe

If concerns about its role shaped IMF's overall approach to the global financial crisis, its specific approach to EU member states in 2008 was further influenced by its participation in a regime complex with an RFA for the first time. The pressure of providing rapid crisis lending to EU member states joined at the hip two regimes: global financial governance and the European economic framework. Despite some questions about the appropriate changes to IMF surveillance and the representation of the euro area in IMF governance, the two regimes had existed so far largely in parallel and without significant overlap (Broome 2013; Pisani-Ferry et al. 2013). Yet, in the context of European programs, the IMF and the EC had to cooperate in designing and managing conditional lending programs to countries in financial difficulties, with the ECB also playing a role in the arrangements. Such interaction was ad hoc and evolved spontaneously under the pressure of events rather than as a strategy of careful and deliberate institutional design.

The main support from the EU came in the form of balance-of-payments assistance through a so-called medium-term financial assistance facility. This builds on an earlier facility for EU countries, established in 1969 to deal originally with the oil crisis, which was transformed into a mechanism for exchange rate protection in the 1980s[18]. It was last used in 1993 for a loan of 8 billion ECU to Italy in January 1993 (Darvas 2009, p. 3). In 2002, it was redesigned specifically as a balance-of-payments facility for non-euro EU members with a ceiling of 12 billion euros. The new legal basis also stipulated that "where a Member State which has not adopted the euro proposes to call upon sources of financing outside the Community which are subject to economic policy conditions, it shall first consult the Commission and the other Member States in order to examine, among other things, the possibilities available under the Community medium-term financial assistance facility" (Council of the European Union 2002 Art 2). This clause highlighted the reluctance of EU member-states to 'call in' the IMF and the challenge the Fund faced.

The regime complex can therefore be described as 'incipient' in late 2008. The EU balance-of-payments facility was present and EU member states were legally required to make recourse to it, but at first it lacked experience and resources. At the outset of the crisis, it drew on just seven full-time staff members in one unit at the Directorate-General for Economic and Financial Affairs (the lowest institutional building bloc at the EC), initial mission teams were hastily arranged, and EC officials had no previous experience of either drafting or implementing a crisis lending program. Furthermore, at a capacity of 12 bn euros, it was insufficient to even cover Hungary alone, and more countries were clearly in trouble. Having spent 15 years in

[18] Interview no. 13, February 2016

inactivity, raising funds through this vehicle on global financial markets, or indeed on-lending them to countries, was also a technical challenge in the midst of a rapidly developing financial crisis. The EC however quickly built up its capacity, both by increasing staffing levels and by raising the overall level of the facility first to 25 bn euros in late November 2008, and then to 50 bn euros in May 2009. Therefore, even if the threat of exclusion was somewhat limited at the outset, the EC addressed its weaknesses, turning itself quickly into a potentially credible alternative to the IMF.

In late 2008, the period of relative inactivity for both the IMF and the EC balance of payments facility came to an end. As outlined above, in November 2008 alone, the Fund approved five new lending programs, three of which were significant in size both in absolute terms and as percentage of the country's quota – Ukraine, Hungary, and Pakistan. Meanwhile, the emerging European RFA negotiated loans in November and December 2008 alongside the IMF in Hungary and Latvia. What stands out even by a quick look at the data in the preceding section is that loans negotiated jointly by the IMF and the EU were larger in quota terms and had higher level of frontloading than other loans (at this stage Iceland was considering a fast-track application to the EU). This is particularly notable as the geopolitical or financial importance of Hungary and Latvia is less clear than the strategic roles of Ukraine and Pakistan for the G5 creditors of the Fund, and especially for the United States. Such more 'generous' financing by the same institution in the same time period to countries with little to no geopolitical significance suggests that co-lending with an RFA has an impact on IMF behavior.

The dynamics of IMF-EU assistance to Hungary

Given large fiscal and financial vulnerabilities, the Lehman shock was the ‘coup de grace’ that tipped a situation that many, including at the IMF, considered unsustainable, into an outright crisis. Government auctions for public debt failed in October 2008, while foreign investors dumped a quarter of all forint-denominated government bonds, in turn putting severe pressure on the recently liberalized exchange rate. Banks faced a sharp reduction in cheap foreign currency funding while their hedging costs increased and swap markets all but disappeared. The stage was thus set for the first program where the IMF would share its leadership with an RFA, in this case – the EC and, to a very limited extent, the ECB.

This section focuses on detailed process tracing of the causal chain that led to the outcomes observed in terms of program design. Such analysis relies on generating multiple causal process observations, focusing in particular on issues such as sequence of events, actions by various participants, and their public and private statements (Hall 2006, p. 28). The goal is to trace as closely as possible where proposals originated, what was the ‘menu of options’ actors considered, and why certain among those options were chosen instead of others. It is impossible and impractical to firmly establish all of these aspects for each element, but by generating many causal process observations one can provide multiple tests for the hypothesized causal mechanism.

This section therefore focuses on the process of negotiating fiscal and structural conditionality, the size and modalities of the financial package, and the shape and extent of private sector bail-in. In these areas, it seeks to disentangle the impact of various actors, chiefly IMF staff and management, member-states representatives, borrower state politicians, and European officials. As these are also the key areas in terms of program design on which existing theories for Fund behavior already focus, they provide a good test for adjudicating between alternative explanations.

Structural and fiscal conditionality

Where did the impetus for limited conditionality come from? Closer process tracing suggests IMF staff chose a negotiation strategy based on two mutually reinforcing strands. First, the IMF team was largely willing to delegate the formulation of the extent and especially the content of adjustment to local policymakers. For example, the fiscal responsibility law, while coordinated and approved by the IMF, was in the works before the arrival of the mission team and submitted to parliament before the approval of the program, suggesting that the initiative did not come from the Fund[19]. Staff also highlighted domestic ownership of the program during the Executive Board meeting: "the authorities were very proactive in developing this program; so I think there is a recognition of the need for fiscal prudence" (IMF 2009b, p. 64). This suggests that, as Piroska (2017, p. 13) argues, "the team was not interested in defining the exact steps through which the Hungarian policy makers were to achieve the set targets" such as the inclusion of Fiscal Council, which was actually proposed by Hungarian officials. The IMF mission chief also shared similar feelings: "these are the authorities' measures which they deem to be the most appropriate under the current circumstances, and there is a very high degree of ownership of the program by the authorities" (IMF 2009b, p. 52).

[19] It is still possible the IMF involvement was central to its approval, but not to its inception.

Beyond the sequence of events, this observation is strengthened by the perception of actors across the table that the IMF was aiming to influence. As the then-central bank governor put it, "I felt that maybe we got away too easily. We thought at the [central bank] that the country needs to take a large number of steps to structurally improve the competitiveness of the economy in order to ensure a sustainable future. The rescue package that we received…only contained conditionality about a few issues, very important issues such as fiscal issues, financial stability, but not much beyond that. We thought that in order to put us on a sustainable path this is not enough, that larger structural changes are also necessary"[20]. When asked what explained this limited conditionality, he pointed to Hungary being "the first in the queue" when the IMF "were keen to put in a large amount of money relatively quickly to stop the dominos from falling". Moreover, he also noted that "the IMF had a reputation that it did huge amount of damage during the Asian crisis…as a result, plus as a result of not having many clients in the 2000s…they softened up and were ready to go into programs with easier conditions."[21] These comments suggest that the Fund's domestic interlocutors were also noting an important shift to less conditionality that was driven by the Fund itself.

The second key aspect of IMF's negotiations with Hungary was the speed with which the staff team proceeded. The Fund, having received the first call on 9 October, dispatched its mission by 13 October, with the EC arriving shortly thereafter. Staff-level agreement was achieved by 29 October, with the Hungarian authorities submitting an official request on 4 November, in turn promptly approved by the IMF Executive Board on 6 November. This is a significantly tighter turnaround than in many previous crisis situations – which is particularly surprising

[20] Interview no. 14, November 2016
[21] Interview no. 14, November 2016

given the lack of financial links to the G5 countries that seem to generally stimulate quick responses since the 1990s (D. McDowell 2017; A. Mody and Saravia 2013). Furthermore, IMF management specifically invoked an emergency mechanism, designed to significantly shorten the negotiation period in the context of a rapidly unfolding crisis (IMF 2011, p. 11). The alacrity of the response, well noted by many directors at the Executive Board, is suggestive of the desire of the Fund to get involved.

This speed was reflective of a relatively conflict-free division of labor, in which the EC, somewhat less equipped for dealing with financial emergencies, followed the lead of the Fund. As a high-ranking member of the IMF team recalls, the EC "agreed ex-post…it was a bit of a parallel operation – the program was done, then they questioned certain elements, we explained to them why they were there, they had no more direct influence on the policy design at that stage"[22]. The Hungarian authorities also shared this assessment; the central bank governor points out that "obviously, the IMF had much more experience at that time…for the EC it was a new task and for them it was a learning curve"[23]. Furthermore, the sequence of actions seemed to favor the Fund as the Economic and Financial Council of the EU approved its contribution of 6.5 bn euros on 4 November, and only then gave the authority to EC staff to negotiate the conditions. This meant that the IMF was able to move ahead by confirming its conditionality before the EU team was ready with its own parallel arrangements. As the IMF mission chief noted at the EB meeting on 6 November, "the EU support has already been approved by the [Economic and Financial Committee]. It is important to stress, however, that the details…have

[22] Interview no. 3, September 2015
[23] Interview no. 14, November 2016

[not] been fully worked out. Those institutions have missions in the field at this point" (IMF 2009b, p. 53). The EU-Hungary MoU was only signed on 19 November, or two weeks later.

Notably, this *modus operandi* emerged in the absence of formal criteria regarding IMF-EU interactions. The lack of a protocol for cooperation led staff to include a box with additional information in the Hungarian request for a loan, stating that "as agreed during the initial discussions among the institutions on procedures, it is expected that the EU conditionality to be included in the EU Council decision and MoU will be consistent with IMF conditionality. In addition, EC surveillance mechanisms will incorporate policy commitments made by the authorities" (IMF 2008a, p. 7). In response to some criticism during the Executive Board discussions, the ECB representative seemed to confirm that the "conditionality of the IMF has to be reflected or mapped onto our own requirements in terms of, for example, an update of the convergence program, in terms of the excessive deficit procedure". He was furthermore clearly aware this was setting the precedent for future programs: "Hungary…might be a test case in this respect. There might be other EU countries that in the period ahead come to the IMF" (IMF 2009b, p. 51). According to another ex-post investigation, this created the expectation that the "Fund-supported program effectively determined fiscal targets" which would then be incorporated in EC surveillance mechanisms (Kincaid 2016, p. 51).

After Fund staff has negotiated the program, the action shifted to the Executive Board of the IMF, which needed to approve the program. Here, several Executive Directors, acting on behalf of creditor governments, expressed reservations but ultimately passed the program. The US director was blunt: "The reduction in the budget deficit to 2.5% of GDP in 2009 (from 3.4% in

2008) is not particularly ambitious…there should be procedures in place to develop additional fiscal and structural measures if this target is missed…we see fiscal underperformance as a significant risk to the program" (IMF 2009b, p. 20). The German director reiterated the message: "Ambitious medium-term fiscal goals to ensure debt sustainability will be a condition sine qua non for the success of the program" (IMF 2009b, p. 33). Many non-EU directors pointed out that the short-term fiscal consolidation was not backed up by longer-term measures. As the Swiss ED noted, "on the fiscal adjustment, my first thought when I looked at the program was that the adjustment is rather on the low side…what is missing are more structural fiscal measures" (IMF 2009b, p. 49). Such reluctance suggests that creditor governments, including at least two powerful G5 countries, US and Germany, were not highly supportive of the program, and considered the structural and fiscal measures to be especially limited, but ultimately still approved the conditionality negotiated by the IMF staff.

As usual for IMF programs, the arrangements underwent some change during the actual implementation phase that suggested some friction between the Fund and the Commission. At the time of the first review in mid-February 2009, it became clear the economic recession is going to be deeper than the initially assumed 1% contraction of GDP, with projections reaching -3% of GDP; in turn, the fiscal deficit for 2009 was revised upwards from 2.6% to 2.9% of GDP, or just under the 3% of GDP EU SGP threshold. In mid-May 2009, during the second review mission, the contraction was already estimated at -6.7% of GDP, leading the EC to eventually back down and agree a revision to the deficit target to 3.9% and an extension of the Excessive Deficit Procedure (EDP) under which Hungary would otherwise be threatened by financial sanctions. This reveals some frictions between the Fund and the EC, although of a surprising nature as it was the Fund that actually pushed for the *larger* fiscal deficit (see Lütz and Kranke 2014). The IMF felt during review missions that EU targets were designed for the 'steady state' and such limits were ill suited for the specific situation in Hungary. Nevertheless, the Hungarian authorities were wary of breaching EU rules on EDP, particularly at the time of the first review, leading them to assume what the IMF considered a procyclical fiscal stance (IMF 2011, p. 19,25).

Similar dynamics can be observed in terms of structural conditionality over the implementation of the program. Thus, conditionality increased during the program as the EC eventually move to establish its position on core competencies. As the EU post-program evaluation puts it, "given the short duration for the design of the assistance given the situation's urgency, there was limited time to have a structured discussion on structural reform measures…many conditionality that were related to the medium- and long-term objectives were added throughout the implementation of the operation" through addenda to the MoU (Ecorys 2013, pp. 58, 81). Thus, over 2009 the EC consistently proposed stricter terms than the IMF, driven partly by a negotiation mandate to agree a fiscal target no larger than 3% of GDP (Piroska 2017, p. 16). In turn, these were increasingly adopted by the Fund despite its wishes to allow automatic stabilizers to operate fully in cushioning the larger than expected contraction in the GDP in 2009 (Kincaid 2016, p. 52).

The process-tracing analysis thus suggests several observations. First, Executive Directors, including those from G5 countries, had significant doubts about the extent of fiscal and structural conditionality in the program, but ultimately approved the proposal of IMF staff. This is consistent with their limited financial and geopolitical interests in this country, especially when other programs of larger strategic significance such as Ukraine and Pakistan were being negotiated at the same time and as many of them were focusing at fighting the consequences of the global financial crisis at home. Meanwhile, IMF staff did not experience any significant conflicts over conditionality with the borrowing country government, which was due to their strategy of focusing on specific end goals and leaving the Hungarian authorities to develop a number of structural reforms. In that sense, the program largely corresponded to the borrower initial preferences as also evidenced by just how quickly local authorities and Fund staff found enough common ground to put forward a program to the Executive Board.

To that extent, conditionality presents a case in which IMF staff had significant influence in the context of no meaningful conflicts with local authorities or G5 creditors over strategy. Such influence was not hindered and was even enhanced by the presence of an alternative RFA. Despite the absence of previous experience, IMF-EU staff and management-level cooperation was surprisingly smooth, with the Fund often in the lead. There were some concerns at the outset of the program when Hungary initially contacted the IMF[24], but once the existence of the requirement in EU treaties to consult the EC became clear, Fund staff moved to incorporate EC officials pragmatically into the program. While there was some thinking along the lines of developing procedures for cooperation, none of the actors involved considered this to be a high priority as they found they can advance on the basis of staff-to-staff contacts and did not anticipate any significant conflicts to emerge. Meanwhile, Europeans brought an in-depth and

[24] Hungary's call to the IMF seems to have "aroused a tempest in Brussels, where the EC was jealously guarding its role as the executive body of the EU and it had no intention of allowing the IMF to run the whole show in Hungary" (Blustein 2016, p. 63).

close knowledge of the history of Hungarian economic policymaking, even if at occasions their insistence on respecting the 3% of GDP fiscal deficit limit as set in the European treaties caused frictions. However, differing mandates and lack of previous experience did not hinder cooperation and a division of labor began to emerge in areas of conditionality.

In contrast, established theories have a relatively limited 'fit' with either the process or the outcome in Hungary in terms of conditionality. As noted above, the exposure of key G5 states was limited and, at the time, they were preoccupied with containing the global financial crisis. This in turn means they had little incentive to spend political capital, or engage in informal governance, over Hungary. There are no traces of significant involvement by any of the key creditors along the way, beyond some general comments by Executive Directors which revealed their skeptical but ultimately accommodating position vis-à-vis proposals coming from IMF staff. Therefore, limited conditionality is better explained by staff actions rather than interventions by powerful states to weaken the strings attached to IMF money.

The limited structural and fiscal conditionality is even more surprising as at that point the country was governed by a minority government, with elections expected during the time of the program. This would have usually led the IMF to hold off further loans or to insist on more and more precisely defined conditions due to the limited credibility of the current government (Stone 2002). However, whereas the political risks were widely acknowledged, they did not seem to prevent the Fund from pursuing a program with surprisingly little conditionality at the outset. Directors from Latin America highlighted that "the political outlook may entail a serious risk", whereas some Asian directors expressed worries that "the risk that this political support could unravel is high given the painful adjustments that have to be made and that the government still lacks a parliamentary majority", comments largely echoed by the UK, and the Netherlands (IMF 2009b, pp. 15, 19). What somewhat assuaged such fears was that five days after the Fund's arrival Gyursceny had convened a national summit with other political parties, trade unions, and state officials in an attempt to build support for the eventual program. An important caveat is that at this point Viktor Orban was beginning to develop his nationalist rhetoric in opposition, which might have influenced the IMF, but this has not emerged clearly during the process tracing analysis; it would take another two years for Orban to actually get into power.

Finally, the regime complex analysis has some commonalities with existing theories that emphasize staff influence. In particular, it shares the insight that in the absence of strong preference by G5 countries, staff and management can exercise key influence in program design. However, it differs by attributing the motivations for such actions to the Fund's strategic response to participation in an incipient regime complex. Whereas existing theories highlight shared normative ideas, there is limited evidence of this in Hungary. Such theories consider normative orientations to be similar if country officials attended leading Western university economic departments or had previous work experience in the Bretton Woods institutions. Neither of these conditions held true for any of the top Hungarian financial policymakers in 2008-2009[25]. Furthermore, staff and local officials did not necessarily see eye-to-eye on policy

[25] Indeed, probably the opposition leader, the CEU-educated and right-wing Victor Orban, can be assumed to share more of a neoliberal normative background with IMF officials than a Socialist-led government with officials who received their economic training under communism.

measures, but rather the IMF stepped back in the definition of appropriate targets, so much so that some local actors were even disappointed.

Financing and burden-sharing

In terms of financing, IMF staff focused on a strategy that emphasized providing a large and up-front financial package. At the outset, the Hungarian government aimed for a program, which would only cover the budgetary financing needs of around 3 bn euros to pay foreign debt coming due in December 2008. However, once on the ground, IMF staff quickly sought to convince the authorities that a much larger program was needed to cover large private external debt and to increase low reserve coverage as banks struggled to finance their foreign obligations in the interbank market. Part of their reasoning were concerns about regional spillovers – both through the largest Hungarian bank, which had subsidiaries abroad, but also through the exposure of euro area banks, primarily from Austria, to the country (Ecorys 2013, p. 82; IMF 2011, p. 6). In addition, staff also specifically incorporated 'credibility buffers' on top of these financing needs. Therefore, "the IMF negotiating team as a first step convinced the Hungarian authorities that they are in need of a far greater amount of assistance than originally envisioned" (Piroska 2017, p. 12). Given that larger financing implies less austerity measures, it is not surprising local authorities agreed to drive up the package. However, it is notable that the initiative to do so came not from them, but rather from Fund staff.

Another key issue during the program negotiation was how to provide the Hungarians with substantial amounts of money as soon as possible to stem a run on their banking system and contagion across the region. The IMF responded by heavily front-loading the package and by standing ready to disburse this money quickly. The domestic authorities indeed drew this amount in full in November 2008 as soon as the program was approved. Furthermore, it was clearly felt that Hungary was not ‘responsible’ for its predicament; as staff put it, “Hungary’s successful macroeconomic adjustment has been disrupted by the global financial crisis” (IMF 2008a, p. 19). Increasing the amount of front-loading presents a trade-off for the IMF: it provides money to the country precisely when it is most needed, but also limits the level of control the Fund can exercise throughout the program by reducing the value of follow-up tranches for the government. In the case of Hungary, the government received 72% of the whole IMF loan immediately upon approval of the program.

Naturally, this approach also implied significant repayment risks given Hungary’s already high debt levels. The county was rather unique in the region due to the combination of both public and private debt concerns – while sovereign debt stood at 71% in 2007, total external debt stood at 106% of GDP. This was the first case since Argentina in the early 2000s where the IMF was lending into a country with such high vulnerabilities on both the public and private side, and the Argentina experience was not IMF’s finest hour (Blustein 2006; IMF 2008a, p. 4). Thus, while staff considered the exceptional access criteria, particularly the one related to a sustainable debt position, to be met, this was “critically dependent on a policy change” (IMF 2008a, p. 16). This approach meant however that “staff’s assessment implicitly expanded the restrictive application of the exceptional access criterion, which until then had been interpreted to exclude forward-looking assessments, including programmed policy adjustments” (IMF 2011, p. 10). This again suggests staff and management were ready to bear a larger risk than in previous cases, tip-toing around a policy introduced to prevent the IMF from lending to countries with high public debt – such as Hungary. Given large fiscal vulnerabilities, staff could have chosen to emphasize such problems, but instead consciously refrained from doing so.

Such an approach caused unease among Executive Directors, who represented creditor governments, and especially so if they represented non-European constituencies. The American director was blunt: "This program presents extremely high risks for the Fund. This is a very significant front-loading of a very large program by any metric…what has to be stated clearly is that the Fund's assistance to Hungary of this nature is warranted only by a country-specific set of circumstances" (IMF 2009b, p. 21). Some also expressed doubts to what extent the exceptional access policy criterion for debt sustainability was actually being fulfilled. Yet, directors justified such access by referring to spillover effects. The Swiss director, particularly critical of the program, noted that "This is indeed…a very large program, it may even be over-financed, but this may also be appropriate in this case given the systemic risks" (IMF 2009b, p. 48). The Brazilian representative argued that "the problem is mainly external to Hungary…total financing for Hungary is very large. This will not only support Hungary's adjustment efforts, but also minimize spillover effects to neighboring economies" (IMF 2009b, p. 29).

Another part of the discussions at the Executive Board focused on the controversial (and unprecedented) setup of IMF-EU division of financial labor. Directors from some North African countries were concerned by statements by Hungary's PM that "the EU loan is a refinancing line to be used only if rollover terms are more expensive than current ones" raising the question if "it was appropriate to assume that EU assistance was additional to Fund financing" (IMF 2009b, pp. 40, 57). As the discussion evolved, the US representative became more concerned about burden-sharing arrangements, noting that "if it did turn out that the Fund was bearing all the early risk, this was an unfortunate precedent" and calling for more adequate sharing of early risk in future programs (IMF 2009b, p. 66). Such comments clearly present the position of creditor governments, which seek to limit their potential exposure. However, at this point staff seem little concerned about the precise disbursement modalities, perhaps seeing the EU as simply providing funding with little impact on Fund's decision-making as in previous cases of 'supplementary financiers' (Gould 2006).

This view partly reflected the constraints that the Europeans faced in providing both adequate and timely financial assistance in November 2008. The EC relied on a Medium Term Financial Assistance vehicle, which was last activated in the early 1990s. Their more recent experience was with a Macro-Financial Assistance instrument, with annual disbursements of 17 million euros per operation in 2006-2008 (Ecorys 2013, p. 82). Providing 382 *times* larger financing of 6.5 bn euros in Hungary was considerably more difficult. This facility operates by the EC raising funds in international capital markets using the strength of the common EU budget, which are then passed on to the borrowing country (back-to-back financing). With little credit history and experience, the EC simply could not finance the large upfront loan that Hungary needed due to market constraints. Thus, whereas the IMF disbursed its first tranche on the day of program approval by the Executive Board on 6 November, EC financing was only actually disbursed on 9 December, although this was also partly due to a delay in the agreement on the EU-Hungarian MoU (Kincaid 2016, p. 50).

In addition to the 'need for speed', the Hungarian crisis also required large financial packages to stem the investor run and possible contagion. Here again the EU financial tool faced significant constraints. At the outset of the crisis, including throughout the discussions over the Hungarian program, its overall capacity stood at about 12 bn euros (although it was raised to 25 bn euros on 4 November). Given the sheer total size of the Hungary program at 20 bn euros, there were significant worries that it was not large enough to accommodate the possible needs of a number of emerging European countries that seemed likely to soon require financial assistance. Therefore, whereas the first IMF tranche, disbursed almost immediate, was worth 5 bn euros *alone*, the EC could only disburse over three equal installments of 2 bn each, for a total of 6 bn euros. Furthermore, in line with the EU focus on fiscal issues, "actually disbursed EU support from the BoP support operation was focused exclusively on sovereign debt financing" whereas IMF support also included crucial funds for bank support and increasing currency reserves (Ecorys 2013, p. 23). Hungarian authorities also shared these perceptions about the size of the 'war chests' of the institutions. When asked about the relative burden-sharing, the former central bank governor thought that "it was more about the budget they had and the overall pools of money at their disposal"[26].

Overall, Fund staff pushed for a large-scale program, focused on front-loading at the expense of control, and downplayed worries about debt sustainability. In that sense, the final financing package closely reflected their initial preferences. It is particularly striking that on all these measures, it was IMF staff and management that were the driving force rather than local authorities or G5 creditors. Meanwhile, conflicts with either of these stakeholders did not arise.

[26] Interview no. 14, November 2016

One possible explanation, which has been advanced publicly, is that the IMF was just responding to a capital account crisis drawing on previous lessons. Indeed, the Fund has previously been criticized about disbursing too little, too late in the East Asia crisis in 1997, and there is a strong case for acting as lender of last resort in addressing liquidity problems. Yet, this does not explain why staff framed the problem as a capital account crisis and the problems as external to Hungary. Even in the context of a global financial crisis, it was clear that Hungary has significant structural vulnerabilities, as noted also by Executive Directors.

Such staff behavior is also consistent with the incentives of management, even though separating their relative influence remains difficult. In September 2008, the remainder of the Turkey program of 2002 constituted 78% of total outstanding credit. By early November, after the IMF approved three new loans – for Iceland, Ukraine, and Hungary, the composition has markedly changed, even if only the first tranche of the new programs has been drawn so far. As a result, the Turkish program dropped to 38% of total IMF credit exposure, with Hungary coming second at 27.5%, Ukraine at 20%, and Iceland at 3.6%. Furthermore, the Hungary program alone reduced the Fund's forward commitment capacity, or its 'war chest', by 8% - meaning another couple of similar programs might soon lead private actors to question whether the Fund had the necessary firepower to deal with the global financial crisis. This led staff to point out that "the proposed arrangement with Hungary entails significant financial risks to the Fund…the proposed access represents a significant share of the Fund's liquidity, is at the high end of recent exceptional access cases, and is relatively front-loaded" (IMF 2008a, p. 10). Nevertheless, in November 2008 the Fund had both the spare capacity and the incentive to use Hungary as a signal for other borrowers.

In terms of financing, cooperation with the EU was again relatively smooth at the staff level despite some concerns over burden sharing expressed by Executive Directors. In fact, the presence of additional, non-IMF financing, meant that the chances for program success were higher as the Fund needed to rely less on domestic adjustments to close the identified gap. Here again a division of labor emerged between the IMF and the EC, with the Fund using its capacity to provide quick financing to avert the immediate danger through a highly-frontloaded program, while the EC provided its loans at later stages when it had the chance to mobilize funding through its balance-of-payments assistance vehicle. As the EU post-program evaluation puts it, "given the emergency character of the operation, it was therefore vital to have the IMF funds as they were available on a short notice and could be frontloaded" (Ecorys 2013, p. 86). While the EU contribution was less than IMF funding, it still augmented IMF resources by around 50% and might have contributed to the willingness to lend a large sum relative to quota by reducing the repayment risks for the Fund. Thus, through cross-institutional strategies, the IMF secured additional external funding for the program, which might have contributed to a skeptical Executive Board passing such a large program in the first place.

The dynamics over financing reveal shortcomings in other established theories in the Hungarian case. From the palpable unease in Executive Board discussions, it is clear that large shareholders, and especially the US and other G5 representatives, are concerned about potential repayment risks in what is a very large program. Yet, ultimately, they consent to the financing arrangements even if they would prefer to shift more of the exposure to the European institutions. Meanwhile, the exceptional size and structure of the program are the result of IMF's actions, undermining a key contention of theories focused on domestic politics that point to actions by local elites. Therefore, in Hungary it is not a case of leaders exploiting two level games to obtain larger financing, but rather IMF staff and management pushing for higher loans and anticipating they would be acceptable to their Board. Finally, there is little to indicate that shared ideational background drove the actions of the IMF given the nature of the Socialist government in Budapest led by policymakers who received their economics education under the old communist system.

Private sector involvement and cross-border banking

The Hungarian banking system carried large vulnerabilities, which in turn risked spreading financial contagion across the region. The biggest Hungarian bank, OTP, was active in the broader region. It has large subsidiaries in various countries across the region, some of which are of considerable importance in their local markets. Therefore, any funding pressures it experiences are likely to propagate through the credit channel to other emerging European countries hard hit from the global financial shock. The rest of the foreign-dominated system carried risks for its euro area parents, but especially for Austria, with a financial exposure of 37 bn USD, or 8% of Austrian GDP.

Financial vulnerabilities were well realized by the Fund. However, initially its approach was to take them as a sign for the need of a large-scale financial program to stem market panic. Thus, the IMF argued for a ‘shock and awe’ response that provided “a very substantial external financial buffer” that “will help to shore up private investor confidence” (IMF 2008a, p. 6). Hungary’s representative at the Board also indicated that “underfunding of the program would have clearly been a higher risk than seeking a margin of possible overfunding” (IMF 2009b, p. 69). Program financing needs were further enlarged by the argument for a separate bank support package that provides funds for capitalization and guaranteeing interbank lending, worth 2.6 bn euros (Ecorys 2013, p. 23).

Nonetheless, the IMF recognized the risk of a cross-border banking run and sought assurances from foreign banks they will not 'cut and run'. Such behavior would create significant problems for the Fund as financial assistance would essentially end up just shifting private debts onto its balance sheet without addressing the problems. Therefore, in parallel to large financing, IMF negotiators and local policymakers sought a promise by the biggest financial institutions to retain their Hungarian holdings, and achieved it: "foreign parent banks of the major banks in Hungary have been encouraged to maintain their exposures to Hungary and have responded favorably" (IMF 2008a, p. 6). As a high-ranking member of the IMF team in Hungary sums it up, "the program was anyway very big because we wanted a shock and awe effect, so much money available that nobody would want to run. But we were aware of this importance and we got these letters in cooperation with the central bank"[27]. The lynchpin of the cross-border financial side of the program was therefore the rollover rate of external debt.

Even with the (confidential) letters from banks, IMF staff faced a largely skeptical Executive Board. The key plank of the IMF program was that "foreign-owned banks…are cautiously assumed to roll over 80% of their funding from parent banks" (IMF 2008a, pp. 8–9). This assumption was subject to significant questioning by Executive Directors at the IMF from varying constituencies. Although welcome, many, including the US, the Netherlands, the UK, and others, challenged how realistic it was to expect such large rollover rates given risks of

[27] Interview no. 3, September 2015

capital repatriation. The Brazilian director asked pointedly about whether there was a ‘Plan B’ if rollover rates undershot. The response from IMF staff was that this was a prudent assumption given both assurances and incentives to remain engaged given significant brick-and-mortar investment in the region, additionally highlighting that the Hungarian “authorities would argue that it is overly prudent, but we wanted to err on the side of caution” (IMF 2009b, p. 56). What emerges however is a picture of support for such action even if skepticism abounds over both its feasibility and the actual means of monitoring such exposure. The US, Germany, and Russia for example all explicitly welcomed the agreement even as they note worries about its implementation.

Even after the program was approved, however, questions remained whether such soft commitments would be credible. The Fund faced two problems – it could not directly deal with banks as its remit was sovereign lending and it could not engineer a regional approach given its country-by-country focus. In turn, without a regional perspective, foreign bank commitment in one country could come at the expense of another, leading to contagion. As one of the key EBRD officials involved explains, “these were two things that I saw the EBRD would be able to bridge, because we had the partnership with all those banks, and we had a cross-border view”[28]. Thus, the EBRD seized on discussions going on among banks themselves to organize meetings and obtain commitments from all banking actors involved, backed by some EBRD investments and a monitoring system. By providing additional financing, bringing diverse stakeholders together, and otherwise leveraging their relationship with private financial actors,

[28] Interview no. 15, November 2016

the EBRD helped to resolve the ‘prisoners’ dilemma’ situation banks were facing, and strengthened further the credibility of the arrangement.

While recognizing some of the dangers of rapid cross-border retrenchment, EU authorities largely viewed the situation through a prism of fiscal issues. Therefore, during the discussions about how to get bail-in commitments from foreign banks, the EC remained on the sidelines and was skeptical of the initiative. Particularly at the beginning, EC officials appear to have been little involved. The only time when Commission staff participated actively in financial discussions was when actions by the authorities seemed to challenge the competition rules that underpin the Single Market. As the crisis deepened and some of the bank support vehicles had limited impact, the Hungarian government decided unilaterally in March 2009 to lend directly to three big domestic banks a total of 2.4 bn euros (1.4 bn of which went to OTP) to deal with immediate FX needs. From the EC perspective, these funds were seen as opaque and posing risks to public finances. The Commission’s Directorate-General for Competition was only officially notified after the loans were paid out, although its officials were informally aware about the intention of the authorities. It immediately set out to enforce its state aid rules (Ecorys 2013, p. 84). The EC then “required an adjustment of the pricing of the loans to reduce the subsidy element and ensure consistency with EU competition rules”, as well as ruling that some of the financial help was non-compliant with EU rules (IMF 2011, pp. 21–22).

A final EU actor is conspicuous by its limited involvement in the crisis – the ECB. Before the IMF and EU program, the ECB had announced a swap deal with the Hungarian central bank, the MNB, worth 5 bn euros. While it seemed to parallel arrangements made across the world among major central banks, this deal was in fact a repo deal. Therefore, in exchange for ECB liquidity, the MNB had to pledge not forint, but euro denominated assets, which in effect meant the swap line had no real impact on the overall foreign reserves of the central bank. A similar arrangement was reached with the Swiss National Bank, but once again, in the words of the MNB governor, "It was not CHF-forint swap facility, but it was in euros, which was much less of a use, but that's what the Swiss National Bank was ready to provide". Similarly, regarding the ECB, he argued that "we were thinking maybe we should get swap lines…we wanted to get agreement that they accept our securities as collateral as well…I understood the logic, they are the central bank of the Eurozone, not of the EU. But what they had not adequately recognized is that the crisis does not recognize these borders, and they could've done much more to help us if they wanted to"[29]. The Hungarian experience with the ECB is thus representative of the reasons for the critical assessment by many commentators of ECB's role in the region (Aslund 2010; Darvas 2009; Piroska 2017).

Drawing the theoretical lessons from the debates over private sector involvement in the Hungarian case is not straightforward. On the one hand, the structure of banking exposure (through brick-and-mortar subsidiaries), the expectations of future profits, and the subsidiary relationships generated powerful incentives for banks to remain committed to the region (Epstein 2014). On the other hand, banks nevertheless faced a scenario of 'prisoner's dilemma' in which there was a real risk that uncertainty about competitors' actions might prompt them to withdraw (De Haas et al. 2015; Pistor 2012). This was resolved by linking the commitment letters to the IMF-EU program, essentially threatening to stop the program if they did not

[29] Interview no. 14, November 2016

comply, which in turn would lead to bank losses. As the Hungarian central bank governor explains, "it was ideal we had this IMF-EU program under construction because it was a deal [for the banks] as well…it was never formally connected in terms of conditionality, but it was very clear that one would not happen without the other"[30]. Thus, the economic structure played an important role, but still falls somewhat short of explaining the eventual outcome.

For the IMF staff, such 'bail-in' killed two birds with one stone by reducing the need for adjustment for the borrower country and effectively closing a financing gap between IMF and EU's resources and potential financing needs. As explained above, the IMF was presenting an already very large program of 20 bn euros together with the EU and the World Bank, but that was still short of the potential 39 bn euros financing gap staff identified for Hungary. Increasing the program further might have alienated the Executive Board while also increasing the risk of putting public money in the country that just finances the exit of private investors – a key lesson from Argentina and other previous financial crises (IEO 2003, 2004). In the absence of bank commitments, and potentially without the region-wide initiative of the EBRD, it is likely the 80% rollover rate, which underpinned the Fund program, would not have been achieved. In that way, bail-in was crucial to enabling IMF staff to present a 'fully financed' program to its Executive Board which was small on conditionality and large on financing so as to be attractive to Hungary and a powerful signal to other countries in a similar situation.

