



THE LONDON SCHOOL
OF ECONOMICS AND
POLITICAL SCIENCE ■



LSE 'Europe in Question' Discussion Paper Series

The European Rescue of the Washington Consensus? EU and IMF Lending to Central and Eastern European Countries

Susanne Lütz & Matthias Kranke



LEQS Paper No. 22/2010

May 2010



Editorial Board

Dr. Joan Costa-i-Font

Dr. Vassilis Monastiriotis

Dr. Jonathan White

Ms. Katjana Gattermann

All views expressed in this paper are those of the author and do not necessarily represent the views of the editors or the LSE.

© Susanne Lütz & Matthias Kranke



The European Rescue of the Washington Consensus? EU and IMF Lending to Central and Eastern European Countries

Susanne Lütz & Matthias Kranke*

Abstract

The latest global financial crisis has allowed the International Monetary Fund (IMF) a spectacular comeback. But despite its notorious reputation as a staunch advocate of restrictive economic policies, the Fund has displayed less preference for austerity in recent crisis lending. Though widely welcomed as overdue, the IMF's shift away from what John Williamson coined the 'Washington Consensus' was met with resistance from the European Union (EU) where it concerned Central and Eastern European (CEE) countries. The situation of hard-hit Hungary, Latvia, and Romania propelled unprecedented cooperation between the IMF and the EU, in which the EU has very actively promoted orthodox measures in return for loans. We argue that this represents a European rescue of the Washington Consensus. The case of Latvia is paradigmatic for the profound disagreements between an austerity-demanding EU and a less austere IMF. The IMF's stance contradicts conventional wisdom about the organization as the guardian of economic orthodoxy. To solve this puzzle, we shed light on three complementary factors of (non)learning that have shaped the EU's relations vis-à-vis CEE borrowing countries in comparison to the IMF's: (1) a disadvantageous institutional setting; (2) vociferous creditor coalitions; (3) the precarious eurozone project.

Keywords: International Monetary Fund (IMF); European Union (EU); Washington Consensus; lending; learning; Central and Eastern Europe (CEE); Latvia

* **Otto Suhr Institute for Political Science, Free University of Berlin, Germany**

Correspondence:

Prof. Dr. Susanne Lütz, Otto Suhr Institute for Political Science, Free University of Berlin, 14195 Berlin, Germany; email: luetz@zedat.fu-berlin.de

Matthias Kranke, M.A., Otto Suhr Institute for Political Science, Free University of Berlin, 14195 Berlin, Germany; email: mkranke@zedat.fu-berlin.de

Table of Contents

Abstract	
1. Introduction	1
2. The Conventional Wisdom: The IMF as a Tough Policy Enforcer	3
3. United in Disaccord: Joint EU-IMF Lending to Latvia	5
4. Tougher than the IMF: EU Lending and Non-learning	11
4.1. Disadvantageous Institutional Setting	12
4.2. Vociferous Creditor Coalitions	20
4.3. Precarious Eurozone Project	25
5. Conclusion	30
References	

Acknowledgements

This is a slightly revised version of a conference paper presented at the 51st Annual Convention of the International Studies Association (ISA), New Orleans, LA, February 17–20, 2010. We wish to thank Ian Canaris, Stephan Kreutzer, Sibylle Schaefer, and Andreas Storz for their invaluable research assistance.

The European Rescue of the Washington Consensus? EU and IMF Lending to Central and Eastern European Countries

1. Introduction

The International Monetary Fund's (IMF) record of activity looked very bleak before Monday, September 15, 2008. Merely four countries—Peru, Gabon, Iraq, and Honduras—had received financial support under a Stand-By Arrangement (SBA), the major IMF facility for non-concessional loans¹. Georgia became just the second country in 2008, after Honduras, to sign an SBA, and a number of other countries soon followed suit. Almost seventeen months and twenty-two SBAs later, including Georgia's, with a total agreed volume of more than fifty-nine billion special drawing rights (SDRs)², the IMF has staged a first-class comeback after having fallen somewhat into disuse, especially since 2004, when many borrowing countries began to repay their loans. Its fate, many observers acknowledged, has been turned around by the advent of the latest global financial crisis.

¹ The IMF's lending 'portfolio' comprises various other loan facilities; currently, these are the Flexible Credit Line (FCL), the Extended Credit Facility (ECF; formerly the Poverty Reduction and Growth Facility, PRGF), the Exogenous Shock Facility (ESF), and the Extended Fund Facility (EFF) (more at <<http://www.imf.org/external/np/exr/facts/howlend.htm>>).

² The SDR is an international reserve currency that was created by the IMF in 1969. Based on a weighted basket of the four lead international currencies (in decreasing order: U.S. dollar, euro, Japanese yen, and British pound sterling), the SDR stood at US\$1.53 on February 12, 2010. The data on SBAs above is provided as of February 28, 2010. The IMF updates its current lending arrangements on a monthly basis (<<http://www.imf.org/external/np/fin/tad/extarr11.aspx?memberKey1=ZZZZ&date1key=2020-02-28>>).

However, the immediate repercussions of the crisis seemed to spell the end for strictly orthodox lending policies. The London Summit in April 2009 sent an unmistakable signal that the old Washington Consensus (Williamson 1990) was dissolving or had in fact already been declared 'dead', as British Prime Minister Gordon Brown put it; even IMF Managing Director Dominique Strauss-Kahn emphasized that fiscal stimuli were now being embraced as an integral part of countercyclical economic policies. Though widely welcomed as overdue, the IMF's new approach was met with resistance from the European Union (EU) where it concerned Central and Eastern European (CEE) countries. Because some of the countries in that region had been particularly hard hit by the global financial crisis and experienced severe balance of payments (BoP) problems in its aftermath, their situation initiated unprecedented cooperation between the IMF and the EU. Hungary, Latvia, and Romania have all secured multilateral aid packages of different compositions, including IMF loans under the SBA facility and EU loans under Article 119 of the Treaty establishing the European Community (TEC)³ for member states not (yet) part of the Economic and Monetary Union (EMU) of the EU.

The conflict in crisis lending between the EU and IMF presents the fundamental puzzle to be 'solved' in this article. We argue that the EU's recent lending policies amount to a European rescue of the Washington Consensus⁴: While the IMF has—at least in part—relaxed its formerly tight stance on economic conditionality attached to its loans, the EU has actively promoted orthodox measures in return for loans to those countries that are designated to join the single currency area and hence have to meet certain economic criteria. Against this background, the cases of Hungary, Latvia, and Romania, all of which are EU member states outside of the eurozone, exemplify the rift between the IMF and the EU over how best to overcome the severe balance of payments problems looming in these CEE countries.

³ With the entry into force of the *Treaty of Lisbon* on December 1, 2009, TEC (initially the 1957 *Treaty of Rome*) was renamed *Treaty on the Functioning of the European Union* (TFEU). Article 143 of the consolidated TFEU is equivalent to the former Art. 119 TEC, under which Hungary, Latvia, and Romania were given BoP assistance.

⁴ The title of our article is inspired by Alan Milward's (1992) monograph *The European Rescue of the Nation-state*.

This article is organized as follows. We start with a brief review of the relevant literature to extract the conventional wisdom about the IMF, which happens to be a more appropriate characterization of recent EU lending practices to CEE countries. We then take a closer look at the case of Latvia, which, planning to accede to the euro area by 2014 (revised from 2012), has shouldered the harshest conditions of the three countries, to establish what we coin the European rescue of the Washington Consensus. To solve the underlying puzzle, we shed light on three complementary factors of (non)learning that have shaped the EU's relations vis-à-vis CEE borrowing countries in comparison to the IMF's: (1) a disadvantageous institutional setting; (2) vociferous creditor coalitions; (3) the precarious eurozone project.

2. The Conventional Wisdom: The IMF as a Tough Policy Enforcer

The International Monetary Fund has a notorious reputation for its orthodox lending policies. In the academic literature, the IMF has traditionally been seen as prescribing such policies regardless of the specific circumstances in countries that applied for loans to overcome balance of payments problems. This perception also dominates contemporary media coverage. John Williamson, as early as 1989 (Williamson 2004–05: 195), coined the term 'Washington Consensus' to summarize the form of economic orthodoxy to which both the IMF and World Bank adhered in their policy reform advice to indebted Latin American countries (Williamson 1990). Twenty years later, Williamson's phrase is still a good point of departure for reviewing the wide body of literature on IMF lending policies. Indeed, in looking at 'lending side' of the equation (allocation of funds, not their impact⁵), this phrase encapsulates much of what has long been considered characteristic of IMF policies:

⁵ Much has also been written on the effects—both economic and political—of IMF lending. See, for example, Vreeland (2007: ch. 4), Edwards (2006), Garuda (2000), or Brown (2009).

In return for continued disbursements of IMF loans, countries must follow austere policy conditions designed to ensure debt repayment, stabilize the economy, and promote national prosperity (Vreeland 2007: 132).