At the same time, beyond the EBRD European institutions did not express any clear-cut preferences over private sector involvement. This is likely to reflect to a large extent the limited

[30] Interview no. 14, November 2016

exposure of banks from large Western European states, although there was systemic exposure of banks by at least one euro area country, Austria. On financial matters, the EC generally readily deferred to the IMF, which corresponded to its limited expertise in addressing banking crises (although it did quickly increase its competency in applying competition law to a relatively new area, financial sector bailouts). Thus, it did not act on its initial skepticism for the EBRD-led Vienna Initiative, neither supporting nor really actively opposing it. Meanwhile, the lack of ECB attention, for reasons that go beyond the scope of this research, meant in practice that the IMF role was not significantly challenged. Therefore, in this area the key alternative elements of the incipient regime complex, the RFA and the potential source of bilateral swap lines, remained either cooperative or passive.

Nevertheless, the evidence on record is only suggestive of such dynamics without necessarily fully refuting some alternative explanations. In particular, there are conflicting reports about where the initiative for both the initial comfort letters and for the Vienna Initiative originally came from. Thus, there is a possibility that the IMF played a secondary role in both, as comfort letters were instead signed on the initiative of the Hungarian central bank[31] and as the EBRD seized the initiative to fill-in an institutional vacuum[32]. If that is the case, the fundamental causal factors on this matter might lie instead with domestic political actors or other international organizations. Nevertheless, had they not addressed these issues, it remains likely IMF staff would have still sought some form of bail-in to make it possible to offer a ‘generous’ package that limited risks to its own resources and to program implementation.

[31] Interview no. 14, November 2016, interview no. 3, September 2015
[32] Interview no. 15, November 2016

Conclusion

Given well-known vulnerabilities, nobody was surprised when Hungary called the IMF and the EU for help in November 2008. However, many observers were indeed surprised by the eventual design of the financial assistance program. On conditionality, the IMF sought a package with surprisingly limited fiscal consolidation and structural benchmarks despite large-scale public sector weaknesses in the country. In relation to financing, the Fund put together what was at the time one of its largest ever programs, with significantly frontloaded access, raising worries about whether it was not taking undue risks. When it comes to bail-in, the IMF influence was more nuanced as it extracted some commitment promises from banks, but played a more passive role.

What explains the observed conditionality, financing, and bail-in arrangements in the Hungary program? Previous scholarship has argued that such 'generous' terms seemed reserved only to 'special' cases of geopolitical or financial importance, where the Fund aimed to support domestic political actors, or when IMF staff shared a normative orientation with local policymakers. Yet, the exposure of the key G5 creditor states in Hungary was low, and process tracing revealed Executive Directors were often arguing for more stringent terms, even if they agreed to staff proposals in the end. Overall, domestic political actors did not actively attempt to play 'two-level games' drawing on domestic constraints, although there might have been some preferences to avoid a change of government. Indeed, many of the elements in which one would expect to find proactive local actors, such as the size of financing or conditionality were driven more often by Fund's own staff. Finally, IMF negotiators did not share an educational or professional background with their key interlocutors, and it is unlikely that shared ideas played a major role in 'loosening' the terms of the package given the Socialist background of the government.

Instead, IMF staff managed to translate their initial preferences at the outset of negotiations into the actual IMF-EU program. In this context, G5 creditors were vocal in words, but largely passive in actions given limited financial exposure to the country. Meanwhile, local policymakers often found that IMF staff was if anything willing to go beyond what they believed possible, which meant that the program was negotiated quickly and without any major disagreements. In this context, neither borrower nor creditors made active recourse to the alternative RFA as a strategy to align the IMF with its preferences since there was no conflict with the Fund in the first place. In the absence of such threats to the Fund's position within the regime complex, the level of influence of the IMF and its staff and management was enhanced in the bargaining process.

Furthermore, the IMF made a proactive use of such relative discretion by drawing on the resources of other IOs in the regime complex to achieve their preferences – that is, they pursued a strategy of *co-working*. Instead of digging their heels into turf wars as some might expect, staff engaged in cross-institutional strategies in crafting the Hungary program by relying on the European authorities for local knowledge in relation to conditionality, additional financing, and an elaborate region-wide structure to mitigate the risk of chaotic cross-border bank deleveraging. All the three elements were interlinked – ensuring soft private sector involvement through the Vienna Initiative increased the chance of success and decreased the risk to IMF resources, which, alongside substantial EU co-financing, made possible a larger program than otherwise might have been feasible. Once these aspects were secured, the IMF could offer a particularly large loan with rollover commitments from private actors, which allowed it to accept a program with limited conditionality by reducing the need for adjustment from the borrower side. It is therefore likely that in the absence of an RFA with which to work, the program would have incorporated less IMF preferences as constraints to its unilateral capacity in terms of knowledge, resources or contact would have become binding.

All this meant that despite no prior history of co-lending, differing mandates, and severe time pressure, the IMF and the EU institutions *co-worked* in a surprisingly effective and efficient manner. Such observations are in line with other empirical studies, which found "no evidence for substantial conflicts in the Hungarian case" (Lütz and Kranke 2014, p. 318). This happened in the absence of any formal coordination mechanisms, and indeed very few concerns were voiced throughout the negotiations about the potential for conflict within this unprecedented setup. In fact, the Fund managed to draw on the institutional context, leveraging it to achieve its objectives (and also helping the RFA achieve theirs) and relying on it to get beyond some of the usual constraints on the use of IMF resources. However, the Fund was to learn in another emerging European country just a few weeks later that the presence of a regime complex could also become a significant impediment to its goals under different circumstances.

V. The IMF in Latvia (2008-2011): A junior partner

At first glance, the 2008 Latvia IMF-EU program appears to be a classic case of crisis management by the Fund. Latvia went through a boom fueled by high corporate borrowing and large scale foreign bank inflows, which served to finance ever-growing current account deficits. Once the global financial crisis hit, it experienced a classic 'sudden stop' of capital inflows, prompting an intervention from the IMF and European partners. In addressing the situation, the country insisted on maintaining a currency peg, which implied undertaking draconian fiscal consolidation that numerous outside economists saw as simply delaying the inevitable. Yet, a closer look at the program negotiations reveals that it was the Europeans, not the IMF, that "rescued" the Washington consensus (Lütz and Kranke 2014). Indeed, the Fund argued against the design of the eventual program, most notably by supporting an upfront devaluation against the wishes of local authorities and EU institutions. However, it found itself for first time in its history forced into the role of a 'junior partner', both in terms of financing and influence.

Why did the IMF participate and eventually agree to a program that it believed was ultimately doomed to fail? IMF staff and management had consistent views they voiced repeatedly, expressing a strong preference for some sort of devaluation as this would have allowed for less 'draconian' program. Indeed, many felt they were putting money and reputation on the line in a way, which strongly reminded them of the case of Argentina, taken as a prime example of what *not* to do within the Fund. In previous cases, especially given the lack of direct financial interests of G5 creditors, countries like tiny Latvia would have been forced to devalue their currencies given that they had little choice but to agree to the conditions imposed by the Fund under the pressure of an imminent financial collapse.

In explaining this outcome, this chapter proceeds in three parts. First, it introduces the origins of Latvia's financial troubles, follows the debate over the exchange peg and the positions taken by different actors, and outlines the eventual program that emerged amidst sharp disagreements between the Fund on the one hand and local authorities and EU institutions on the other. Second, it considers the potential explanations for such behavior, presenting the expectations of alterative state-centric, bureaucratic, and regime complexity arguments about the relevant causal mechanisms. Finally, the chapter considers in-depth the process through which the parameters of the final program, such as conditionality, financing, and private sector involvement, emerged. Throughout it pays attention to why and when conflicts between local authorities and the IMF came to boiling point and how they were resolved.

The IMF financial assistance program for Latvia

This section serves to present the main aspects of the IMF-EU crisis lending package to Latvia. The goal is to establish the parameters of the program as the dependent variables that alternative theories, presented in the next section, should explain. It begins by briefly outlining the origins of Latvia's boom and bust cycle. It then examines in more detail the most controversial element of the program, namely the decision to maintain the exchange rate peg. The section concludes by presenting the key outputs in terms of conditionality, financing, and bail-in arrangements.

Latvia's boom and bust: "Nothing special"

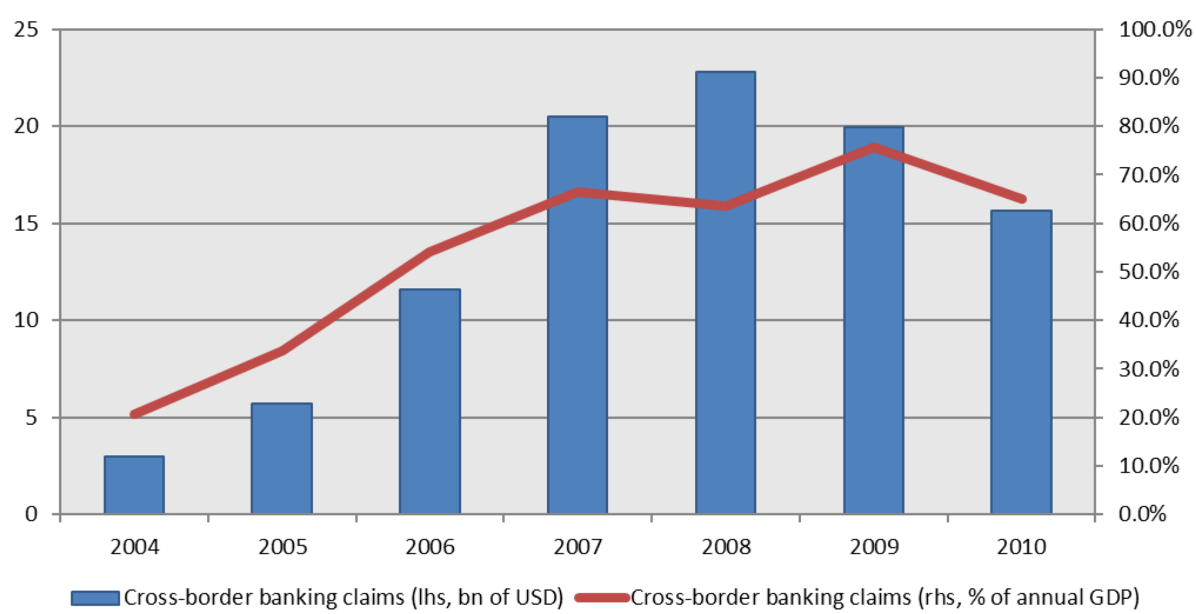
When asked about the causes of the Latvian crisis in late 2008, the then-finance minister infamously declared they were "nothing special" in a TV interview. This became a rallying cry for protestors, but many in the IMF would have shared his assessment of the situation as a textbook boom-and-bust cycle. Following independence in 1991, Latvia went through a painful transition experience, culminating in a recession in 1995 and the Russian financial crisis of 1998. Following this, and several IMF programs, the economy experienced a boom similar to that of other emerging European economies (Bakker and Gulde 2010). GDP growth accelerated to an average of 7.5% in 2001-2004, and, after accession to the EU, reached 11% annually in 2005-2007 (Bakker and Klingen 2012, p. 113). Crucially, after floating its currency for a short period, Latvia decided in 1994 to peg it to the SDR basket to reduce inflation. This peg was then adjusted to the euro in 2005, and Latvia joined the ERM2 mechanism. This is known as the 'waiting room' for the euro: countries need to spend at least two years in the mechanism maintaining their currency stable relative to the euro (in the case of Latvia, fluctuation was limited unilaterally by Riga to +/- 1%)[33]. Latvia was not an exception: Lithuania and Estonia also joined ERM2 in 2004, while Bulgaria has maintained a currency board with the euro since 2001.

However, the roar of the Baltic tigers was based on large-scale capital inflows, nowhere more so than in Latvia, which led to a 'sudden stop' once Lehman Brothers collapsed. The 'rocket fuel' for the pre-2007 growth contained several factors. First, foreign banks, particularly from Sweden, bought several Latvian banks and drove up credit, which reached 50% annual growth in 2006 (IMF 2009c, p. 5). In addition, the second biggest bank, Parex, was domestically owned, but largely funded by non-resident deposits and short-term borrowing from the wholesale market (Åslund and Dombrovskis 2011, p. 20). Second, domestic demand raced ahead, driven by significant wage increases that outpaced productivity growth and by a striking rise in real

[33] Other requirements for euro adoption correspond to the Maastricht requirements: 1) price stability and low inflation; 2) public sector deficit under 3% of GDP; 3) public debt under 60% of GDP; 4) low long-term nominal interest rates (TFEU 2012 Art. 140).

estate investment. Therefore, in late 2006 the current account deficit peaked at an astonishing 25% of GDP, while fiscal policy was procyclical as expenditure grew 80% between 2003 and 2007 (IMF 2009c, p. 5). Finally, the currency peg also influenced inflows by creating the impression that foreign currency borrowing was largely risk free, which meant that the economy was highly euroized by 2008. Meanwhile, with fixed currency regime and lack of capital controls (which are mostly prohibited by EU law), the Bank of Latvia was caught in the 'impossible trinity' and unable to run an independent monetary policy (Bakker and Gulde 2010). The result was a gross external debt of over 130% of GDP, of which 50% of GDP was with maturity under one year, even as public debt itself remained very low at just 9% of GDP (IMF 2009c, p. 6).

Figure 14: Foreign bank inflows to Latvia, 2004-2010

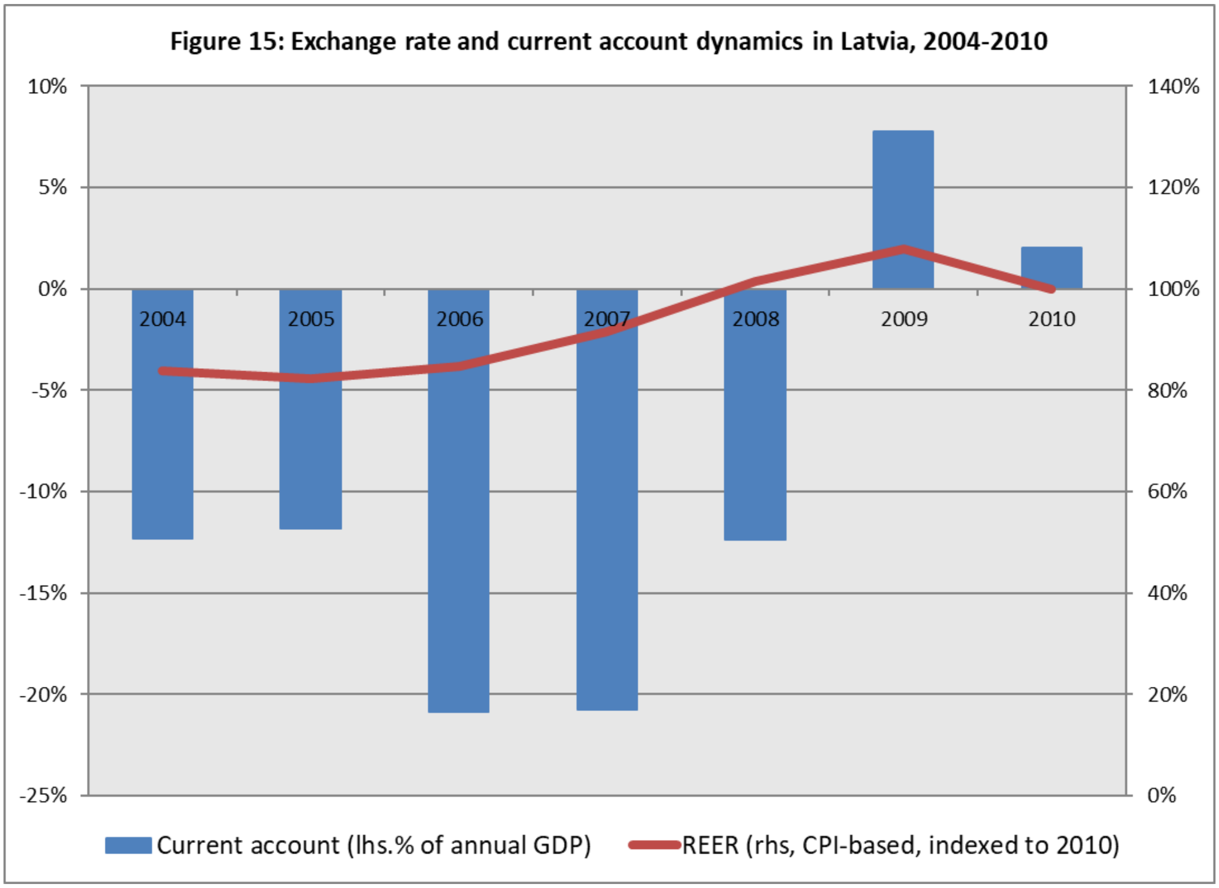


Source: BIS Consolidated Statistics, IMF WEO

All this combined to set up Latvia for a hard fall. The boom started to cool down in late 2007, when Swedish banks began to rein in their lending to the country worried about credit risk; simultaneously, the Bank of Latvia began to tighten regulatory policy and mortgage standards. This in turn led to a fall in housing prices of around 35% in 2007, and a credit crunch began to emerge (Åslund and Dombrovskis 2011, pp. 35–35). The slowdown turned into a full-blown crisis in 2008, with deposits declining by 10% between August and November, while the Bank of Latvia sold almost a quarter of its reserves in foreign currency in just four months. Meanwhile, a run on Parex Bank forced the government to take over the bank, although at first they largely kept in place the existing management, and to impose a partial deposit withdrawal freeze on 1 December. Ultimately, the IMF estimated that the combined outflows from Parex due to syndicated loans, Eurobonds, and non-resident deposits could reach 1 billion euros, or close to 4% of GDP (IMF 2009c, pp. 8–9). In summary,

> the anticipation of a large scope for catch-up growth, together with cheap external financing, led to an initially healthy boom. As time passed, the boom turned unhealthy, with overheating leading to appreciation and large current account deficits, along with lower credit quality and the balance sheet risks associated with foreign exchange borrowing (Blanchard et al. 2013, p. 336).

In this situation, and facing a fiscal deficit about to spiral out of control, the government called in the IMF and the EU for help.



Source: IMF WEO

The exchange rate dilemma

In December 2008, it was clear that given Latvia's current account deficit of 25% of GDP the country was facing a wrenching adjustment. The crucial decision at the core of the IMF-EU financial assistance program was whether to maintain Latvia's currency peg to the euro. On the one hand, preserving the peg implied that Riga must pursue 'internal adjustment' though significant wage cuts to regain competitiveness and compensate for the sudden stop of capital inflows. On the other hand, an 'external adjustment' through the exchange rate would be quicker but could wreck the chances of joining the euro area in the near future as the country might crash out of the ERM2 mechanism.

Proponents of ‘internal adjustment’ had several key arguments. First and foremost, this was basically the unanimous desire of the Latvian population and policymakers, who saw the peg as contributing to rapid growth following the 1998 Russian crisis and were strongly committed to euro area entry. Whenever doubts were expressed in public, the Prime Minister and the central bank governor were quick to slam down such talk, with security services even arresting some economists and journalists that expressed the opinion that devaluation was inevitable (Åslund and Dombrovskis 2011, p. 40). Second, a staggering 70% of bank deposits and 90% of loans were in foreign currency, and private sector net foreign currency debt stood at 70% of GDP. Given the highly euroized nature of the Latvian economy devaluation would lead to “large balance sheet effects, with a risk of negative feedback loops” (IMF 2009c, p. 10). Third, contagion risks, particularly to other currency board countries (Estonia, Lithuania, and Bulgaria) was considered high, in turn potentially leading to spillovers into Western European (mainly Swedish) banks. Finally, there were some other more technical reasons to doubt the effect of devaluation such as the high pass-through of inflation in a small and open economy. In addition, the relatively shallow financial market in Latvia meant that it was hard for speculators to obtain local currency. There were just 1.9 bn USD worth of lat-denominated government bonds, the daily turnover of the stock market was barely 200 000 USD, and in any case holders of lats had an interest in supporting the currency (Åslund and Dombrovskis 2011, p. 84). Thus, according to proponents of the ‘internal adjustment’ strategy at the time, a devaluation was likely to overshoot, wreck the banking system, and cause negative spillover effects, all without improving Latvia’s external competitiveness that much (Aslund 2008; Stokes 2008).

Pointing to decades-long experience with similar crises, supporters of devaluation highlighted that when breaking the peg appears inevitable, it is much better to do it sooner rather than later. Recognizing some of the criticisms above, especially related to balance sheet effects, the general logic was that maintaining the peg is throwing good money after bad and that a quick devaluation will be painful in the short term, but will lead to a faster recovery afterwards. The Latvian exchange rate was significantly overshooting according to the IMF, which estimated internally in 2008 such overvaluation to range between 16% to 37%, with an average of 27%. Given this, any 'internal adjustment' would be simply too painful as the scale of the cuts will be such that maintaining political support for such policy would be impossible (Kincaid 2016, p. 52). Thus, as a prominent commentator argued at the time "the kind of internal deflation process the Latvian government has just accepted is normally very difficult to implement, which is why economists tend to favor the devaluation approach" (Hugh 2008). Many other well-known economists drew comparisons with IMF's disastrous attempt to support overvalued pegs in Asia and Argentina, with Krugman directly branding the country "the new Argentina", while Roubini, a veteran of IMF crises, argued that "Latvia's currency crisis is a rerun of Argentina's" (Krugman 2008; Roubini 2009). In addition, there was a danger of a deflation trap, particularly if the government reduces drastically its expenditure, which would then in turn exacerbate the recession in the short term (Hugh 2008; Roubini 2009). Finally, while there were worries about balance sheet effects, economists argued that defaults are likely to be large scale in both cases, and therefore contagion risks would also be hard to contain whichever strategy was chosen (Hugh 2008; Krugman 2008). Moreover, there was a normative argument – why should then Latvians and other countries with exchange pegs pay for mortgages extended by Swedish banks in search of easy profits during boom times (Johnson 2009)? In short, devaluation had many high-profile supporters, who saw it as the inevitable outcome due to the political difficulty of implementing draconian austerity.

The IMF largely shared the position of proponents of devaluation, both in private and, to a large extent, in public. Sharp disagreements over the exchange rate strategy delayed negotiations over the program for almost a month and required two separate IMF missions, in contrast to Hungary, where the program was agreed with local authorities within days. Once the negotiations got underway, "IMF staff reaffirmed its estimates of real exchange rate misalignment (about 30 percent)…any change in the peg was strongly opposed by the Latvian authorities, the EC, the ECB, and Sweden" (Kincaid 2016, p. 53). Indeed, once the mission chief for the IMF broached the subject during the negotiations, the central bank governor accused him of "issuing an ultimatum" and calling even the suggestion "unprofessional and immoral" (Blustein 2016, p. 67). Allegedly, the IMF managing director was also very skeptical, and is quoted saying during a meeting "I don't believe for one second it will be possible to maintain the peg" (Blustein 2016, p. 68). Publicly, the IMF staff report that proposed a SBA arrangement for Latvia in December 2008 was candid: "the authorities unequivocal commitment to the exchange rate peg has determined their choice of program strategy…[there is a] possibility that recession could be protracted, perhaps more so than if an alternative strategy has been adopted" (IMF 2009c, p. 9).

IMF staff's preferences were made clear and were unusually outlined in their report to the Executive Board of the Fund. Staff backed an alternative strategy combining elements of depreciation and creative euroization. Their ideal scenario would be widening the exchange band from the current +/- 1% to +/- 15%, as allowed under ERM2, which would cause balance sheet problems initially, but would improve competitiveness more quickly, thus adjusting the current account balance. In addition, this could be combined with immediate euro adoption at this depreciated rate, limiting the risk of overshooting and providing Latvia (with public debt of barely 9% of GDP) with access to deeper capital markets (IMF 2009c, pp. 26–27). However, as the report puts it bluntly, "the EU authorities have firmly ruled out this option, given its inconsistency with the Maastricht Treaty and the precedents it would set for other potential euro area entrants" (IMF 2009c, p. 10). Thus, the IMF report continues, "a technically more attractive alternative – accelerated euro adoption at a depreciated exchange rate – is not consistent with EU rules" (IMF 2009c, p. 23).

The discussion at the Executive Board largely shared staff's misgivings and worries about the program. In particular, as with Hungary, the US representative is especially blunt, and is worth quoting at length:

> This Stand-By Arrangement is perhaps the riskiest use of exceptional access that the Fund has considered in many years…there are no clear precedents for countries being able to achieve a real depreciation of the expected magnitude without nominal devaluation…Euroization at the lat's current value would have been the optimal outcome. Unfortunately, we must accept the political reality that European authorities are not able or willing to allow euroization to solve Latvia's currency risk…if there is one clear lesson from the emerging market crises at the turn of the century, it is that the Fund should not support unsustainable pegs (IMF 2009d, p. 8).

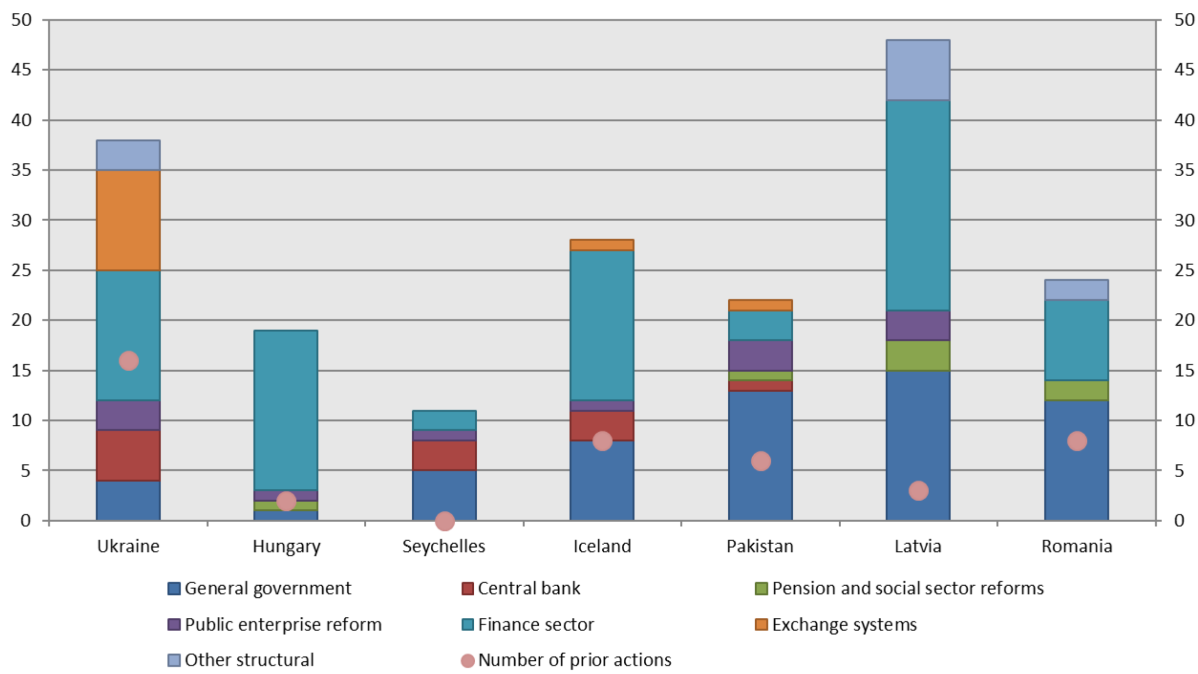
Such concerns are echoed by representatives from Japan, the other non-European G5 country at the Executive Board: "any economist can easily recognize the substantial risks that accompany this program in which the exchange rate is pegged at the current overvalued level" (IMF 2009d, p. 47). Others are ambivalent about maintaining the peg, with some supporting the overall program and others expressing significant reservations. Thus, Canadian directors argue that "adjusting the exchange rate would be a simpler and a fairer way of delivering the required economy-wide reduction in real incomes" (IMF 2009d, p. 17), while Latin American directors ask staff whether they have a "contingency plan in the event that the peg needs to be abandoned in an orderly fashion (IMF 2009d, p. 24). The Chinese are less direct, but agree that "technically it might not be the best option" (IMF 2009d, p. 26). Nogueira Batista, the Brazilian representative, however, is characteristically outspoken: "if Latvia's currency is not "fundamentally misaligned", it becomes very hard to see to which other currency the label would apply", pointing out the "apparent contradiction" in staff proposing to maintain the currency board while estimating the currency is overvalued by about 30% (IMF 2009d, p. 37).

Outline of IMF-EU program for Latvia

Yet, despite such widespread misgivings about maintaining Latvia's peg by IMF staff, Executive Board directors, including from non-EU G5 countries, and prominent economists, the final program was based on preserving the country's currency board. As the IMF summary puts it, "the program is centered on maintaining Latvia's exchange rate peg through strong domestic policies and substantial international financial assistance" (IMF 2009c, p. 4). This was reflected in the conditionality, financing, and, to a lesser extent, the bail-in aspects of the financial assistance program.

In terms of conditionality, the Latvian program was particularly heavy and frontloaded, reflecting the need to carry out an internal deflation without using the exchange rate as a tool for adjustment. The program envisaged measures worth 7% of GDP in 2009 alone in order to maintain a deficit of just under 5% of GDP; this was also the target for 2010, with the assumption that by the end of the program in 2011 the deficit will return under the 3% of GDP threshold set by EU SGP criteria (IMF 2009c, pp. 14–18). On the structural side, the program included a very high number of conditions, including many binding prior action conditions and a large list of general government requirements that are painful to implement. Particularly painful measures included a 25% cut in public wages and policies in 2009 (IMF 2009c, p. 18).

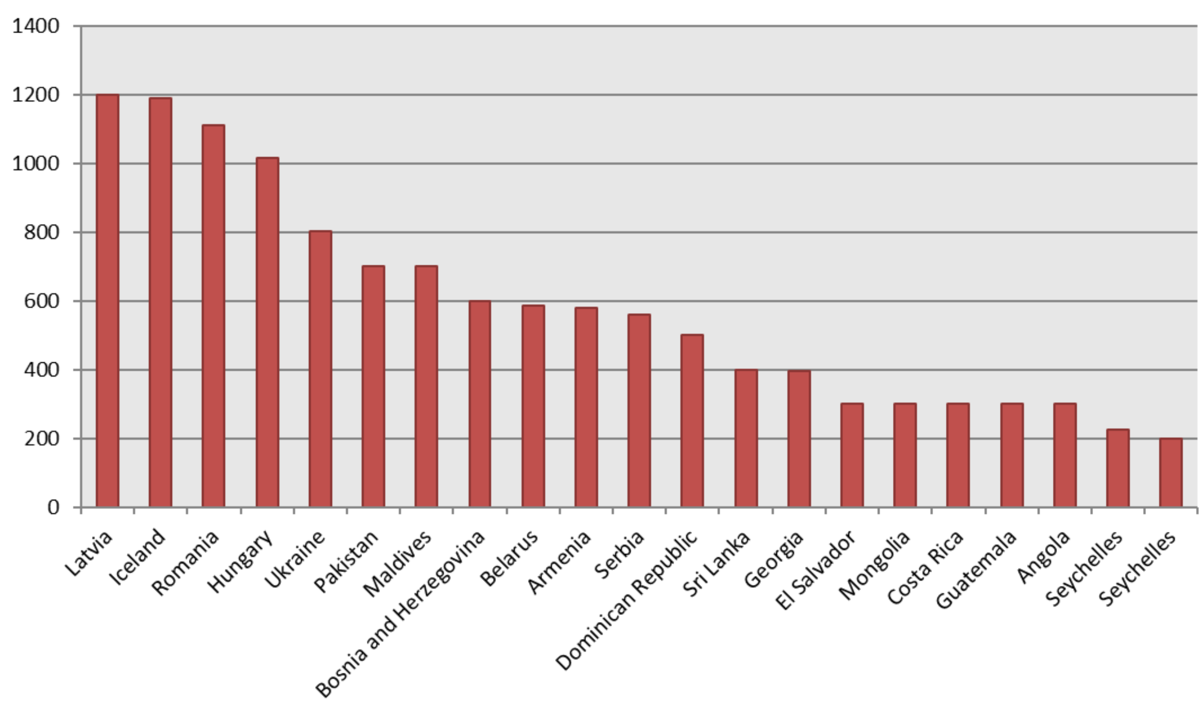
Figure 16: Conditions in IMF programs, Nov 2008-May 2009 (number and type)



Source: IMF MONA database

Latvia also received a financing package together with the EU that had three main characteristics. First, for the IMF, it was the largest program it has approved relative to country size since at least 2002 at about 1200% of Latvia's quota. This made it the largest program of all programs approved in 2008-2009, and the 5th largest program from a total of 71 loans the Fund negotiated between 2002 and 2013 (behind the four euro area programs in Greece in 2010 and 2012, Ireland, and Portugal). Second, when measured in absolute terms, the size of the loan itself was not large – at 1.7 bn euros, this was only the 22nd largest loan among the 71 disbursed by the Fund over the 2002-2013 period, and only the 8th largest among the 21 loans disbursed in 2008-2009 (Fig. 17). Third, the IMF contribution ultimately made up only 23% of the total IMF-EU package of 7.5 bn euros. This is in sharp contrast with Hungary and Romania, the other two EU countries to receive join financial packages, where the Fund had provided 63% and 65% of all funding. Instead, here it was the EC that provided 3.1 bn euros through its balance-of-payments facility (the same as used in Hungary), while a number of bilateral loans were also coordinated by Sweden, totaling another 2.7 bn euros.

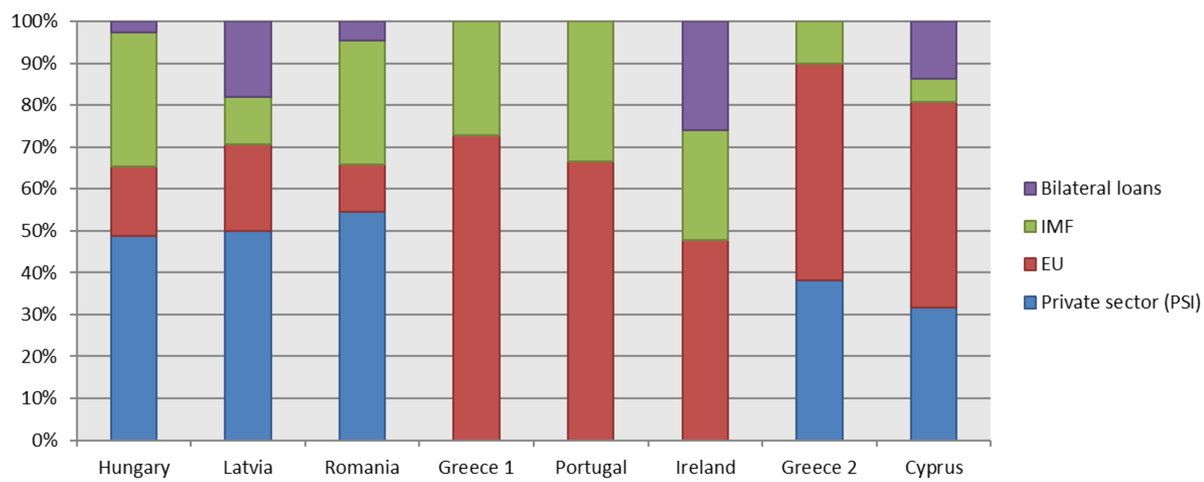
Figure 17: Size of IMF programs, 2008-2009 (% of quota)



Source: IMF MONA

Finally, given the large-scale financial sector vulnerabilities in Latvia, especially in terms of reliance on non-resident deposits for the funding models of local banks, some sort of private sector involvement was necessary to ensure official liquidity did not simply go towards repaying foreign creditors. In this context, similarly to Hungary, commitments were secured from foreign – and especially Swedish – banks to maintain exposure through rollovers, which were discussed in the context of the Vienna Initiative. Foreign banks provided 'comfort letters' in January 2009 but did not ultimately sign formal commitments in September 2009 beyond some general promises. Regardless, as part of the program their soft bail-in still aimed to cover around half of the identified total financing gap (Kincaid 2016, p. 54). In addition, there were important worries about the potential costs of restructuring Parex Bank and other domestic banks that might face problems, which were estimated conservatively at around 17% of GDP, although that would eventually prove considerably higher than the actual outlay, which was closer to 10% of GDP (IMF 2013b, p. 21).