Scholars attribute austere IMF lending to various causal mechanisms, ranging between internal and external sources. As to internal sources of IMF policies, the role of staff has received the most attention. Momani (2005), for example, argues that the IMF's entrenched organizational culture prevents change or—at the very least—reduces the rate of change even after official attempts have been launched to 'streamline' conditionality. Furthermore, IMF staff seems to be more sympathetic toward those who share a similar professional background and, in effect, validate its own policy preferences (Chwieroth 2007a). This strand of the literature sees little change within the IMF but concludes that staff positions are more or less constant over time.

The most prominent external source of IMF policies has been located in its host country, the United States. The local proximity to the U.S. government may be a factor or not, but U.S. (geo-)political and economic interests—with support from private actors (Broz and Hawes 2006)—figure among the common explanations for the thrust of lending policies, as well as its occasional deviations (Momani 2004; Stone 2008; Thacker 1999; Wade and Veneroso 1998). The strength of U.S. influence on IMF conditionality, coupled with its effective veto power on the Executive Board, dates back to the early days of the organization (Babb 2003: 15–17, 2007: 155). Likewise, other large stakeholders, often also driven by influential domestic business interests, try to pursue their own agenda at the Fund (Copelovitch 2003, 2004). An interesting twist lies in the argument that borrowing countries utilize IMF assistance to signal economic soundness to investors (Bird 2002; Broome 2008; Marchesi and Thomas 1999). While accounting for individual countries in crisis lending, this strand overlooks the role of economics blocs, such as the EU.

These analyses cannot adequately explain the conflicting views that the EU and IMF have held on recent crisis lending to CEE countries. Their many impressive findings

notwithstanding, few of these analyses capture how the IMF has moved away from strictly orthodox policies. Gould's (2006) study of supplementary financier influence proves to be an exception in this regard. More important even, few capture how the EU as a new actor in crisis lending has come to the rescue of the Washington Consensus, which some had already pronounced dead.⁶ Unlike some have predicted (Gore 2000; McCleery and De Paolis 2008), its demise is not inevitable. Contrary to the conventional wisdom in both academia and news reporting, we claim that the Washington Consensus has not been rescued by the IMF but by the EU. The result has been austere lending to CEE countries. Latvia, where tensions became most visible, serves as an instructive case to emphasize the conflict between the EU and IMF in crisis lending.

3. United in Disaccord: Joint EU-IMF Lending to Latvia

The global financial crisis has given rise to unprecedented joint EU-IMF lending to Central and Eastern Europe. Since 2008, Hungary, Latvia, and Romania have applied for, and received, multilateral loans packages, which are mostly composed of loans from the IMF under SBA and BoP assistance from the EU under Art. 119 TEC.⁷ Apart from receiving the same kind of multilateral assistance (see Table 1), the three countries have another fundamental feature in common: All are members of the European Union, but none has yet acceded to the euro area. Their national currencies—the Hungarian forint, the Romanian leu, and the Latvian lats—have not been replaced by the euro. Farthest down the track, Latvia has scheduled its eurozone entry for 2014 (revised from 2012). As an interesting aside, the incumbent governments of all three countries lost office in 2009—in each case after part of the funds had been loaned out.⁸

⁶ Some authors have therefore proposed the formation of a 'post-Washington Consensus' (see Krogstad 2007; Stiglitz 2008).

⁷ For a detailed breakdown, see Table 2 in the next section.

⁸ In February 2009, the Latvian Prime Minister Ivars Godmanis resigned and was officially succeeded by Valdis Dombrovskis the next month. In April 2009, the Hungarian Prime

Table 1. SBAs and EU Balance-of-Payment Assistance for CEE Countries since 2008

	<i>SBA from the IMF</i>	<i>BoP Assistance from the EU</i>
Hungary	November 6, 2008	November 17 (19), 2008
Latvia	December 23, 2008	January 26 (28), 2009
Romania	May 4, 2009	June 23, 2009

Note: Bracketed numbers in the right-hand column indicate the day on which the memorandum of understanding (MoU) with the respective borrowing country was signed in Brussels as opposed to the country's capital.
Source: IMF and EU.

Among the three cases of joint EU-IMF lending, Latvia represents the most contentious one. Nowhere have EU interests been both more evident and more at stake than in Latvia. Substantial differences with the IMF started to surface as the unfolding crisis forced Latvia to seek external help. In particular, the EU and the IMF have had some profound disagreements over the best course of action for the Baltic country, and the political authorities in Riga have often found themselves caught between diverging external demands. In the following paragraphs, we seek not only to sketch the interactions in the 'lending triangle' between the EU, the IMF, and the Latvian authorities, but also to highlight the prevailing differences over how to address the crisis in Latvia. It is important to note here that virtually all of the conflict between the EU and the IMF has revolved around one issue: The Latvian peg, the linchpin of the country's current exchange rate regime on the route to its planned accession to the single European currency area, has come to be the main bone of contention.

Two decisions—one by the EU, the other by the IMF—predated the intense wrangling over Latvia's rescue package. At the request of the Latvian authorities, the lats was included in the Exchange Rate Mechanism II (ERM II) in late April 2005 at a

Minister Ferenc Gyurcsány fell in a constructive vote of no confidence to Gordon Bajnai. In October 2009, the Romanian Prime Minister Emil Boc seemed to become the latest victim of the crisis in CEE when also being ousted in a vote of no confidence, but after a close presidential race, the re-elected President Traian Basescu again appointed Boc to lead the government.

central rate of 0.702804 per 1 euro. Even though currencies in ERM II are generally allowed to float within a range of plus or minus fifteen percent relative to this rate, the Latvian authorities unilaterally committed themselves to keeping the lats within a range of one percent in either direction. The inclusion of the lats in ERM II was the first decision that set the stage for the profound disagreements between the EU and the IMF.

The second one was an IMF decision in June 2007 that would later concern three very dissimilar countries, namely the Maldives, China, and Latvia. Influenced at least in part by U.S. Treasury concerns about the presumably undervalued Chinese renminbi, the IMF Board of Executive Directors decided to strengthen country surveillance under the regular Article IV consultations⁹. Following that decision, IMF staff was entrusted with the task of detecting ‘fundamentally misaligned’ (either under- or overvalued) currencies. IMF staff first tested the Maldives only to find out that the country had other, more pressing economic problems than a flawed exchange rate regime. The candidate next in line was Latvia. IMF staff found that the Latvian lats was indeed overvalued as the country suffered from a large current account deficit. These findings prompted a suspension of consultations under Art. 4 because many at the IMF feared that if Latvia were allowed to pass through such consultations despite an obvious fundamental currency misalignment, China could never be encouraged to realign—that is, revalue—its own currency. In the end, discussions about Latvia, a potential showcase for fundamental misalignment, were silenced at the board level (Interview 2009c)¹⁰.

It was against the background of these two decisions that the first differences emerged behind the scenes. The advent of the financial crisis in the Baltics put an end to the unnatural official silence about Latvia’s exchange rate regime. Thus, quite a while before the emergency deal was sealed with the eventual backing of both the

⁹ Article IV (‘Obligations Regarding Exchange Arrangements’) consultations are usually held annually to assess financial and economic developments in individual member countries.

¹⁰ Interviews with IMF officials at the organization’s headquarters in Washington, DC, were conducted on condition of anonymity. For ease of reading, we have deviated from the spoken word in the interviews where grammatically appropriate without changing the meaning of the quotes.

EU and the IMF, the misaligned nature of Latvia's fixed exchange rate appeared on the IMF's agenda. Conflict had thus already been smoldering under the surface when, in December 2008, the Governor of the Bank of Latvia, Ilmārs Rimšēvičs, simultaneously involved the IMF and other institutions. The central bank governor also called the President of the European Central Bank (ECB), Jean-Claude Trichet, the Director General for Economic and Financial Affairs¹¹, Marco Butti, the Governor Alternate of France at the World Bank's International Finance Corporation (IFC), Xavier Musca, and the Governor of the Swedish Central Bank, Stefan Ingves, in an effort to coordinate support.

The conflict inevitably rippled through the IMF as it became known that Latvia would seek IMF help. The SBA under discussion provoked strong resentment from countries that had already had their share of bad experiences with pegging their national currencies. Russian representatives, for example, lamented: "Why are we doing this? This is ... just the thing we tried to do, and [it] failed" (Interview 2009d). While the program received unanimous acclaim from the EU organs, some of the (larger) EU member states, most notably the United Kingdom as a prominent 'euro outsider', remained highly skeptical. In light of the country's short but painful experiment with the ERM II from 1990–92, UK representatives cautioned against the risks involved in maintaining a peg. A floating currency, they argued, was less liable to attacks by speculators and thus less prone to collapse. Yet this skepticism fell on deaf ears. The peg was ultimately incorporated into Latvia's program with vocal support and under mounting pressure from the Nordic countries, Sweden in particular, and the European Commission. "European discipline" (Interview 2009a) worked: As the program was put before the Board, no country even dared to abstain (Interview 2009c).

In retrospect, alternative solutions did not stand a chance. Three exit strategies would have been possible for Latvia from a purely economic point of view: floating,

¹¹ The Directorate General for Economic and Financial Affairs (DG ECFIN) reports to the Commissioner for Economic and Monetary Affairs, currently Olli Rehn from Finland.

realignment, and euroization¹² (Levy-Yeyati 2009). As described above, the key advocates of a floating regime were sidelined early on; realignment in the form of a contained devaluation never really made it onto the agenda; those at the IMF who initially favored euroization as the right option for Latvia encountered fervent opposition from the euro club:

Then the Fund, pondering what was the right thing to do, in the end ... advocated ... what they called a 'unilateral euro to euroize the economy', but with a lower exchange rate. They would devalue a bit ...; not join but just switch the currency so that it could be the legal tender. Then, the ECB and all the European systems said, 'No way!' (Interview 2009c).

Latvia is sticking to that peg. ... it's amazing how overriding an objective this is ... that they are willing to across the board live miserably for several years to ultimately adopt the euro. I am really astounded. ... I thought, 'Let them euroize. Can't the ECB look the other way?' ... But Latvia didn't want to do that because that would get the Europeans upset because they wouldn't actually be in the eurozone ... (Interview 2009d).

The idea of euroization, however, proved to have a longer-lasting appeal. Some member states and euro candidates such as Poland or Hungary soon openly demanded that the option of accelerated accession to the euro area be considered by the EU. Thus, the contentious issue resurfaced in the spring of 2009, leading to a short series of public exchanges among the relevant actors. Just after delaying a tranche payment to Latvia because of its failure to rein in the budget deficit to five percent of gross domestic product (GDP), as agreed under the terms of the SBA, the IMF reignited the debate over the prevailing conditions for eurozone entry. The IMF's proposal to allow Latvia the introduction of the euro without formal EMU membership was certain to draw a sharp rebuttal from the ECB. Entirely in line with its initial position, the ECB, as well as the influential Eurogroup of EMU finance

¹² Similar to dollarization, euroization is defined as a unilateral adoption of the euro. A country that euroizes uses its foreign exchange (forex) reserves to exchange domestic notes for euro notes and redenominate financial liabilities in euros.

ministers (see Puetter 2004), dismissed the IMF's proposal outright, insisting that such rule-bending was neither politically tolerable nor economically sensible. The sole way to enter the much-revered EMU was by abiding by the established rules, even if honoring the convergence programs meant additional hardship for already ailing economies (Interview 2009a, 2009b).

The firm stance of the ECB, the Commission, and other leading EU bodies was not without social consequences in Latvia. The country's commitment to the currency peg resembled, or followed, the EU's fiscal and monetary preferences. In any case, the authorities kept the lats pegged to the euro, rather than allowing it to depreciate, which required deep cuts in public spending up to a point that forced them to administer reductions of social expenses. Although the IMF did not warm to the authorities' request to extend the previously agreed target by two percentage points to seven percent of GDP, that refusal would not have precluded an agreement on the abandonment of the peg. In fact, the IMF would have much preferred a path with which the costs of adjustment would have been more evenly distributed over a slightly longer period of time to ensure a less painful economic recovery in the long run (Interview 2009b). That 'softer' path became obstructed by the preferred strategy of most EU actors and also the Latvian authorities, who, in effect, had chosen to travel down the 'bumpy' highway.

Regardless of such opposition, IMF officials repeatedly emphasized the social burdens of adjustment. More than once did they advise the Latvian authorities to maintain a minimum standard of social services in spite of the deepening recession. Many at the IMF continued to perceive negative social impact as directly related to Latvia's fixed exchange. Even though some of its officials have tried to gloss over remaining differences with the EU, there is ample evidence that a significant number of people at both IMF staff and executive levels would as well have endorsed a less austere program for Latvia to avoid disproportional burdens from shrinking public expenditures for the poorest:

In the end, we decided to follow the preferences of the country, and this entails a relatively more demanding course of restructuring than ... what we thought optimal. Thus, we would have viewed it to be economically easier and socially more acceptable if the necessary restructuring had been more drawn out ... (Interview 2009b).

In short, the IMF has somewhat shied away from too austere lending policies. The EU has stepped into its shoes with a lot of verve, as the brief overview of the recent case of Latvia has illustrated. Tensions between both institutions stemmed overwhelmingly from diverging positions about the actual necessity of maintaining the peg of the lats to the euro. At least as far as Latvia was concerned, the IMF's more pragmatic approach to crisis management was not in high demand. In a sense, the IMF was, as before the U.S. 'subprime crisis', condemned to 'watching from the sidelines' (Beeson and Broome 2008)—this time in the midst of the crisis.

4. Tougher than the IMF: EU Lending and Non-learning

The fundamental puzzle inspiring this article lies in the observation that the EU, rather than the IMF, has come to the rescue of the Washington Consensus. Indeed, the EU has been the foremost advocate of orthodox economic policies in recent crisis lending to CEE countries. For Hungary, Latvia, and Romania, Washington Consensus-like conditionality came not so much from Washington as from Brussels. What we have been witnessing since the onset of the global financial crisis is hence a partial revival of the Washington Consensus, or—put bluntly—its European rescue, of which Latvia, as outlined above, is the prime example.

This observation contradicts standard accounts in both academic state-of-the-art literature and media coverage. While the IMF is most frequently depicted as guarding its role as a global lender of last resort by an elaborate set of austere lending policies, we find that, in the recent crisis, the EU has assumed precisely this role in insisting that certain conditions be met before loans were to be disbursed to Hungary, Latvia, and Romania. In all three cases, the EU actively promoted

conditionality that was as tough as, or even tougher than, what the IMF deemed necessary to avert a deepening of the crisis in CEE and ensure effective handling of the most pressing economic problems. It is also noteworthy that, although many Western EU member states have embraced extensive domestic stimulus packages to help their economies rebound, EU actors, early on, ruled out similar Keynesian incentives for CEE countries relying on external sources of financing.

We have drawn on the example of Latvia as the most contentious case of joint EU-IMF crisis lending to substantiate our argument of the European rescue of the Washington Consensus. To explain this puzzle, we propose a three-tiered argument about the EU's and IMF's differential learning processes that became evident in crisis lending to CEE countries: (1) a disadvantageous institutional setting; (2) vociferous creditor coalitions; (3) the precarious eurozone project. Our three hypotheses combine empirical insights about EU and IMF lending to Hungary, Latvia, and Romania at different analytical levels: intra-institutional, intergovernmental and transnational, and supranational. We consider each in turn.

4.1. Disadvantageous Institutional Setting

Institutions learn over time. In most instances, an institution's body of knowledge encompasses lessons learned, even if some historical lessons become forgotten or less imperative in making important decisions. The concept of organizational learning, derived from disciplines such as Sociology or Business Administration (see, for example, Argyris and Schön 1978), captures the critical component of processes of collective learning; that is, the degree to which new information is retained and applied—whether within or outside the organization. Political economists now pay increasing attention to the conditions under which international institutions learn and how their learning interacts with their evolution over time.

Learning processes shape the design of political institutions, and vice versa. An institutional setting can either encourage or inhibit learning, be advantageous or disadvantageous to learning. Intra-institutional learning takes different forms,

ranging from policy to organizational learning. Learning within an institution can therefore result in changes of varying depth depending on whether it concerns instruments or process-related behavioral patterns (see Zito and Schout 2009: 1110). Most of the time, however, the one will not occur without the other. Indeed, an institution's ability to learn from past mistakes, retain such valuable 'trail-and-error' knowledge, and to adapt to a changing environment is vital to fulfilling its role; it allows an institution to 'update' its mission when its original tasks have become obsolete or when new, additional challenges arise to which appropriate responses are sought. Our evidence suggests that, for a variety of reasons, the EU has been in a less favorable institutional setting than the IMF to apply a large body of knowledge and 'fresh' expertise to the task of recent crisis lending.

The chief reason is history. As the established global lender-of-last-resort institution, the IMF has been able to build on innumerable lessons learned from its past activities in lending. The organization has a long history of more than six decades in providing loans to crisis-ridden countries¹³, during which time it has gathered a plethora of experiences. This has given rise to a mode of predominantly incremental learning and adaptation that only severe crises can temporarily unsettle. During a crisis, a window for deeper organizational reforms opens; in the longer run, incremental learning prevails again. Some open windows, such as the first oil crisis in 1973 (see Mueller 2008) or, as we argue below, the 1997–98 Asian financial crisis, lead to substantial reforms within an institution while others do not but instead close unused. The critical point to be made about the IMF is this: The organization has been engaged in lending for so long that it has gained enormous first-hand experience, accumulated technical expertise, and developed internal procedures for carrying out its operations.

The Fund's expertise in lending is not matched by the EU's. Rather, it stands in stark contrast to the record of activity of the Union, which had not been engaged in crisis lending prior to 2008. That is to say that, while the IMF's lending operations have

¹³ France, in 1947, was the first country to draw funds from the IMF, followed by the Netherlands, Mexico, and the United Kingdom in the same year. The SBA facility as the principal lending window has been in existence since 1952.

facilitated incremental learning over decades, the EU, being a first-time lender, lacks experience in this area. As the EU did not establish a lending facility for EMU candidate countries until February 2002,¹⁴ the latest global financial crisis has represented the first test case for EU assistance to distressed European economies. As a result, the EU has found itself in a disadvantageous institutional setting. This unfavorable setting has inhibited learning within the EU so that its expertise can, at best, have been modest when it came to providing liquidity to member states affected by the crisis. In short, the IMF has long evolved in a path-dependent manner with regard to crisis lending; the EU, by contrast, at first had to create a comparable path.