Figure 18: Burden-sharing among public and private actors in Europe (% of financing gap)



Source: IMF program documents, Kincaid (2016)

In short, the Latvia program stands out in three ways when compared to other similar IMF programs during the same period and region. First, it has a relatively high level of structural conditionality and stringent fiscal adjustment targets. Second, even though the program was among the highest in the Fund's history when adjusted for the size of Latvia's quota, the Fund was still just a minority contributor to the overall financing package led by the EU and Sweden. Third, foreign banks, similarly to Hungary, were 'bailed-in' through voluntary rollover commitments, which considerably reduced the financing gap. These parameters stem from the decision to maintain Latvia's currency peg, which the local authorities strongly supported, against the analysis and preferences of IMF staff and management.

Competing explanations

What are some of the possible explanations about why a tiny Baltic state with one of the smallest economies in Europe managed to achieve its strategic objective in negotiations with the IMF, which was openly skeptical and advocated for an alternative strategy of devaluation? This section outlines the possible competing explanations for this outcome. It first begins by considering state-centric approaches, focused on the interests of G5 creditors or domestic political actors. Then, it proceeds to discuss rational and ideational bureaucratic approaches. Finally, it presents the position of the IMF as part of a regime complex with the EU institutions.

State-centric approaches

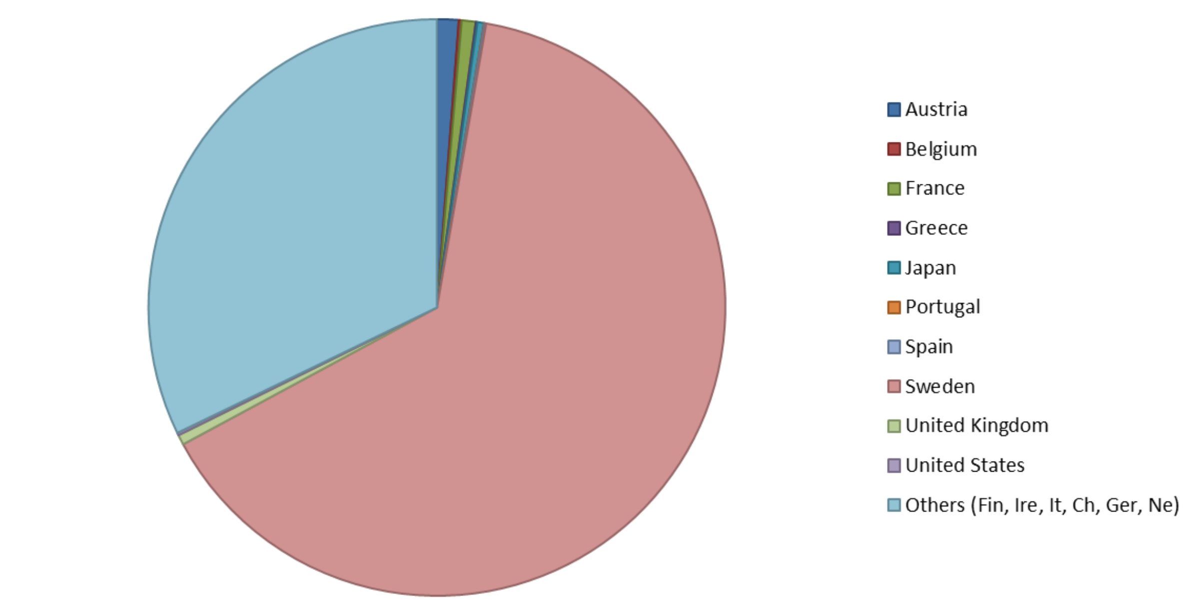
State-centric approaches focus on the roles of creditors and/or debtor states in shaping IMF behavior through various formal or informal channels. Creditors are assumed to be motivated to act either because of their financial exposure or their geopolitical interests, which lead them to intervene in IMF decision-making in order to make sure loan terms correspond more directly to their interests than if left to Fund staff alone. In terms of financial exposure, Latvia, with a population of just 2.2 million and a GDP of 35 bn USD in 2008, hardly qualified as a 'systemic' threat to global financial stability that might interest the G5. Nevertheless, there were substantial concerns about spillovers across the Baltic region, which in turn could represent a significant hit to Swedish and other Nordic banks. In fact, according to BIS data, Swedish banks were by far the biggest foreign players in the Latvian banking system, holding assets worth 20.8 billion USD in late 2008, or around 66% of all foreign-bank held assets, with another 30% likely held by the remaining Nordic countries – a situation similar to that in other Baltic states. Therefore, total Swedish exposure across the region accounted for 12.8% of Swedish GDP, enough to create substantial worries at the Riksbank. Given this, unsurprisingly, the Swedes advocated for maintaining the currency board, multilateral financial assistance (as opposed to bilateral loans from Sweden), and no bank commitments from Swedish banks to allow them to focus on bolstering their capital at home. However, Swedish quota at the IMF is just under 1% of voting rights, far below that of the G5 countries usually considered as having enough sway over the Executive Board in order to shift IMF decisions in their favor. This pattern of exposure therefore indicates a large role for Sweden and its Executive Director in trying to 'nudge' the Fund in its preferred direction (somewhat similar to the role of Austria in the Hungarian crisis), but does not suggest that Sweden will have the necessary formal or informal means of substantively altering the Fund program.

Table 4: Foreign bank exposure to the Baltic countries in 2008

	Latvia	Lithuania	Estonia
GDP (bn USD, 2008)	35.8	48.1	24.3
Foreign bank assets (% of all bank assets)	66%	93%	99%
Swedish bank assets (% of all foreign bank assets)	66%	63%	93%
Swedish bank assets (% of Swedish GDP, 2008)	4%	3.6%	5.2%

Source: IMF WEO, BIS Consolidated Statistics, Claessens and van Horen (2014)

Figure 19: Foreign bank claims on Latvia, 2008 Q4 (% of total foreign claims by bank home country)



Source: BIS Consolidated Statistics (ultimate risk basis)

Another important variable in the case of Latvia would appear to be geopolitical interests. Tensions between the Baltics and Russia are well known, and ethnic Russians account for just over a quarter of Latvia's population. Previous research on the region has also argued that international economic policies were at least partly motivated by the desire to reduce dependence on Russia (Abdelal 2001). Therefore, one would expect that if large shareholders prioritized supporting Latvia for geopolitical reasons, this would have led them to relax the conditions and to increase the funding offered to the country. Moreover, such worries should be most salient for EU countries as they are closest to the area of potential security concern. Finally, it is worth noting that in 2008 Latvia, along with the rest of the Baltics, was already a NATO (since 2004) and EU member (since 2007), which meant they were largely institutionally embedded in the European security architecture.

Another approach focuses on how domestic politics can influence IMF behavior. This also appears initially plausible in Latvia given a very fragmented political scene. The government that negotiated with the IMF at the outset of the crisis in late 2008 was composed of four parties, and its successor from early 2009 consisted of five different parties. Moreover, regular elections were scheduled for late 2010, well within the timeframe of the IMF program, raising further political risks. In this situation, domestic political entrepreneurs can seek to use the Fund as a tool for external pressure to pursue reforms that otherwise would encounter resistance. Alternatively, the IMF can be constrained in its ability to threaten to withdraw support if it fears this can bring down the government and usher in a more antagonistic administration, raising the risk that they would renege on previous agreements. If these mechanisms were in action, one would expect to observe Latvian political leaders engaging in 'two-level games' and consistently drawing Fund's attention to its political constraints and to the lower likelihood of program success if the government changes. However, by March 2009, almost all parties in the Latvian parliament (except for two smaller parties representing the Russian minority), as well as all major employer and worker associations had signed up to the IMF/EU agreement. Meanwhile, Latvia saw one major anti-austerity protest on 13 January 2009, but further social unrest has been limited in contrast to some IMF programs in the euro area (Metinsoy forthcoming). This all restricted domestic cleavages over the financial assistance program, which in turn should have enhanced IMF influence.

Bureaucratic approaches

Bureaucratic approaches prioritize instead the role of staff in shaping IMF programs either for ideational or rational reasons. On the ideational side, such approaches focus on the potential alignment of economic background and ways of 'diagnosing the problems' between IMF staff and country policymakers. The closer they are normatively and especially in terms of economic ideas, the less worried the IMF will be about ‘slippage’, thus taking a more ‘accommodating’ stance. In Latvia, this certainly has some purchase. The prime minister in late 2008, Ivars Godmanis, was also prime minister between 1990 and 1993, a period during which Latvia obtained three IMF loans. He was replaced in March 2009 by Valdis Dombrovskis, a former finance minister between 2002 and 2004 when he “became known as a classical liberal and fiscally conservative politician” according to market participants (Christensen 2009). Furthermore, his finance minister in 2009, Einars Repse, was the former governor of the Bank of Latvia between 1991 and 2001, also comprising the 1991-1993 period of IMF programs in Latvia. Finally, he was succeeded as head of the Bank of Latvia in 2001 by Ilmars Rimsevics, who has remained governor since then. Rimsevics, a key player in the 2008 and 2009 negotiations, studied in the US in 1988-1989 and obtained his MBA from Clarkson University in 1992, which should also reduce the ‘ideational distance’ between him and IMF officials. This all suggests that the IMF should find a receptive audience, enhancing its influence. Yet, despite some shared ideational background, in the case of Latvia there were sharp disagreements over program strategy between Fund staff and local authorities.

In terms of rational bureaucratic approaches, some argue that the IMF is prone to protect previous choices made in the context of the country relationship with the Fund in order to avoid ‘blame’ for ‘wrong’ policy advice (Miller 2006; Setser and Gelpern 2006; Ngaire Woods 2006b). Before the crisis, the IMF had a largely positive relationship with Latvia – until 2007. In 1992-1994, it lent money to the country in three separate programs, concluding another five precautionary arrangements afterwards, with the last expiring in 2002 (IMF 2008b, pp. 1–2).

Surveillance also recognized Latvia's vulnerabilities well before the 2008 crisis. Whereas there was some internal debate to what extent they were just a side effect of convergence with Western Europe, the warnings in IMF reports and publications were stark (Enoch and Ötker-Robe 2007; IMF 2005; see also Wagner 2010). Indeed, an interdepartmental team was formed in 2007 to "do high-frequency monitoring and develop contingency plans" for Latvia (IEO 2011, p. 16). However, despite increasing worries between 2004 and 2006, no Article IV consultation was submitted to the Executive Board of the IMF in 2007. This is because that year the IMF adopted a Decision on Bilateral Surveillance over Members' Policies (IMF 2007), largely responding to American concerns about a 'fundamentally misaligned' Chinese exchange rate. However, Latvia became a collateral victim of this policy[34] – staff estimated in 2007 that its exchange rate was probably overvalued by an average of 27% owing to its exchange peg, but discussions of this issue at the Executive Board was postponed as the controversial Chinese Article IV report, dealing with the application of the 2007 surveillance decision, was also delayed (Kincaid 2016). As the IMF's own evaluation unit puts it, "In Latvia, for example, an otherwise good surveillance effort was ultimately derailed by the new emphasis on the exchange rate level, creating a rift in communications and a weakening of traction with the country authorities just before the crisis erupted" (IEO 2011, p. 16). Outside commentators are blunter: "in the end, the most perverse sort of symmetry and even-handedness prevailed – that is, all countries escaped labeling" (Blustein 2013, p. 83).

The IMF-EU regime complex and Latvia

Given the short time between the Hungarian program, negotiated in October 2008, and the Latvian program, negotiated in November and December 2008, there was relatively little

[34] Other countries in a similar situation included Malaysia, Fiji, and the Seychelles (Blustein 2013, p. 83).

change in the context for either the IMF or the EU within the regime complex. On the IMF side, its main lending facilities have hardly changed, either in size or shape. Following Hungary (15.7 bn USD), it has approved another large loan to Pakistan (7.6 bn USD) and smaller loans to Iceland (2.1 bn USD) and Seychelles (0.03 bn USD), adding to previous loans to Ukraine (16.4 bn USD) and Georgia (0.75 bn USD) agreed earlier in 2008. Thus, the Fund had further expanded its loan portfolio, which had reduced its Forward Commitment Capacity, but it still stood at healthy 150.2 bn USD in December 2008, compared to a small 2.2 bn USD Latvian program (IMF 2008b). Meanwhile, on the EU side, as a non-euro EU member state, Latvia had access to the same facility that Hungary tapped several weeks earlier. Initially set at 12 bn euros, it was rather depleted by the Hungarian program and EU member states raised the ceiling to 25 bn euros on 2 December with an eye on increased demand for external financing in the region (Council of the European Union 2008). This meant that Latvia's relatively small program in terms of absolute size might be easily accommodated. Another difference is also that due to the ERM2 membership of Latvia, ECB representatives also joined the EC directly in the negotiations. However, in Latvia as in Hungary, the role of the ECB was limited beyond insisting on following existing rules for euro accession as explained below. Finally, having gained some experience after scrambling to assemble a team for Hungary, the EC was marginally more prepared when it came to Latvia.

There were also some differences worth noting, mainly stemming from the particularities of Latvia's situation in comparison to Hungary. In terms of size, the Latvian program was much less important than Hungary, not only in absolute value (being more than 7 times smaller), but also in terms of how it affected overall IMF finances. While Hungary reshaped drastically the makeup of the IMF lending portfolio following the declining revenue stream during the 2004-2007 period, Latvia had a much more limited impact. The disbursement of the large first tranche of the loan amounted for just 3% of total IMF exposure, making Latvia only the sixth largest IMF borrower and reducing slightly the share of the top 5 (Turkey, Hungary, Ukraine, Pakistan, Iceland) from 91% to 88% of programs in the full IMF portfolio. In short, the Latvia program was characterized as having a "modest impact on the Fund's liquidity position" (IMF 2008b, p. 8). While Hungary represented 56% of the pre-program IMF total loan portfolio, Latvia stood at just 5%. Nevertheless, even so the Latvian program would "exceed all exceptional access cases in recent years aside from Turkey" relative to the size of the borrower, coming at 1200% of its quota, just ahead of Iceland (IMF 2008b, p. 5). Additionally, the precedent of lending to EU countries, even if jointly with the EC, had already been established with Hungary.

Finally, the biggest change for the IMF was that during the course of the program its 'war chest' was significantly strengthened, assuring it will play a key role going forward in contrast to the doubts about the future of the institution at the outset of the Hungary crisis. After initially judging its position 'satisfactory' in October 2008, Fund staff called in January 2009 for a doubling of resources to respond to the financial crisis (IMF 2009e). Indeed, the Fund had jumped from relative obscurity to being too small to address potential issues in a series of emerging markets such as Brazil, Turkey, Mexico, Poland and others; in a worst-case scenario it estimated financing requirements would exceed 300 bn USD, which was almost twice as much as the IMF's Forward Commitment Capacity. Instead of simply doubling capacity, member states let Strauss-Kahn know a tripling of Fund resources was in the offing on 10 March 2009 (Blustein 2016, pp. 74–77). This was formally confirmed at the G20 London meeting on

2 April 2009 with a half-trillion dollars boost to its coffers through emergency loans based on the New Arrangements to Borrow (G20 2009). This led Strauss-Kahn to proclaim that "The IMF is back. Today you get the proof" (IMF 2009g). This adds an important consideration to the Latvia program – notably, whereas at the outset of the program the Fund position in the global economy was still in doubt, by the time of the first review in March 2009, which was eventually postponed until August 2009, the role of the institution in global economic governance appeared more certain.

Given these characteristics, a regime complexity perspective suggests that borrower governments, facing a conflict with the IMF, would actively use the threat of turning towards an RFA instead in order to bring the Fund closer to its own preferences. In the case of Latvia, IMF staff expressed relatively clear preferences for following a devaluation strategy both in public and private. The source of these preferences is beyond the scope of the thesis, but in this case appears to be the overall negative experience of the Fund in supporting what it considers overvalued pegs, especially in Argentina (Blustein 2006). However, equally clearly, local authorities are overwhelmingly unanimous in their support for maintaining the peg, for a variety of reasons. In such situations, a regime complexity perspective suggests borrowers will make use of the available 'fixed' options in the regime complex and move towards channeling assistance through an alternative RFA, which is closer to their positions – a strategy of *confrontation* with the IMF. In the Latvian case, there is indeed such an RFA present – namely, the EU balance-of-payments facility. Therefore, in short, this perspective would expect to see local authorities consistently threatening to turn towards EU institutions whenever conflicts with the IMF come to a head.

The design of the IMF-EU financial assistance program

The choice of preserving the overvalued currency peg therefore became the lynchpin of the IMF program in Latvia. It shaped and was reflected in all aspects of program design. This section traces in details specifically how the exchange rate discussion translated into the observed conditionality, financing, and bail-in arrangements. It also traces how these evolved over time, paying specific attention to initial discussions over the program in December 2008 and the large and visible disagreements between the IMF and the EU in June 2009. Throughout, it seeks to assess the explanatory power of state-centric explanations relying on the actions of Executive Directors or local political leaders, bureaucratic explanations relying on normative or reputational concerns, and a regime complexity perspective that focuses on the impact of threats from borrowers to exclude the IMF from the financial assistance program.

Fiscal and structural conditionality

The Latvian program stands out from all IMF programs in Europe as having the highest levels of fiscal and structural conditionality observed. Without opening the black box of program negotiations, it would appear at first sight that there is nothing remarkable about the IMF imposing large-scale conditionality on a small country with extensive vulnerabilities amid a financial crisis. Yet, closer process tracing indicates that such extensive conditionality was a direct consequence of the Fund accepting to support the Latvian currency peg despite serious misgivings. Moreover, the IMF often argued for less conditionality, especially smoother fiscal adjustment than the EU institutions, and was largely supportive of measures to protect social spending.

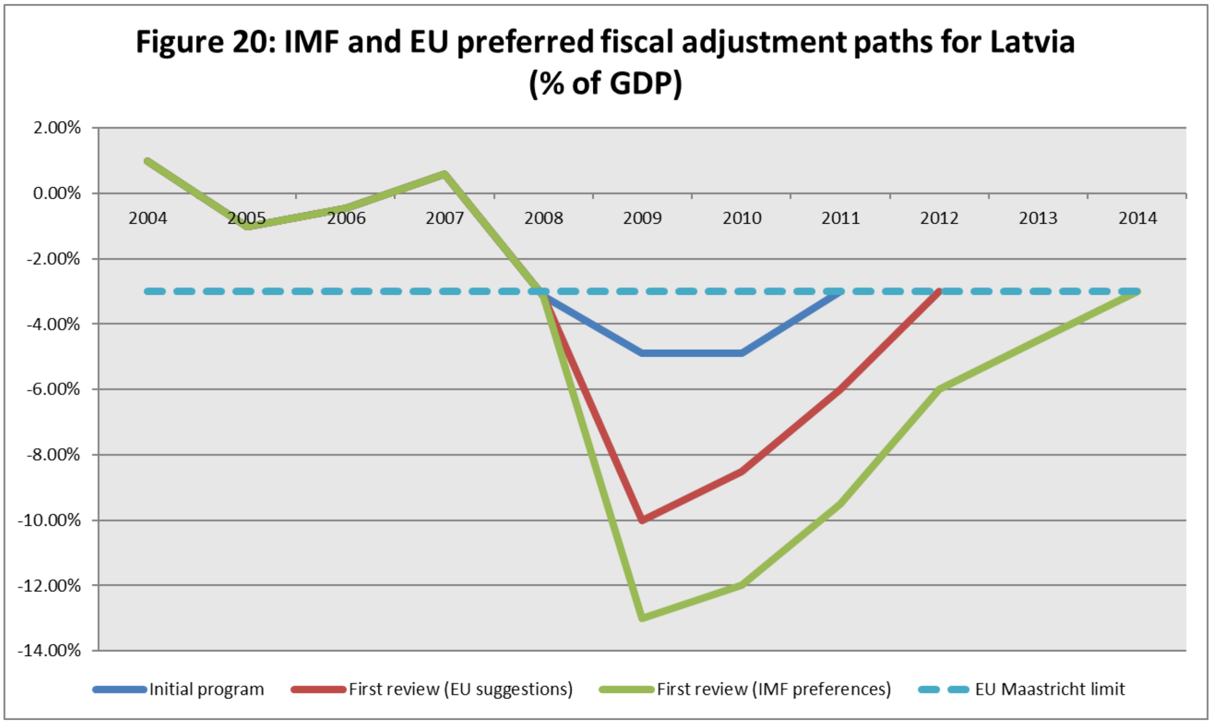
To maintain the peg, the IMF judged that "domestic policies need to be radically strengthened" (IMF 2009c, p. 10). In terms of fiscal adjustment, this meant substantial tightening to both limit financing needs (including creating the space necessary for potential contingent banking liabilities) and drive real depreciation. Initially, the program projected a 5% fall in GDP for 2009, a fall in inflation, and a reduction in the current account deficit. This in turn would have pushed the deficit to 12% of GDP. To avoid that, the parliament passed a new budget on 11 December with fiscal measures worth 7% of GDP in order to contain the deficit below 5%. These included expenditure cuts worth 4.6% of GDP in 2009 alone, but protected some social spending and capital outlays (particularly spending that co-financed EU cohesion fund projects). It is worth pointing out that the IMF, alongside the World Bank, even built in an increase of social spending by 1.5% of GDP in 2009, something rarely observed in previous Fund programs (IMF 2009c, p. 30). Nevertheless, financial tightening meant cuts in wages and bonuses in the public sector of some 25% in 2009, with the hope that this would also induce reductions in private wages, and thus increase competitiveness. The size of this adjustment was massive, but also not unprecedented according to the IMF: "Latvia's fiscal consolidation plans would fall among the largest consolidation episodes in comparable countries in the past two decades" (IMF 2009c, p. 29).

However, by mid-March 2009 the fiscal and structural adjustment policies seemed to be all coming apart as the downturn proved far sharper than anticipated – instead of the projected 5% fall, on which the original program was based, output was on course to collapse by staggering 18% of GDP. As the IMF puts it, "this decline is among the most severe in the world, and the cumulative output decline exceeds that of the Asian countries in 1998-99." As a result, unemployment doubled from 7% to 14%, and, while the current account actually snapped into surplus, a yawning fiscal deficit of 18% in 2009 and 24% of GDP in 2010 loomed (IMF 2009f, p. 23). Meanwhile, the thorny question of the exchange rate was not going away. Indeed, the collapse among Latvia's international partners meant its "real effective exchange rate has appreciated by 3% since the start of the program" despite the goal of achieving a significant real depreciation, while lat deposits fell by 15% in the first half of 2009 (IMF 2009f, pp. 5, 10). These shocks had political repercussions: a first IMF review was scrapped as the government collapsed in February 2009, following particularly massive anti-austerity protests on 13 January 2009. A new coalition government between five parties, led by Valdis Dombrovskis, was formed and promised the Fund a supplementary budget, which was to be passed in June 2009, following European and municipal elections.

By that point, the program appeared significantly off-track. According to the IMF report, the government missed the fiscal deficit it promised for December 2008, just a few weeks after the negotiations were concluded, by 1% of GDP as "fiscal measures were only partly implemented…only around one third of the 4.5% of GDP in expenditure cuts [originally promised] appear to have been implemented…indicative wage-bill targets for end-December, end-March, and end-June were also missed…the structural performance criterion on submitting a fully-fledged supplementary budget to parliament by end-March was not met" (IMF 2009f, pp. 10, 14). As a result, staff considered reopening the exchange rate issue: "amid all these uncertainties – the deeper downturn, loss of confidence in the lat, growing fiscal deficit – Latvia's exchange rate peg has faced waves of heavy pressure" (IMF 2009f, p. 16). In this climate, the main bone of contention was the new supplementary budget, originally promised for March 2009 and eventually delivered in June 2009.

The clash over the supplementary budget mirrored to a large extent previous clashes between the IMF and Latvian authorities. The new government proposed further 4% of fiscal measures, which were extremely painful and included closing down 35 out of 59 hospitals and 100 schools in the country, while laying off 23 000 civil servants, 29% of the total. Ultimately, the government passed these measures on 16 June, aiming to keep the deficit under 10% of GDP (Åslund and Dombrovskis 2011, pp. 73–74, 83–84). The IMF, however, was considerably more pessimistic, and considered that a much larger deficit was still likely. Yet, IMF staff's main complaint was less about the size of the budget but that "across-the-board cuts could impair the quality of public services", that some cuts (especially in pensions) were unlikely to be sustained, and that the burden fell disproportionately on the poor (IMF 2009f, pp. 24, 46). Therefore, the IMF found itself in an unfamiliar role: "on balance staff argued for allowing a slightly higher budget deficit in 2009 to protect basic services and to rebalance the burden of adjustment", including a 1% of GDP provided additionally for social safety net measures (IMF 2009f, p. 24).

The Fund's other disagreement was with the EU. The EC was pushing for a quicker fiscal adjustment that results in a deficit of under 3% in accordance with Maastricht criteria (a requirement for euro adoption) by 2012, which staff dubbed 'rapid adjustment'. Under the IMF program, the deficit path would be significantly different: allowing for 13% of GDP deficit in 2009, gradually reduced to 12% of GDP in 2010 (vs. EC's insistence of 8.5%), reaching the 3% threshold only in 2014 (IMF 2009f, p. 26). Uncharacteristically, staff was blunt on these projections, including a detailed comparison between the EC ‘rapid adjustment’ and the Fund’s ‘program adjustment’ in their report (IMF 2009f, pp. 26–30). The staff appraisal of the first review is especially downbeat, highlighting mixed record of implementation, worries about the sustainability and targeting of cuts, concerns over the robustness of the social safety net, and a preference for a “more targeted supplementary budget based on structural reforms”, concluding that the “outlook has become more uncertain, with downside risks” (IMF 2009f, pp. 40–41).



Source: IMF (2009c) and IMF (2009f)

There was certainly no love lost between Latvian authorities and IMF staff either. As the then-Prime minister recounts, Fund staff pushed for a plan B in which Latvia prepares for devaluation, but the government sternly refused. The general impression in Riga was that “the IMF wanted to force Latvia to devalue” by not releasing its second tranche while the country was running out of international reserves; indeed, the prime minister felt that “at the IMF headquarters in Washington…the Latvian SBA was perceived as unsustainable and thus a mistake. Therefore, it was considered better to let Latvia fail early on before the IMF pumped it up with debt" (Åslund and Dombrovskis 2011, pp. 85–86). In this context, he assessed that the EU's decision to complete the first review on its own and disburse before the IMF in July 2009 was crucial and without the involvement of the EC, the IMF would have insisted on devaluation and Latvia might not have been in a position to resist such pressure.

Tellingly, Latvia had to back down whenever the EC and the IMF were in agreement, even if it went against its wishes. In October 2009, the EC and the IMF asked for more consolidation worth 4.2% of GDP. This was more than the government thought necessary, but, according to the Latvian PM, "given the asymmetric bargaining power, the government eventually had to do more or less what its creditors demanded" (Åslund and Dombrovskis 2011, p. 88). As a sympathetic external observer puts it, after Dombrovskis refused further measures, "everybody came down like a ton of bricks on him and he had to give in" (Aslund 2009). This underlines that borrower governments pick from a 'fixed menu' of existing institutions and whenever alternative RFAs are not ready to back them against the IMF they have little choice but to back down themselves.

In sum, conflicts over conditionality, seen as the flipside of the goal of maintaining the peg, were highly visible in the case of Latvia. Most clearly, Fund staff clashed with the Latvian authorities and EU institutions over the supplementary budget in mid-2009, when the program appeared considerably off-track and the IMF advocated a more gradual adjustment path. The final decision – to pursue 'rapid adjustment' – was taken by Latvian authorities with the backing of the EU institutions against the preferences of Fund staff. The former PM at the time assessed that without the presence of the alternative RFA, Latvia would not have been able to resist IMF pressure – a reasonable counterfactual given Fund's experience in previous programs with small borrowers outside regime complexes. At the same time, conflicts suggest that shared ideational background was not enough to make Latvian policymakers receptive to IMF advice, while there is little evidence of any involvement by creditor governments apart from Sweden over the design of adjustment policies.

Financing and burden-sharing

The Fund's acquiescence on the exchange rate question was reflected in the way the Latvia program was financed. The initial program involved funding of 1.7 bn euros from the IMF, which corresponded to about 1200% of Latvia's quota. This was largely in line with other non-euro EU members, narrowly surpassing Hungary (1015%) and Romania (1111%), but nevertheless this ranks Latvia as one of the biggest IMF programs relative to country size in its history. Therefore, "Latvia's proposed access would be high and front-loaded…peak exposure to Latvia would exceed all exceptional access cases in recent years aside from Turkey" (IMF 2008b, p. 5). Nevertheless, the small country size meant that this large program would only have a "modest impact on the Fund's liquidity position", coming up to just "the sixth largest exposure in the Fund's lending portfolio" at 3% at end-2008 (compared to 23.8% exposure in Hungary) (IMF 2008b, p. 8). Moreover, the Latvian program reduced the Fund's Forward Commitment Capacity by barely 1.5%. The IMF loan was heavily frontloaded, with 422% of quota, or 0.6 bn euros (2.8% of GDP), available upon approval, and another 0.4 bn euros to be disbursed by May 2009.

One area of controversy was, as usual, debt projections. The large scale of the program at 1200% triggered the exceptional access criteria of the IMF. While public debt remained limited at 10.2% of GDP, serious concerns were raised over external private debt, with gross foreign debt in 2008 standing at 130% of GDP[35]. Fund staff was especially worried about the short-term nature of much of these liabilities, with around 40% of total external debt (or 57% of GDP) representing lending by unaffiliated foreign banks to Latvian banks and non-resident deposits. Meanwhile, over 90% of corporate loans were denominated in foreign currency, mostly euros. Nevertheless, IMF staff judged the debt position to be sustainable (IMF 2009c, pp. 31–33).

The combination of maintaining the exchange rate and the level of external debt raised plenty of eyebrows at the Executive Board. The US representative declared that “this Stand-By Arrangement is perhaps the riskiest use of exceptional access that the Fund has considered in many years” (IMF 2009d, p. 8). Other non-European directors looking at such numbers argued they present “quite a depressing picture underlining significant financial risks to the Fund”, but such “risks are mitigated by the relatively smaller loan amount” (IMF 2009d, pp. 29–31). Thus, the Swiss director for example warned about “financial risk but also reputation risk”, as “it is a matter of judgment whether the exceptional access criteria are all fulfilled” and “it is also debatable whether the criterion on the chances of success can be safely deemed as met” (IMF 2009d, pp. 38–41). The Russian representative found that it is “not clear…how the requirement of the exceptional access framework on the sustainable debt position is taken into account”; however, he also highlighted that “after a similarly high access was provided to Iceland

[35] This was partly offset by foreign assets worth some 60% of GDP. However, there were significant maturity mismatches, with many external assets representing long-term investments with uncertain valuations in a financial crisis, while they were being mostly financed by non-resident deposits (IMF 2009c, p. 33).

(1190%) and Hungary (1015%)…we expect that other countries in similarly desperate situations can count on equal treatment by the Fund" (IMF 2009d, p. 45). Finally, Japan, the other non-EU G5 member on the board with the United States, was equally critical of the program, expressing worries that Fund resources might be "consumed" and "provide temporary support to overseas creditors". In addition, "since the arrangement of supporting an overvalued peg deviates from standard economic theory, there are "reputation risks", as well as financial risks, in that the Fund might be criticized as having approved an arrangement that is apparently unsustainable" (IMF 2009d, p. 48). Similarly to the United States, the Japanese also expressed worries about the Fund bearing too much of the upfront risks and asked for confirmation that EC would respect the IMF preferred creditor status (IMF 2009d, p. 50). The discussion at the Board suggests that both up-front risks and preferred creditor status were discussed with the EU, but that the Fund was unable to obtain clear cut commitments on this from the Europeans, an issue that irked in particular the US director as representative of the Fund's biggest creditor.

However, even such uncomfortably large amounts of IMF money, relative to the size of the country, were grossly insufficient for Latvia. The Fund estimated a net financing gap of 7.5 bn euros until 2011 that needed to be filled if the exchange rate was to be maintained (IMF 2009c, p. 19). The IMF commitment of 1.7 bn euros was just 22% of the total financing needs, reflecting the sheer scale of funding required to keep the peg, even with draconian spending cuts. The EU doubled its balance of payment facility in early December to 25 bn euros to allow for substantial funding for Latvia, eventually agreeing a program worth 3.1 bn euros. Notably, as in Hungary, the negotiations with the EC took longer, with the first loan only disbursed on

25 February 2009, while the first IMF loan was disbursed as early as 23 December 2008 (Kincaid 2016, p. 54).

There were three marked departures from the Hungarian case. First, the relative share of financing presented, in the words of the EC, a “reverse Hungary”, following pressure from the Europeans to maintain the peg: the IMF contributed 22% of the overall program, while the EC contributed 41%, or almost twice as much (Blustein 2016, p. 68). This was the first time in its history that the Fund has assumed a junior financing role, leading to significant worries within the IMF whether the institution was not delegating responsibility for its resources to another organization, something which went against its own rules. Second, the EC was offering a strongly frontloaded program, with 2.2 bn euros out of a total of 3.1 bn euros to be disbursed by mid-2009; in turn, this reduced the reliance on Fund resources even in that crucial early stage. Finally, the Latvia program was unusually topped up with large scale bilateral lending and lending from other institutions worth some 2.2 bn euros, or almost 30% of the program. This was mainly Swedish funds, but it also included some other Nordic, Baltic, and Central and Eastern European countries reflecting spillover concerns (Forsberg 2009). Meanwhile, the Swedish and Danish central banks provided a bridge swap line of 0.5 bn euros that ‘tied Latvia over’ until it the IMF money arrived. Finally, the World Bank provided 0.4 bn euros to support the social safety net, with the EBRD providing some 0.1 bn euros for bank recapitalization (Åslund and Dombrovskis 2011, pp. 45–47).

What explains this ‘reverse Hungary’ result in terms of financing? On the one hand, the small absolute size of the program was crucial for the IMF, which considered that the program “entails significant financial risks to the Fund" due to the focus on maintaining the exchange rate, but "the relatively small size of the loan (in SDR terms) in relation to the Fund's finances helps contain the risks to the Fund" (IMF 2008b, p. 10). On the other hand, the IMF was not ready to provide more money given its doubts over the chosen strategy, and had significant misgivings about assuming early risk and the potential challenge to its preferred creditor status. As the former Latvian prime minister sums it up, "after Hungary had got 12 times its quota, Latvia could hardly be given less. Yet, non-European IMF members were not prepared to accept more" (Åslund and Dombrovskis 2011, p. 45). According to some, "an important precedent was thus set: the Fund might take a subordinate position in a program in Europe, and European policy makers could prevail over the best technocratic judgment of the Fund's management and staff if Europe was putting up the majority of the funding" (Blustein 2016, p. 69).

This precedent came back to haunt the IMF as early as mid-2009. By February 2009, the program was off-track, the collapse was much deeper than projected, and the government had resigned. Following negotiations, the next IMF disbursement, which was linked to submission of a supplementary budget, was put off until after the municipal and EU elections in June 2009. The supplementary budget was eventually passed on 16 June, but the IMF had significant concerns, as outlined above, and was not ready to disburse until they were addressed. The EC and the Nordics, however, were more concerned about the mounting pressure on the exchange peg, "seeing the IMF as too willing to risk a currency crisis to obtain improvements in fiscal policy" (Kincaid 2016, p. 55). Given misgivings among Fund staff and management, it is possible this was indeed a proxy battle over the strategy of maintaining the peg, which, in June 2009, the IMF felt was failing. The Fund position was backed at that point by numerous prominent economists with former IMF experience such as Roubini and Rogoff in the international press (Magnusson 2009; Roubini 2009). However, the Europeans moved quickly as the European Council expressed support for the next EC disbursement on 19 June, the EC proposed disbursement on 24 June, and the Council took the final decision formally on 2 July (European Commission 2009a, 2009b). The Fund then eventually followed suit by completing its review on 27 July and disbursing its tranche on 27 August (IMF 2009h, 2009i).

This disbursement had significant implications for Latvia, the Fund, and future relations within the regime complex. First, the EC disbursement largely put an end to devaluation speculation and was seen as crucial in allowing Latvia to complete the rest of the program. Meanwhile, the IMF was seen as being 'wrong' about the difficulties of internal adjustment under fixed exchange rate, ending up with an "egg on its face" (Blustein 2016, p. 71). Second, as an internal evaluation puts it, "the Fund mission was surprised that the EC would disburse without the IMF" (Kincaid 2016, p. 55). Indeed, the same assessment says that "the EC by deciding to go it alone without the IMF displayed its independence and confidence" leading to a "perception of the IMF as a junior partner" (Kincaid 2016, p. 56). Finally, this marked the moment in which "the EU no longer accepted the IMF's leadership", with senior EC officials such as the Commissioner for Economic and Monetary Affairs, Joaquin Almunia, becoming more and more active in contrast to IMF management (Åslund and Dombrovskis 2011, p. 86).