Moreover, the existence of a rather different path has precluded the EU from learning essential lessons about financial crisis management. The rigid financial rules contained in the Stability and Growth Pact (GSP) do not leave much room for the development of new and perhaps even creative approaches to handling financial crises. The EU's overarching concern is with the maintenance of stable fiscal frameworks of member states. The Commission, as the executive branch of the Union, then follows the path that country representatives have set out to be 'without alternative':

... there is ... a fiscal path specified [in the excessive deficit procedure].
So if you have this path specified, it is very difficult for the Commission to deviate from it because their political masters [= member states] have endorsed this (Interview 2009b).

The Commission's narrow focus on fiscal 'appropriateness' is due to its broad political mandate. This may—at least at first glance—seem surprising but can be explained with the consequences of being endowed with a *political*, rather than technical, mandate: Such a mandate, which cannot be divorced from members'

¹⁴ Council Regulation (EC) No 332/2002 introduced a facility for medium-term financial assistance under the then Article 119 of the EU treaty (see also fn. 4) for those member states not participating in the single currency. Council Regulation (EC) No 1360/2008 of 2 December 2008 expanded the facility to 25 billion from €12 billion under the previous regulation, which itself had revised the ceiling slightly downwards from €16 billion. Another amendment, to €50 billion, followed in March 2009 just a few weeks ahead of the G-20 summit in London (Council Regulation (EC) No 431/2009).

interests, inhibits the development of strong policy autonomy and flexibility. Not surprisingly then, a high degree of early politicization characterizes the EU's handling of economic issues. While IMF staff members can decide flexibly relative to the circumstances in a country program, EU actors have to consult Joaquín Almunia, the European Commissioner for Economic and Monetary Affairs, about critical financial matters. The responsible Directorate General for Economic and Financial Affairs (DG ECFIN) has almost assumed an informal veto position on lending and related matters (Interview 2009b). The scope of an institutional mandate does, in itself, not translate into more or less autonomy. In contradistinction to IMF staff, however, EU bureaucrats enjoy less discretionary power in designing and implementing policies. That the EU Commission has little expertise in IMF-style crisis country programs adds to the limitations under which learning about lending has occurred, if it all. Expertise in other areas such as the high-profile Lisbon Agenda (Interview 2009b) hardly helps to devise viable country programs that aim to avert the spread and intensification of a financial crisis. Deepening market integration has consumed most of the EU's energy, and effective lender-of-last resort activity coordination is still lacking (Pauly 2008). Learning in the EU has to take place within these institutionally restricted bounds.

The IMF has been given a less politicized mandate than the EU. With a large staff whose technical and country expertise is indispensable for the organization to perform its functions (Interview 2009b), the IMF has also developed and retained more policy autonomy than a supranational political institution can be expected to exercise vis-à-vis its individual members. The staff's edge of technical knowledge is underpinned by internal governance practices. For example, pragmatic procedures, sometimes rightly labeled intransparent (Woods 2003: 72), expand, rather than constrain, IMF staff discretion and flexibility in applying general institutional objectives to specific tasks and developing new norms (Chwieroth 2007b, 2008). In turn, the degree to which staff and management can wield influence not only internally but also externally is contingent on leadership. Many observers report that the incumbent Managing Director Strauss-Kahn has pushed for reforms within the

IMF that have empowered staff and management significantly vis-à-vis the Executive Board (Interview 2009a, 2009c, 2009d).

Yet another important facet lies in the institutionalization of learning and the reflection of successes and failures. In 2001, the IMF embarked upon a project of knowledge management by establishing the Independent Evaluation Office (IEO) as its internal 'watchdog', which operates independently from the IMF, including the Executive Board. The work of the IEO falls into four main areas, one of which is to "enhance the learning culture within the Fund"¹⁵. Even though part of the IEO's mission is to provide independent feedback to the Board, thereby helping it to meet its governance and oversight responsibilities, its role extends beyond that of serving the directors for two reasons. First, the IEO conducts its evaluations of issues relevant to the IMF's mandate 'at arm's length' from the Board. Second, the IEO gathers information and provides evaluations on which all at the IMF, as well as interested outsiders, can rely when fulfilling their respective professional duties. Thus, the founding of the IEO reflects a broader attempt by the Fund to manage its collective knowledge and expertise.

Knowledge management necessitates drawing a distinction between useful and useless (or no longer useful) institutional knowledge. This is, generally speaking, what the IEO was created for. Given the timing, however, we can speculate that its establishment was a response to the Asian crisis, which the IMF, according to a great many critics, mismanaged rather than managed. Faced with the daunting prospect of irrelevance soon after the crisis, the organization itself had to undergo some change and adapt to its new environment. The creation of the IEO can be interpreted as an attempt to counter widespread charges of bureaucratic inertia and cultural ignorance, but also to retain established, and acquire new knowledge so as to be better prepared for future crises. The IMF's approach to knowledge management is

¹⁵ The other three are: "strengthen the Fund's external credibility, promote greater understanding of the work of the Fund, and support institutional governance and oversight" (information available on the IEO website at <<http://www.ieo-imf.org/>>). The IEO seems to be modeled after the World Bank's Independent Evaluation Group (IEG), which, however, was already set up in 1973 by then World Bank President Robert McNamara.

therefore characterized by a greater readiness to learn afresh than its most ardent critics would concede.

The differential learning processes in the EU, on the one hand, and the IMF, on the other, have manifested themselves in many ways. The first-time lender EU continues to prescribe austerity measures for its troubled CEE members while the IMF has 'softened' its erstwhile policy stance. The latter appears to have learned from past mistakes in lending that the former never had the chance to commit before the crisis of 2008–09. Over the years, the IMF has reconsidered and adjusted some of its lending policies, not least following its heavily criticized series of orthodox prescriptions during the Asian crisis.

Emblematic of this broader trend toward policy reform is the official abandonment of the much-decried one-size-fits-all approach to supporting countries in financial distress. One such example is Strauss-Kahn's recent reaction to Brazil's introduction of capital controls, which entails a levy of two percent on short-term inflows. He claimed to have "no ideology on this", adding that capital controls were "not something that come from hell" (Financial Times 2009). In other words, there has been a shift away from the concept of TINA ('There is no alternative'), though not to TATA ('There are thousands of alternatives', Susan George) but to what could be named TASFA ('There are some feasible alternatives'). From the—albeit at times grudging—acceptance of more than one possible way thus emerged increased flexibility on the part of the IMF in preventing or, if need be, handling economic crises of its members. The IMF's enhanced policy flexibility has come to light in at least three main areas surrounding crisis lending.

First, the IMF has reformed the scope, depth, and number of conditions attached to its assistance programs. It was the practice of tying both the conclusion of such a program and later loan disbursements to harsh conditionality that generated perhaps the strongest outrage against the IMF. Again, the origins of change can be traced back to the Asian financial crisis in the late 1990s. In the lead-up to the crisis, the IMF had advocated for orthodox fiscal and monetary policies, and many of the austerity programs during the crisis were conceived in the same vein, often even shaped

through personal involvement of U.S. Treasury staff members in particular IMF country missions. But in the wake of the crisis came a backlash, and the IMF began to ascertain the appropriate degree of conditionality (Interview 2009e). Instead of clinging to a vast array of structural conditions, the organization came to design its programs in a more focused way. It gradually refrained from imposing structural conditions and shifted toward applying negotiable benchmarks. In effect, that change created additional latitude for IMF staff members to negotiate such benchmarks with the relevant authorities in a country applying for assistance (Interview 2009b, 2009d, 2009e). Hungary, for example, was granted a waiver for not fully meeting structural performance criteria by the end of March 2009. The departure from structural conditions commenced already under the directorship of Horst Köhler, during which the idea of ‘country ownership’ (see Best 2007) took hold and during which a conditionality review¹⁶ was initiated against the backdrop of the previous crisis. His successor but two soon displayed a strong preference for restraint in the use of conditions. He pondered about “conditionality light” (Interview 2009e) at a time when neo-Keynesian economic thought in general had experienced a renaissance (Interview 2009c). In this respect, it is noteworthy that the IEO (2007) criticizes IMF conditionality in a recent report as still too comprehensive, and calls for a more parsimonious approach, which tends to be increasingly reflected in the use of flexible benchmarks over structural conditions.