The decision of the Europeans to disburse before the IMF is illustrative of the dynamics of a regime complex. For the Latvians, the presence of two overlapping financing options was clearly crucial in allowing them to eventually pursue their preferred strategy of maintaining the peg; if the tiny Baltic state was negotiating by itself with the IMF, this would have been very likely been impossible. As the Latvian Prime Minister at that point puts it, “without the EC checking the IMF, the international stabilization program could easily have fallen apart in June 2009. For Latvia, it has been an advantage to have both parties at the table rather than one” (Åslund and Dombrovskis 2011, p. 87). Meanwhile, it is clear that disbursement by the EU was designed explicitly to overrule the IMF and promote their key preference – maintaining the peg, which avoided regional contagion and spillover while protecting the rules for euro accession. The Swedish Prime Minister thus revealingly said that “We think that a clear signal of support from the EU would help them to achieve support from the IMF”, promoting a frustrated reply by observers: “if the IMF isn’t leading, then what is it doing” (Hugh 2009). As for the Fund, this was a painful climb down, but it could do little about it. The EU’s July 2009 tranche was worth 1.2 bn euros, or over 70% of the *total* IMF program financing, limiting the financial need for the Fund to be involved; for comparison, the IMF August 2009 tranche was worth just 0.2 bn euros. The IMF could have broken relations at this stage, but instead yielded to the competitive logic of regime complexes.

In short, the conflicts over the peg were also reflected in the financing arrangements, which represent the ‘skin in the game’ for institutions like the IMF and the EU. The IMF first accepted a junior financing role in December 2008, and then was forced to disburse against its preferences in June 2009 following the unilateral decision by the EC to complete its own review. A plausible counterfactual in the absence of a regime complex is that Latvia would have been forced to change its policies, especially likely in mid-2009, in order to obtain Fund financing. Meanwhile, the Swedish government managed to achieve its goal of maintaining the peg, but had to put in its own bilateral loans that 'topped up' the multilateral EU and IMF lending, thus opening itself to losses if the program was derailed. However, no other creditor government appears to play a significant role and, crucially, local policymakers relied on the threat to circumvent the Fund through an alternative RFA, rather than on 'two level games' based on domestic political cleavages.

Private sector involvement

The final component of the program was focused on the Latvian banking system. While resembling Hungary, in the case of Latvia the boom was even larger. Credit grew more than 50% in 2006 alone, driven by large-scale inflows from international capital markets, which were intermediated by both foreign and domestic banks. Foreign banks controlled about 67% of all foreign bank assets, and of those, Swedish banks accounted for about two-thirds (Claessens and van Horen 2014). They relied almost exclusively on credit lines from their parent institutions, which, once the crisis hit, were under pressure. Domestic institutions were dominated by Parex, the country's second biggest bank with just under 20% of all deposits, which however relied extensively on short-term syndicated loans and non-resident deposits. Therefore, it is hardly surprising that the immediate trigger for the IMF/EU program was a bank-run on Parex in mid-November 2008. Risks in Parex alone were high and "could lead to a 1 bn euro capital outflow", or roughly 4% of GDP, but the whole of the Latvian banking system was under significant pressure due to its reliance on short-term loans in foreign currency (IMF 2009c, pp. 5–9, 32).

The program therefore had two key aims with relation to the financial sector. First, foreign financial institutions played a crucial role as the IMF report puts it: "the program includes clear commitments from foreign banks to maintain their presence" (IMF 2009c, p. 13). These commitments were made public and in several cases banks promised not only liquidity but also capital injections if necessary. This was key to program design as such commitments covered around half of the gross financing needs of the country, reducing the financial gap from 15 bn euros to 7.5 bn euros (Kincaid 2016, p. 54). Indeed, the largest part of external debt – around one third of the total - was owed by Latvian subsidiaries to their parent banks, which was estimated to be worth around 43% of GDP (IMF 2009c, p. 32). Therefore, similarly to Hungary, foreign banks were supposed to be directly involved in crisis resolution in a substantial matter, accounting for roughly the same proportion of the program as official creditors. However, as one of the IMF mission chief explains, these commitments were considered somewhat vague as they were not explicitly linked to the IMF-EU program (Andersen 2009).

Second, in relation to Parex, resolving the problems there was considered an "immediate objective" for the program (IMF 2009c, p. 9). Initially, the government made half-hearted attempts to preserve the existing and well-connected local management in place and to prop up the bank with liquidity. However, this failed to stem the deposit outflow and the IMF pushed for more forceful measures, which were made a structural condition for the loan. These were unanimously welcomed by the Executive Board and eventually led to the government taking over 85% of the bank and bringing in the EBRD to run the restructuring process, booting out local management (EBRD 2009). Domestic banking problems were at the top of the Fund and authorities' concerns given around 43% of all external debt was cross-border loans by unaffiliated foreign banks and non-resident deposits to the country, which together reached 57.8% of GDP. Facing such pressures, the IMF estimated that bank restructuring could lead to fiscal costs of as much as 15-20% of GDP. Thus, the importance of financial sector became central in program design – as the Fund readily recognized, “the program will only succeed if the financial sector stabilizes” (IMF 2009c, pp. 32, 21).

There was once more skepticism among shareholder representatives at the IMF Executive Board meeting regarding staff projections. The US representative for example, considered the commitment of Swedish banks as “integral to the financing of the arrangement” but expressed doubts about both the 80% assumed rollover of bank credit lines and the 40% assumed rollover of domestic banks external liabilities (IMF 2009d, p. 10). Directors from Latin America, China, and Switzerland warned that “assumptions on the debt rollover for bank and corporate debt may not materialize” and asked staff about “contingency plans” (IMF 2009d, pp. 25, 27, 41). Staff were also challenged on their assumption of 15-20% of GDP of fiscal costs from bank restructurings. Unsurprisingly, the ECB representative saw this as “rather high” as the program should sustain the currency peg, which should reduce the costs of banking rescues, while staff explained their projections based on increases in non-performing loans going forward (IMF 2009d, pp. 52, 58). In particular, what seemed to allay some concerns is that a relatively small part of Nordic bank lending went to Latvia, that Swedish banks had received help at home already, and that a longer-term view suggested that Latvia should once again be an attractive place for business after the crisis (IMF 2009d, pp. 56–58). Indeed, a mission chief for Latvia highlighted that Nordic banks, in having put out public statements and in pledging in some cases to provide capital if needed, “have, in many ways, gone further than we have seen in past experiences” (IMF 2009d, p. 72).

Finally, here, as in Hungary, the ECB inaction was keenly felt. As Latvia was part of ERM2, ECB representatives participated in the negotiations and were even present at the IMF Executive Board meeting. However, the ECB role was circumscribed narrowly towards resisting any efforts to relax rules for euro accession, thus ruling out the preferred option of IMF staff. It is hard to understate how frustrated local authorities were with the ECB's non-response. The Latvian prime minister reaction is illustrative: "neither before, during, nor after the crisis did the ECB lift a finger for Latvia…if the ECB had provided swap lines to Baltic states, Poland, and the Czech Republic….the output collapse in the Baltic region would in all probability have been contained" (Åslund and Dombrovskis 2011, p. 47). Instead, the country received a 0.5 bn euro swap line from the Swedish Riksbank and the Danish National Bank, bolstering the Bank of Latvia reserves at a crucial moment on 16 December 2008. The swap served to provide hard currency for the country to address illiquidity in its banking system and acted as a 'bridge loan' to IMF financial assistance, which was approved a week later, on 23 December 2008.

The theoretical implications of such behavior are somewhat mixed, as in Hungary. Clearly in this case program design included a significant bail-in component, chiefly through the rollover of external commitments. It also appears to have worked relatively well, with initial fears over the financial sector and the rollover of very short-term liabilities going away by the time of the first review in mid-2009, even as the economy was continuing to tank (IMF 2009f). The sequencing of events suggests that the IMF was proactive in obtaining the public commitments of banks, which reduced significantly the financing gap projected under the program. However, this remains somewhat inconclusive at this stage, as there was also a clear self-interest among banks, particularly those with subsidiary relations, long-term loans, and ‘brick-and-mortar’ operations to protect the value of their investment. Therefore, it is once again difficult to adjudicate the relative importance of the structure of economic exposure and IMF staff behavior in driving the observed outcome.

However, as with Hungary, discussion over financial sector issues is reflective of the interests and approaches of the IMF and European institutions. For the Fund, financial sector issues were the immediate program priority, and this involved imposing some burden sharing on foreign banks. Thus, the fact that the public commitments were only made by banks after about a month of negotiations with the IMF and several days before the formal adoption of the program for Latvia suggests that the Fund played at least an important coordinating role in overcoming a ‘prisoners’ dilemma’ among foreign banks. This contrasts heavily with the EC, which appeared again to rely mostly on a narrow perception based on the fiscal impact of bank restructuring and competition issues. Unlike other areas of program design, on financial sector issues, where the EC has limited expertise, it relinquished leadership to IMF and much of the final program in this area appears driven by Fund staff, even when it went against the initial wishes of the local government, as is the case with the Parex resolution. The ECB played a blocking role, limiting itself to opposition against any suggestion of rapid euroization made by the IMF in late 2008. It successfully ruled such proposals out, as recognized by Fund staff, but offered little in terms of support. Arguably, this is even more controversial than in Hungary, where it was mostly a disinterested observer, given that its position on the exchange peg was crucial to program design and that the peg was specifically tied to the euro.

Conclusion

The Latvian program stands out among IMF programs for its size and strictness, but closer process-tracing reveals this is not because of, but rather *despite* Fund staff and management preferences. As in Hungary, the IMF sought pro-actively policies to relatively reduce the burden of adjustment on the country. At the time of negotiating the program in December 2008 the IMF argued for combining devaluation and rapid euroization as a path to a smoother fiscal adjustment. In June 2009, staff were even more explicit, arguing against a “rapid adjustment” scenario and were willing to tolerate larger deficits for longer. On both occasions the IMF contradicted the wishes of local authorities, who strongly preferred maintaining the peg. However, the final program opted for maintaining what the Fund considered an overvalued exchange rate and was underpinned by the “rapid adjustment” fiscal scenario and by extensive structural conditionality. In terms of financing, the IMF proposed an exceptionally large package relative to Latvia’s quota, but despite this agreed to a ‘junior role’, with the EU providing the bulk of financial resources. Finally, in terms of cross-border bank involvement, in Latvia, as in Hungary, such banks were co-opted to play an important role in reducing the overall financing gap by maintaining their exposure.

Latvia is an intriguing case to consider as it confounds many of the expectations of existing theories of IMF behavior. In terms of state-centric approaches, its economy is not of systemic exposure and its financial exposure to G5 banks is non-existent, creating limited financial incentives for powerful states to intervene, thus presumably increasing the power of IMF staff. This is underlined by the very skeptical attitude of Executive Directors from G5 countries, including the United States, towards the program. The exception is Sweden, which strongly backed maintaining the peg to avoid losses, but however still had to agree to ‘top-up’ bilateral funding and rollover commitments from its banks. There is a more plausible first cut explanation focused around geopolitical exposure, although it begs the question why the European partners, which are closest and hence most exposed to security concerns, insisted on *more* painful measures and repeatedly refused to relax their rules. Furthermore, despite a largely fragmented political system, domestic political elites were largely ‘reformist’ and united in defending the currency peg. As the process-tracing revealed, local authorities did not opt for ‘two-level games’ drawing on internal political cleavages.

Bureaucratic accounts would also once again suggest that the scope for IMF influence should, if anything, be larger in Latvia than in alternative programs. Domestic elites, particularly the new prime minister that took over in March 2009 and the central bank governor, had some ideological affinity with neoliberal ideas, which should have also enhanced IMF influence. However, despite this element of shared training there were repeated and bitter clashes between IMF staff and local authorities. Another strand of bureaucratic theories focuses on rational incentives, in particular protecting the reputation of the Fund when staff had previously offered policy advice to the country. In Latvia, staff has been relatively successful and candid in identifying various risks during its boom period, even as internal considerations delayed Executive Board discussion. Having been ‘right’ in the run-up to the crisis against more complacent local and EU authorities, staff should have had more, not less, influence. Yet, despite these factors, the IMF was relegated to the status of ‘junior partner’.

What therefore may account for this outcome in a case where many existing theories would suggest the Fund should instead have been successful in pursuing its preferences? The IMF mission chief in 2008 justified sticking with the peg because, “first and foremost, this is the Latvians’ program”, while the ex-post evaluation of the IMF highlights program ownership as the most important lesson (IMF 2013b; Rosenberg 2009, p. 26). While commendable, attention to the priorities of country authorities is unlikely to account for the IMF position given the quasi-unanimous opinion among staff and non-European directors that the peg is unsustainable. Instead, at crucial points in the negotiations the Latvian authorities were able to use the presence of an alternative RFA to restrict the Fund’s room of maneuver. The conflicts were most clearly visible in late 2008 when the program was being negotiated, and in June 2009, the time of the first review, when the program appeared significantly off-track. In both instances the Latvian government turned towards the EU in order to receive financial aid on conditions that corresponded better to its preferences, relegating the IMF to a ‘junior partner’ role.

Such a *confrontation* strategy adopted by Latvian policymakers in the context of a regime complex was both intentional and consequential. Indeed, the Latvian authorities highlight themselves that in these disagreements it is “difficult to judge to what extent the fact that regional partners with their financing were involved” mattered in making the Fund “sufficiently flexible to accommodate the authorities’ strategy” (IMF 2013b, p. 39). Valdis Dombrovskis, Latvian prime minister from March 2009 until January 2014, is even blunter: “The crucial role of the EU must be underlined…without the EC checking the IMF, the international stabilization program could easily have fallen apart in June 2009. For Latvia, it has been an advantage to have both parties at the table rather than one” (Åslund and Dombrovskis 2011, p. 87).

Therefore, it is a plausible counterfactual, as suggested by the process tracing analysis in this case and by existing theories that draw on previous experiences and predict *increased* Fund influence, that in a similar situation of severe financial crisis a small non-systemic economy would not have been previously able to withstand strong IMF demands. However, in the presence of a regime complex, Latvian authorities successfully resisted such pressure by making the threat of drawing on an alternative financing institution and acting on it.

Therefore, it appears that on the exchange rate question the IMF was forced to go against its own better judgment not because of pressure by G5 shareholders, domestic political considerations, ideological conflict, or bureaucratic considerations, but rather because the local authorities could rely on an alternative RFA which shared many of their preferences. In the Latvian case, the 'fixed menu' from which they 'forum-shopped' provided such an institution. If the IMF hoped that its 'junior' status in a regime complex would be a one-off exception due to 'special circumstances', any such illusions would be shattered just months later in Greece.

VI. The IMF in Greece (2010-2012): Faustian bargaining

When Greece formally asked for help from the IMF and the EU in May 2010, few would have expected that eight years and three programs later the country would still be under economic, social, and political strain. At the time, a newly elected Greek administration hoped to come clean about the country's long-standing problems, implement tough reforms, and turn the state back from the verge of default with the support of its European and international partners. Instead, the Greek case laid bare the incompleteness of the EMU, spooked markets about the prospects of states carrying heavy public debts across the euro area, and sparked fears of contagion among European policymakers . The scene for the ensuing events was largely set in 2010 and 2011 with the negotiations surrounding the first Greek financial assistance program.

The Greek case has understandably attracted widespread attention not only among the media, but also among scholars of international political economy. Given its high profile, by now there is an abundance of accounts that chronicle all the major events of the crisis, which allow for triangulation and an in-depth detailed analysis (Bastasin 2012; Forelle and Walker 2011; Irwin 2013; Spiegel 2014; Walker et al. 2010a, 2010b). The unique characteristics of the Greek case have also attracted extensive attention (Palaiologos 2014a; Pelagidis and Mitsopoulos 2014; Panagiotarea 2013; for a comparative perspective, see Jones 2013). Academic analysis has largely focused on the politics of euro area crisis management, with particular criticism reserved in varying proportions for the role of member states and EU institutions (Jones et al. 2016; Copelovitch et al. 2016; Matthijs and Blyth 2015; Howarth and Quaglia 2015; Orphanides 2015; Schimmelfennig 2015; Verdun 2015; Pisani-Ferry 2014; Donnelly 2014; Peter A. Hall 2014, 2012; Hodson 2013; De Grauwe and Ji 2013; Hodson 2011).

One actor that has received until recently relatively limited attention in this context is the IMF. Some scholars have focused on its role in complementing the ‘incomplete’ monetary union (Henning 2017a; Hodson 2015; Schwarzer 2015; on the incompleteness of the EMU, see Jones 2015a). However, instead of attempting an explanation for the behavior of all institutions involved, this chapter focuses more specifically on the IMF in the Greek crisis in order to address several outstanding puzzles. First, why did the Fund agree to provide the largest-ever loan in its history and yet accepted a subordinate position? Second, why was it ready in the process to break many of its own rules, despite significant doubts over the sustainability of the program? Ultimately, what explains the acquiescence of the Fund during most of the first Greek program, for which it has been subsequently heavily criticized? The answers to these questions shaped its overall approach to the country, which was reflected in a program exhibiting increasing levels of fiscal and structural conditionality, exceptionally large financing, and no meaningful bail-in.

This chapter proceeds in three main parts. First, it introduces IMF-EU financial assistance to Greece by briefly setting the scene for the Greek crisis, discussing the debate around debt restructuring in 2010, and presenting some of the key features of the program in the context of Fund history. Second, drawing on state-centric, bureaucratic and regime complexity approaches, it generates theoretical expectations based on the characteristics of the Greek case. Finally, in order to adjudicate between alternative explanations, it traces in detail how the final program was negotiated and the logic behind the included conditionality, financing arrangements, and very soft form of bail-in of cross-border banks

The way to the IMF-EU financial assistance program in Greece

The goal of this section is to introduce the Greek financial assistance program and its main elements, outlining in the process the preferences of creditors, Greek authorities, and IMF staff and management and the extent to which they were reflected in the final program. Therefore, this section first provides a short introduction to the developments leading towards the Greek crisis. It then discusses briefly the positions of key actors within and outside the Fund on the program, with a focus on debt restructuring discussions. Finally, it outlines the features of the program in terms of conditionality, financing, and private sector involvement.

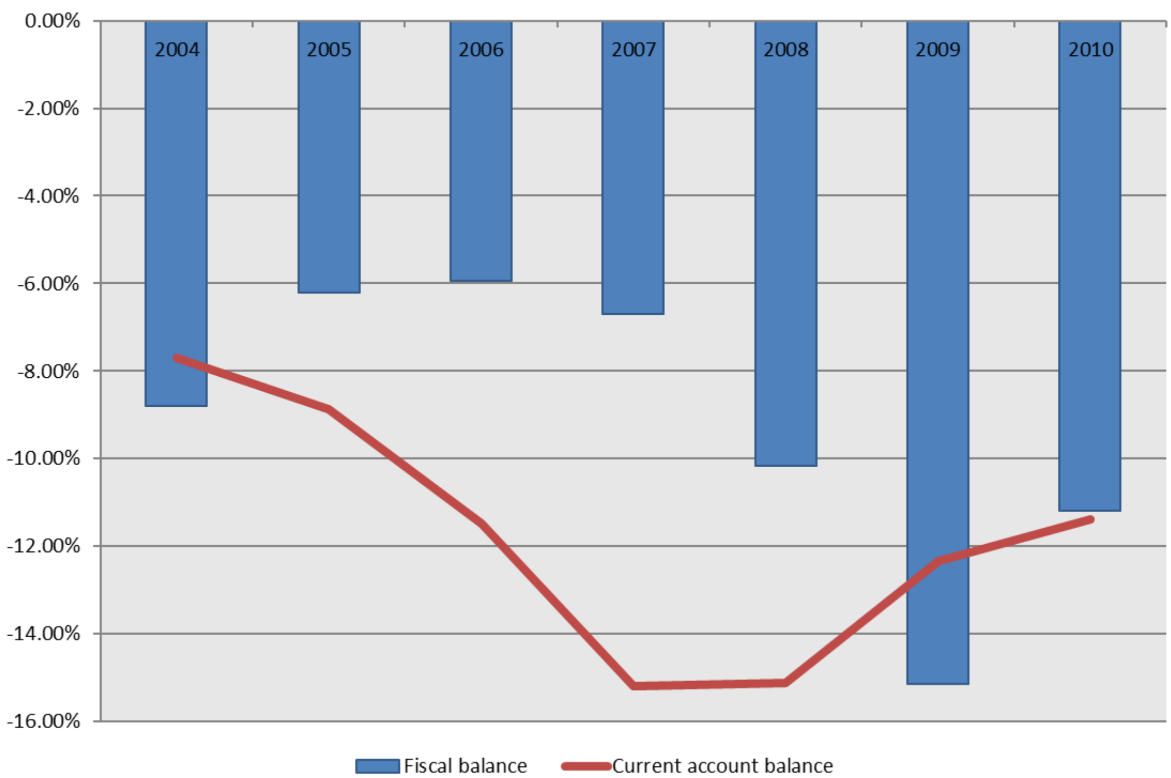
A crisis in the making

When Greece finally joined the euro area in 2001, two years later than the original founding members due to worries over inflation and government debt, it appeared that the pain had been worth it. Long-term government bond yields came tumbling down, essentially converging with those of other euro area countries, and driving down government interest expenditure from 11.5% of GDP in the 1990s to 5% of GDP in mid-2000s (IMF 2013c, p. 5). The result was a certain relaxation of fiscal discipline, with the primary balance shifting to a deficit in 2003, and a highly procyclical fiscal policy, leading to an increase of the fiscal deficit from 4% of GDP in 2001 to 15.6% of GDP[36] (Wyplosz and Sgherri 2016, pp. 4–5). This allowed national policymakers to navigate euro area rules and prosper through patronage while remaining within the formal constraints of the Maastricht criteria (Panagiotarea 2013). However, thinking of the Greek crisis only in fiscal terms would be overlooking other financial developments (Jones 2015b). Greece also exhibited a large and increasing current account deficit, reaching 15% of

[36] Unless otherwise indicated, all figures are the final estimates following multiple revisions from Eurostat.

GDP in 2008, financed particularly by intra-euro area capital flows, mainly intermediated through the banking system (Baldwin and Giavazzi 2015). This in turn made Greece very vulnerable to a sudden stop of capital inflows in a similar way as with other case studies in the thesis. According to local policymakers, these 'twin deficits' were also the key problem for Greece on the eve of the crisis[37].

Figure 21: Greece's twin deficits, 2004-2010 (% of GDP)



Source: IMF WEO

In this context, Greece navigated the period between the outbreak of the global financial crisis until late 2009 in relative calmness. The Lehman Brothers collapse raised the spread of Greek 10-year bonds over German Bunds from 50bps to 300bps, leading to a credit rating downgrade, but this did not initially price Greece out of markets (Wyplosz and Sgherri 2016, p. 6).

[37] Interview no. 20, Athens, June 2016

Meanwhile, the limited exposure of Greek banks to toxic products, coupled with some government support, meant that at first problems appeared limited[38]. However, following the October 2009 elections, the new government announced revised figures for the 2009 deficit, which was raised from 4% to 12.5% (the final estimate would reach 15.6%)[39]. This also implied sharp upwards revisions of Greece's already high public debt to 115% of GDP, providing a jolt to nervous bond markets and credit rating agencies (IMF 2010a, p. 6).

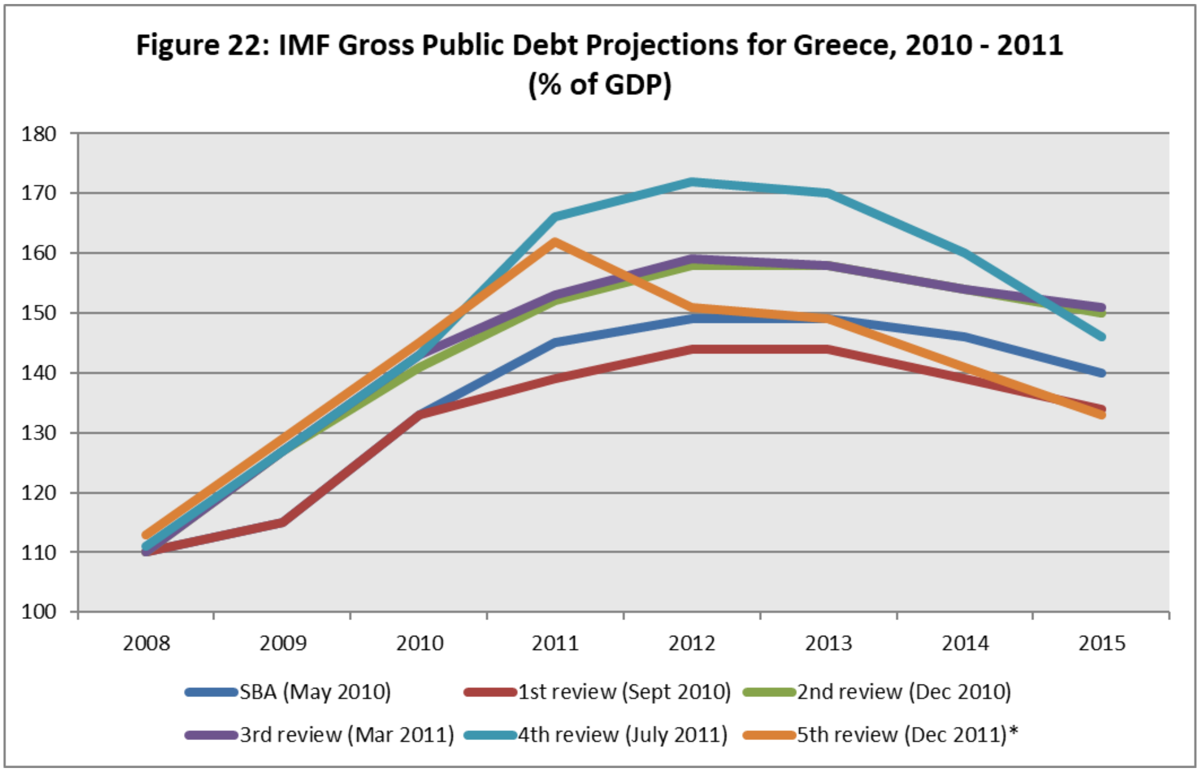
Given this background, the new Greek government had to act. At first, they announced a detailed economic stabilization package, which aimed to regain the confidence of the markets based on an up-front fiscal adjustment of 4% of GDP in 2010. In their plan, the Greek authorities forecasted barely a 0.3% economic contraction for 2010, followed up by growth in the next years, which allowed them to return to the SGP requirement for deficit under 3% of GDP by 2012; in this scenario, public debt peaked at 120.6% in 2011 (Ministry of Finance of Greece 2010). This plan was approved by the European Commission with some caveats (European Commission 2010). However, the discrepancy between the report and the escalating financial turmoil made it glaringly obvious that market actors did not perceive the plan as credible. This apparent flop by the Commission was noted in Berlin (Henning 2017a, p. 79). Meanwhile, however, Greece faced a large impending amortization in May 2010, and with market access deteriorating, lobbied intensively its European partners for financial support (Papaconstantinou 2016). Eventually, the Fund and the EC were invited for negotiations in April 2010.

[38] Interview no. 19, Athens, June 2016

[39] This was not the first time concerns have been expressed about Greek statistical data. In 2004 fiscal deficit numbers for 2003 were similarly revised, with doubts raised about the quality of the statistics. However, European governments decided not to investigate further, while Greece submitted updated estimates for its GDP, which mechanically pushed the deficit for 2006 below the 3% requirement (Wyplosz and Sgherri 2016, p. 6, fn 4).

Debt restructuring debate

The most controversial aspect of program design required balancing concerns over Greece's debt sustainability against worries about regional and global contagion. The original IMF program projected public debt peaking at around 154-6% of GDP in 2013, with a return to markets in 2012 (IMF 2010a). This was clearly based on a number of optimistic assumptions regarding Greek economic developments that many contested both at the time and later (Schadler 2016). If such debt proved unsustainable, then providing money to Greece without a debt restructuring would be counter-productive in several ways. First, it might not actually resolve the underlying problems of the country, which makes a return to private markets – a key tenet of the program – less likely. Second, this then could lead to further complications as the crisis deepens further before a delayed restructuring is actually implemented. Third, by financing the service of external debt during a period before a foreseen 'haircut', official institutions can end up providing a 'bailout' for private creditors by shifting debt to official loans which are harder to restructure and thus commensurably increasing the level of losses on private claims needed to later regain sustainability.



Source: Wyplosz and Sgherri (2016), *5th review included the projected effect of the debt restructuring of 2012

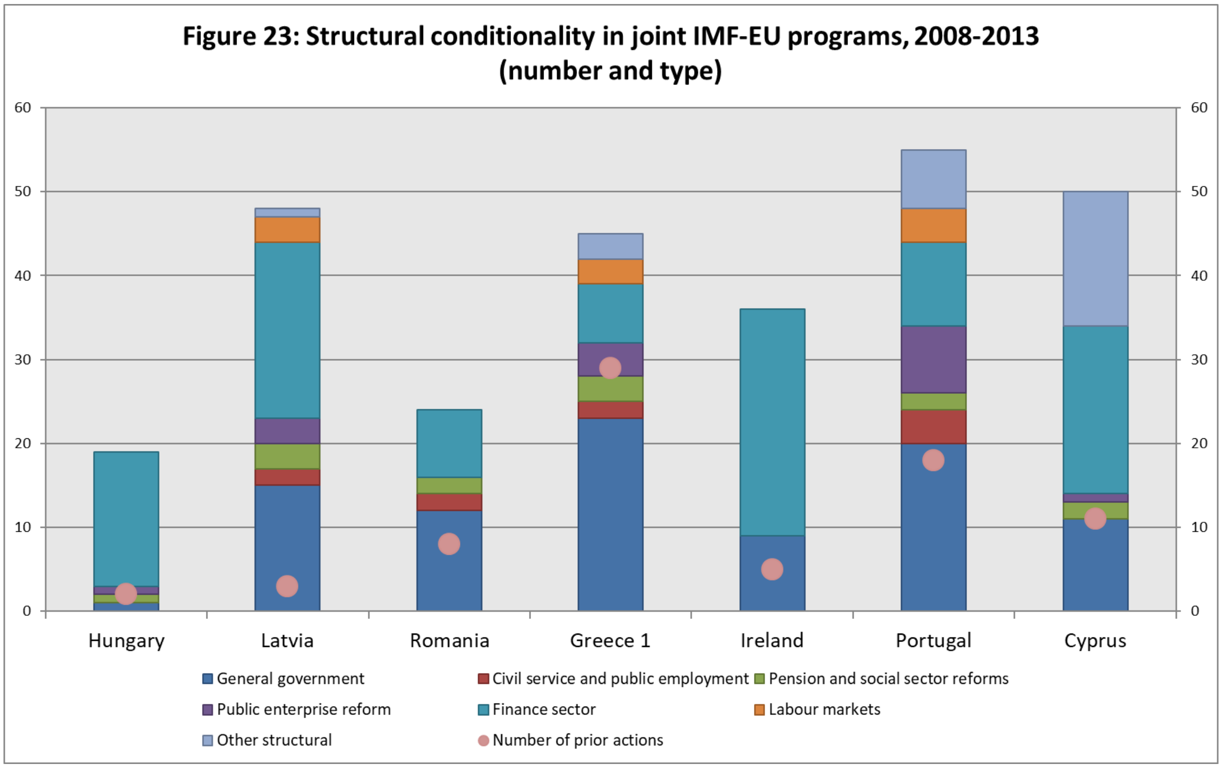
Such risks were well recognized by staff and Executive Directors at the IMF. Officials from the Strategy, Policy, and Review (SPR), Research, and Legal Departments of the Fund made the case for debt restructuring in the run up to the program. In particular, they expressed worries over the possibility that IMF resources might just go towards paying bondholders rather than addressing the problems of the country. This was an argument which some of those staffers also made externally to representatives from France and Germany, albeit with little success (Blustein 2016, pp. 115–120). Within the Executive Board, many non-Europeans shared their uneasiness over the program. As the Argentina director put it drawing on their own experience of delayed restructuring, "the risk here is that of postponing, and maybe, worsening the inevitable" (IMF 2010b, p. 52). The Brazilian director meanwhile warned (presciently) that "the program risks substituting private for official financing. In other and starker words, it may be seen not as a rescue of Greece….but as a bailout of Greece's private debt holders, mainly European financial institutions" (IMF 2010b, p. 49). Later, the IMF itself would come around to agreeing that an "an upfront debt restructuring would have been better for Greece although this was not acceptable to the euro partners", characterizing the program as a "holding operation" (IMF 2013c, p. 28).

However, proponents of avoiding a debt restructuring at the current juncture often pointed towards the spillover risks of such actions. Contagion could spread through sovereign debt markets towards other fiscally weak euro area countries, to banks exposed to Greek debt, and to South East Europe where Greek banks were active. Moreover, beyond these channels, "contagion could become extremely unpredictable, including serious risks to the still fragile world recovery" (IMF 2010a, p. 7). This prompted staff to overwrite the requirement that debt should be sustainable with a 'high probability', which was part of the Fund's exceptional access policy introduced after the Argentina misadventure, introducing an exemption when there is a "high risk of international systemic spillover effects", discussed more at length below (IMF 2010a, p. 20).

These arguments against debt restructuring were a serious consideration for many at the time. As the Greek representative to the Executive Board put it, "the IMF is participating in the effort to avoid contagion at the European as well as at the international level" (IMF 2010b, p. 57). Eventually, a large proportion of the Executive Directors were swayed by the contagion argument. The Japanese director, who represents the second largest shareholder at the Fund, expressed the dilemma succinctly, "Given the growing concern of contagion from Greece to other euro member countries, it seems that now we have no other choice but to support the proposed SBA program" (IMF 2010b, p. 65). Some IMF staff shared similar feelings, as demonstrated by a memo by the European Department from 24 March 2010 that argued that haircuts "should not even be considered at this juncture" due to "the large risk of contagion to other vulnerable advanced countries in the euro area" (quoted in Blustein 2016, pp. 115, 119). Meanwhile, the Deputy Managing Director John Lipsky seemed to also back this position at the Executive Board, declaring himself "a little disturbed by the suggestion that the Fund program should obviously have involved debt restructuring or even default…officials who have access to greater detail should be more thoughtful and precise" (IMF 2010b, p. 102).

The Greek financial assistance program

Eventually, however, the IMF decided to go along with the program in the absence of debt restructuring. This necessarily implied a serious adjustment effort on the part of Greece. Thus, the program included fiscal measures of 11% of GDP, on top of measures worth 5% of GDP already taken by the government, and initially aimed to shrink the budget deficit to 3% of GDP by 2014. Similarly to Latvia, this was a very ambitious if not necessarily completely unprecedented adjustment. Meanwhile, the program also included large number of structural conditions, although that was partly due to an increase over time. It is roughly similar in number of overall conditions to Latvia, Portugal, and Cyprus. However, it is higher than all programs in the number of 'general government' conditions, which are often particularly painful as they represent direct changes to the way the government functions, and in terms of the presence of the most binding type of conditionality in the form of 'prior actions' required before money is actually disbursed.

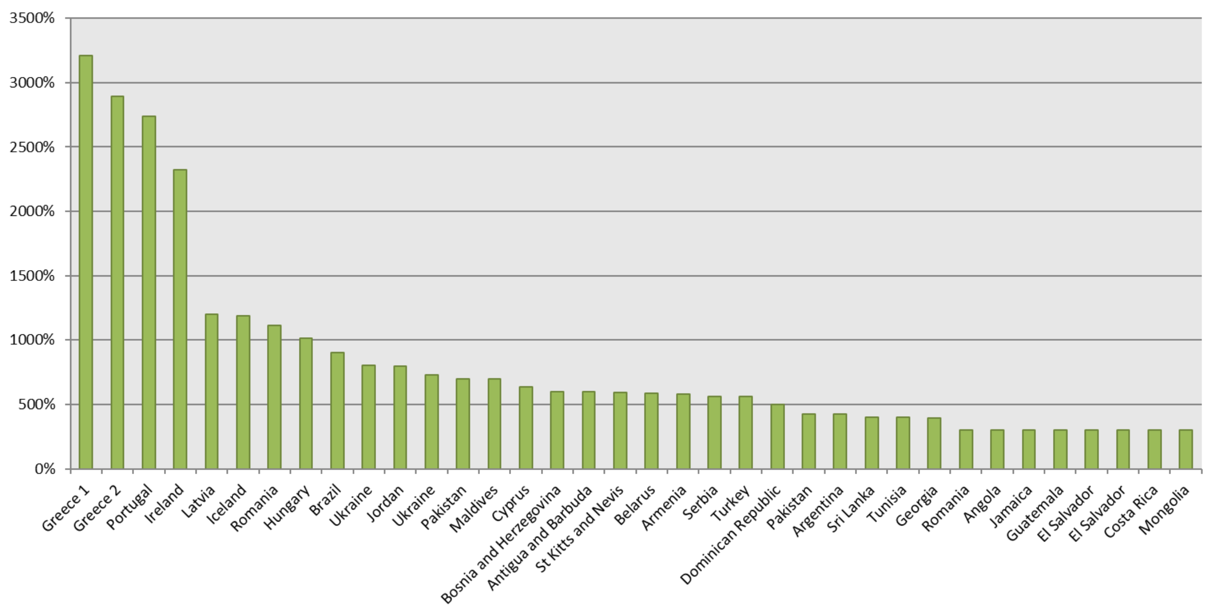


Source: IMF MONA database

The Greek program also stands out clearly for the amount of financing provided by the IMF. Looking across all IMF loans in its history in absolute value, the first Greek program comes very close to the top program in terms of size, which was Brazil in 2002. However, it is by far the biggest program relative to the quota of the crisis country in the Fund's history at 3211%, almost triple the size of Latvia barely 15 months earlier. While by this metric the programs in emerging Europe were slightly bigger than comparable programs over the 2002-2013 period (but smaller than some previous programs, notably Korea), the euro area programs of 2010-2012 clearly stand out as a group as being significantly larger than previous cases. Nevertheless, in terms of burden-sharing the IMF again found its role reduced to a 'junior partner', just like in Latvia, this time contributing 27% of the total financing package, with the EU institutions providing the remainder (compared to 23% in Latvia, 63% in Hungary, and 66% in Romania).

This pattern was representative of the rest of the euro crisis, with the Fund providing 33% of total financing for Portugal, 26% for Ireland, 20% for the second Greek program, and barely 6% of the Cypriot financial package.

Figure 24: Size of IMF programs*, 2002-2013 (% of IMF quota)



Source: IMF MONA database; *only programs larger than 300% of quota included

Finally, the program was notable for the lack of any formal private sector involvement. As outlined above, public debt restructuring was ruled out at the outset. Meanwhile, no bail-in of foreign banks occurred along the lines of the Vienna Initiative. This is partly justified by the different pattern of economic exposure – most foreign banks held Greek sovereign debt rather than operate brick-and-mortar operations within Greece. Nevertheless, it is a striking outcome that no PSI component was introduced in 2010 in relation to banks, which allowed a large number of private creditors to withdraw from the country by the time of the debt restructuring in 2012. Thus, in contrast to Hungary and Latvia, in Greece official liquidity appeared to go towards repaying private bondholders, while making an eventual restructuring more difficult as the size of bonds held by banks and other investors declined.

Alternative explanations

Despite being skeptical about the chances of success in the absence of debt restructuring, IMF staff and management ultimately decided to go along with this strategy, which was reflected in the program design that involved extensive conditionality, exceptional financing albeit still in a 'junior partner' setup with the EU, and no bail-in, even of the soft variety observed in emerging Europe. This section serves to elaborate theoretical expectations based on existing theories and the proposed alternative explanation in the thesis in the case of Greece. Therefore, it first presents established state-centric approaches and bureaucratic approaches, before outlining a regime complexity view.

State-centric approaches

State-centric approaches focus on the role of leading states at the IMF, in particular the role of G5 governments in 'animating' decision-making at the Fund. They can be motivated by geopolitical or financial concerns in directing the IMF to offer assistance at better 'terms' than it might otherwise do. In the case of Greece, geopolitical factors between 2010 and 2012 appear to be of relatively limited importance[40]. This is a period that significantly precedes the more recent surge in migrant numbers into Europe, the increased Chinese presence in the Greek economy, or the confrontation between Europe and Russia during and after the Ukraine conflict. Greek authorities made some attempts to leverage geopolitical arguments by asking China and Russia for loans. However, they were quickly rebutted by both countries, which did not consider strategic interests to be intense enough to warrant taking significant financial risks by lending

[40] In fact, the Syriza government tried but failed to leverage geopolitical concerns at later stages. For example, Greece threatened to turn to Russia for assistance in 2015 and blocked EU resolutions critical of China's human rights record in 2017, both of which occurred during crucial IMF negotiations, but had limited effect (Bechev 2015; Emmott and Koutantou 2017).

bilaterally to Greece (Papaconstantinou 2016; Reuters 2010b, pp. 68, 86). Therefore, geopolitical arguments appear to have limited purchase in this case.

Much more salient are the interests of euro area G5 members, Germany and France, through their financial exposure to potential problems with Greek sovereign debt. In a narrow sense, French, German, and British banks had some exposure to Greece in the middle of 2010. However, given that Greece, accounts for barely 2% of euro area GDP, total claims by French banks were worth just 2% of the country's GDP, while the exposure of German banks was less than 1% of Germany's GDP. Nevertheless, there were broader worries, in particular the risk of contagion – with Greek troubles seen to rebound not only on Portugal and Ireland, but also, most worryingly, on Spain and Italy. Thus, while German and French banks had relatively limited exposure to Greek sovereign debt (23 bn USD and 31 bn USD respectively) and exposure to the combined public debt of Spain, Greece, and Portugal reached 12.1% and 8.3% of their combined Tier 1 capital, their total exposure to residents of Greece, Portugal, Spain, and Ireland was just under 1 trn USD – half of which represented exposure to Spain (Avdjiev et al. 2010, p. 21). In addition, there was also strong US desire to prevent contagion given potential boomerang effects on the still-fragile US economic recovery, leading them to adopt a position of an 'interested broker' (Henning 2017a, pp. 149–154). As the then US Treasury Secretary Geithner put it later, "The second drag on our recovery was Europe, which was in financial and economic disarray…even the possibility of contagion was shaking confidence, tightening credit, and depressing growth in the United States" (Geithner 2014, p. 441).

This strongly suggests a leading role for G5 creditor states in the Greek case motivated by the desire to limit contagion. State-centric approaches present several alternative mechanisms of state-driven influence within the Fund. First, there is formal voting power at the Executive Board based on quotas. On this metric, France and Germany held 4.86% and 5.88% respectively of all votes in 2010; however, the euro area total together comes at 22.92%, which is magnified by the constituency-based representation at the Executive Board to 36.30%[41]. With US voting power standing at 16.77%, it is clear their interests need to be taken into account by any program forwarded to the Executive Board by staff. The Executive Board has limited formal role in the negotiation process and very rarely takes votes, partly because of the risk of negative market reaction, thus increasing the influence of staff (Martin 2006, p. 143). However, formal voting power would imply that during the process staff would identify voting constraints on the Board and seek to build a program around a majority alliance; therefore, the main concern would be whether the program would pass Executive Board scrutiny or not.

[41] As euro area states are broken up in various constituencies, often with non-euro area countries, the total voting power estimated here reflects the total voting power of constituencies that include euro-area states. In some cases, their influence is likely to be limited, as for example in the case of Ireland, which only contributes around 10% of the total quota for its constituency. Influence is probably limited in the case of Spain, which, while providing an Executive Director, is only one of three big contributors to its constituencies' voting power, accounting for just 30% of total constituency quota. The case of Finland, which is the only euro country in the Nordic constituency, is less straightforward – it only contributes around 17% of constituency votes, but all other countries are very closely integrated with the EU. Excluding the Spanish, Irish, and Finish constituency still leaves euro-area dominated constituencies with voting power of 24.77%.

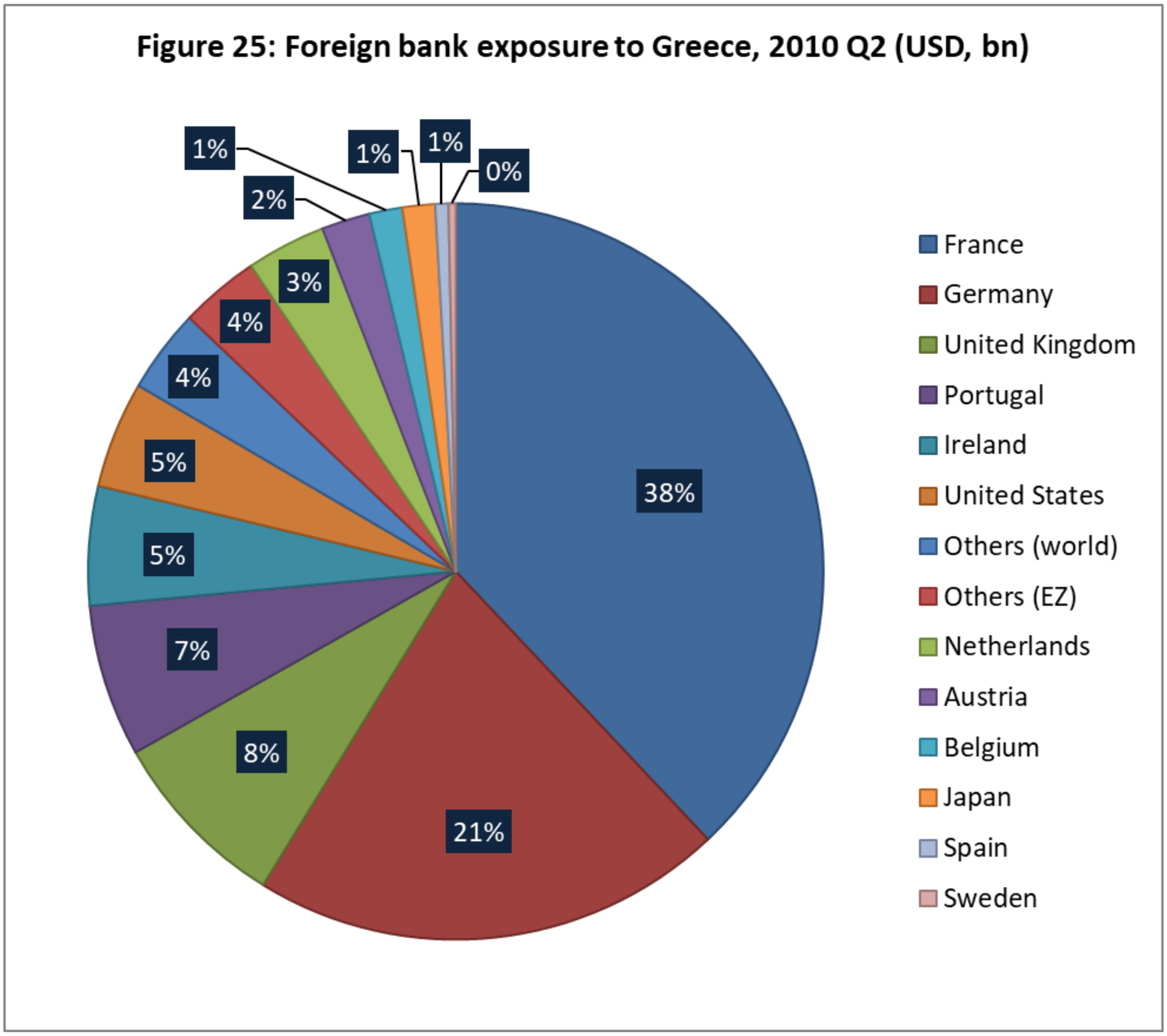


Figure 25: Foreign bank exposure to Greece, 2010 Q2 (USD, bn)

Source: BIS Consolidated Statistics (ultimate risk basis)

Another state-centric approach focuses on explaining the influence of powerful shareholders ‘behind the scenes’. In this case, the ‘insulation’ of staff from Executive Board pressure and the lack of transparency in the negotiation of programs creates conditions for states with strong outside options to take control temporarily. This is based on reciprocal understanding between powerful and less powerful states – in ‘normal’ times, powerful states agree to limits on their role in formal decision-making, in exchange for deference and ability to influence programs under ‘exceptional’ circumstances (Stone 2011, 2013). In this case, one would expect staff to be consistently approached by euro area actors behind the scenes, with strong guidance provided on how to proceed under the circumstances.

Bureaucratic approaches

Bureaucratic approaches focus on the relative autonomy of actors within the IMF. Depending on the approach, staff is driven by a mixture of rational and ideational concerns. The main rational motivation for Fund negotiators is to 'make a success' out of the relevant program, which critically depends on its domestic implementation. In the case of Greece, domestic considerations initially played a limited role. In the face of the newly elected left-wing PASOK government Fund staffers appeared to have a government that wanted to come clean on previous fiscal transgressions and had a fresh mandate. Whereas there were significant doubts about the commitment of the opposition, at that point the other main party in Greek politics was New Democracy, which was considered more conservative and right-wing oriented. Therefore, while most of the Fund was yet to learn in-depth about clientalistic practices and weak implementation capacity of the country, political will at the outset of the program would suggest relatively little need for staff to relax its requirements in order to support an incumbent administration or preferred government actors against internal opposition. In turn, this should increase the ability of the IMF to achieve its goals.

Bureaucratic accounts of IMF behavior also have an ideational dimension, suggesting that Fund staff 'plays favorites' when negotiating with officials that share their normative orientation (Chwieroth 2013; Nelson 2014; Nelson 2017). 'Sympathetic interlocutors' in borrowing countries therefore are likely to reduce staff worries over non-implementation and could even positively bias Fund staff's assessments of their determination for implementing tough conditionality measures. Shared (neoliberal) ‘normative worlds’ are often identified based on previous experience in dealing with the Bretton Woods institutions or shared educational background in top-rated economics departments in the United States and the United Kingdom. Given that Greece had not borrowed from the IMF in recent history, the former can safely be ruled out[42]. Meanwhile, the composition of the newly elected Greek government of 2009 suggested if anything a relative neoliberal bias[43]. The Prime Minister George Papandreou was educated in Amherst College and the London School of Economics, albeit in sociology, while his father was a professor of economics at the University of Minnesota. His first finance minister, George Papaconstantinou, received his economics degrees from New York University and the London School of Economcis and spent over ten years working for the OECD; the minister of economy and later minister of labor and social security, Louka Katseli, received her PhD in economics from Princeton and was a former director at the OECD. The central bank governor, George Provopoulos, was educated at Essex University and served as CEO of two of Greece’s biggest banks before his appointment to the Bank of Greece. This should in turn have biased IMF lending decisions towards less stringent conditionality and larger financing.

Regime complexity

In the period between the controversial first review of the Latvia program in July 2009 and the beginning of discussions about IMF involvement in Greece in March 2010, the ‘institutional environment’ for the Fund has evolved. This included changes both within the IMF and among EU financial facilities. Since the Latvian program, the IMF had approved loans to another 16

[42] Greece previously last borrowed by the IMF in 1974-1976 (IMF 2010a, p. 125).
[43] Papandreou’s successor as technocratic prime minister was Lucas Papademos, a MIT-educated economist that was a vice president of ECB between 2002 and 2008. His government, from November 2011 to June 2012, can also be described as ‘neoliberal’.

emerging market countries, worth altogether around 36 bn USD; of those, nearly half were loans to Romania, another EU member state, worth 17 bn USD. Another important change for the IMF was the augmentation of its resources at the London G20 summit in 2009 as described in the previous chapter (G20 2009). Notably, this was achieved by emergency bilateral loans, which were considerably less reliable than quota increases that were however painstakingly difficult to negotiate. Thus, while total IMF *quota* resources have not meaningfully changed compared to March 2009 (increasing by about 20 bn USD to 335 bn USD in March 2010), total IMF resources had jumped from 335 bn USD to just under 600 bn USD.

The most significant changes in the regime complex however were made on the European side. Notably, in the case of the euro area, Article 125 of the TFEU, known as the 'no bailout clause' was a significant consideration that prohibited the EU and member states to "assume commitments of central governments, regional, local or other public authorities" of another member state (TFEU 2012 Art. 125). This meant that the EU balance-of-payment facility that financed the EU contribution to programs in Hungary, Latvia, and Romania was explicitly made unavailable to euro area states. However, as part of the euro area, these member states had access to ECB refinancing facilities during the crisis. Ultimately, EU states crossed the Rubicon by adopting, at Germany's behest, the doctrine of 'ultima ratio' that when the financial stability of the euro area as a whole was imperiled, then governments can provide temporal assistance. Thus, in May 2010 they established the Greek Loan Facility (GLF), which funded the first Greek program. In June 2010, euro area states established the European Financial Stability Facility (EFSF) as a temporal facility with guarantees of up to 440 bn euros and effective lending capacity of 255 bn euros. In October 2011, after programs were adopted for Ireland and

Portugal, the EFSF guarantee structure was increased to 780 bn euros by members, which gave it an effective lending capacity of 440 bn euros (Gocaj and Meunier 2013; Henning 2017a, pp. 167–179).

Within this context, the IMF had to navigate two key constraints. First, the G5 creditors have intense preferences at stake given direct exposure to the country and worries that contagion could spread from Greece to the whole of Southern Europe, and especially Italy and Spain. This provided significant motivation for them to exert pressure on the Fund to adopt a strategy that minimizes the costs for their financial and fiscal systems. Second, there were marked differences between euro area creditors and at least some of IMF staff preferences in terms of crisis management strategy. In particular, many of the G5, especially France and Germany, but also to an extent the United States and the United Kingdom given significant linkages with the euro area, had a strong desire to avoid debt restructuring in early 2010. At the same time, there were a number of important actors within the Fund, notably the SPR department, who pushed for exactly this policy as the 'least bad' option among a set of impalpable alternatives. In this context, with intense G5 preferences and disagreements between key creditors and IMF staff, a regime complexity perspective suggests that such creditors will make moves *outside* of the Fund in order to align its behavior with their preferences.

Bargaining within the regime complex

Having established theoretical priors about the main causal mechanisms and effects, this section traces the bargaining surrounding key decisions at the outset of the first Greek financial assistance program. The goal is to 'process-trace' the chain of events and the plausible alternative options during the negotiation of the program, as well as the internal discussions and debates. Therefore, it discusses the position of the IMF within the regime complex, places debates over IMF involvement in the context of debt restructuring discussions and draws some implications for the different theoretical perspectives that arise from these events.

IMF position within the regime complex

How did the Greek program fit into the IMF-EU regime complex? As discussed above, this was the largest loan in Fund's history in terms of quota, peaking at around 3200%[44] (IMF 2010a, p. 128). In absolute numbers, it was also the highest ever program the IMF had initially approved at 39.5 bn USD[45]. Naturally, the sheer magnitude of the program reshuffled considerably Fund resources. The Greek loan accounted for 46% of the pre-program total IMF portfolio of loans, and a full 28% of the Fund's forward commitment capacity. In addition, Greece was the first case ever of an euro area country asking for IMF assistance, and the first time since the 1976 program with the United Kingdom in which an advanced economy had asked for Fund help.

This mattered to the IMF both for immediate and longer-term reasons. In the short term, a number of other euro area economies appeared to be on the verge of financial meltdown and were likely to soon require Fund support, most notably Portugal and Ireland, but also potentially Spain. All of these programs were potentially similar in size to that of Greece, with a Spanish loan likely to be considerably bigger. In a broader strategic context, involvement in the euro area would confirm not only that the Fund was back following its pre-2008 period in the

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[44] Previous large loans peaked at 1938% in the case of Korea in 1997 and 1560% in the case of Turkey in 2001.

[45] The largest ever loan in absolute terms was extended to Brazil where the total size of the loan reached 41 bn USD (increased in 2003 from an original 30.4 bn USD in 2002). Total commitments to Korea reached 21 bn USD in 1997 (albeit from a larger package that totaled over 58 bn USD). In Argentina, IMF exposure peaked at 22 bn USD in 2001, Russia had a 22.6 bn USD program with the IMF in 1998, and Mexico received 17.8 bn USD in 1995.

wilderness, but also that it was an institution that has a role to play at the very core of the global financial system. This would transform perceptions of the IMF as an institution that lends just to emerging and developing countries. Therefore, the IMF had very strong incentives to join the Greek program, both because of its sheer size but also because of its precedent value.

The high opportunity cost of exclusion for the IMF from the program described above was complemented by a significant threat of such exclusion due to the regime complex in the euro area. First, this was a result of the significantly enhanced financial assistance capabilities of euro area states. The creation of the GLF and the EFSF transformed the landscape, creating a palpable alternative to IMF funding. Thus, the 145 bn USD Greece program could have been accommodated relatively easily within the nearly 640 bn USD EFSF framework. On the other hand, the IMF would have struggled to finance the Greek funding gap by itself if it was to choose the same final program design. Fund's total quota resources stood at 335.5 bn USD at the outset of the Greek crisis, and its forward commitment capacity was 247.3 bn USD. Accommodating the Greek program would have significantly depleted IMF resources, raising doubts across the world about its capacity to support other countries in difficulties; in that sense, the Fund was always going to need either additional European financing or other measures to reduce the financing gap (discussed below).

Second, prior to the Greek program European policymakers exhibited considerable doubt about the value of bringing the IMF in. Significant opposition was voiced from the French president Sarkozy and German finance minister Schauble, as well as from the European Commission and the ECB. This suggests that expertise was not a primary concern, and in any case the EC argued it had developed sufficient capacity to take over the program administration. The outgoing Commissioner for Monetary and Economic Affairs Joaquin Almunia argued in early 2010 that “the European Union and the Economic and Monetary Union have enough instruments to deal with the challenge and solve this problem" (Traynor 2010). In short, therefore, exclusion from the Greek crisis would have been problematic for the Fund, but appeared possible given that an alternative RFA eventually emerged.

In or out? Opposition to IMF involvement in the euro area

The debt restructuring discussion took place against a backdrop of uncertainty over the IMF involvement in the crisis in contrast to emerging Europe. As the focal institution for crisis lending, it has been part of numerous financial assistance programs over the decades. However, its involvement in the case of the euro area crisis was uncertain until mid-April 2010. For the IMF, the question of potential involvement with euro area countries had attracted relatively limited attention prior to 2010, apart from some discussions in the run-up to the introduction of the euro in the late 1990s (Broome 2013; Kincaid 2016, pp. 2–4). However, as the situation in Greece deteriorated after October 2009, Dominique Strauss-Kahn sought to maneuver the Fund into playing a role in the likely future financial program. Publicly, Strauss-Kahn did not pressure EU leaders, diplomatically saying that “[Greece] is a eurozone country and it is totally normal that the eurozone and the European Central Bank try to work out its problems alone” in January 2010, while nonetheless adding that the Fund stands ready to help if a request is made (Reuters 2010a).

Most European policymakers strongly preferred a solution without the IMF. In January and February 2010 a number of key figures explicitly ruled out in various terms the need for the

Fund. Understandably, the most vocal opposition came from institutions whose authority would have been challenged by the introduction of the IMF into the regime complex. The EC was worried about the Fund usurping its mandate and disrespecting European fiscal rules, and the Commissioner for Monetary and Economic Affairs forcefully claimed that "we don't have to call in the IMF…we have more than enough instruments in the [EU] treaty" (Cohen 2010). In addition, the ECB and Jean-Claude Trichet in particular took a strong stance against involving the IMF for a number of reasons, most due to concerns over the Fund setting monetary policy conditions that might impinge on ECB's mandate and independence (Bastasin 2012, p. 175).

Resistance to IMF involvement was not just restricted to inter-institutional turf wars but also came from political leaders. Another strong opponent was German Finance Minister Wolfgang Schauble, who considered that "accepting financial aid through the International Monetary Fund would…be an admission that the euro countries can't solve their problems through their own efforts" (Fildes 2010). Instead, he advocated the establishment of an European Monetary Fund, something that built on ongoing discussions and proposals by think tanks and experts (Gros and Mayer 2010). Finally, Sarkozy was staunchly against the IMF too, arguing that involving the Fund would give too much sway to American decision-makers over European policies, although he might also have been motivated by a desire to keep Strauss-Kahn, a potential presidential candidate in the next elections, at bay from the European political scene (Henning 2017a, p. 83; Papaconstantinou 2016, p. 93).

Eventually, however, Angela Merkel decided to make IMF participation a condition of German support for providing financial assistance to Greece. This was discussed in the 25 March

Eurogroup summit, and the willingness to provide "substantial IMF funding and a majority of European financing" on an *ultima ratio* basis was announced (Eurogroup 2010). This accomplished several goals for Merkel – it provided domestic cover both against political opponents and against the Federal Constitutional Court, limited backlash in Greece against EU institutions, and included an institution that Germans believed to be much 'tougher' on Greece than the 'unreliable' Commission (Henning 2017a, pp. 94–96). This suggests that IMF involvement was therefore conditional on not departing too far from German interests.

As for the Greek government, they were understandably not too interested in involving the IMF initially given the potential domestic backlash. However, as they grew more and more concerned that European dithering might lead to a default in May 2010, they sought to play the 'IMF card'. Facing demands for more cuts after already agreeing to a painful stabilization program, Papandreou made it publicly known that he is ready to turn to the Fund if Europeans did not provide financial support (Hope et al. 2010). Notably, what likely gave Papandreou comfort was both his personal acquaintance with Strauss-Kahn and his belief that the Washington-based institution was becoming less dogmatic and more attuned to social concerns – a direct consequence of the IMF program strategy in emerging Europe (Papaconstantinou 2016, p. 70). Ultimately, this appeared like a successful move to the Greek finance minister, who later argued that "because the prime minister and I had openly discussed the IMF as last resort, our partners had finally been forced to accept that the stability of the Eurozone involved creating an European support mechanism" (Papaconstantinou 2016, p. 84). Whereas this threat probably had limited credibility, it nevertheless highlighted that the Greeks were also making attempts to instrumentalize Fund involvement for their own goals.

This context made the Managing Director worried about IMF's position in the regime complex. As he recalls, even as late as the final meeting to agree Greek assistance on 9 May 2010 IMF participation was uncertain, with Strauss-Kahn recalling that "it was a real fight" and that he had to spend a lot of time on the phone that evening (Blustein 2016, p. 129). Ultimately, he achieved his goal as the decision to announce the EFSF on the following day included a sentence that declared that "the IMF will participate in financing arrangements and is expected to provide at least half as much as the EU" (Council of the European Union 2010). However, in exchange that meant that the IMF had to keep close to the German position on key issues such as debt restructuring. According to Strauss-Kahn, pushing for such measures to be included would have achieved little: "We were just recovering, trying to re-establish our role in the global system…I couldn't accept the idea, which would have been lethal to the IMF, that the Europeans would handle the crisis by themselves. I could play this game a little. But I couldn't go too far." (Blustein 2016, p. 146).

Implications for Fund decision-making and behavior

In the end, Merkel opted for the IMF inclusion both for domestic political reasons but also as a tool to control and oversee an European Commission which she did not trust[46]. The goal here is not to explain why Germany was able to achieve its preference or what were the sources of such preferences (see Henning 2017a). However, the IMF, and especially its Managing Director, recognized that given this constellation, going against key German policy preferences

[46] In addition to mistrust arising from the Commission's approval of the January Greek stabilization program, Merkel may have also harbored more general doubts over the role of the EU executive in the Greek euro entry in the first place. As she said during a joint press conference, "I would like to thank the IMF again. I think it is good and important that the IMF is involved in these negotiations. In the year 2000, the issue was whether Greece could or could not join the euro zone. It turns out that the decision made then was not examined thoroughly enough. I think it is right for the European Commission, the European Central Bank and the IMF with their combined experience to be leading these program negotiations together" (IMF 2010c; Smaghi 2013, p. 34).

would lead to exclusion from a program which was both large in size and which set an important precedent for the role of the Fund in the global financial system. Behind the scenes, he explored debt restructuring options both before and immediately after the program was approved (Blustein 2016, pp. 120, 144). However, given German concerns over moral hazard in the case of a 'profligate' country, and consequent potential domestic political repercussions, debt restructuring was off the table. Therefore, it was moves 'away from the negotiating table' made within the context of a regime complex which likely pushed the IMF to accommodate German preferences, and not necessarily German formal or informal influence within the Fund.

This series of events is consistent with a regime complexity perspective on Fund behavior. Having taken the decision to provide mutual assistance to Greece, euro area states could have channeled financial help exclusively through European mechanisms. This was a significant and credible threat, particularly as opposition to IMF involvement went beyond other institutions and was widespread among key member state decision-makers. Significantly, explicit proposals for an *European* Monetary Fund were making the rounds at that point, strongly backed by European political leaders. Throughout, the IMF was kept at an arm's length distance from Greece and was only allowed to start discussions with the country in late April 2010, leaving extremely short amount of time to actually negotiate the program before an impending repayment deadline in early May 2010. Greek leaders were also aware of regime complexity dynamics, explicitly seeking to leverage a (limited) threat to go to the IMF to prod Europeans towards providing assistance, thus consciously playing institutions against each other.

Meanwhile, the bargaining process described above does not easily fit with the causal process hypothesized in alternative explanations, even if the eventual outcomes might be similar. In terms of state driven approaches, one would expect either formal or informal means of influence to have pushed the IMF to avoid debt restructuring. Certainly voting power at the Executive Board was a consideration, especially since the US was also against debt restructuring at that juncture (Geithner 2014, p. 442). However, it did not seem to have played a key role in decision making around the crisis as evidenced by the lack of references to building coalitions or worrying whether the program would pass the Executive Board. In fact, without having an invitation to join the financial rescue, the IMF would not be able to put forward a program to the Board in the first place. This is in line with the general evaluation of the Board during the euro area crisis, in which it is described playing "an anemic role…since it lacked the timely and substantive information it needed" (de Las Casas 2016).

Informal mechanisms, on the other hand, are harder to observe. However, it is notable that the staff discussion around debt restructuring was relatively free-flowing, even if in the end the Managing Director knew which way he needed to steer it. There is little evidence of state officials directly participating or attempting to sway staff one way or another (Blustein 2016, pp. 122–128). Another important consideration is that the IMF was excluded from talks until relatively late, and once negotiations did start, Europeans could obtain all necessary information through their direct representatives through the EC in the Troika. Both of these reduced their need to rely on potentially costly informal mechanisms. Therefore, in short, instead of exercising formal and informal governance *within* the Fund, states chose to exercise a strategy that relied on elements of the regime complex *outside* the Fund to achieve their preferences.

Meanwhile, given both the strong incentives to join the program and the credibility of the threat, the management of the IMF was strongly swayed to accommodate policy preferences over program design that it was at best ambivalent about.

Program design

How did regime complexity dynamics filter into actual policy design? The next section traces how the pressure on the IMF translated into program outputs. It therefore serves to provide for the 'transmission wheel' between strategic considerations and actual IMF practices. The final program exhibited large-scale fiscal and structural conditionality, extremely large financing, and no meaningful private-sector bail-in scheme. Negotiations of each of these components is taken up in turn below.

Fiscal and structural conditionality

The cornerstone of the program was regaining control of public spending and closing the fiscal deficit, which, at the time of the program announcement stood at 13.6% of GDP for 2009[47]. Overall, to regain market access by mid-2012 and to put debt on a declining path from 2013 onwards, Greece needed to shrink this deficit quickly and to begin generating primary surpluses. This was to be achieved by introducing measures worth 11% of GDP (on top of 5% of measures already agreed with the EC at the beginning of 2010) of which 5.2% were expenditure cuts such as elimination of additional payments and reductions in allowances and pensions. From the rest, 4% were revenue measures, including a raise in the VAT rate, excises

[47] This was revised upwards from a January 2010 estimate of 12.5%, and would be revised one again in December 2010 to 15.5% of GDP (IMF 2013c, p. 20).

and a number of other tax measures, while 1.8% accounted for structural measures (IMF 2010a, p. 11).

This fiscal path, while incredibly ambitious, also highlights the impact of involving the Fund in the program. The original '4-3-3' plan by the EC has been to reduce the deficit to below 3% of GDP by 2012. Instead, the IMF and the Greeks managed to achieve a slightly milder adjustment path, with the deficit falling under the 3% SGP limit by 2014 instead (IMF 2013c, p. 20; Papaconstantinou 2016, pp. 128–129)[48]. However, once fixed, the 2014 target remained despite the increasingly evident worse-than-expected GDP collapse and in spite of the successful implementation of the overwhelming majority of measures by the Greek government by that point. The 2014 target was changed only in December 2011 when a debt restructuring and a new program had already been all but agreed (IMF 2013c, p. 21).

Such fiscal measures were combined with structural policies and conditionality aimed at increasing growth. These were a direct reflection of Greece's euro area membership, which made it impossible to use the exchange rate mechanism and which therefore required an internal devaluation in another parallel to Latvia. However, IMF staff only counted the effects of structural measures towards the end of the program and estimated them at just 1.8% of the total adjustment, and then only in 2013. Notably, however, structural conditionality increased heavily during the program – from the initial 14 conditions (of which 12 were fiscal measures) to eventually over 45 measures. Implementation began to slip after the Deauville declaration of

[48] The impetus for this appeared to come from Strauss-Kahn, who pushed for extending the period during the early stages of the negotiations over the joint program (Papaconstantinou 2016, p. 116).

late 2010, and eventually conditions proliferated in the 4th and 5th reviews, which also relied more extensively on prior actions (IMF 2013c, pp. 41–43).

Table 5: Evolution of conditionality through the 2010 IMF-EU Greek program

	Request (May 2010)	1st review (Sept 2010)	2nd review (Dec 2010)	3rd review (Mar 2011)	4th review (July 2011)	5th review (Dec 2011)
New conditionality at each review						
Fiscal	12	0	3	3	4	5
Competitiveness	1	0	1	1	2	4
Financial	1	1	1	2	1	3
Amount of prior actions (PA) among new conditions						
PA	3	1	0	0	4	5
Implementation performance by Greece						
Met	11	1	1	1	4	0
Met with delay	3	0	4	5	2	0
N. a.					1	17

Source: MONA database and IMF (2013c)

Structural policies were increasingly controversial during the program. Review teams began to note limited government and administration capacity for implementing decisions, which have already been taken in Parliament (IMF 2013c, pp. 24–25). However, on structural reforms the IMF largely ended up deferring to the EC both as the Commission had a much more detailed relationship with the country but also because of lack of time during the negotiations. This resulted in a significant discrepancy between the IMF program and the parallel EU program – whereas IMF conditionality was relatively limited, EU requirements were extensive. As staff admitted at the time, “The authorities’ agenda in these areas is significantly shaped by long-term discussions and efforts with the EC, as reflected in the broad range of measures covered in the EC MoU", later noting again that the structural reform reflected the "leadership of the EC" (IMF 2010a, pp. 15, 19).

These issues were extensively debated at the Executive Board of the Fund. Directors representing African and Asian constituencies described the fiscal adjustment as "unprecedented" and the challenges as "colossal" (IMF 2010b, pp. 13, 14, 19). Latin American directors from Brazil and Argentina warned that "the risks to the program are immense", the austerity measures were "draconian", and that their implementation will be "socially unfeasible" (IMF 2010b, pp. 47, 52–53). In addition, several expressed worries about a deflationary spiral, where austerity measures become self-defeating as they lead to further collapse in demand. In response, European directors shot back that "while recognizing that the required adjustment is challenging, it is not unprecedented" (IMF 2010b, p. 9). Another area of disagreement were structural policies. The Australian director summed up the feeling among non-Europeans, arguing that EU structural conditions "read a bit like a shopping list. Sometimes…it reads a bit like a list of EU directives, which up to now have been ignored, but circumstances in Greece now provide a good chance to get those reforms done" (IMF 2010b, p. 62).

In addition, the arrangement for 'joint monitoring' with the EU authorities led a number of directors to express worries over IMF independence at it appeared the Fund was engaging in 'cross-conditionality'. As the Chinese director noted, "it is not clear how the independence of the Fund would be preserved, should a difference arise. We have seen parallel financing in past crisis, but a joint monitoring seems to be a new modality", while the Canadian director added that without clear roles, there are "coordination, operational, reputational risks" (IMF 2010b, pp. 42, 73). The Swiss director asked pointedly, "what will happen when the EC and ECB decision-making bodies do not reach the same conclusions on program performance as the Fund's Executive Board?" (IMF 2010b, p. 43). Staff did not consider this to be a strong concern, noting to directors that "the EC has had a long, very intense engagement with the Greek authorities in all these areas. In many of them, the necessary reforms are in the drawer, and one needs to open the drawer and start implementing them" (IMF 2010b, p. 82). Explaining their own decision, staff argued that "we could not absorb this in our table of structural conditionality. We have tried to extract – without causing cross-conditionality or conflict – some issues that we felt should come first" (IMF 2010b, p. 86).