Second, the IMF has overhauled its lending programs little by little. These reforms, extending over more than a half-century, have included the adjustment of existing, the abandonment of old, and the creation of new facilities (Bird 2003: 231–235). The most recent innovation is the Flexible Credit Line (FCL), an instrument under which disbursements are not conditioned on policy implementation. Contrary to an SBA, under which disbursements are phased, the FCL allows countries that meet the pre-set qualification criteria of sound economic fundamentals and policies (so-called ex-ante conditionality) to tap the earmarked funds whenever necessary and even all at

¹⁶ Referred to as the ‘streamlining initiative’, the review led to an approval of a set of guidelines on conditionality in 2002. These new guidelines replaced those that had been in effect since 1979.

once. Countries that qualify for the FCL enjoy upfront access to the resources made available for six months without being subject to any ex-post evaluations; a mid-term review of eligibility is to be conducted only if a country requests an extension to twelve months.¹⁷ The timing of the overhaul is striking. The FCL was introduced in March 2009, after the crisis had reached its peak. The Executive Board also decided, among other things, to discontinue the application of structural performance criteria and to double annual and cumulative access limits to 200 and 600 percent of a country's SDR quota, respectively.¹⁸ Our three countries benefitted from a case-by-case provision of assistance above these limits. Under the fast-track Emergency Finance Mechanism, all were granted SBAs that by far exceeded—or would have exceeded¹⁹—even the new ceilings: The respective total support amounted to 1,015 percent of Hungary's, 1,200 percent of Latvia's, and 1,111 percent of Romania's quota. Inspired by IEO findings, the IMF has addressed many of the shortcomings identified in its programs as hampering economic recovery. It is indicative of the IMF's institutionalized learning processes that it has swiftly done so.

Third, the IMF has developed a concern for the potential social consequences of its engagement in borrowing countries. This new policy focus was launched under the rubric of 'social conditionality' with a view to developing or maintaining basic levels of social safety even when some harsh measures are inevitable. Efforts to protect the poorest and most vulnerable societal groups are also contained in the IMF programs to CEE countries. Strauss-Kahn's leadership seems to have been particularly decisive in that regard. However, not all at the IMF share his position: Some back his agenda believing that lending programs are likely to yield better results and increase loan repayment ratios if accepted as both necessary and fair by the entire population of a borrowing country (Interview 2009c); others remain wary that, unlike the World Bank, the IMF lacks sufficient expertise in this area (Interview 2009d). Despite not having achieved internal unanimity on the degree to which social aspects need to be

¹⁷ To date, Colombia, Mexico, and Poland have subscribed to the FCL.

¹⁸ Later that year, the IMF also undertook a reform of its lending facilities for low-income countries, which included increased concessionality of financial assistance and a more flexible use of available resources.

¹⁹ Hungary's and Latvia's loans were agreed on before the decision to double access limits (see Table 1 above).

taken into account in programs, the IMF promoted socially balanced loans for CEE countries. For example, the IMF's mission chief for Hungary, James Morsink, stated a few weeks after the loan had been approved: "... a key challenge is to improve the targeting of social benefits to the people who need them most" (IMF 2009b). Accordingly, the program, rather than eliminating the 13th-month pension, stipulated a cap on it to insulate the poorer pensioners from the harshest effects of the crisis. Similar 'cushioning' provisions of social protection are contained in Latvia's²⁰ and Romania's SBAs. These protective clauses, according to Strauss-Kahn, justified the exceptional access to IMF funds in excess of the usual loan-quota ratios. It is still too early to judge whether 'social conditionality' will end up being just another entry into the endless list of 'buzzwords' that international organizations invent so routinely, but its inclusion nonetheless points to a greater awareness within the IMF of the multidimensionality of lending: How well a country has weathered a crisis is no longer to be measured solely against fiscal and monetary achievements but also against the social implications of economic 'belt-tightening'. Why the EU, by contrast, has tended to display fewer concerns about these implications than the IMF is further illuminated by our second hypothesis.

4.2. Vociferous Creditor Coalitions

Institutionally restricted learning can explain internal deficiencies that led EU actors to dismiss charges of inappropriate responses to the crisis as unwarranted. It would, however, be naïve to assume that no external forces have pushed the EU toward embracing the values of the Washington Consensus. In particular, EU actors have faced enormous pressure from market actors with high stakes in the troubled region. Resting on the idea that affected actors—often 'supplementary financiers' (Gould 2006)—join forces to obtain their favored policy outcome, this argument draws on an impressive scholarly history in explaining the specific character of EU lending policies. The multi-level polity of the EU transcends different level of analyses. Therefore, EU lending is a blend of intergovernmental (Moravcsik 1997), trans-

²⁰ See previous section.

national (Cerny 2009), and supranational interactions. Our focus in this subsection is on the intergovernmental and transnational levels, since the supranational sources of orthodox EU lending are dealt with in the subsequent subsection.

If we are to account for the role of creditor coalitions, or ‘invested interests’ (Frieden 1991), the ‘Vienna Initiative’ (short for ‘European Bank Coordination Initiative Group’) deserves mention. Named after the Austrian capital, where the first meeting took place in January 2009, the initiative has culminated in a series of several meetings between international institutions and market actors with a stake in the countries that depend on external financial assistance. The European Bank for Reconstruction and Development (EBRD), the IMF, and the European Commission were the most notable institutions to initiate this process of private-sector involvement. The Vienna Initiative was specifically designed to ensure that foreign-owned banks would not exit but maintain their exposure to program countries. Avoiding typical collective action problems ranked high on the crisis-response agenda, as Anne-Marie Gulde, senior advisor in the IMF’s European Department, highlights in a recent *IMF Survey*: “In fact, those funds [from multilateral and bilateral lenders] would have served only to bail out the private sector ...” (IMF 2009a).

Exposure to the region was maintained through the rollover of loans and the recapitalization of foreign banks’ subsidiaries. While some banks signaled their commitment to rollover and recapitalization even before Hungary and Latvia went to the IMF, great strides were made in the negotiations of the programs for Serbia and Romania. The novel achievement lay in the express link between multilateral help *and* ongoing private-sector commitment. In the case of Romania, for example, the parent institutions of the nine largest foreign-owned banks²¹ pledged to remain exposed to the country. Concrete insurances, such as to keep the capital-adequacy ratio above the ten-percent level throughout the program period, formed an important part of their commitment to continuing exposure. Thus, the meetings

²¹ Those nine banks were (in alphabetical order): Alpha Bank, Erste Group Bank, Eurobank EFG, National Bank of Greece, Piraeus Bank, Raiffeisen International, Société Générale, UniCredit Group, and Volksbank.

under the umbrella of the Vienna Initiative, bringing together all relevant actors, succeeded in fine-tuning public-private coordination amid severe financial problems of individual countries.

How is this related to our learning argument? So far, the existence of the initiative points to neither more nor less learning on part of the EU. The initiative came about with the help of the EU and the IMF because it was in the interest of both to shore up their rescue packages with commitments from the private sector. That way, their joint undertaking would be rendered more effective under improved market conditions: higher liquidity, fewer bankruptcies, and better investment prospects to name but a few potential benefits from this signaling strategy for the EU and the IMF.

The real core of the matter is the different degree to which invested market actors can influence policymaking at the EU and the IMF. When some member states have high stakes, policy flexibility can be considerably constrained by their narrow preferences. The EU's learning capacity is a product of these 'external' limitations, though the manifold interests of its now twenty-seven member states might attenuate these restraints to some extent. Of course, the same countries are members of the IMF, but most countries are grouped in regional constituencies, each of which is represented by just one director vested with the right to cumulative voting on behalf of the six or more countries in his or her constituency. EU member states can inhibit learning in the EU, but not so much in the IMF, where their access to decision-making is less direct and mediated by other members. Furthermore, these states are less likely to run up against opposition to their proposals among similarly affected fellow member states than in the diverse IMF membership. They could, in turn, more easily forge influential, or vociferous, creditor coalitions with domestic banks that the crisis had left exposed and with other European countries in a similar position in order to bring that influence to bear in the Union. All three CEE countries had high levels of outstanding euro-denominated debt—as much as eighty percent for Latvia—to be serviced and eventually paid back to foreign creditors. The common exposure to the

stumbling economies of emerging Central and Eastern Europe pushed many ‘old’ member states, alongside their banks, into such creditor coalitions.

Consider, for illustrative purposes, the position of Sweden during the crisis. Swedish banks had been among the first to expand in the Baltics. Owing to the dominance of Swedbank, SEB, and Nordea, Sweden had become the biggest foreign investor in Latvia. Being the most heavily exposed among all foreign banks, its banks were at the same time very nervous about rumors of a potential devaluation of the lats, through which they would have incurred huge losses. Sweden and other Nordic countries acknowledged this risk by contributing about one-fourth, or nearly €2 billion, to the overall loan package for Latvia (see Table 2).

Table 2. Breakdown: Composition of Emergency Loans (€ in Billions)

	<i>Hungary</i>	<i>Latvia</i>	<i>Romania</i>
IMF	12.5 (62.5 %)	1.7 (22.7 %)	12.95 (64.9 %)
EU	6.5 (32.5 %)	3.1 (41.3 %)	5.0 (25.1 %)
Other Creditors			
World Bank	1.0 (5.0 %)	0.4 (5.3 %)	1.0 (5.0 %)
EBRD		0.4 ^a (5.3 %)	1.0 ^b (5.0 %)
Individual Countries		1.9 ^c (25.3 %)	
Total	20.0 (100.0 %)	7.5 (100.0 %)	19.95 (100.0 %)

Notes:

^a With Poland and the Czech Republic.