Overall, these considerations suggest regime complexity dynamics at play at several levels. First, the nature of the wrenching adjustment is linked to the contours of the program as elaborated by the Europeans. To make debt sustainable without debt restructuring and with a fixed amount of financing provided (discussed below), Greece found itself obliged to bear a significant part of the adjustment costs (Wyplosz and Sgherri 2016, pp. 25–27). Despite the bigger GDP collapse, fiscal targets were only adjusted in December 2011 when the debt restructuring was already looming, while structural conditionality continued to increase. Second, the desire of European political actors to impose significant structural conditionality is clearly channeled through the EU's role in joint monitoring without any mechanism for resolving conflicts. This created a lot of uneasiness at the Executive Board and among staff about the IMF 'outsourcing' conditionality to another institution. A former deputy director for example expressed his doubts publicly at the time, saying "This has the makings of a strange dog's breakfast. If a regional grouping can set IMF conditionality, what is the point of the Fund anyway?" (Hughes et al. 2010).

To be sure, this reflected the broad preferences of powerful states, most notably Germany, for the reasons discussed in the context of debt restructuring. However, such influence did not flow through the traditional mechanisms expected in the literature such as the Executive Board or behind-the-scenes informal governance. The need for formal approval of the deal by the Executive Board did not prevent staff from extending the period for fiscal adjustment slightly, from 2012 to 2014. Neither did unease at the extent of structural conditionality expressed at the Executive Board have any appreciable impact on the proliferation of conditions as the program advanced. Meanwhile, EU preferences of conditionality were also not reflected in the IMF program, and were instead channelled through the EC. Informal mechanisms also appear to be relatively absent when it comes to fiscal and structural conditionality. Again, this is related to the presence of a regime complex – Europeans had a direct agent, through the EC, and did not need to engage in behind-the-scene manoeuvres to either obtain information or influence negotiations. The presence of a regime complex therefore reduced their need for exercising potentially costly informal governance within the IMF.

Bureaucratic approaches also have relatively limited explanatory value. This is not surprising as their impact is generally most visible when there is little involvement of large shareholders in crisis management (Copelovitch 2010; Woods 2006a). However, if anything, staff would have incentives to reduce both fiscal and structural conditionality. This is because of both the ideological affinity with key policymakers in Greece and because less wrenching adjustments and more financing are less likely to lead to program failures. As the IMF post-program evaluation of the Greek case notes, staff "were encouraged by the authorities' strong commitment to the program. The government also had a fresh mandate from the election and a strong majority in parliament" (IMF 2013c, p. 20). Their faith was well-placed as the government did indeed mostly carry out its planned fiscal adjustment until early-2011, and had relatively good initial record of structural reform. However, as conditions deteriorated further and the initial assumptions became less and less realistic, staff was constrained from adapting the program as "the need to reach agreement with other creditors on macro-critical issues in order to receive their financing assurances limited flexibility" during the first four program reviews to adjust targets, something which is often done in other risky programs (Wyplosz and Sgherri 2016, p. 38). Therefore, ultimately, staff exerted limited influence within the larger contours of conditionality set by European policymakers due to the presence of other veto actors within the Troika monitoring setup.

Financing arrangements

Another key part of the IMF-EU program is the financing, which international institutions provide in exchange for the conditionality measures. From the final total package of 110 bn euros, the IMF contributed 30 bn euros, which made Greece the largest ever program in relation to country quota in Fund's history at 3212%. The first disbursement was made almost immediately given an imminent Greek repayment deadline on 19 May 2010, or barely 10 days after Board approval (Wyplosz and Sgherri 2016, p. 15). The program was somewhat frontloaded, with 5.5 billion euros disbursed immediately (about 18% of the total agreement), with another 41% to be disbursed within the first year. In addition, Greece agreed to draw on European resources with a ratio of 8:3 in relation to Fund resources, and received 14.5 bn euros upon approval from the Europeans. That means that the first European disbursement just by itself came at just under 50% of *total* projected IMF contribution during the whole of the program (IMF 2010a, p. 5).

The size of the program, combined with the decision to not seek debt restructuring, understandably generated a lot of unease among staff and Executive Directors. The program was projected to take Greece out of the market for 2010 and 2011, with the country regaining market access by 2012. According to the program design, “successful access to the market will be critical for Greece’s repayment capacity to the Fund” (IMF 2010a, p. 21). The financial dangers were particularly high as Fund debt service alone would peak at about 4.5% of GDP, highlighting “very substantial risks to the Fund” that will also “reduce Fund liquidity significantly”, making Greece “one of the larger users of Fund resources” (IMF 2010a, pp. 129, 133). The Brazilian director highlighted “credit risk” to the Fund, while the Australian director, among several others, talked of “unprecedented” financial risks (IMF 2010b, pp. 47, 61). Meanwhile, several directors raised the broader issue of overall IMF resources as for example the Egyptian director, who asked whether “the Fund [can] muster sufficient resources to cover the potential needs that may arise?” (IMF 2010b, p. 76).

In terms of financing, a clear preference among the Executive Board emerged for pushing the Europeans to bear a significant part of the rescue. As the representative of Japan, the second biggest creditor of the Fund, puts it, “the current problem for Greece would primarily be regarded as a problem within the euro area. In this light, it is necessary that the euro area complete its obligations toward the resolution of Greece’s problem…euro area countries must be prepared to provide appropriate resource support" (IMF 2010b, p. 29). The United States, the single biggest shareholder, is more circumspect, invoking instead the preferred creditor status of the Fund: "we simply and strongly reiterate the Fund's seniority and preferred creditor status. In the event that there are setbacks or additional financing requirements, we will look to continued European leadership" (IMF 2010b, p. 34). Some other directors questioned how far the preferred creditor status can be taken for granted given the presence of bilateral loans by the Europeans and there is clear unease about the lack of explicit acknowledgment of the Fund's special status by other actors, something that parallels concerns over previous programs such as Latvia (IMF 2010b, p. 43). Yet, once again the worries of Executive Directors did not appear to filter through to lending arrangements.

One of the key issues surrounding the financing of the package was whether Greece satisfied the requirements for such 'exceptional access'[49]. The IMF policy, introduced in the wake of the Argentina debacle, in theory prohibited lending to countries unless debt can be judged sustainable with "high probability". However, staff clearly felt uneasy with such a high evidentiary standard, leading to significant internal debate on how to approach the question, closely connected to the issue of debt restructuring (Blustein 2016, pp. 126–128). Ultimately, the decision was made to revise the rule to allow for exceptional access in cases of systemic contagion. Thus, the final program announced that "on balance, staff considers debt to be sustainable over the medium term, but the significant uncertainties around this make it difficult to state categorically that this is the case with a high probability. Even so, Fund support at the proposed level is justified given the high risk of international spillover effects" (IMF 2010a, p.

[49] For an in-depth analysis of the background, logic and debate around the exceptional access policy, see Schadler (2016).

20). This amounted to a significant revision of the rules for exceptional access, which however was only included as part of the Greek program, and even then, as a single sentence on page 19 without context or analysis; in the words of one director, it was "kind of hidden, one sentence" (IMF 2010b, p. 93).

This was a controversial policy change of general Fund rules arising entirely from staff actions and surprised the Executive Board. Indeed, directors were generally unaware that a policy change was being proposed, with even the US representative admitting that "I did not pick this up either in my quick read of the documents" (IMF 2010b, p. 96). Once this became clear, a number of directors, including those from the US, Japan, Canada, and Switzerland, expressed their desire to avoid making a policy change and make this an ad hoc decision instead. However, staff explained that "Fund policies are decisions that are of general applicability and must be applied uniformly", and were backed by the head of the Legal Department of the Fund, who argued that "the Board has no authority to make an ad hoc exception" (IMF 2010b, pp. 88, 92). The Board eventually accepted the 'hidden' staff proposal and introduced what became later known as the 'systemic exemption'[50]. Overall, as one ex-post evaluation puts it, the decision "was the result of debate within Fund staff and management. There is no evidence that any government officials played a direct role. In fact, many government officials interviewed were not fully aware of the framework" (Schadler 2016, p. 7)[51].

[50] This was subject to further Fund debates and was eventually eliminated and replaced by a new set of criteria in 2015 (see Chapter 7).

[51] In addition, "management had been considering different alternatives for the modification to the exceptional access policy since, at least, end-April. Yet, the Board was not consulted or informed during this period…neither management nor staff drew the attention of the Board to the proposed decision itself or to the fact that the exceptional access criteria would effectively be modified by approving the SBA" (Wyplosz and Sgherri 2016, p. 18)

Strikingly, while the package was extraordinarily large for the IMF, the amount of Fund financing did not seem to be a particularly salient point of negotiations with the EU. This reflected partly practical considerations – the pure size of the needed financing made it unlikely the Fund could drive the operation by itself without additional resources. In short, “to finance the entire Greek program, the IMF would have halved its ability to lend to other members or its forward-commitment capacity”, and it would have been fully depleted by the Portuguese and Irish programs (Kincaid 2016, p. 12). This also reflected the logic of the Fund’s inclusion – it was made part of the regime complex by the Europeans for reasons other than its financing contribution. This explains also why the European loans carried a large interest rate, including a contentious ‘service fee’ as the Germans needed to demonstrate that this is not a backdoor to breaching the euro area ‘no bailout’ rule, but rather an ‘ultima ratio’ loan. In short, another internal IMF evaluation concludes that “the IMF’s possible financial contribution seems not to have played a significant role in these discussions [over IMF involvement]” (Kincaid 2016, p. 11).

The actual amount of financing was negotiated relatively late. It appears that initially the Europeans considered a total figure of around 25 billion euros (Geithner 2014, p. 444). Discussions over the size of the envelope occurred during a teleconference on 11 April 2010, at which point a proposal was floated for 30 bn euros for the first year of a three year program and “assurances that the IMF would add 15 bn euros” (Papaconstantinou 2016, p. 108). At this stage, the IMF was pushing for a considerably larger program at around 80 bn euros, but Europeans sought to limit the amount of financing publicly announced to just that of the first year to reduce domestic political costs. The next discussions were on the margins of the IMF-

World Bank spring meetings on 24-25 April 2010. At this point, Strauss-Kahn "pledged 30 billion euros from the IMF" in the words of the Greek finance minister, while the Europeans considered a contribution of around 45 bn euros (Papaconstantinou 2016, p. 116). Later, after a meeting between Merkel and Strauss-Kahn, the joint EU-IMF package was raised to between 100 and 120 bn euros (Papaconstantinou 2016, p. 120). This illustrates that whereas the IMF made a substantial contribution, a significant part of the impetus behind the eventual 30 bn euros envelope from the Fund was the behavior of the Managing Director rather than pressure from the Europeans.

Notably, the IMF contribution and involvement were discussed in Europe and not in Washington or Athens. As the debate nudged towards involving the Fund, the Eurogroup announced readiness to provide financial support to Greece, if requested, on 25 March 2010. They announced that their mechanism is "complementing the IMF" and involves "substantial IMF financing and a majority of European financing" (Eurogroup 2010). This financing envelope directly reflected intra-European bargaining, allowing for the preference of many actors for European-led rescue while also involving the IMF to assuage German concerns. However, the IMF itself was not party to these discussions and despite the official announcement, did not comment; meanwhile, no official meaning to "substantial IMF financing" was given during this period. The IMF contribution was not discussed even internally at the IMF during informal Board meetings on 16 and 29 April, and was only announced with the program request on 2 May. In short, as the evaluation of the Troika mechanism makes it clear, "The IEO has found no evidence that Fund management and staff attempted to define the nature of the IMF's possible involvement with Greece and the euro area, or to discuss the related issues with the Executive Board" (Kincaid 2016, p. 12).

Similarly, the approval of the program by the Executive Board on 9 May was happening in parallel to the European discussions. Symbolically, the Managing Director prioritized spending time with the Europeans at that crucial point, leaving the meeting to be chaired by his deputy. Throughout the meeting, directors express their lack of knowledge of ongoing discussions in Europe, asking repeatedly the German representative to provide them with more information (IMF 2010b). Furthermore, on the next day the Europeans would announce new mechanisms totalling 750 bn euros, also stating that "the IMF will participate in financing arrangements and is expected to provide at least half as much as the EU contribution", or 250 bn euros (Council of the European Union 2010). This announcement was made without prior discussion at the Executive Board and immediately ran up against legal and financial problems: the Fund can only lend on country-by-country basis and its forward commitment capacity was, after the Greek program, already below 200 bn euros. This forced management to backtrack on the nature of the commitments even as it welcomed them, with the First Deputy Managing Director clarifying that the mentioned Fund contribution is "illustrative" and "hypothetical" (Kincaid 2016, p. 14).

Overall, discussions surrounding the financing of the IMF program are highly suggestive of regime complexity dynamics. Throughout the process, the most important decisions, such as whether to involve the IMF and in what precise financial ways, were taken outside the Fund itself, even as potentially the biggest Fund program in history was being prepared. The IMF was also brought in late in actual policy discussions, by which point there was limited room for manoeuvring before a crucial repayment deadline – in almost a mirror reversal of the Hungary program, where it was the EC that was put in such a position by the IMF. Nevertheless, throughout the process management played an important role in shaping the program, successively raising the size of the IMF contribution. Its main constraint appeared to be chiefly the overall resource ceiling of the Fund, and that meant that the usual approach of financing such a large program alone was off the table from the start. In the process, management preferred to paper over internal staff differences over whether the 'exceptional access criteria' were indeed being met by Greece. Thus, as one evaluation puts it, "IMF management was also eager to be involved" (Schadler 2016, p. 6).

Notably, financial resources were at best a secondary consideration for the Europeans, which gave Fund management considerable latitude that was used to increase the size of the program. At the same time, management, staff and directors jointly pushed for even more financial contributions from the Europeans. The discussion at the Board highlighted the desire of some of the biggest non-European shareholders such as Japan and the United States to shift the financing burden as much as possible to European institutions and states. This reflects the unease of major non-European shareholders for being 'on the hook' for European money, while also at the same time needing to support the program due to contagion worries. In this context, 'pushing' more of the burden on the other institution reduces credit risks to the Fund.

Such dynamics and outcomes are a relatively limited fit for both state-driven and bureaucratic accounts of IMF behavior. In terms of state-centric approaches, the Executive Board is largely sidelined from any discussions during the program, including from key issues such as size of financing, the exceptional access policy, and information on developments in Europe, to the extent that even the Managing Director prioritizes being in Europe over chairing the final meeting for Board approval of the program. There is also surprisingly little evidence for informal governance activities by state representatives. In particular, on the crucial question of debt restructuring it appears the debate has taken place fully among staff, without 'input' from Europeans, even if at the end management arbitrates in the direction that will keep the Fund involved. As the then-Greek finance minister puts it, "IMF leadership was completely in line with its European partners" even as some of the staff within argued for debt restructuring (Papaconstantinou 2016, p. 117). Meanwhile, the Executive Board was clearly uneasy about how late it has been brought into the program and complained extensively about lack of information and delays – and that notably included practically all non-European directors, including the United States. Given how removed directors appeared to be from the process, from little initial engagement to discovering changes in Fund policy in the middle of the discussion on the program proposal, it is unlikely they exercised strong control over the institution they were supposed to oversee on this particular occasion.

Cross-border banking and bail-in

The final element of the IMF/EU program in Greece pertained to the role of private institutions in financial assistance, or what is known as 'private sector involvement'. Similarly to emerging Europe, such foreign banks played an important role in 2010 since they were by and large the main holders of Greek sovereign debt, and were also exposed to the country through their investment in Greek banks. In particular, French banks held the most Greek assets, followed up by German and UK financial institutions. Notably, at the beginning of 2010, out of a total of

288 bn euros of Greek sovereign debt, over 212 bn euros was held by non-residents (Pisani-Ferry and Merler 2012). In this case, addressing the banking situation was a significant concern. As one executive director from Argentina put it, there were also reputational costs in that the Fund "could be blamed for simply buying time or ensuring that foreign banks will be paid in full over the next year before the inevitable happens" (IMF 2010b, p. 55).

Maintaining private sector involvement was fundamental to the program both in the short and medium term. In the short term, a clear danger for the Fund was financing capital outflows in anticipation of an unavoidable debt restructuring. This in turn meant staff relied on continued rollover by market participants to limit the 'financing gap' and to avoid simply substituting private debt with debt to the official sector. In the medium term, renewed market access in 2012 was key to the 'exit' from the program as further large debt obligations were falling due in 2013 and 2014. In that context, staff argued that "the strength of the program and the scale of official support are expected to catalyze market access over time as the authorities demonstrate their success in adhering to the program. There may be scope to bolster this by seeking coordinated voluntary rollover understandings among creditor groups (similar in spirit to the European Bank Coordination Initiative), although the dispersion of government debt holdings may make it difficult to build a critical mass" (IMF 2010a, p. 18).

To achieve this rollover, private banks were contacted during February-May 2010 and 'encouraged' to maintain their lines of credit in a fashion that appears to indeed mimic somewhat the Vienna Initiative that was arranged for emerging Europe. In February 2010, Joseph Ackermann, the head of Deutsche Bank made a proposal for a joint lending package of

30 bn euros, half of which coming from the private sector and the other being cofinanced by state agencies in France and Germany. However, at that point Germany was not ready to move and the initiative died relatively quickly (Papaconstantinou 2016, p. 86; To Vima 2014). However, the issue again came to the fore with the preparation of the final Greek program, with a number of countries seeking to push their banks to maintain exposure to Greek sovereign debt, including France and Germany (Daneshkhu 2010; Reuters 2010c). In both countries banks were heavily exposed to Greece, but also to other euro countries which were potentially next in line, especially Spain. Per one estimate, French banks held around a quarter of all foreign-held Greek government bonds at just under 50 bn euros, followed by German banks at close to 30 bn euros and Swiss banks with potential exposure of up to 44 bn euros; altogether, these three countries accounted for around 2/3rds of all foreign held Greek bonds (Economist 2010). The IMF was partly aware of such proposals, but was not in a position to act on them. As one post-program evaluation puts it, "at least two banks reached out to major European governments and senior management of the IMF with proposals for maturity extension and/or coupon write-downs…communication between staff and management on the one hand and banks on the other appears to have been scanty" (Schadler 2016, pp. 12, 24).

Bail-in provisions were also heavily discussed at the Executive Board meeting and, notably, one of the key new arguments (not included in pre-meeting briefs) that German and French representatives cited in support of the program were the newly reached 'soft' agreements with their country's banks. The German director, for example, stressed that there is action taken on a "very voluntary basis" by German banks that "want to maintain a certain exposure to the Greek banks, which means that they will not sell Greek bonds and they will maintain credit lines" (IMF 2010b, p. 61). The French representative added that "French banks commit to maintain their exposure to Greece over the lifetime of the program…French banks, which are one of the most exposed banks in Greece, are going to do their job" (IMF 2010b, p. 68). Other directors, including the US representative, roundly greeted these comments and the Dutch director announced a similar commitment for Dutch banks. However, just as in the cases of Hungary and Latvia, there was also widespread skepticism about whether this will lead to "meaningful outcomes" and was described as "soft approach" and "insufficient" by Latin American directors (IMF 2010b, pp. 49, 63, 69). Even the IMF mission chief for Greece, while being fully supportive, accepts that "safeguards in this area are not fully up to what we would want" (IMF 2010b, p. 79).

In addition to banks, another actor with a direct effect on the financial sector aspects of the program was the ECB. Before the program was negotiated, it played an important role in opposing any suggestions of debt restructuring, being described as "apoplectic about anything that resembled a Eurozone member 'not honoring its sovereign signature'" by the Greek finance minister (Papaconstantinou 2016, p. 126). By providing liquidity assistance to Greek banks, which were increasingly shut out of global capital markets due to the weaknesses in sovereign finances, the ECB and Trichet in particular held a 'Damocles sword' above the Greek banking system. Thus, one Greek advisor described the ECB as the "crucial veto player"[52] as any withdrawal of such assistance would lead to the collapse of the banking system and the need to re-introduce the drachma to keep economic activity going[53]. The ECB had several reasons for

[52] Interview no 19, Athens, June 2016
[53] The threat was made most explicitly by the ECB in April 2011 when the Greek government broached the subject of rescheduling its public debt (Palaiologos 2014b).

its steadfast opposition to debt restructuring, the main of which was that this was seen as taking pressure off governments to introduce painful structural reforms (Blustein 2016, p. 96).

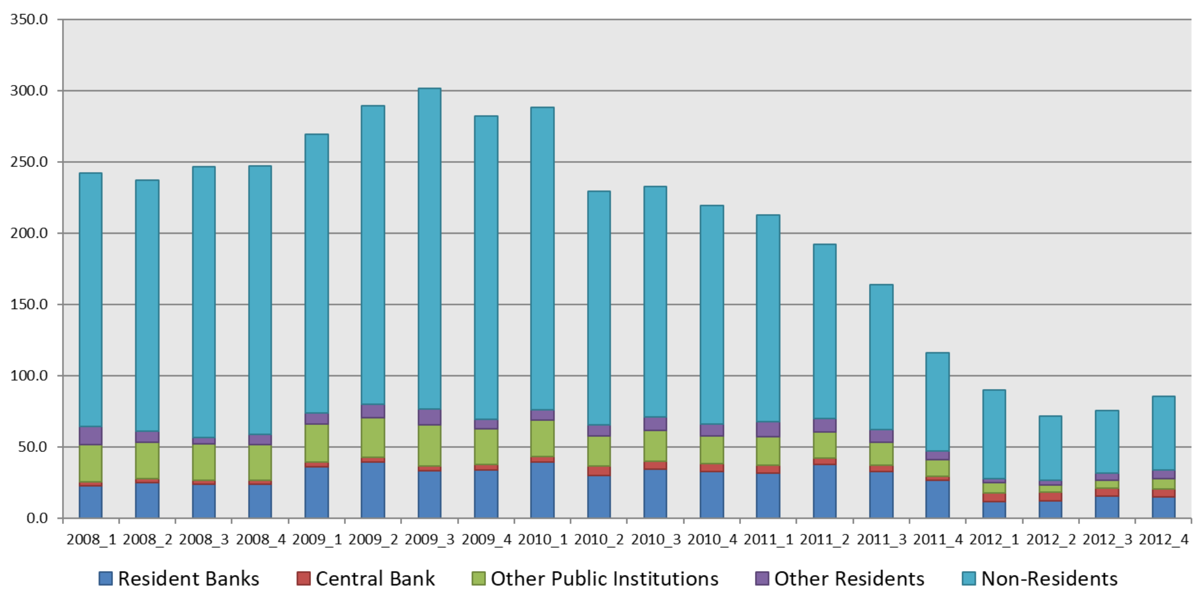
In the context of the first Greek program, the ECB played a crucial part in the Troika setup even if its position was the least defined (Pisani-Ferry et al. 2013). First, it was unprecedented for the IMF to have the de facto monetary authority on its side of the table negotiating with the national representatives on the other side. This also meant that by definition the option of imposing monetary conditionality was off the table, something which has not been the case in previous IMF operations in currency unions (Tan 2016). Second, the ECB announced in the run-up to the meetings on 7-9 May that it will suspend credit rating requirements for collateral which Greek banks can pledge in exchange for its emergency assistance. This was strongly welcomed by Executive Directors and staff, who noted that "this decision effect ensures markets that such bonds will remain eligible for repo transactions, removing a serious uncertainty that had continued to weigh on banks' willingness to hold such bonds" (IMF 2010a, p. 23). Finally, once the euro area governments had publicly announced a new 'firewall' and thus done 'their bit', the ECB unveiled its Securities Markets Program, agreed some days before, to buy bonds of countries facing financial pressure in the secondary markets in order to "restore an appropriate monetary policy transmission mechanism" (ECB 2010). This put the ECB on the road to becoming a large holder of Greek government bonds with the accompanying risks of such exposure; thus the central bank "began operating a program that affected the viability of Troika programs without being integrated into them" (Henning 2017a, p. 93).

Drawing implications from developments related to cross-border banking in the case of Greece is illustrative of some differences with relation to the cases of emerging Europe. In terms of rollovers, in emerging Europe these were made as explicit commitments, negotiated during program design, and backed up by a joint European Banking Coordination (Vienna) Initiative, with an important role for the EBRD. In the Greek case, however, such commitments were left to countries to organize and were only vaguely referenced in the program despite their crucial importance in closing the financing gap. Ultimately, while the EBRD initiative was successful in maintaining exposure, as per the IMF's own ex-post assessment, in the case of Greece "private creditors were able to significantly reduce their exposure", leading to "a large scale substitution from privately-held to publicly held debt" (IMF 2013c, pp. 17–18). Meanwhile, "by the time the [debt restructuring] was finally implemented in spring 2012, most large foreign banks had sold their stakes to official institutions and Greek banks, which in turn had to be bailed out" (Wyplosz and Sgherri 2016, p. 22). One potential explanation for this would be the difference in exposures, as presented by the IMF mission chief:

> "in [emerging European] countries the issue is really one of exposure of home banks to the subsidiaries in these countries. It is relatively easy to get those home banks and their regulators into a room together with Fund staff and other stakeholders and try to come up with a commitment to maintain exposure. In the case of Greece, the issue is not primarily of maintaining exposure of home banks to subsidiaries, but claims on holders of Greek government bonds. These holdings are, it appears, widely spread and this points to major complications." (IMF 2010b, p. 78)

However, while accurate, such explanations are somewhat at odds with actual bank behavior during the crisis. As outlined, some euro area banks actively reached out in self-interest to coordinate financial support, and many pledged, in accordance with their country's request, to not offload Greek sovereign debt. Meanwhile, as the graph below demonstrates, after an initial fall, non-resident Greek holdings stabilized for most of 2010, with the Deauville declaration of October 2010 potentially prompting for the next significant drop in nonresident bond holdings (but see also Mody 2014). Therefore, it would appear that, in addition to the pattern of banking exposure (direct presence through subsidiaries vs. sovereign bond holdings), the political economy of the IMF program also had an effect on cross-border bank behavior. Notably, in emerging Europe Fund staff was proactive in developing a scheme that directly linked bank rollover commitments with the ongoing implementation of the IMF/EU programs, whereas in the Greek case there is no evidence of such actions. From late 2010 onwards, banks were able to reduce their exposure to Greece before debt restructuring occurs. This is suggestive of a limited credibility of the implied IMF threat to 'pull the plug' on the programs in case foreign banks do not cooperate, potentially because banks believed that such actions would only lead to the IMF removal from the Troika rather than actual program suspension.

Figure 26: Greek sovereign bond holdings by quarter*, 2008-2012 (EUR, bn)



Source: Bruegel Sovereign Bond Holding Dataset (Pisani-Ferry and Merler 2012); *excludes IMF and EFSF holdings of Greek sovereign bonds

Another example of regime complex dynamics is the behavior of the ECB. Whereas it played a largely passive role in emerging Europe, in the euro area, naturally, it was much more active. Notably, the involvement of the ECB on equal footing in the Troika ruled out a number of possible policy options for the IMF, which are part of its usual toolkit. Furthermore, ECB actions, in line with the central bank's vaunted independence, are separate from Troika discussions even though they affect significantly the financing conditions of states and banks, and thus the prospects of a return to market access. This is particularly clear in the case of the SMP, which very significantly impacts debt sustainability but was kept hidden and was announced only after the IMF had approved financial assistance for Greece. In this way again moves in shaping the regime complex that occur *outside* of the IMF had significant consequences on what the Fund can propose and accomplish.

It is somewhat harder to account for the banking aspects of program design based on state-centric approaches. There is limited evidence to suggest that the preferences of the Executive Board had an important influence on this aspect of program design. In particular, while there was clear apprehension about the risks of capital outflows, the actual staff program remains relatively silent on bank bail-in. Indeed, it is only at the Executive Board meeting that directors announce country-specific agreements with their banks to maintain exposure to Greece, suggesting such discussions happened largely outside of the Fund. Equally, there are limited traces of informal governance in the context of bank bail-in. There is no account of state influence on rollover projections or that Germany and France provided any more information to staff about their national meetings with banks than they did to the Executive Board. Staff, knowing that the banks that were exposed were based in some of the Fund's largest shareholders could not go further than providing soft encouragement in the context of the program documents and discussions. Most notably however, the main countries involved felt that they did not need to integrate any of their promises with the Fund program. This is consistent with the idea that they preferred to channel their activities outside of the IMF and thus influence Fund behavior indirectly in a way that corresponds to their interests.

Conclusion

This chapter served to provide a close process tracing from the perspective of the Fund of the discussions and debates that culminated in the first Greek IMF program in 2010. Such process tracing is particularly useful for adjudicating between different causal mechanisms that might lead to a similar ultimate outcome. It therefore first presented the context of the case study, including the run-up to the crisis, the different views on debt restructuring, and an outline of the crisis lending program that eventually emerged. Second, based on the main characteristics of Greece it established some theoretical expectations about possible explanations for the Fund's behavior, outlining the differences between state-centric, bureaucratic, and regime complexity perspectives. Third, it then demonstrated how debt restructuring debates, the key bone of contention over program strategy, took place against a backdrop of heavy speculation about the possible exclusion of the IMF in the financial rescue, noting how such threats were used by powerful creditor states but also, with limited success, by the borrower country. Finally, the chapter traced how these discussions over broad program strategy affected specific aspects of IMF program design. Structural conditionality was largely set by the European partners outside of the framework of the IMF agreement, while fiscal parameters were only slightly relaxed from the initial Greek-EC deal prior to Fund involvement. The IMF financing of the program was highly controversial, but revealed a key role for management in driving up the

Fund envelope, a desire by large shareholders to shift the costs to the Europeans, and staff ultimately deciding to change the 'exceptional access' criteria without significant *direct* pressure by state representatives. Finally, cross-border banks faced extremely 'soft' form of bail-in based on their bilateral discussions with national authorities, which, unlike emerging Europe, was not integrated into the Fund program, partly because of the pattern of exposure and partly because of the IMF's political economy.

Greek program discussions in 2010 and 2011 shed more light of regime complexity dynamics. In this case, the preferences of key G5 principals were intense due especially to concerns over spillover effects. At the same time, the G5 strongly preferred avoiding a debt restructuring, something that clashed with views of much (but not all) of the Fund's staff that was involved in program negotiations. Given this, powerful G5 states decided to keep the IMF 'in check' not through traditional formal or informal mechanisms, but by establishing an alternative and tightly controlled financing arrangement – i.e. through a strategy of *entanglement*. In the context of the program, Fund management therefore had to maneuver carefully in order to be involved given the limited importance of its financial contribution for European governments. The IMF faced a very credible threat of exclusion, underlined not only by the significant resources that the Europeans eventually mobilized but also by the vocal, repetitive and convincing pronouncements between January and May 2010 by influential political leaders and institutions that they would prefer an European-only solution. Meanwhile, the Fund's own leverage in such discussions was severely restricted given the importance that its management attached to participating in the Greek rescue. They were likely motivated both by the unprecedented size of the IMF program and by the crucial precedent of involving the IMF in lending to an advanced economy in one of the world's most developed regions. Thus, the final deal reflected these dynamics: the IMF adopted many of the European positions, up to and including European leadership on all key topics, while at the same time making a substantial contribution to an euro area country financial package. This Faustian bargaining cemented the IMF's role at the core of the world financial system and marked a dramatic turnaround from its reputation as lender for developing countries that appeared to many commentators to have outlived its usefulness just two year earlier.

The regime complexity perspective also reveals important insights over the mechanisms through which such an outcome was eventually reached. As this chapter shows, the final deal indeed reflected closely the preferences of key states in the regime complex. Yet, this was not due to the mechanisms that the literature has so far highlighted. The Executive Board exercised limited authority and influence and found itself sidelined for much of the discussions by both staff and creditor states. Meanwhile, powerful states did not appear to engage in informal governance because they did not require it to achieve their interests as they are directly represented in the negotiations through the EC, which acted as their agent. Instead, the key mechanism by which powerful states realized their preferences was through the threat of exclusion of the Fund from the program. This threat made management responsive to their preferences, and ultimately swayed the institution to adopt a large-scale program over which many among the staff had equally large-scale reservations. This a novel causal mechanism that differs significantly from the ones that have so far been outlined in the academic literature on the IMF, and one which would come back to haunt the IMF over and over again throughout the euro area crisis, a Mephistophelean threat to IMF's Faustian role.

VII. Lessons from IMF-RFA cooperation in Europe

The cases of Hungary, Latvia, and Greece all have some unique characteristics, but the challenge they pose to the IMF is similar – how to navigate the proliferation of overlapping institutions for financial assistance? The Fund had to face the same question again in other political and economic contexts in Romania, Ireland, Portugal, and Cyprus. Given the specific particularities of the region, some might hope that such tensions are confined to the 'European crisis' of the Fund and that they will subside along with the financial pressures on these countries. However, the proliferation of RFAs among almost all regions of the globe means that the pattern of uneasy coexistence observed in crisis lending programs is unlikely to go away. In the cases of IMF-RFA cooperation so far, the Fund sometimes benefitted from the presence of overlapping institutions, but on numerous occasions it also suffered from the logic of regime complexity. The cases discussed here illustrate just how fraught such interactions can be in the absence of clear ex-ante arrangements. However, they also hint at the difficulties of agreeing long-run 'rules for the road' when powerful state actors stand to benefit in the short term from strategic ambiguity.

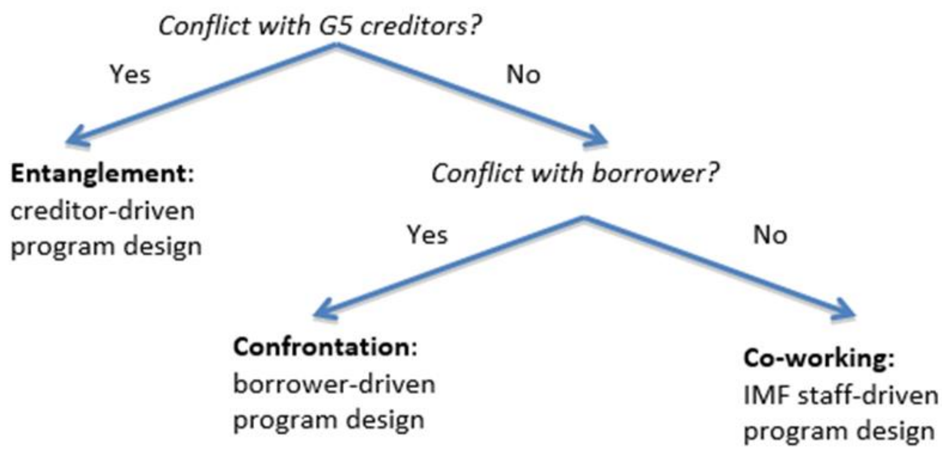
This chapter aims to fulfill two main goals. First, it returns to examine the central question of the thesis in light of the evidence presented so far. It therefore seeks to assess the reasons for the varying impact of regime complexity on IO behavior across cases in which the IMF was aligned to a different degree to the preferences of its creditors, borrowers, and staff. This complements the within-case analysis carried out in the previous empirical chapters. Second, the chapter tackles some of the theoretical and policy implications arising from this study. If the proposed framework is empirically valid, then it speaks to a number of ongoing debates in studies of IOs, regime complexes, and IMF behavior in particular. Moreover, with the rise of RFAs these questions are likely to plague the IMF more and more often, and in response this chapter seeks to offer a theoretically informed assessment of the Fund efforts to address this challenge so far.

This chapter therefore proceeds in three main parts. First, it ties together the findings from the case studies and tests a regime complexity explanation for the cross-case variation against possible alternative accounts. Second, it steps back to consider what are the theoretical lessons that stem from these findings for larger questions in the academic literature on IOs. After that, it turns towards ongoing debates about how to tackle IMF-RFA given the proliferation of such overlapping institutions and assesses the Fund's internal deliberations on this topic.

Hungary, Latvia, and Greece: A cross-case analysis

The thesis so far considered cases largely independently of each other in order to test the explanatory value of a regime complexity account. Such within-case analysis relied on process-tracing techniques, strengthened with congruence assessment and counterfactual analysis. However, the argument presented here also has implications for the comparison across cases. In particular, the presence of overlapping institutions is hypothesized to affect state strategy differently in the presence of disagreements with G5 creditors, conflict with borrowers, or general alignment between the Fund and its creditors and borrowers. More specifically, the theoretical expectations suggested that across cases, those where significant conflict with G5 creditors is present are likely to result in *entanglement* and a creditor-driven program design *regardless* of borrower or IMF staff preferences. Similarly, conflicts with borrowers (in the absence of conflict with G5 creditors) also took precedence over IMF preferences, leading to *confrontation* and borrower-driven program design. Therefore, it was only in the absence of these two conditions that the IMF staff would be able to engage in *co-working* with other IOs in a way that achieves a program beyond what the Fund would have the capacity to deliver by itself.