^b With the European Investment Bank (EIB).

^c Jointly by Sweden, Denmark, Finland, Norway, and Estonia.

Minor deviations from one hundred percent are due to rounding to one decimal place.

Sources: MoUs between the EU and each of the three borrowing countries.

This Nordic creditor coalition already exerted its influence on the discussions that paved the way to the conclusion of Latvia's €7.5 billion loan program. Sweden soon emerged as the coalition's unofficial leader given the paramount role of Swedish banks in Latvia's financial sector. In the lead-up to the negotiations of Latvia's SBA with the IMF, the Governor of the Latvian Central Bank let his Swedish colleague in on his plans to request IMF assistance. His commitment to keeping the lats pegged to the euro was endorsed by the other Nordic countries and the European Commission later during the program negotiations (Interview 2009c, 2009d). The 'Nordic' constituency in the IMF, to which all Baltic and Scandinavian states, as well as Iceland and Finland, belong, displayed a high degree of consensus on this crucial issue. Its members disseminated within the Fund their position in favor of the peg, which concurred fully with the view of Latvia's highest central banker.

The Nordic coalition did not falter with the commencement of the program. It remained undivided and maintained its close link with Central Bank Governor Rimšēvičs even when political authorities in Riga began to question the logic of the program in light of its severe day-to-day consequences for the country. Since the first installment, the Latvian government had gone to great lengths to reassure its creditors that it would not abandon the peg to ease economic restructuring. Still, it proved difficult to quell such speculations as continued fiscal austerity aggravated the social burdens for most Latvians. These burdens also came to affect Latvian homeowners, most of whom had taken out euro-denominated mortgages. Confronted with increasing domestic pressure, the Latvian Prime Minister tested the water in October 2009. Dombrovskis made public his growing discontent with unequal burden-sharing between borrowers and lenders (The Guardian 2009). Under his proposal, the liabilities of mortgage-holders to (foreign) lenders were to be limited to the current, not the original, value of an owned property. Property prices had fallen sharply such that the implementation of his scheme would have resulted in billions of losses for the big three Swedish banks with a dense web of subsidiaries Latvia.

His proposal generated a double outrage. The protest from the government of Sweden, the country's major creditor, was neither surprising nor long in coming. The Swedish Minister for Finance, Anders Borg, spearheaded the ranks of the vociferous critics from the Nordic creditor coalition. He reminded the Latvian premier bluntly of this obligation to keep future public spending in check as agreed with all the creditors. The Swedish government, which had loaned emergency funds to the tune of €3 billion from the ECB in June to recapitalize its banking sector, responded to Dombrovskis's idea by threatening to withhold a credit tranche of more than €1 billion for 2010. By these standards, the negative response from the country's own central bank was a little more surprising. Its officials also criticized the prime minister for creating new insecurity about the country's course. These criticisms again hinted at underlying concerns about an impending currency devaluation. It is striking that, irrespective of his mortgage plan, Dombrovskis never declared any intention to break the peg with the euro. Instead, he ruled out devaluation as an option. He had tested the water; now he knew that it was hot enough to burn the incautious.

The Nordic creditor coalition has not been the only one, albeit clearly the most vocal. What is true for Sweden in Latvia applies to debtor-creditor relations in general; that is, other EU member states have had exposure structures comparable to Sweden's in Latvia. Another case in point is the exposure of Austrian banks to both Serbia and Romania (Interview 2009e). The influence of creditor coalitions—in Latvia more than anywhere else in CEE—becomes even more plausible in combination with our third hypothesis.

4.3. Precarious Eurozone Project

Our final hypothesis holds that countries such as Sweden or Austria were continuously preaching to the choir. In addition to being lobbied by invested market actors, EU actors have had their very own interests in mind when deliberating on the best course of action for Hungary, Latvia, and Romania. The typical ingredients of

the Washington Consensus serve as handy instruments for EU policymakers and EMU officials to safeguard the eurozone project, which they see as precarious. According to this hypothesis, they attach inherent value to the supranational project of European monetary integration (see McNamara 1998). For them, the project in itself, with a common currency at its core, is worth preserving apart from all economic benefits that might come with it. It provides policymakers with a normative framework within which supranational policies can be framed.

The project of European monetary integration has been underway since 1999, when the euro was created as the single currency. In sharp contrast to crisis lending, monetary integration policy has been one of the EU's most prolific areas. It has also been one of, if not the most, contested activity that the Union has undertaken in its history. Through its many integration policies, the EU has been able to build on experiences that it has not made in crisis lending. Oddly, however, the path in this policy area does not produce 'transferable' learning outcomes. The present logic of monetary integration does not foster flexibility for institutional learning that could be harnessed for crisis lending. The opposite is true: The 'European project' still rests not on flexibility and pragmatism to achieve certain outputs but on—at least officially—strict adherence to rules once decided to be meaningful criteria for eurozone entry²². Put differently, supranational policymakers have been 'captured' on a self-imposed path of contested normative value.

For all those believing in the project, Latvia presented both a critical case and a welcomed political opportunity to reassert the appeal of EMU membership. It was not without reason that the EU committed its largest relative share to Latvia, the CEE country with the smallest absolute loan package. By far the biggest stakeholder in Latvia, the EU has pledged some forty percent, followed by the Nordic creditor coalition (see Table 2). The EU's prominent role as the largest creditor reflects a depth

²² To qualify for the adoption of the euro, countries have to meet the set of the five Maastricht criteria of the SGP relating to inflation, budget deficit, national debt, long-term interest rates, and exchange rates. Of them, the two best-known are that a country's deficit must be below three percent and its overall debt below sixty percent of GDP. EU member states willing to join the eurozone bring their policies in line by adopting so-called convergence programs prior to accession.

of commitment that has been absent in the cases of Hungary and Romania. The EU's prominent role has also helped to defend the Latvian peg against the IMF's position of general skepticism and recurrent resistance.

The ECB, the European Commission, and the EMU members feared the wider implications of an abandonment of the peg. They all portrayed Latvia as centrally important to monetary integration at the EU's external borders, not least because it would become the first Baltic state to introduce the single currency. As was confirmed by our interviewees (Interview 2009c, 2009d), the euro area members shared a permanent aversion to rapid euro adoption if that implied undermining the long-established and reaffirmed entry criteria (ECB 2009). If countries were allowed to 'export' their way out of the crisis by violating the ERM II stipulations at the expense of foreign (i.e. Nordic) creditors, this would, in their view, lead to 'contagion through devaluation' and also encourage moral hazard in the sense that tough rules could be bent to be more accommodating:

Do you really want that first Lehman Brothers and then the collapse in one of the Baltics ...? If Latvia goes, then Estonia will go and Lithuania will go, Bulgaria will go ... (Interview 2009c).

Two recent episodes may help to illustrate our point. The first episode was, in some ways, a rerun of the IMF and EU's argument over the ratio of pegging the lats. Within the EU, an emerging cleavage pitted the proponents of the peg, the ECB and eurozone central bankers, against the central bankers from non-eurozone Eastern and Central Europe. The central bankers from Poland, Hungary, and the Czech Republic had continued to try to convince the ECB that sovereign bonds denominated in their national currencies should be accepted as securities in refinancing operations with banks active in the region. They advertised it as a powerful liquidity-enhancing measure. During a meeting in May 2009, the central bank governors from the new member states were even asked to leave the room while the ECB Executive Board discussed the measure. This shows just how contentious the discussions surrounding this issue in fact were. The 'old' central bankers, fearful of potential currency risks, rejected that motion (EuroWeek 2009). It

is interesting that, despite domestic political pressure, Latvia's governor Rimšēvičs never swerved or aligned with his colleagues from the new member states. By refusing to submit to devaluation demands, the Latvian Central Bank kept a course of remarkable resemblance to the position of ECB, other EU bodies, and the Nordic creditors. It seems an impossible task to disentangle how much of that course was due to exogenous pressure and how much of it reflected true endogenous conviction.

The second episode exposed the diverging perceptions of the EU and the IMF as to how Latvia would fare economically in the near future. In July 2009, the Economic and Financial Affairs Council (ECOFIN) of the EU opened an excessive deficit procedure for Latvia, Lithuania, Malta, Poland, and Romania under Art. 104(6). The Council called on crisis-battered Latvia to achieve a deficit of no more than three percent of GDP in 2012 and set a deadline at January 7, 2010, until which 'corrective action' had to be taken (Council of the EU 2009). While ECOFIN believed that the deficit target was still attainable, the IMF displayed less optimism. In a conference call three weeks after the Council had initiated the deficit procedure for Latvia, Anne-Marie Gulde and Mark Griffiths, the mission chief for Latvia, sounded already skeptical that those ambitious targets under the EMU convergence program were realistically attainable. Another month later, the IMF Board had completed its first review of the SBA with Latvia. IMF staff members advocated for a 2009 fiscal deficit target of thirteen percent, instead of the initially envisaged five percent, acknowledging candidly that such a revision would imply later euro adoption (IMF 2009c). Based on the staff report, the Board undertook the significant adjustment of the target in light of an exceedingly deep contraction of Latvia's economy. Similar differences over appropriate timing have also surrounded the question as to when financial support ought to be unwound. Here again, the EU is the tougher player: The ECB favors early exit and cannot but criticize the IMF's preference for delaying exit.