Figure 27: Impact of regime complexity on IMF program design



The goal of this section is to test the validity of this hypothesized 'hierarchy' of conflicts, which can be represented as the sequential decision tree presented in Figure 27 above. This is an important element of the argument advanced in this thesis, as otherwise it would fail to generate consistent predictions of IMF behavior across cases. Testing the empirical validity of this element of the argument however is not possible through within-case analysis as during each individual case of program negotiations the positions of creditors, borrowers, and staff are relatively fixed. By focusing on a cross-case basis, the impact of a varying level of conflict between the different IMF constituents on program design can be assessed.

Ideally, these cases would only vary in terms of conflict, but in the real world data constraints mean some degree of difference on other variables is also likely to be observed. However, Hungary, Latvia, and Greece share a number of similarities that reduce the risks of confounding factors. First, they are all high-income countries[54] that share a common institutional framework due to their EU membership. Of course, Greece is at the time of the program already a euro area country, which shapes some crucial aspects of the program, notably the lack of initial financial backstop due to the 'no-bailout' clause and the worry of contagion to other euro area states. However, this is variation that the model takes into account through its impact on the political interests of creditors. In economic terms, the loss of monetary sovereignty does not significantly alter the situation in which these countries find themselves, and the Greek crisis experience is comparable to those of some non-euro area countries (Mabbett and Schelkle 2015; Jones 2013). Hungary worried extensively about the effect of devaluation on the capacity of households to repay loans that were overwhelmingly taken in foreign currency (Zettelmeyer et al. 2011). Latvia, meanwhile, is in a currency board with the euro, making it a de facto euro area member but without the presence of political and contagion worries that were evident among creditors in Greece.

Second, the programs all occurred over a relatively short period of time. This helps to hold constant a number of factors such as the global economic environment, the presence of the generally same set of individual decision makers, the state of economic ideas and thinking within the Fund and outside, and the main institutional features of the IMF such as voting power. Indeed, the period between the start of negotiations in Hungary until the signing of the first Greek program is less than 19 months. This is a significant difference with other IMF studies that often span decades as they focus on questions of institutional change in driving the

[54] According to World Bank classification. This also holds for all other cases of IMF-RFA cooperation so far, with the exception of Romania (which is classified as upper-middle-income country).

actions of the Fund; instead, the current study focuses on explaining the variation in Fund behavior given a relatively *fixed* institutional context.

The relative importance of conflicts with G5 creditors and borrowers

The model advanced in this thesis first suggests that whenever G5 creditors have intense preferences that diverge from those of IMF staff and management, they will opt to pursue a strategy of *entanglement*. This would entail using or, if not available, creating an alternative institution that is directly aligned with their interests and that is used to 'rein in' the IMF through the threat of exclusion. In the three cases discussed, G5 interests were particularly intense in Greece, where Germany, France, and, to an extent, the United States and the United Kingdom, preferred to avoid a debt restructuring in early 2010 due to fears of contagion. However, even if IMF staff views were not uniform, they at least seriously explored the possibility of such restructuring at the time, which led to diverging preferences. In this case, G5 creditors chose to advance an alternative vehicle for financing, the GLF, later transformed into the EFSF[55]. In both cases, the EC acted directly as a (severely constrained) 'agent' for the euro area member states, which pooled their loans through a special purpose vehicle outside of EU treaty framework (Pisani-Ferry et al. 2013). In this context, borrower efforts to play the EU 'against' the IMF and vice versa had relatively limited impact. Greek authorities attempted in early 2010 to nudge the Europeans into action by threatening to go alone to the IMF, but this was not a credible threat for euro area member states, who in any case had extensive direct representation at the Executive Board that could in theory block an IMF-only program. The strategic moves

[55] This section does not discuss the EFSM, which represented a direct 'translation' of the balance of payments facility for emerging Europe for the euro area. However, as this facility is based on guarantees from the common European budget, which is relatively limited at about 1% of EU GDP, it was restricted in size to about 60 bn euros and therefore it played a limited role in the crisis. Nevertheless, it disbursed part of the EU financing in both Ireland and Portugal.

made by G5 creditors also left the Fund with little room for maneuver and ultimately the IMF had to break its own internal rules on exceptional access and debt sustainability in order to lend to Greece (although notably this appears to have been a result of internal processes in response to threat of exclusion rather than direct pressures from shareholders).

In Hungary and Latvia the preferences of the G5 were considerably less intense. Big IMF shareholders did not have any significant exposure to those two countries, did not share the same extent of worries over possible contagion (which was seen as restricted to emerging Europe), and ultimately were preoccupied with crisis-fighting at home in late 2008. In both cases *some* creditors were highly exposed, and they made proactive moves to mobilize more international assistance in order to reduce their own costs, but ultimately G5 countries balked at assuming to the same extent the costs of rescues as they had in the case of Greece. Austria for example aimed to mobilize a large package in early 2009 that covered the whole of emerging Europe, where Austrian banks were particularly active, but this initiative quite quickly fell apart. Similarly, Sweden sought a large IMF-EU program, but had to ultimately still offer sizable bilateral funding for which it would have been 'on the hook' if the program went off-track – which was what IMF staff and management largely expected to happen. Furthermore, in both cases Austrian and Swedish banks were 'involved' in the program through a soft bail-in by a rollover of their commitments to these two countries. In short, given their smaller financial resources compared to those of the G5 shareholders, they were unable to *entangle* the IMF directly through the creation of a new financing institution, and they faced constraints in their efforts to convince G5 countries to assume a significant part of the overall bailout resources.

This contrast between the success of German and France to pursue an *entanglement* strategy and the failure of Austria and Sweden to do so reflects the power politics *among* creditors within the IMF. It also highlights the structural position of power of G5 creditors within the Fund that governance arrangements (in terms of quota/voting power and in terms of the appointment of individual Executive Directors) gave these countries as of 2008-10. However, for the purposes of the thesis, it is notable that creditors do pursue this cross-institutional strategy to achieve their preference, rather than other, within-institutional, formal or informal governance approaches. This suggests that even where power politics play an important role, they do so through different causal mechanisms than previously assumed.

Second, in the absence of G5 preferences over program strategy and design, a regime complexity perspective suggested that a borrower that disagrees with IMF prescriptions would be able to leverage the existence of a plausible alternative into pushing the Fund closer to its preferences. Such a strategy of *confrontation* is evident in a clear-cut way in Latvia. Throughout program discussions, Fund staff consistently expressed skepticism over the prospects of recovery if what they perceived to be an overvalued currency peg was to be maintained, while the Latvian authorities strongly preferred preserving the exchange rate in order to enter the euro area. In late 2008 and mid-2009, when tensions flared most clearly, Latvia was hardly a systemic country or one with significant G5 exposure – yet it managed to push the Fund to lend on terms relatively close to its preferences. It is hard to establish a perfect counterfactual, but it seemed plausible that the pressure the IMF exercised on a small open economy in the midst of a financial crisis would generally result in an outcome close to the Fund preferences. However, the borrower in this case had access to an alternative RFA that shared at least to an extent its preferences about overall program strategy. The Latvian authorities turned to the EC on several occasions explicitly in *opposition* to the IMF, most notably in mid-2009 when the program appeared to go off-track, but the EU disbursed the money the country needed, effectively eliminating the leverage of the IMF over the borrower. However, a crucial element for Latvian authorities was that, unlike the case of creditors above, they are operating within a fixed regime complex as, given their need for external financial support, borrowers lack by definition the financial resources to create *de novo* alternative lending institutions. Therefore, they must choose among pre-existing options that might or might not align with their interests – and in 2008 and 2009 the Latvians found the EC to be closer aligned to their preferences than the Fund. However, in 2010 the local authorities had to back down when their preferences over the fiscal adjustment path clashed with *both* the IMF and the EC (which is also suggestive of how in a counterfactual IMF-only scenario the Fund would have been considerably more likely to push through a devaluation strategy).

Borrower preferences are less clear-cut in the cases of Greece and Hungary. In Greece, the government would have ideally preferred to avoid a debt restructuring, although it was unclear it is nearly as adamantly opposed to this strategy as the euro area creditors. Nevertheless, the question is whether it would have been able to achieve such an outcome *even if* it was strongly favored by Greek leaders in 2010. This would have likely meant not receiving any financial help from the EU and relying exclusively on the IMF, something that was already problematic given the limits of the Fund's balance sheet. Moreover, there was a possibility for G5 creditors exercising their power to block a Greek program at the Executive Board level – although again, it is unclear how euro area leaders would have behaved if their 'bluff' was called given anticipated large-scale contagion effects. However, the costs of such high-stake games for the Greeks would have been large, potentially resulting in some form of 'Grexit' from the euro area, which may explain their reluctance to countenance debt restructuring at the outset of the program in the first place.

In the case of Hungary, borrower preferences appeared to be largely in line with Fund policies, a finding that echoes the conclusions of the few existing studies to consider this particular IMF program (Lütz and Kranke 2014; Piroska 2017). In fact, the process-tracing evidence suggested that it was often the IMF that was pushing for less 'stringent' measures in terms of conditionality or financing during the negotiations, which the government was understandably ready to accommodate. Given this, local authorities did not have the incentive in the first place to make use of potential regime complexity strategies such as *confrontation*. It appears plausible that if there was a significant conflict over some aspects – for example, if the IMF had proposed extensive conditionality, the local authorities might have made use of such strategies in a similar way to Latvia. It is possible that such IMF preferences as expressed by staff and management during the negotiations might have been designed to pre-empt exactly this potential outcome. However, if this were the case, it would still suggest an important causal role for regime complexity through its anticipation by staff[56].

The final hypothesis suggested that in the absence of intense G5 preferences which conflict with the Fund *and* lacking serious disagreements with the borrower, IMF staff would be able

[56] If staff preferences proactively took into account such strategies through anticipation, one would expect similarly the incorporation of Latvian preferences in 2008; instead, the program was dominated by conflicts between local authorities and the IMF. This suggests that preferences at the staff level might reflect other factors, such as economic ideas or institutional learning rather than such anticipation effects.

to translate its initial preferences into program design. What makes this more than a trivial prediction is the expectation that the IMF will actually *expand* its ability to achieve its preferred program design *because of* the presence of a regime complex by drawing on the complementary resources of other IOs in order to increase the chances of program success. These conditions appear to apply most directly in the case of Hungary. As described above, G5 creditors did not have direct financial stakes in this crisis (albeit a smaller IMF member, Austria, did) and there is no record of any major disagreements between staff and local authorities or EU institutions. To an extent this is particularly surprising given the absence of any previous experience of IMF-EU cooperation in crisis lending and the severe time pressures. Yet, despite negative factors like these, the final program proceeded relatively smoothly[57]. However, in the absence of overlapping institutions such as the EU balance of payments facility for emerging Europe, the EBRD, and others, the program would have likely been different. Notably, with considerably less financing available and without the additional regional framework for the rollover of bank credits (Vienna Initiative), the financing gap facing the country would have likely required further adjustment efforts from the country itself. At the time the IMF was already providing an exceptionally large program, meaning it likely would have struggled to mobilize even more resources on its own. Therefore, without other IOs, the program would have likely involved larger fiscal and structural conditionality, reducing the chances for success and working against staff preferences for limiting conditions in the aftermath of the controversial Asian and Argentinian experiences.

[57] Indeed, this surprising outcome, which could have been perceived as ‘success’ by participants, may have contributed to initially lowering concerns over possible IMF-RFA conflicts in future programs before the experiences in Latvia, Greece, and elsewhere.

In contrast, the context of overlapping institutions in the other two cases ended up *reducing* the bargaining power of IMF staff. In particular, the presence of an identical set of regional actors – a EU balance of payments facility, reluctance of the ECB to provide support, and an active EBRD supporting regional rollover commitments – had an opposite effect in Latvia than in Hungary. Given the many other similarities between the two countries - EU members with foreign-dominated banking systems, little direct exposure or contagion dangers for G5 creditors, and two programs approved within barely 47 days - this observation suggests differences in terms of IMF staff bargaining power stemmed from the different behavior of borrowers within the regime complex. It is considerably more difficult to discuss potential IMF behavior if G5 creditors and borrower preferences were aligned with those of Fund staff in Latvia or Greece. However, it is likely that the general outlines of such counterfactual programs would not be too dissimilar from Hungary. This would have required borrowers and G5 creditors to favor debt restructuring in Greece, or Latvians to favor devaluation – two distinctly implausible scenarios given political economy constraints. However, for purely illustrative purposes, possible programs centered around these strategies would have involved a division of labor between institutions that would have strengthened the prospects of program success by providing financing in addition to IMF resources and involving private sector in crisis resolution (in Greece), while reducing the fiscal and structural conditionality demands on the crisis country.

Table 6: Summary of cross-case comparisons			
	Hungary	Latvia	Greece
Conflict with G5 creditors?	No	No	Yes
Conflict with borrower government?	No	Yes	No (limited)
Impact of regime complexity on IMF	*Co-working* (IMF staff-driven program design)	*Confrontation* (Borrower-driven program design)	*Entanglement* (G5 creditor-driven program design)

Theoretical implications

This thesis began with a question focused on the impact of a new empirical trend – the proliferation of overlapping and nested institutions. In doing so, it aimed to contribute to a larger set of questions related to long-standing debates about IO behavior. The goal of this section is to go beyond the IMF and to consider how the findings of the preceding chapters help shed some light on these topics. It therefore first assesses more narrowly the relationship between the regime complexity argument and alternative explanations of IMF behavior, seeking to highlight both areas of convergence and, crucially, divergence. It then returns to larger theoretical questions over the drivers of IO behavior.

Regime complexity and alternative explanations

How do the findings of the empirical chapters relate to state-centric, borrower-driven and bureaucratic accounts that have dominated the literature on Fund behavior? Existing accounts of IMF crisis lending aim at general explanations about IMF behavior across all cases. Such explanations rely on implicit assumption of IMF exclusivity, which leads them to consider conflicts within the institution as the key to understanding such behavior. A regime complexity perspective focuses instead on a particular subset of cases, namely those where the IMF engages in its core function, crisis lending, in the presence of overlapping RFAs to which borrowers and/or creditors can turn to in lieu of the Fund. In these specific cases, the assumption of IMF exclusivity is not met, and this has material effects on the process and outcomes of bargaining between creditors, borrowers, and staff. In short, regime complexity alters the choices that such actors make in subtle ways by introducing an alternative outside option that existing approaches have not yet integrated.

State-centric approaches, particularly those focusing on the power of G5 creditors within the current governance setup, have established themselves as one of the dominant ways to think about IMF behavior. The regime complexity approach shares the general point that the IMF will behave differently when G5 creditor key interests are at stake than in cases where G5 preferences are less intense. However, it differs crucially in the means through which such powerful creditors exercise their influence. The empirical case with strongest G5 interests examined in this study is clearly Greece. A classic state-centric explanation would have expected to observe an important role for either formal governance mechanisms through the Executive Board, or informal actions 'behind the scenes'. Yet, in this case, the Executive Board was sidelined from making effective decisions, as evidenced by their peripheral consultation even on key changes to IMF policies such as the exceptional access criteria, while Europeans had direct access to the negotiations through the EC participation in the Troika, which reduced the need to resort to costly informal means. Instead, management felt constrained in its options because of the threat of exclusion as euro area creditors set up an alternative RFA, and chose to break its own rules rather than break with the European creditors. Thus, the end result was similar – an IMF program that was closely aligned with creditor interests, but the process through which creditors achieved this goal is starkly different. This is a substantial difference, as the observation that powerful creditors can get what they 'want' more often than less powerful borrowers or staff is by itself trivial and true by definition. The interesting question is under what conditions and with what means they will be able to achieve their goals.

A general shortcoming of state-centric models focused on G5 interests is that they have little to say about Fund behavior when such interests are not particularly intense, as in the cases of Hungary and Latvia. Here, another set of explanations might appear pertinent – those focused instead on domestic borrowers playing 'two level games' with the Fund. Thus, the desire to avoid a change of government with a less 'sympathetic' administration that might put the whole program in jeopardy can reduce IMF influence. Initially, this appears particularly plausible in Latvia with its fragmented politics and four- and five-party coalitions. However, the empirical observations reveal little if any attempts at leveraging internal constraints despite a change of government at a relatively early stage of the program. In fact, it is hard to find many actors within the main political parties that are sympathetic to the Fund's demand for devaluation, which is understandable given the high level of support that the currency peg enjoyed among the population. Instead, local authorities exploited the presence of a pre-existing alternative RFA – the EU balance of payments facility operated by the EC – which is much closer aligned to their preferences. This decreased the otherwise significant bargaining power of the IMF in similar situations as the Fund is forced to participate in a program designed in a way that many among its staff believe to be destined to fail. In turn, this suggests that regime complexity can, under particular circumstances, increase the leverage of 'weak' borrowers vis-à-vis the Fund even in the absence of the 'two-level games' emphasized by existing accounts.

Bureaucratic accounts, on the other hand, aim to often fill in the gap in IMF behavior when G5 preferences are not particularly intense. They focus on self-interested rent-seeking behavior or the incentives that a shared ideational background between staff and local negotiators creates for IMF behavior. Such similar economic worldviews facilitate discussions by aligning the perspectives of the two sets of participants over the key problems, their sources, and their potential solutions. In turn, this internal commitment by local policymakers to the 'right' approaches reduces the need for monitoring and external control devices in the form of conditionality or significant constraints on the size and method of disbursement of IMF resources.

Empirical observations, however, do not bear out these predictions. In Latvia, many of the key decision makers shared a general common training, which roughly corresponds to what the literature considers to be 'neoliberal'. However, this did not prevent rather dramatic conflicts between local authorities and Fund staff that culminated in a *confrontation* strategy by the Latvian government. Conversely, in Hungary there appears to be relatively little basis for a shared worldview given the starkly different training of local officials dating back to communist times and the socialist character of the government. Yet, despite this, cooperation was relatively harmonious with little conflict observed. Instead of shared ideational background, what seems to have aided this outcome in Hungary appears to be the ability of the IMF to 'tap' other institutions in the regime complex for their resources, local knowledge, and contacts. Thus, by relying on substantial additional financing by the EC and the ability of the EBRD to reach out to foreign banks, IMF staff managed to put together a program that reflected their preferences and minimized the potential for conflict with the local government.

Table 7: Comparison between existing and regime complexity accounts of IMF program design			
	Most likely case	Theoretical expectations of existing explanations	Empirical findings of the thesis
Creditor-centric approaches (G5 interests)	Greece	Executive Board action and 'behind the scenes' interference align IMF with creditor interests.	Creditors create a new RFA (GLF and EFSF) and rely on threat of exclusion from the Troika to shape program.
Borrower-centric approaches (domestic politics)	Latvia	Domestic elites play 'two level games' based on political constraints.	Provision of crucial financing by the EU in late 2008 and mid-2009 left IMF as 'junior partner'.
Bureaucratic approaches (staff ideas)	Hungary	Shared ideas between staff and domestic government create common worldview.	IMF draws on other IOs through reliance on EC resources and EBRD foreign bank coordination.

Theoretical takeaways for studies of IOs

So far, the thesis has put forward a regime complexity account and has evaluated it through a combination of process tracing and cross-case techniques in three case studies of IMF-RFA cooperation. However, if the assessment of the validity of the argument is accurate, then it would also speak to theoretical discussions pertinent to IOs more broadly. This section draws on the conclusions suggested by the empirical investigation to present some of the implications that arise for our understanding of how IOs function. Therefore, it seeks to place the findings within the context of debates over drivers of IO behavior and to discuss their relevance to our understanding of the dynamics of regime complexes.

Perhaps the biggest single theoretical lesson to draw from a regime complexity perspective is that conditions of overlapping institutions open new strategies to member-states to pursue their goals vis-à-vis IOs. Such states might no longer rely on the formal or informal means for control over the institution and are sometimes able to bring it closer to their own preferences through moves 'away from the table' of negotiations. This chimes with recent discussions of 'contested multilateralism' that focus on how threats of exclusion by dissatisfied actors with a credible outside option can lead to institutional change (Morse and Keohane 2014). The phenomenon identified in this thesis points to another implication in a similar direction – namely, that such threats can be a new mode of control rather than means to force institutional change. This represents a significant addition to existing understandings of the IMF that emphasize formal or informal means of control by member-states, which, under conditions of overlapping institutions, might miss important causal mechanisms. This is a particular danger when the overall observed effects are similar due to equifinality or overdetermination.

However, while this new mode enlarges the set of cross-institutional strategies for states, this does not necessarily spell the end of IO staff influence. It is evident in the cases that under particular circumstances IOs also pursue joint strategies that allow them to achieve their own goals more efficiently. This therefore links the perspective presented here with a recent strand of literature that focuses on how IOs make use of their institutional context to overcome the gap between lofty expectations and petty resources that often characterizes state delegation through a process of 'orchestration' (Abbott et al. 2015). A regime complexity perspective shares the observation that IOs will not be simple passive 'vessels' for state preferences and that they will proactively try to make use of their environment, to the extent permitted to them by their ultimate paymasters. Moreover, it largely lends support to some central orchestration hypotheses and findings, namely that such behavior is more likely to occur when mechanisms for oversight are weak and that states might be indifferent or indeed deliberately encourage orchestration when they prioritize efficiency. One of the important implications that arises is that relations between IOs are not a 'lose-lose' game as a basic turf-war perspective would suggest; instead, it is possible for two IOs to cooperate in a way that increases for both of them their chances of translating their own management and staff preferences into policy outcomes.

This naturally leads to a follow-up question – cui bono in a regime complex? The cases presented here suggest that under different circumstances, powerful states, weaker members, and IO staff might benefit from the presence of overlapping institutions. However, the argument also developed the explanatory conditions in a sequential manner that reflects a hierarchy of interests – namely, cases of disagreements with powerful states result in complexity outcomes that favor such actors *regardless* of weaker state or IO staff preferences (such as in Greece). In that sense, the empirical findings echo the concerns of some commentators sympathetic to regime complexity who highlight how it might end up benefitting the already powerful. As Drezner for example argues, "although all actors will engage in forum-shopping, only the great powers will possess the capabilities necessary to enforce, implement or resolve inter-regime disputes" (Drezner 2009, p. 67).

Nevertheless, there is a whole constellation of cases in which powerful states might not have particularly strong preferences – and indeed, these might be the majority. In these cases, other states and IOs find themselves with a 'fixed' menu of overlapping institutions created by powerful states. One intriguing implication of the sequential argument presented here, however, is that in these cases regime complexity may enhance the bargaining power of 'weak' states vis-à-vis 'strong' institutions. This might be welcome by those who worry about global institutions with weak democratic legitimacy 'dictating' actions to nation-states, although it is conditional on exogenous constraints, namely the pre-existence of an alternative IO that is ex-ante more closely aligned to the 'weak' state's preferences. Therefore, powerful states exercise 'milieu shaping' power for others, but this is mostly done inadvertently as they respond to the specific set of pressures they experience in a given moment. However, how they respond at these critical junctures can create opportunity structures for both less powerful states and IOs to increase their bargaining power down the line by combining forum-shopping with contested multilateralism or by leveraging orchestration strategies within a 'fixed menu' of institutions.

Another question that dominates the literature is the concern with explaining the origins and proliferation of regime complexes. This study consciously opted for treating such overlapping institutions as an independent rather than as a dependent variable. Nevertheless, the argument presented here also has certain implications for this topic. The finding that powerful creditor states might create alternative institutions to the IMF in order to push the Fund to align with their preferences parallels Henning (2017a). He argues that powerful states opt for 'tangled governance' of the sort observed in the euro area crisis to limit potential agency drift. In that sense, one could expect that it is such powerful creditor states that generate increases in regime complexity, often in response to the short-term exigencies of a specific situation. This study demonstrated how changes in the regime complex, such as increasing the balance-of-payments facility in Latvia or creating the Greek Loan Facility and later, the EFSF, were indeed tightly linked to strategic moves by states to put pressure on the Fund. This therefore suggests that the reason why regime complexes look 'messy' and 'uncoordinated' is often because they are not planned with long-term consequences in mind but are a response to short-term considerations in a particular moment. In that sense, moves by powerful actors may be thought of as the 'microfoundations' of such regime complexes.

Another focus of studies of regime complexity is the effect of increased competition on IO effectiveness. Earlier studies often expressed concerns that the proliferation of institutions might undercut the coherence of international regime and thus lead to fragmentation. More recent approaches have moved away from this normative concern towards seeking a more positive understanding of the phenomenon, albeit at the price of losing sight of some of the consequences of such developments. What the findings here suggest however is that the outcome is hardly predetermined and uniform. Left to their own devices, IOs can find ways to cooperate rather than get embroiled in turf wars. IOs are motivated by the desire to produce successful outcomes, which provides incentives to join forces with other IOs if this can help increase the influence of each institution involved by increasing the resources, knowledge, or contacts at their disposal. Yet, the outcome of the presence of overlapping IOs can shift from division of labor to conflict when states have incentives to play institutions off each other to achieve their own preferences. This study therefore contributes to focusing attention on the factors that shape whether IOs conflict or cooperate in overlapping areas by drawing attention to a source of conflict different from turf wars, namely how states might instrumentalize regime complexity at critical junctures in accordance with their interests.

In summary, this section has sought to assess the theoretical returns on the investment in a regime complexity perspective to IO behavior. It first argued that in the specific cases under consideration this argument uncovers an explanation that is a better fit for the empirical evidence than existing explanations. Second, it drew a number of broader implications about how such an approach might add to our understanding of how IOs function. It suggested that such behavior can vary significantly, although it is always likely exercised in the shadow of power, and shed light on some questions related to the origins, contours, and consequences of regime complexity. Nevertheless, these should be treated as potential suggestions and pointers rather than assertions given the difficulties from generalizing from the examination of such dynamics in just one context with its own institutional and regional particularities.

IMF-RFA cooperation: Past, present, and future

While aiming to contribute to broader debates about IO behavior, this thesis focused in particular on the case of IMF-RFA cooperation. Although most of the experience of such cooperation can be found in Europe, this is an issue that presents a challenge for the global role of the IMF going forward. The goal of this section is to discuss how the findings of the thesis relate to policy debates about IMF-RFA interactions. Therefore, it first assesses how widespread this phenomenon currently is and what is the direction of travel for RFAs across the globe. Second, it discusses the impact of regime complexity on IMF thinking so far and risks some tentative predictions about likely future developments.

The growth and growth of RFAs

How significant is the challenge that RFAs put to the IMF? The answer to this question depends on the number and size of such alternative financing institutions across the globe. The thesis considered in depth a set of European RFAs, notably the balance-of-payments facility for non-euro EU members and the set of euro area financing arrangements around the EFSF. This choice was dictated by the limited experience of IMF-RFA interactions so far, but this is hardly likely to remain a European-only challenge for the Fund. As of 2017, currently there are seven RFAs covering 81 different countries across Europe, the Middle East, East and Central Asia, and Latin America (IMF 2017a, p. 8). Some of them existed before the global financial crisis, and date even back to the oil shocks of the 1970s. However, the majority of RFAs were established after the crisis, and those that were already in existence were significantly revamped and increased. The reversal of fortune for the Fund has been particularly stark as it has fallen behind the RFAs in terms of total commitments despite increases in its quota and borrowed resources. Thus, as of March 2017, the Fund disposed of around SDR 475 bn of quota resources and 426 bn of borrowed resources for a total lending capacity just over 1.2 trillion USD. However, collectively RFAs also dispose of over 1 trillion USD of resources.

In most cases, RFAs are actively lending these resources, and especially so since the global financial crisis. In the EU, the ESM (in its various institutional forms) has disbursed a total of just over 300 bn USD to five countries since 2010, while the EU BoP facility - 21.3 bn USD to three countries since 2008 (IMF 2017a, pp. 16, 22). The three smallest RFAs have also been lending actively. Since 2009, the most recent one, the EFSD, has disbursed 5.3 bn USD worth of loans to four countries, with the overwhelming majority going to Belarus in 2011 and 2016 (IMF 2017a, p. 14). The more established ones have a long history of lending – the Latin American FLAR for example has made 47 loans since its creation in 1978, totaling around 7.5 bn USD, with most recently a 0.5 bn USD program with Venezuela in 2016 and two programs with Ecuador in 2012 and 2014 that totaled 1.1 bn USD (Mühlich and Fritz 2016, p. 21). The Arab Monetary Fund has been used most extensively, albeit for lower amounts – it has extended 177 loans since its establishment in 1976 for a combined 8.4 bn USD, with the biggest recent loan of 0.3 bn USD going to Egypt in 2015 among a number of other smaller loans to Sudan, Mauritania, and Jordan (IMF 2017a, p. 8). In sharp contrast however neither the CMIM nor the (much more recent) BRICS CRA has ever been activated so far. That means that roughly two-thirds of RFAs by lending resources are using these actively in practice and thus challenging directly the previously assumed monopoly of the IMF over crisis lending.

Table 8: Overview of IMF and existing RFAs

	Established	Size (USD bn)	Members
IMF	1945	$645 bn*	189
European Stability Mechanism (ESM)	2012 (based on 2010 EFSF and EFSM)	$587 bn**	19 (euro area states)
Chiang Mai Initiative Multilateralization (CMIM)	2010 (based on 2000 Chiang Mai Initiative)	$240 bn	14 (ASEAN+3)
BRICS Contingent Reserve Arrangement (CRA)	2014	$100 bn	5 (BRICS countries)
EU Balance-of-Payments Assistance Facility	2002 (based on 1988 BoP facility)	$59 bn	9 (non-euro EU states)
Eurasian Fund for Stabilization and Development (EFSD)	2009	$8.5 bn	6 (Russia and Central Asia)
Arab Monetary Fund (AMF)	1976	$4.8 bn	22 (MENA countries)
Latin American Reserve Fund (FLAR)	1991 (based on 1978 Andean Reserve Fund)	$4.7 bn	8 (Latin America except Argentina, Brazil, Chile)

Source: IMF (2017a, p. 8) and IMF documents. Does not include the North American Framework Agreement. *Quota resources only. Another $575 bn available as borrower resources. **Effective lending capacity. ESM paid-in capital is $822 bn.

Two regions stand out in this landscape. One is, predictably, Europe. Since the first Greek program, the euro area architecture has undergone significant changes, including to its financing facilities. At that time, loans were first provided via a hastily-arranged Greek Loan Facility that was soon turned into an European Financial Stability Facility. This was initially created as a temporary special purpose vehicle in May 2010 and aimed to pool together loans guaranteed pro-rate by euro area governments, with no precautionary facilities. Its effective lending capacity was increased to 440 bn euros in October 2011, when it was also given a role in bank recapitalization and the purchase of bonds. In September 2012, the EFSF was turned into the ESM with a lending capacity of 500 bn euros, which is also an official intergovernmental and permanent IO (Gocaj and Meunier 2013).

In the process, the involvement and relationship to the Fund was intensely debated. Early drafts of the agreement from March 2011 suggested a strong role and close cooperation with the IMF, including joint negotiations over conditionality and debt sustainability analysis. However, in the meantime significant conflict between the Fund and the EU emerged as the Greek program began to go off-track. In response, euro area governments decided to water down IMF involvement to a rather vague standard in the final ESM mandate: "a euro area Member State requesting financial assistance form the ESM is expected to address, wherever possible, a similar request to the IMF". This appears to have been driven by the desire to avoid giving the Fund a veto over the use of ESM, particularly as non-European IMF members began to express more and more reservations (Henning 2017a, pp. 174–176).

More recently, European policymakers have revived the idea of turning the ESM into an European Monetary Fund. In line with the regime complexity argument, this was floated in parallel to attempts to bring the IMF to support a third financing program for Greece[58] and functioned as a not-too-subtle threat of exclusion (Tetlow et al. 2017). Although it has the backing of several key actors, it is unclear what exactly falls under this label. Some commentators see it as an institution that can enable an orderly sovereign debt restructuring mechanism for the euro area and provide a credible fiscal backstop for the European Banking Union, all underpinned by a governance structure that moves away from unanimity (Sapir and Schoenmaker 2017). Politically, Germany appears to view an EMF as a way to exercise more independent oversight over national budgets, while Southern European states focus instead on reducing the burden of conditionality. Such discussions are unlikely to culminate in a full-fledged EMF any time soon, but are indicative of a direction of travel, evident since the watering down of the original ESM mandate for cooperation with the IMF, towards replicating Fund capabilities and choosing to deliberately keep IMF-RFA cooperation in this case under the Damocles sword of 'going it alone'.

Whereas the past experience in Europe has been so far the most controversial, the region where this is likely to have the biggest future implications is East Asia, where regional financial cooperation and power politics often sit uneasily together (Grimes 2008). Going back two decades to the outset of the 1997 crisis, Japan floated an Asian Monetary Fund, but that proposal was met with determined resistance by the United States, China, and the IMF, which reflected

[58] Since 2015, Greece has received financing only from the EU, with the IMF insisting on debt restructuring which the Europeans have not been ready to offer given the direct losses they would suffer. Instead, the Fund eventually agreed to pre-approve joining a third IMF-EU program in Greece "in principle" and subject to receiving assurances from the EU on debt sustainability.

a mix of national interests and concerns about undercutting the ability of the Fund to achieve policy adjustments. Instead, the countries of the region settled for a currency swap arrangement within the context of the ASEAN+3 (that is, the 10 ASEAN members plus China, Japan, and South Korea), known as the Chiang Mai Initiative. It was established in May 2000, but included an “IMF link” that required a full-fledged Fund program if countries sought to draw more than 30% of their allowance (Henning 2002).

The Chiang Mai Initiative continued to evolve, with several important developments in 2010 and 2011. First, it moved from a network of bilateral swap arrangements to a single multilateral swap arrangement under the name ‘Chiang Mai Initiative Mutualization’ (CMIM). This streamlined decision-making procedures and should improve response speed. Second, it was doubled in size, from 120 bn USD to 240 bn USD, making it potentially more relevant to the smaller ASEAN economies. Third, member states launched a permanent secretariat, the ASEAN+3 Macroeconomic Research Office (AMRO), which was tasked with carrying regional surveillance and could serve as the embryo for a more independent CMIM. Similarly to the ESM, AMRO was turned into a formal IO under pubic international law in 2016, although it remains for now technically separate from the CMIM, which has no legal personality (IMF 2017a, pp. 10–12).

Yet, despite its existence, the Chiang Mai Initiative was not activated when the biggest financial crisis in the past 80 years hit in 2008. This reflected the reliance of East Asian economies on a different layer of the global financial safety net, namely the accumulation of international reserves in a costly ‘self-insurance’ strategy. However, it also prompted a significant debate about the future of the Initiative, with some arguing explicitly for developing CMIM as an alternative to the IMF by cutting the 'link' and integrating it with AMRO (Kawai 2015). This parallels discussions over the creation of the ESM as a separate and self-standing institution, although it is interestingly motivated by the opposite drive – whereas in Europe controversy arose because the IMF was seen as too close to EU countries, then in Asia in 1997-8 the Fund appeared to be far too detached from the interests of local states (Volz 2013).

This relates to perhaps the biggest difference when it comes to IMF-RFA relations in Europe and Asia, which is the underrepresentation of Asian countries and overrepresentation of European states within IMF governance. Following the period under study, in 2016 the IMF implemented a major decision from 2010 that doubled quotas and realigned shares, with China emerging as the third largest members and with all BRIC countries now in the top 10 by voting power. Yet, EU countries together still hold 29.6% of votes at the Executive Board, with euro area countries holding 21.5% of votes – more than the 16.5% of the United States, and considerably more than Asian countries such as Japan (6.15%), India (2.64%), and Korea (1.73%).

Given its focus on European cases, the study cannot offer firm conclusions on how this difference will affect IMF-RFA cooperation in Asia. However, one plausible consequence might be that absent the common 'principals' of overlapping institutions observed in Europe, such relations are likely to be even more fraught with conflicts. Nevertheless, the experience of IMF-RFA interaction in Europe will have repercussions on the future of regional financial cooperation in Asia, potentially in the direction of increasing further regional mistrust of the

Washington-based institution and accelerating local RFA development. This process will also pose further important challenges to the Fund (Darvas 2017; Rhee et al. 2013).