These two episodes demonstrate nicely how central European actors adhere to the rules of the supranational project. Their disposition is not about to change soon: Greece, one of the economically weakest eurozone members with a ballooning

deficit, has very recently thrown the project into a deep identity crisis. Greece, which is in danger of defaulting while being in the once-so-safe euro area, can be seen as the reverse case of Latvia, which is so eager to join it. In line with its concern for the supranational project, the ECB has offered help in both cases—to keep Greece and pull Latvia on board—under the rules that have guided European monetary integration from the very beginning.²³

The precarious state of the eurozone project completes the picture of the European rescue of the Washington Consensus. This last hypothesis as to why the EU has acted as it has in crisis lending to CEE countries makes sense of the particular case of Latvia, where the conflict between the EU and the IMF has proven to be most pronounced. Disagreements still relate to the critical issue of euro adoption, which the EU strongly endorses while the IMF has taken a more pragmatic stance of what helps and what does not. Counterfactual reasoning would have it that the case of Latvia would probably have taken quite a different turn if the country had not been elevated to be the Baltic model for euro adoption. Vociferous creditor coalitions with stakes in CEE have then found reliable partners in the ECB and the Commission, which already have institutionally limited room for learning. Table 3 summarizes our three-tiered argument about learning and non-learning in the EU and the IMF. As should have become clear throughout the paper, the hypotheses are not exclusive but rather complementary and mutually reinforcing.

Table 3. Flexibility for Learning in Crisis Lending

	<i>EU</i>	<i>IMF</i>
Institutional Setting	–	+
Creditor Coalitions	–	0
Eurozone Project	–	+

Key: –/0/+ = inhibiting/neutral/encouraging factor.
Source: Authors.

²³ A recent ECB legal paper (Athanassiou 2009) states that a member's unilateral withdrawal from the EMU would have to be followed by an expulsion from the EU as a whole.

5. Conclusion

This article has challenged the common misperception that the IMF prescribes ‘poisonous medicine’—that is, pushes countries to pursue uniform economic policies—under all circumstances. What is needed is at least a partial rethink of the IMF’s reputation as a staunch advocate of orthodox lending policies. Although it remains true that, even in its emerging ‘post-Washington-Consensus era’, the IMF does not distribute its funds in an overly generous manner, the organization is not necessarily the toughest player in the field. As the cases of Hungary, Romania, and especially Latvia have demonstrated, the EU can take over this role with relative ease, provided that some broader interests are at stake.

The results of our research indicate a European rescue of the Washington Consensus. The EU, not the IMF, strove to tighten the conditions that the three CEE countries had to fulfill to qualify for assistance loans prior to their eventual disbursements. The EU, not the IMF, has shown limited concern for potential economic and social ramifications of thus tightened conditionality in the recipient countries during the program period. Most important, the EU, not the IMF, has proven adamantly opposed to suggestions that Latvia would do well to abandon its currency’s peg to the euro. The IMF has, by contrast, not only been open to this option, but a few times even recommended that the country devalue the lats by giving up the peg to render economic recovery less painful. Yet with the peg forming the ‘anchor’ of Latvia’s crisis exit strategy into EMU membership in the near future, the EU has not budged an inch. It does therefore not come as a big surprise that, of the three countries examined, the case of Latvia has thus far stirred up the greatest tensions between the EU and the IMF.

We have identified three complementary factors through which the EU has been propelled to rescue the Washington Consensus. Each conveys a particular notion: At the same time as its disadvantageous institutional setting has put the EU in a position of insufficient knowledge and untested procedures, vociferous creditor coalitions have reinforced a mantra of economic orthodoxy, which many EU actors

already believed to be the supranational 'Holy Grail' in an unstable currency area. Whereas this widely held perception of eurozone precariousness appears to have been the most decisive factor with regard to Latvia, the disadvantageous institutional setting and the strong influence of creditor coalitions within the EU have been at work in all three cases.

Three caveats, however, apply to our tentative conclusions. First, we have largely disregarded the domestic situations in Hungary, Latvia, and Romania. Such disregard might have blinded us to causal mechanisms at the domestic level. Possible candidates are political power-wrestling, policy capture, and commitment strategies on the part of political authorities to voluntarily 'tie their hands' (Broome 2008). Second, we have relied on a rather limited sample of three cases to advance, substantiate, and illustrate our central argument. Even though the selection was carried out on a well-founded basis (including only EU member states outside the euro area that have received loans from the IMF under an SBA and from the EU under the scope of Art. 119 TEC), this particular sample might be weakened by a selection bias, because of which we might not have looked for the most significant factors at work between the EU, the IMF, and the CEE borrowing countries. Third, much of what has been analyzed in this article remains in flux and is thus still subject to change. Hungary, for example, announced just in November 2009 to forgo the third installment of its loan package. How one will assess the IMF's and, indeed, the EU's lending policies in the years to come will depend on future developments—at least until the expiration of the respective loan periods—that could not be incorporated in this article.

These limitations notwithstanding, this article lends weight to claims that the IMF has changed, albeit only incrementally. Embedded in a social environment that facilitates some choices, while constraining others, the IMF continuously evolves, as do all political institutions. Both in-depth single-case and comparative studies of IMF lending are needed if we are to understand how the organization has pursued its policies since the Asian crisis, as well as since the most recent crisis, and to what extent and why that differs from previous periods.

Finally, this article dispels the myth that the Washington Consensus is tied to any one institution or a certain set of institutions, such as, most notably, the IMF and the World Bank as the Bretton Woods institutions. The IMF might nevertheless have to continue to live with its oft-diagnosed 'legitimacy crisis' (Best 2007; Seabrooke 2007) because joint EU-IMF lending carries the seal of austerity. Without close empirical scrutiny of the recent cases of the CEE countries, one might be left with the fallacious impression that the IMF has once again embraced economic orthodoxy. Given our findings, paying more attention to other players in the crisis lending 'game', such as the EU or powerful market actors, offers promising avenues for future research. The IMF may be *the* lender of last resort, yet it is by no means the sole actor to which economically troubled countries might choose to turn for support.

References

- Argyris, Chris and Donald A. Schön. 1978. *Organizational Learning: A Theory of Action Perspective*. Reading, MA: Addison-Wesley.
- Athanassiou, Phoebus. 2009. "Withdrawal and expulsion from the EU and EMU: Some reflections." Legal Working Paper Series No 10. December 2009, Frankfurt a.M.: European Central Bank. <<http://www.ecb.int/pub/pdf/scplps/ecblwp10.pdf>>, accessed 14 January 2010.
- Babb, Sarah. 2003. "The IMF in Sociological Perspective: A Tale of Organizational Slippage." *Studies in Comparative International Development* 38(2):3–27.
- Babb, Sarah. 2007. "Embeddedness, Inflation, and International Regimes: The IMF in the Early Postwar Period." *American Journal of Sociology* 113(1):128–164.
- Beeson, Mark and André Broome. 2008. "Watching from the sidelines? The decline of the IMF's crisis management role." *Contemporary Politics* 14(4):393–409.
- Best, Jacqueline. 2007. "Legitimacy Dilemmas: the IMF's pursuit of country ownership." *Third World Quarterly* 28(3):469–488.
- Bird, Graham. 2002. "The credibility and signalling effect of IMF programmes." *Journal of Policy Modeling* 24(9):799–811.
- Bird, Graham. 2003. "Restructuring the IMF's Lending Facilities." *The World Economy* 26(2):229–245.
- Broome, André. 2008. "The Importance of Being Earnest: The IMF as a Reputational Intermediary." *New Political Economy* 13(2):125–151.
- Brown, Chelsea. 2009. "Democracy's Friend or Foe? The Effects of Recent IMF Conditional Lending in Latin America." *International Political Science Review* 30(4):431–457.
- Broz, J. Lawrence and Michael B. Hawes. 2006. "Congressional Politics of Financing the International Monetary Fund." *International Organization* 60(2):367–399.
- Cerny, Philip G. 2009. "Multi-nodal politics: globalisation is what actors make of it." *Review of International Studies* 35(2):421–449.
- Chwieroth, Jeffrey M. 2007a. "'The Silent Revolution': Professional Training, Sympathetic Interlocutors and IMF Lending." Paper presented at the APSA Annual Meeting, 30 August–2 September, Chicago, IL: American Political Science Association. <http://www.allacademic.com/meta/p210967_index.html>, accessed 28 January 2010.
- Chwieroth, Jeffrey M. 2007b. "Testing and Measuring the Role of Ideas: The Case of Neoliberalism in the International Monetary Fund." *International Studies Quarterly* 51(1):5–30.
- Chwieroth, Jeffrey M. 2008. "Normative Change from Within: The International Monetary Fund's Approach to Capital Account Liberalization." *International Studies Quarterly* 52(1):129–158.