The (mis-)adaptation of IMF policies to regime complexity

As the clear trend towards more RFAs around the world demonstrates, the IMF is likely to be plagued by the question of how to approach IMF-RFA cooperation in the coming years. As this research demonstrated, *co-working* can be a win-win scenario for everybody involved if the capabilities of institutions in the regime complex are mobilized in a complementary way. This is most straightforward in terms of resources, where the IMF quotas, which have been consistently falling relative to global capital flows, can be topped up by RFAs with their own large 'war chests'. Such complementarities are also evident in terms of information, with the Fund often criticized for not being familiar with the local economic, political, and social context of countries for which it is designing crisis programs. RFAs, given their much narrower geographical mandate, are closer to their members, often have staff from the affected countries, and generally carry out more systematic and in-depth ongoing economic monitoring of regional developments. Finally, RFAs could offer the key to another Fund challenge – namely, the disadvantage that the IMF has in talking directly to private actors as its mandate is restricted to sovereign borrowers. In an era of financial globalization, the actions and reactions of private lenders are crucial to program outcomes and formal or informal channels of communication with them, which an RFA might offer, are especially valuable.

Current approaches to regime complexity are certainly aware of the promise of complementarity. However, they are mostly built on a technocratic understanding of IMF-RFA interaction as a simple coordination issue that fails to take into account political incentives.

Thus, a typical set of proposals aims at leveraging "the Fund's experience in macroeconomic adjustment and its universal risk pooling" with the "the better regional knowledge and country ownership brought by the RFA" through an improved division of labor alongside a 'lead agency' model, as opposed to uncoordinated parallel lending (IMF 2017a, p. 1). This is essentially outlining a *co-working* scenario and again demonstrates that IOs have incentives to seek to cooperate with others to achieve their goals rather than engage in self-defeating turf-wars. However, the evidence in this thesis suggests that such benign cooperation is likely to only materialize in cases where staff preferences do not diverge from the intense interests of G5 creditors or borrowers. Therefore, such proposals are likely to be sufficient for the 'steady state' whenever conflicts are not present, such as in Hungary, but are conspicuously silent in addressing the evident lack of bargaining power of staff when conflicts arise with member-states. In such cases, borrowers and creditors have an incentive to play institutions off each other through *confrontation* and *entanglement*.

Instead, the central problem of IMF-RFA cooperation is a political and not a coordination issue. The flipside of the potential for positive complementarities is that regime complexity also makes available a set of new cross-institutional strategies to states that seek to align the Fund with their specific interests in a given situation. Such strategies, as demonstrated in the empirical sections on Latvia and Greece, allow them to benefit from having the Fund involved while also being able to resist IMF strategies and proposals that go against their preferences. This highlights the broader political problem facing the Fund - time inconsistency in member state preferences regarding IMF-RFA cooperation. In short, while ex-ante efficiency concerns might dominate and suggest some rules for cooperation, ex-post when a G5 creditor or even a borrower finds itself at odds with the Fund, they have very strong incentives to play institutions off each other by instrumentalizing overlapping mandates and using the threat of exclusion.

The natural solution to such problems is to create strong ex-ante commitment mechanisms that are stronger than the 'call of the sirens' in a crisis situation. Such mechanisms should clarify the specific roles of IMF and RFAs in a way that ensures complementarity through a division of labor, even if that comes at the cost of some flexibility in actual lending. In practice, this means that institutions should divide up at least the crucial elements of negotiating a program among themselves *without overlap*. These include elements such as deciding who is in charge of preparing the debt sustainability analysis for the crisis country, who leads in which specific areas of conditionality, and, especially, what are the mechanisms for resolving conflicts between institutions and enforcing such decisions. By reducing duplication and establishing procedures for coming to agreement, the extent of overlap is reduced, which in turn reduces the potential of the threat of exclusion to sway institutions to act against their better judgment, accumulated experience, and internal rules. Currently, the lack of such ex-ante division of labor creates strategic ambiguity about the roles of potentially overlapping institutions, giving leverage to member states to achieve their narrow preferences even when they lead to sub-optimal or even harmful outcomes for others.

While necessary, establishing such ex-ante commitment mechanisms is likely to run up against the interests of both powerful creditors and potential borrowers. The problem is perhaps most acute when it comes to creditors, such as the G5, that have the capabilities to opt for *entanglement* strategies through 'competitive regime creation'. For them, the current state of strategic ambiguity is relatively comfortable, as it gives them the flexibility of establishing alternative and overlapping institutions calibrated to their specific interests when the need arises, which in turn creates the potential for exclusion that generates their leverage in negotiations. Therefore, the efficiency gains that come from complementarity based on ex-ante division of labor might not be enough to entice them to give up the option of exercising their outside option. Such dynamics are evident for example in the watering down of the rather specific initial provisions for the cooperation between the IMF and the ESM in Europe towards the final non-committal and general formula that a state asking for support from the ESM "is expected to address, *wherever possible*, a similar request to the IMF". This brings to the fore a familiar problem for IOs – if powerful states benefit from the lack of clear coordination mechanisms, how can they credibly commit to introduce such arrangements? The new Fund policies are going to be stress-tested in a crisis, and as long as this credible commitment issue remains, are likely to fail in precisely the high-profile and high-cost cases where creditor preferences are most intense.

Credible commitment to an ex-ante division of labor between the IMF and RFAs is also problematic for borrowers for a different reason – the ex-post pull of regional integration is too strong in a crisis. While the functional rationale for IMF-RFA cooperation is based on their better local knowledge and higher country ownership when receiving help from its neighbors, these factors also have potentially serious downsides. Such benefits stem from the closer political ties of member-states with their regional partners than with the global membership of the IMF. Moreover, Fund programs are limited in time, and eventually staff pack up and leave, while RFAs are often specifically tied to larger regional integration projects of a more permanent nature. This means that while theoretically possible in the model presented here, it is rather unlikely that a borrower will side with the IMF against the preferences of its regional partners as expressed through an RFA as the long-term costs of such a challenge might even lead to its expulsion from the regional 'club'. This for example might explain the rather puzzling observation that even when Greek officials' preferences aligned with those of IMF staff and management during the second and third Greek programs, they were unwilling to side fully with the Fund against the EU. This further reduces the leverage of the IMF as borrowers will be reluctant to side with the Fund against an RFA in a *confrontation* scenario when there are disagreements between the two institutions. Hence, the Fund can hardly function as the 'external anchor' for the behavior of RFAs that 'lends credibility' to their actions by its stamp of approval (Weder di Mauro and Zettelmeyer 2017). In turn, this means that by increasing the political and economic ties with the neighbors that make up RFAs, the process of *regional* integration might come in inherent tension with the notion of a *global* lender of last resort.

It would be incorrect to say that the IMF has not recognized the challenge that regime complexity poses, but it is fair to note that it has only recently began to attempt to get to grips with this new reality. Concerns over coordination within the Global Financial Safety Net were clearly evident as early as 2011, when a series of high-level disagreements over program design in Greece, Ireland, and elsewhere prompted the G20 to release a set of guidelines for IMF-RFA cooperation (G20 2011). However, these represented a shortlist of high-level principles such as respecting each other's independence, cooperating as early as possible, and having consistent lending to avoid arbitrage; the only more substantial addition was a pledge to respect the Fund's preferred creditor status. The IMF itself started to grapple with the issues in 2013 with a stocktaking paper that was prepared by staff (IMF 2013a). Gradually, considerations of IMF-RFA cooperation found their way in other strategic documents prepared by staff related to crisis program reviews, the reform of the international monetary system, and the adequacy of the Global Financial Safety Net (IMF 2015a, 2016c, 2016b).

These discussions, often emanating from staff that seek to draw lessons from recent controversial experiences, have now began to slowly seep into adjustments to IMF policies. First, the Fund returned to the issue of the exceptional access policy, and more specifically if and how to lend in cases where debt is sustainable, but not with high probability. This was arguably the case of Greece, where the program introduced with relatively little deliberation a 'systemic exemption' to avoid debt restructuring, as discussed in Chapter 6. However, the subsequent painful experience generated momentum for another change in the framework. This unleashed a process of discussions that culminated with a reform to the exceptional access policy in 2015. The new policy for 'grey zone' cases where there is doubt over the high probability threshold for debt sustainability allows the Fund to still lend exceptional amounts without upfront debt restructuring, but only if non-Fund financing (in the form of resources or reprofiling of debt) is provided that improves debt sustainability and safeguards Fund resources (IMF 2015b).

While an improvement on the previous decision taken ad-hoc in the Greek context, the new policy raises as many questions as it answers. This adjustment recognizes that unlike in 2002, when the framework was initially introduced, the IMF is no longer operating alone. However, in its essence it allows the Fund to lend into countries with what it still considers unsustainable debt as long as it receives assurances that an alternative RFA is ready to bear the majority of the risks involved (Weder di Mauro and Zettelmeyer 2017). The provisions are particularly silent about how to proceed if such ex-ante promises of an alternative institution are vague (especially likely if the goal is to quickly unlock IMF funding in an emergency situation) or if the RFA refuses to comply with its commitments ex-post. Arguably this was the case with the second Greek program, where the IMF felt it had received assurances that the European partners would offer additional debt relief if necessary and found later that when push comes to shove, the Europeans refused to acknowledge the conclusion of the Fund that such relief is indeed necessary.

Another recent IMF policy development is the official introduction of a 'Policy Coordination Instrument' that explicitly seeks to make a more efficient use of global resources by providing a formal means of coordinating the work of IMF and RFAs. The PCI is, curiously, a non-financing arrangement designed to "help countries unlock financing from official and private donors and creditors, as well as demonstrate a commitment to a reform agenda" (IMF 2017c)[59]. Essentially, this is similar to a full-blown SBA arrangement, except that it does not provide financing – a PCI would include commitments by countries to particular targets which parallel fiscal and structural conditionality, would entail a debt sustainability assessment, and will require that it is fully financed - by others. Therefore, it seeks to respond to the increasing demand for precautionary SBA arrangements (i.e. without actual disbursements of money) among countries that require an IMF program to unlock RFA resources (IMF 2017b, p. 14). In

[59] The PCI draws heavily on the 'Policy Support Instrument', which is a technical assistance tool and a non-financing arrangement available to low income countries that is designed to signal the endorsement of their macroeconomic policies by the IMF.

short, it follows a similar logic to the new exceptional access policy by providing IMF advice without putting resources at risk. However, there are doubts about the appetite among countries in crisis to negotiate what is essentially a full-blown SBA program, with all the associated sovereignty costs without any of the direct cash benefits that they need most in a financial crisis.

Such changes to IMF policies are a welcome improvement to a status quo that lacks any significant mechanisms to coordinate the Global Financial Safety Net. They arise from a correct understanding of the power of complementarities in terms of resources, access, or information among IMF and RFAs to overcome some of the biggest critiques that are leveled at the Fund. Nevertheless, the lessons from the empirical findings suggest that unfortunately they are likely to fall well short of the goal of ensuring complementarity among the different layers and institutions. Instead, political dynamics highlighted in this research suggest that creditors and borrowers have significant temptations to make use of regime complexity to further their own goals through a conflictual approach that instrumentalizes overlapping institutions as a tool to gain bargaining leverage by threatening to exclude the Fund if it fails to align to their preferences. Such temptations are the key political reason why the policy adjustments that the IMF has undertook so far are likely to fail to generate the hoped-for complementarities. Instead, current policies appear designed to allow the IMF to limit its reputational concerns from interactions with RFAs by inducing further flexibility when somebody else provides the money (and hence takes on the credit risk) rather than to strengthen its ability to say ‘no’ to programs that it views as unsustainable.

Conclusion

The goal of this chapter was to draw empirical lessons about the validity of the proposed argument but also to step back from the particular cases and discuss the broader implications of the findings. Therefore, it first provided a cross-case comparison that leveraged variance between the Hungarian, Latvian, and Greek financial assistance programs to assess how the elements of the regime complexity framework related to each other. This analysis suggested that there is indeed a 'hierarchy' among strategies dominated by G5 creditors when there are significant disagreements over key policies with IMF staff (*entanglement*), followed by borrower countries that have their own conflicts with the Fund (*confrontation*). However, in contrast to concerns about turf-wars, in the absence of such disagreements the IMF has been relatively successful in forging cooperation with European RFAs through *co-working* as means to achieve its own goals. It then used cross-case variance to examine the validity of alternative explanations based on state-centric or bureaucratic accounts, and found them to provide a relatively weaker fit for the observed differences in terms of whose preferences were reflected in program design across the three cases.

The second aim of the chapter was to 'zoom out' from the specific discussion and assess what is the new knowledge that a regime complexity perspective brings to both theoretical and policy discussions. In terms of theoretical developments, such an approach suggests that traditional explanations might be missing an important causal mechanism for IO behavior if they do not pay attention to the strategies of actors in the context of overlapping institutions as the presence of alternatives significantly affects the bargaining balance among actors within IOs. More narrowly, the argument here also sheds some light on discussions of regime complexity, particularly in relation to questions of who benefits, what are the origins of the phenomenon, and whether the result is competition or cooperation between IOs.

Finally, the chapter discussed the present and future of IMF-RFA cooperation, underscoring that the challenge is, if anything, bound to become more important with developments in Europe, Asia, and elsewhere. Yet, current approaches within the IMF appear to focus on technocratic fixes that avoid thorny political questions about the need for credible ex-ante commitments over the division of labor between institutions. Recent policies appear to aim instead at reducing the short-term financial risk to Fund resources while downplaying threats to its reputation and longer-term relevance. This is perhaps understandable given the difficulty of inducing powerful actors to give up a status quo of 'strategic ambiguity' that favors them, but leaves a number of question marks over the future role of the Fund in a world of deeper regional integration.

VIII. Conclusion

The decisions advocated and ultimately taken by the IMF in the context of severe financial pressures have important consequences for crisis countries. By design, the Fund was created to help ameliorate balance-of-payments difficulties and avoid disruptive adjustments. Yet, as seen in the case studies presented here as well as in its broader history, it is often criticized – sometimes with good reasons, and sometimes less so – for prescribing the 'wrong' medicine and thus exacerbating rather than resolving a crisis. The IMF is expected to step in high-risk situations, where the stakes and the consequences of 'mistakes' are also equally high. Therefore, it is important to understand what makes the Fund 'tick' and where precisely and under what circumstances its decision-making procedures can lead it astray. This task is often undertaken in the hope of not just gaining knowledge, but also helping to identify flaws in a way that allows for them to be remedied.

With this motivation in mind, this thesis sought to investigate a new and increasingly important phenomenon – IMF-RFA cooperation. The overall conclusion suggests that this new type of interaction with overlapping institutions presents a challenge to both the modus operandi of the Fund and to academic understandings of its behavior. On numerous occasions the IMF found itself constrained to pursue a strategy that goes against the professional judgment of its staff. Yet, in other circumstances, the Fund managed to achieve more than otherwise was likely possible thanks to the presence of complementary institutions. It recently began to grapple with the full implications of existing in this new institutional environment, recognizing that the challenges it poses are long-term rather than contained to the specific circumstances of Europe as a region.

The goal of this concluding chapter is to bring together some of the key messages from the thesis that can potentially speak to this challenge. It therefore proceeds in three main parts. First, it summarizes the central elements of this research, such as the main argument, the empirical findings, and some of the implications. Second, it acknowledges the limits of the study, and seeks to discuss the scope conditions and the missing elements that might potentially weaken some of the conclusions reached. Third, it proceeds to offer tentative policy suggestions on topics such as the governance of the Fund, its approach to conditionality and financing, and its role in the global financial safety net. What follows are some final thoughts on the future of the IMF and the study of IOs.

Main takeaways from the research

The thesis sought to tackle a classic question – what explains the behavior of IOs? There is of course extensive scholarship that seeks to address this that can be broadly described as adopting a state-centric or bureaucratic perspective. Such accounts focus, respectively, on the preferences of powerful state principals channeled through formal or informal means and the 'two-level games' that domestic political actors play with IOs, or the incentives of staff to pursue rationalist or ideational goals. Yet, more recently scholars have observed a secular trend towards the proliferation of IOs with partially overlapping mandates, which has been given the name 'regime complexity'. However, this literature has largely focused on state strategies and the consequences for global governance, paying so far limited attention to the impact of regime complexity on IOs and their strategic response to such challenges. This thesis therefore sought to bring regime complexity to studies of IOs and IOs to studies of regime complexity through an examination of the challenges facing the IMF, a classic IO operating in an increasingly competitive institutional environment with the proliferation of alternative RFAs.

What is therefore the impact of regime complexity on IMF behavior? The thesis argued that under conditions of overlapping institutions, the causal drivers of such behavior might be found in moves outside the Fund. This differentiated the proposed explanations from existing accounts that tend to implicitly treat the IMF as a self-standing organization inside which creditors, borrowers, and staff clash. Therefore, the thesis focused specifically on how regime complexity affects the bargaining process between these key actors by introducing new outside options. The result of such bargaining determines whose views and interests shape program design, understood as comprising conditionality, financing modalities, and provisions for private sector bail-in. In the case of the IMF, the presence of overlapping alternative institutions opens a set of strategies previously unavailable to creditors, borrowers, or the Fund, which generates certain empirical predictions. More specifically, G5 creditors are hypothesized to make strategic moves to channel financial assistance through alternative institutions by *entangling* the IMF when both their interests are intense and they disagree with the preferred Fund strategy. If that is not the case, then borrowers facing similar disagreements with IMF staff can also use the threat of turning to another institution - if such an RFA closer to their preferences is already available, leading to a strategy of *confrontation*. Finally, lacking significant disagreements, Fund staff can achieve more of its preferences by engaging with RFAs with complementary resources, knowledge, or contacts through a *co-working* approach.

This argument was then tested empirically through three case studies, chosen to vary in accordance with the independent variable, but with many financial, institutional, and temporal factors held constant. It began with Hungary in November 2008, where the IMF for the first time cooperated with an RFA in the EU context after years of relative obscurity before the global financial crisis. Despite large-scale vulnerabilities in comparison to previous cases and other countries in the region, the IMF-EU program offered a surprisingly generous package. Relative to other contemporaneous programs, assistance came with comparatively little conditionality attached, an exceptionally large financing envelope, and a soft but effective bail-in of foreign banks. A closer process-tracing analysis suggested that the impetus for many of these measures came from Fund staff despite ideological differences with local negotiators. Hungary presented a case where G5 preferences were limited due to lack of direct financial exposure and local authorities also did not have major disagreements with Fund strategy. In this context, staff *co-worked* with other institutions to mobilize complementary resources through the EC and made use of contacts with private actors through the EBRD. Therefore, regime complexity allowed the IMF to put together a more ambitious program than it would have able to enact alone and which was perceived as more likely to succeed than if no overlapping institutions were present.

However, if Hungary was a relatively positive experience for the IMF at least initially, in Latvia the tables turned, and the Fund found itself in a 'junior role' just several weeks later in December 2008. In this case, IMF staff strongly preferred a program strategy based on at least some level of external devaluation, in keeping with lessons learned from the Asian financial crisis. However, local authorities were adamant that they wanted to keep the currency peg with the euro intact and embark on a riskier internal devaluation strategy. In this context, they turned to the EC in key moments in December 2008 and June 2009 to ensure that they will receive financial backing from the Europeans for this strategy as a bargaining tactic to *confront* a reluctant IMF. The result was a program with very high conditionality, a large financing contribution from the Fund which nonetheless was only half as big as that of the Europeans, and a somewhat mixed result in terms of private sector involvement of cross-border banks. Thus, in Latvia a borrower government that was in conflict with the IMF over program strategy deliberately used the presence of an alternative RFA to align the Fund to its preferences in the absence of intense G5 preferences. In the absence of overlapping institutions, it is likely that a similar small, open, and non-systemic economy would have instead had to accept the prescriptions of the IMF.

Finally, the thesis also tackled the now infamous case of the first Greek program of May 2010. It focused on the role of the IMF, which has received relatively limited attention so far in analyses of the euro area crisis. Unlike in Hungary and Latvia, the direct financial exposure of financial institutions and worries about contagion to Italy and Spain meant that in this case G5 creditors, especially France, Germany, and, to an extent, the United States, had strong preferences. In particular, they sought to avoid a debt restructuring at the outset of the program, a policy advocated by many, if not all, at the Fund at the time. Throughout pre-program negotiations, euro area states kept the Fund at an arm's length and ultimately decided to only invite the IMF at a late stage once debt restructuring has been ruled out. They however did not rely on their formal or informal power through the Executive Board to keep the IMF in check. Instead, they created an alternative financing arrangement, the EFSF, through which they disbursed large amounts of financial assistance, thus *entangling* Fund management within overlapping institutions and leaving them little choice than to join in at their terms. Therefore, in this case, intense G5 preferences and disagreements with IMF strategy led creditors to actively wield the threat of exclusion to achieve their goal - a program that was at the same time the biggest and the most controversial in the recent history of the institution.

After carrying out this process-tracing within-case analysis, the thesis proposed stepping back and assessing the overall empirical findings. A cross-case comparison leveraged the variance between the three programs to provide an additional test for the regime complexity argument. In particular, it assessed the prediction that in the absence of ex-ante coordinating mechanisms there will be a ‘hierarchy’ of outcomes, with G5 preferences taking precedence, followed by borrower preferences, and finally, in cases where there are no significant disagreements between either creditors and borrowers and the Fund, staff preferences. After this, it ‘zoomed out’ to assess the current state of affairs when it comes to IMF-RFA cooperation, including outside Europe. It found that RFAs are continuing to proliferate and develop across most regions, most notably in Asia, while the Fund is beginning to grapple with some of the implications. However, as of late-2017, the IMF policy proposals focus on shifting the financial burden and leave the Fund susceptible to repeating many of the same mistakes. What is needed to avoid this are strong ex-ante commitment mechanisms, which would limit the use of the threat of exclusion by self-interested actors by reducing areas of duplicating activities. Yet, this would require powerful actors to give up on the strategic ambiguity of current IMF-RFA relations that has served them well in achieving their preferences so far.

Limitations and further research

This thesis has sought to draw attention to IMF-RFA cooperation as an example of the larger phenomenon of how IOs behave under conditions of regime complexity. In doing so it made choices that involve trade-offs, which point to both the potential limits of the argument and to areas of fruitful further research. These can be summarized in two categories. On the 'input' side of the argument, it consciously bracketed out the sources of preferences of actors and sought to focus instead on whose preferences 'win out' in bargaining over program design. On the 'output' side, in considering such program design the model does not specify the direction or size of outcomes in terms of conditionality, financing, or bail-in that stem from such strategies. Both dimensions are discussed in turn in this section.

Perhaps a key constraint of the current model is the need to establish the ex-ante preferences of actors in the regime complex. In that sense, it is restricted to analyzing strategies and their impact on IO behavior under exogenously given preferences. This approach is fruitful for short-term interactions such as the ones that occur during program negotiations or around key review decisions, which are under study here. However, over longer time periods it is likely that the very interaction between IMF, RFAs, borrowers, and creditors will come to shift some preferences endogenously. Therefore, a fuller model would seek to incorporate how the IMF-RFA relationship changes over time in a way that can in turn affect actors' preferences through learning or through techniques such as 'layering'. This would most naturally be achieved by drawing on insights from the literature on policy learning and historical institutionalism (Gocaj and Meunier 2013; Schwarzer 2015).

Another important caveat on the 'input side' of the model is the need to avoid reading staff preferences as an appropriate measure of 'best' or even 'independent' judgment. Normatively, the model treats staff preferences no different from creditor or borrower preferences and explicitly avoids engaging with an assessment of the 'appropriateness' of such preferences.

Nevertheless, it might be easy to jump to a conclusion that staff is ‘independent’ and draws on ‘technocratic’ expertise to propose ‘objectively best’ solutions. Yet, there is evidence that IMF staff preferences might have a systematic bias towards a particular, ‘neoliberal’ ideology and that bureaucratic incentives can lead staff towards ‘dysfunctional’ behavior (Barnett and Finnemore 2004; Chwieroth 2013; Nelson 2014). Therefore, this research should not be seen as necessarily endorsing IMF staff advice, since providing assessment of its economic appropriateness lies well beyond the scope of the thesis.

Another set of limits are evident on the ‘output’ dimension of this research, which stops well short of making specific claims about the size or direction of the influence of regime complexity on particular program elements. Whereas it discusses how bargaining affects whose preferences are reflected in program dimensions such as conditionality, financing, and private sector involvement, there are a number of potentially confounding factors that make more precise predictions about the magnitude of the effect difficult, most notably due to variance in economic conditions and the specific contours of each crisis. This leaves significant scope for potential integration with existing theories that focus on explaining precisely such variance in Fund program outputs, most likely through a large-N quantitatively oriented study once enough cases of IMF-RFA cooperation have been observed. Furthermore, the framework specifies that for successful borrower strategies in case of disagreement the local government needs to rely on the presence of a suitable RFA exogenously aligned (or at least open to being aligned) to its preferences. However, the current empirical observations do not make it possible to test directly the counterfactual case, namely what will happen to borrower governments if such alternative institutions are lacking in the ‘fixed’ menu that is ‘offered’ to such countries in crisis.

Another question that this research leaves unresolved is whether the involvement of more than one institution in financial assistance is ultimately positive or negative for crisis management. One way to approach this question would be to look at macroeconomic and social outcomes. However, the current framework does not provide a test for whether the policies adopted in programs for Hungary, Latvia, and Greece were appropriate, or even whether the IMF advocated 'better' or 'worse' financial strategies than the EC. Such an economic assessment requires establishing counterfactuals that are beyond the scope of this research. Another way to tackle the topic is to consider whether the presence of multiple institutions provides a healthy competitive 'check' on the Fund or instead undercuts its ability to act independently and hence arguably to serve the 'best' long-term interests of both creditors and debtors. It appears for example that in Latvia the Fund might have been 'wrong' to doubt the possibility of adjustment under the peg, while in Greece IMF staff that argued for debt restructuring was more 'prescient' than the Europeans. Given cross-cutting results, it is likely that the answer is subtler and conditional on the specific configurations of preferences in any given case.

In addition to these questions, the argument can clearly be extended in ways that enhance its external validity. So far empirical observations of IMF-RFA cooperation have been very limited in both number and regional variance. In particular, such cases have been clustered in time and space in Europe in 2008-2013, and while the thesis has suggested that they are representative of broader dynamics it remains impossible for now to dismiss with certainty the possibility that this was not a product of a very specific constellation of circumstances. Furthermore, this thesis has focused on the core justification for the existence of the Fund – crisis lending, but the IMF also engages in other activities such as surveillance and technical assistance. It would therefore be worth to investigate whether similar dynamics occur in other areas of IMF behavior. Finally, the primary ambition of this research was to contribute to our knowledge of the Fund, but to extend this argument more broadly it will be certainly necessary to test it against a larger sample of IOs with varying characteristics.

Policy implications for the IMF

Drawing on the model of regime complexity presented in this thesis paints a rather bleak portrait of the future of the Fund, at least when judged against its sudden re-emergence to prominence in the midst of the global and European financial crises. It suggests that the challenge of IMF-RFA coordination is only going to increase, but that the technical and technocratic fixes we have observed so far are not going to substantially alter the outcomes when the next crisis comes. Nevertheless, a regime complexity argument might also suggest the outlines of an alternative approach by directing attention and efforts to areas that require reform.

Perhaps the most direct policy implications concern proposed governance reforms. The most sustained criticism of the Fund has been to point out the overrepresentation of Europe and the US in terms of voting power relative to the rapid shifts in the distribution of world GDP (Eichengreen and Woods 2016; Vestergaard and Wade 2015). A wide variety of different approaches to remedying this have been proposed, and the Fund finally passed a reform that realigned partially some voting power from over-represented (European) to under-represented (emerging market) countries, among other changes (IMF 2016d). This is indeed welcome and, in the context of contested multilateralism, might reduce some of the long-term incentives for creating alternative institutions.

Yet, what this thesis has demonstrated is that control can be exercised by means that go beyond formal and informal voting power by brandishing the threat of exclusion in the presence of overlapping institutions. Such control might be easier to exercise if the creditor also has a disproportionate role in IMF governance[60], but does not necessarily depend on this. Instead, the key determinant is the financial capacity of a creditor required for setting up alternative institutions. Thus, ultimately it is hard to imagine that in Greece, where creditors wielded the threat of exclusion through the creation of the EFSF, the Fund would *not* have acquiesced to their preferences even if its governance structure was perfectly balanced (not the least because of the marginalization of the Executive Board in this case). Threats to the perceived independence of the Fund therefore arise directly from its engagement with RFAs *regardless* of its internal governance structure and this can contribute to eroding the long-term legitimacy of the IMF. Therefore, finding ex-ante mechanisms for resolving conflicts should be high on the list of priorities. Nevertheless, it is also particularly tricky as it not only requires powerful actors to accept constraints on their freedom, but also might go against the preferences of some of the 'weaker' member states in terms of voting power, such as Asian countries, that might also like to retain the option of using their RFAs flexibly.

Beyond this general governance point, the experience in Europe holds lessons about program design. In terms of conditionality, IMF-RFA cooperation has the potential to leverage the specific knowledge and expertise of each institution. The Fund can draw on its experience across time and countries in financial stabilization and bring strong expertise to the table, whereas RFAs often have much deeper local knowledge of the borrower country and its

[60] For example, a disproportionate voting power can make it possible to theoretically form blocking coalitions within the IMF, or can increase the incentive of IMF management to align with creditor preferences.

political economy. In theory, this complementarity should improve overall conditionality as both organizations focus on their strong areas leading to a division of labor. Yet, determining what is the appropriate division is not a technocratic question. In Hungary, this emerged organically as the EC staff accepted the lead of the Fund in most financial and macroeconomic matters, and provided input over structural reforms and the EU legal framework. Yet, in Greece, Fund conditionality was just a fraction of overall conditionality, with many overlapping areas. Both the Fund and RFAs are sensitive to the dangers of a borrower engaging in arbitrage and 'conditionality shopping', but seem to be initially oblivious to the challenge of solving differences between themselves. None of the programs included any particular provisions for internal conflict resolution. Therefore, it is necessary to establish such procedures at an IMF-RFA level, and, moreover, to do this ex-ante before the particular preferences over a given situation begin to affect its design (Henning 2011). In that sense, aligning the qualification criteria and conditionality guidelines seems to be a sensible proposal, even if it still has to deal with the problem of time inconsistency and credible commitment issues faced by politically powerful states (Lamberte and Morgan 2012). Another area with clear potential benefits from a division of labor are debt sustainability assessments, which should be clearly within the purview of one organization even if there are avenues for input from external sources in their preparation.

Perhaps the biggest implication of the regime complexity argument for program design is in relation to financing arrangements. On the one hand, IMF-RFA cooperation carries the promise of overcoming the problem of insufficient Fund resources to respond to potential liquidity needs. Since the advent of financial globalization in the 1990s, and despite the recent quota increase, the ‘war chest’ of the IMF has been falling as percentage of global capital flows, causing worries particularly at the outset of the global financial crisis that it might not be sufficient for the task. The obvious solution is to increase IMF’s own resources to a level commensurate with capital flows, which would most likely again return it to the preeminence it enjoyed vis-à-vis RFAs from before 2008. Yet, that appears problematic due to the need to also adjust voting power and quotas; instead, the IMF has rightly focused on making sure it can cooperate with others given the large scale of financial firepower embedded in RFAs, currency swap lines, and international reserves. On the other hand, the presence of alternative financing sources can carry significant risks for the Fund that current proposals for IMF-RFA cooperation do not appear to fully appreciate. It is increasingly possible that in controversial cases the Fund can engage in burden-shifting, that is, agreeing to participate in a program that has little chance of success only because it is not directly financially ‘on the hook’ if the situation deteriorates. Unfortunately, this appears to be the direction in which the Fund is moving with the Policy Coordination Instrument and revisions to the exceptional access policy.

Finally, there are also less clear but potentially important implications when it comes to private sector involvement. It is notable that this was often the most controversial topic in euro area programs such as Greece, Ireland, and Cyprus, but was not necessarily a source of conflict in emerging European programs. In the latter region, such bail-in was facilitated by the economic structure but also enabled by the presence of the EBRD, which had close contacts with financial institutions operating locally. Therefore, IMF-RFA cooperation carries particular promise when financial assistance to the sovereign through the IMF can be linked thanks to the coordinating role of regional institutions with credible commitments by private actors to avoid capital outflows, as in the case of the Vienna Initiative. There is also a second aspect in which the presence of overlapping institutions changes subtly Fund's behavior in relation to bail-in. Given limited resources, the IMF has often seen itself as playing a 'catalytic' role that seeks to induce private investors to return to a country that has carried out the necessary adjustment. In the future, it is also necessary to think about the 'catalytic' role of the Fund in relation to mobilizing funding from RFAs, which can be an intermediate step between full IMF financing after a sudden stop, and fully restored market access.

The promise and perils of the future

Perhaps what this investigation has revealed most clearly is that the presence of RFAs is a sustained challenge for the IMF going forward. It is however much more than a pure technocratic discussion, as overlapping institutions also provide possible avenues for alternative strategies for creditors and debtors to constrain the IMF whenever it goes against their intense preferences. Their desire to preserve some strategic ambiguity is likely to prove the hardest challenge when it comes to structuring IMF-RFA cooperation. Yet, if carefully navigated, such cooperation provides an alternative way to deal with many of the issues that have plagued the Fund over the past few decades, such as selecting an appropriate mix of conditionality and financing arrangements.

On current trajectory, however, the IMF is 'damned if it cooperates and damned if it does not'. In one case it risks finding itself going along with programs against its better judgment and in the other it risks falling back into the irrelevance of 2002-2007. Unless IMF-RFA cooperation is structured ex-ante with in-built conflict resolution mechanisms that can withstand the ex-post temptations to defect, it appears possible that the Fund will recede more and more from its financing role and towards a coordinating, surveillance, and knowledge roles in a process that is similar to the recent developments at the World Bank, another formerly predominant international institution increasingly facing regional challengers.

Ultimately, the IMF is likely to be one of many ‘classic’ IOs that find themselves increasingly challenged by the presence of other overlapping institutions. Understanding IO behavior in this context needs to take into account the evolution of the institutional environment in which such institutions operate. This is likely to affect different issue areas, cases, and IOs in different ways rather than necessarily lead to either disruptive fragmentation or healthy competition. In turn, this also raises the challenges associated with studying IOs, but comes with associated benefits of more closely capturing key causal mechanisms in 21st century global governance. Whereas there are pitfalls to regime complexity, it may still be possible and worth the effort to structure cooperation in ways in which it enhances the upsides and limits the downsides. How precisely to do this is likely to be increasingly central to the future of both the study and the practice of IOs.

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Appendix 1: List of interviewees

	Organization	Position[61]	Date and place
1	World Bank	Regional official, emerging Europe	Vienna, July 2015
2	World Bank	Senior official, research role	Washington, D.C., September 2015
3	IMF	Senior member of mission team to emerging European country	Washington, D.C., September 2015
4	IMF	Senior official, research role	Washington, D.C., September 2015
5	IMF	Regional expert, emerging Europe	Washington, D.C., September 2015
6	IMF	Senior official (Director)	Warsaw, February 2016
7	Central Bank of Poland	Management Board	Warsaw, February 2016
8	IMF	Advisor to Executive Board	Warsaw, February 2016
9	Financial Supervisory Authority, Poland	Senior official	Warsaw, February 2016
10	IMF	Regional expert, emerging Europe	Warsaw, February 2016
11	Top 10 Polish bank	Chairman	Warsaw, February 2016
12	IMF	Senior member of mission team to emerging European country	Brussels, February 2016
13	European Commission	Senior EC official	Brussels, February 2016
14	Central bank of Hungary	Governor	London, May 2016
15	EBRD	Senior official	London, May 2016
16	Think-tank, Greece	Director	Athens, June 2016
17	Think-tank, Greece	Senior expert	Athens, June 2016

[61] Position listed is the position held for the period under discussion during the interview. It may therefore be either a current or a former position.

18	Think-tank, Greece	Senior expert	Athens, June 2016
19	Government of Greece	Senior adviser	Athens, June 2016
20	Government of Greece	Senior adviser	Athens, June 2016
21	Central Bank of Romania	Deputy-governor	Bucharest, July 2016
22	Central Bank of Romania	Chief economist	Bucharest, July 2016
23	Central Bank of Romania	Senior official	Bucharest, July 2016
24	World Bank	Senior official	Bucharest, July 2016
25	Central Bank of Ireland	Governor	Dublin, September 2016
26	Central Bank of Ireland	Senior official	Dublin, September 2016
27	Ministry of Finance, Ireland	Senior official	Dublin, September 2016
28	Ministry of Public Revenue, Ireland	Senior official	Dublin, September 2016
29	Ministry of Finance, Bulgaria	Senior official	Sofia, September 2016
30	IMF	Advisor to Executive Board	Sofia, September 2016
31	Hellenic Banking Association	Chairman of Board of Directors	Oxford, November 2016
32	IMF	Senior official (Director)	Oxford, December 2016
33	IMF	Senior official (Deputy Director)	Oxford, March 2017
34	IMF	Senior member of mission team to emerging European country	Oxford, June 2017