- Copelovitch, Mark S. 2003. "Domestic Interests and the International Lender of Last Resort: The Political Economy of IMF Crisis Lending." Paper presented at the APSA Annual Meeting, August 28–31, Philadelphia, PA: American Political Science Association. <http://www.allacademic.com/meta/p64383_index.html>, accessed 28 January 2010.
- Copelovitch, Mark 2004. "Private Debt Composition and the Political Economy of IMF Lending." Paper presented at the 2004 APSA Annual Meeting, September 2–5, Chicago, IL: American Political Science Association. <http://www.allacademic.com/meta/p59861_index.html>, accessed 28 January 2010.
- Council of the EU. 2009. "Council Recommendation to Latvia with a view to bringing an end to the situation of an excessive government deficit." 11660/09 ECOFIN 490, 6 July. Brussels: EU.
- ECB. 2009. "A case for rapid euro adoption?". OeNB Conference on European Economic Integration, Vienna. 16 November. Frankfurt a.M.: European Central Bank. <<http://www.ecb.int/press/key/date/2009/html/sp091116.en.html#>>, accessed 29 November 2009.
- Edwards, Martin S. 2006. "Signalling credibility? The IMF and catalytic finance." *Journal of International Relations and Development* 9(1):27–52.
- EuroWeek*. 2009. "ECB's Trichet confounds eastern Europe hopes of funding." 15 May.
- Financial Times*. 2009. "IMF refuses to rule out use of capital controls." 2 November.
- Frieden, Jeffrey A. 1991. "Invested interests: the politics of national economic policies in a world of global finance." *International Organization* 45(4):425–451.
- Garuda, Gopal. 2000. "The Distributional Effects of IMF Programs: A Cross-Country Analysis." *World Development* 28(6):1031–1051.
- Gore, Charles. 2000. "The Rise and Fall of the Washington Consensus as a Paradigm for Developing Countries." *World Development* 28(5):789–804.
- Gould, Erica R. 2006. *Money Talks: The International Monetary Fund, Conditionality, and Supplementary Financiers*. Stanford, CA: Stanford University Press.
- IEO. 2007. "Structural Conditionality in IMF-Supported Programs: Evaluation Report." Washington, DC: Independent Evaluation Office of the IMF. <http://www.ieo-imf.org/eval/complete/pdf/01032008/SC_main_report.pdf>, accessed 15 July 2009.
- IMF. 2009a. "Agreement with Banks Limits Crisis in Emerging Europe." IMF Survey online. 28 October. Washington, DC: International Monetary Fund. <<http://www.imf.org/external/pubs/ft/survey/so/2009/int102809a.htm>>, accessed 5 December 2009.
- IMF. 2009b. "Hungary: Markets Have Stabilized, but Long Road Ahead." IMF Survey online. 12 January. Washington, DC: International Monetary Fund. <<http://www.imf.org/external/pubs/ft/survey/so/2009/int011209a.htm>>, accessed 30 November 2009.
- IMF. 2009c. "Republic of Latvia: First Review and Financing Assurances Review Under the Stand-By Arrangement, Requests for Waivers of Nonobservance of Performance Criteria, and Rephasing of Purchases Under the Arrangement." October 2009. Washington, DC: International Monetary Fund. <<http://www.imf.org/external/pubs/ft/scr/2009/cr09297.pdf>>, accessed 30 November 2009.

- Interview. 2009a. IMF official. Washington, DC. 8 September.
- Interview. 2009b. IMF official. Washington, DC. 9 September.
- Interview. 2009c. IMF official. Washington, DC. 9 September.
- Interview. 2009d. IMF official. Washington, DC. 8 September.
- Interview. 2009e. IMF official. Washington, DC. 9 September.
- Krogstad, Erlend. 2007. "The Post-Washington Consensus: Brand New Agenda or Old Wine in a New Bottle?" *Challenge* 50(2):67–85.
- Levy-Yeyati, Eduardo 2009. "Is Latvia the new Argentina?". VoxEU.org analysis. 22 June. <<http://www.voxeu.org/index.php?q=node/3683>>, accessed 13 February 2010.
- Marchesi, Silvia and Jonathan P. Thomas. 1999. "IMF Conditionality as a Screening Device." *The Economic Journal* 109(454):C111–C125.
- McCleery, Robert K. and Fernando De Paolis. 2008. "The Washington Consensus: A post-mortem." *Journal of Asian Economics* 19(5):438–446.
- McNamara, Kathleen R. 1998. *The Currency of Ideas: Monetary Politics in the European Union*. Ithaca, NY: Cornell University Press.
- Milward, Alan S. 1992. *The European Rescue of the Nation-state*. Berkeley, CA: University of California Press.
- Momani, Bessma. 2004. "American politicization of the International Monetary Fund." *Review of International Political Economy* 11(5):880–904.
- Momani, Bessma. 2005. "Limits on streamlining Fund conditionality: the International Monetary Fund's organizational culture." *Journal of International Relations and Development* 8(2):142–163.
- Moravcsik, Andrew. 1997. "Taking Preferences Seriously: A Liberal Theory of International Politics." *International Organization* 51(4):513–553.
- Mueller, Julie L. 2008. "Evolutionary Learning in the IMF: A Multi-Disciplinary Approach to Understanding Institutional Change." Paper presented at the annual meeting of the ISA's 49th Annual Convention. 26 March, San Francisco, CA: International Studies Association. <http://www.allacademic.com/meta/p254109_index.html>, accessed 2 February 2010.
- Pauly, Louis W. 2008. "Financial Crisis Management in Europe and beyond." *Contributions to Political Economy* 27(1):73–89.
- Puetter, Uwe. 2004. "Governing informally: the role of the Eurogroup in EMU and the Stability and Growth Pact." *Journal of European Public Policy* 11(5):854–870.
- Seabrooke, Leonard. 2007. "Legitimacy Gaps in the World Economy: Explaining the Sources of the IMF's Legitimacy Crisis." *International Politics* 44(2):250–268.
- Stiglitz, Joseph E. 2008. "Is there a Post-Washington Consensus Consensus?". In *The Washington Consensus Reconsidered: Towards a New Global Governance*, edited by Narcís Serra and Joseph E. Stiglitz. 41–56. Oxford: Oxford University Press.

- Stone, Randall W. 2008. "The Scope of IMF Conditionality." *International Organization* 62(4):589–620.
- Thacker, Strom C. 1999. "The High Politics of IMF Lending." *World Politics* 52(1):38–75.
- The Guardian*. 2009. "Latvia threatens foreign banks with huge losses." 10 October.
- Vreeland, James R. 2007. *The International Monetary Fund: The politics of conditional lending*. London: Routledge.
- Wade, Robert and Frank Veneroso. 1998. "The Asian Crisis: The High Debt Model Versus the Wall Street-Treasury-IMF Complex." *New Left Review* 228:3–22.
- Williamson, John. 1990. "What Washington Means by Policy Reform." In *Latin American Adjustment: How Much Has Happened?*, edited by John Williamson. 7–20. Washington, DC: Institute for International Economics.
- Williamson, John. 2004–05. "The strange history of the Washington consensus." *Journal of Post Keynesian Economics* 27(2):195–206.
- Woods, Ngaire 2003. "Holding Intergovernmental Institutions to Account." *Ethics and International Affairs* 17(1):69–80.
- Zito, Anthony R. and Adriaan Schout. 2009. "Learning theory reconsidered: EU integration theories and learning." *Journal of European Public Policy* 16(8):1103–1123.

Recent LEQS papers

- Hartlapp**, Miriam; **Metz**, Julia & **Rauh**, Christian. 'The agenda set by the EU Commission: the result of balanced or biased aggregation of positions?' LEQS Paper No. 21, April 2010
- Costa-i-Font**, Joan. 'Unveiling Vertical State Downscaling: Identity and/or the Economy?' LEQS Paper No. 20, March 2010
- Delanty**, Gerard. 'The European Heritage from a Critical Cosmopolitan Perspective. LEQS Paper No. 19, February 2010
- Outhwaite**, William. 'Europe at 21: Transitions and Transformations since 1989'. LEQS Paper No. 18, January 2010
- Lavdas**, Kostas A. 'Normative Evolution in Europe: Small States and Republican Peace'. LEQS Paper No. 17, January 2010
- Schelkle**, Waltraud. 'Good governance in crisis or a good crisis for governance? A comparison of the EU and the US'. LEQS Paper No. 16, December 2009
- Keating**, Michael. 'Second Round Reform. Devolution and constitutional reform in the United Kingdom, Spain and Italy'. LEQS Paper No. 15, December 2009
- Hyman**, Richard. 'Trade Unions and 'Europe': Are the Members out of Step?'. LEQS Paper No. 14, November 2009
- Dani**, Marco. 'Economic and social conflicts, integration and constitutionalism in contemporary Europe'. LEQS Paper No. 13, November 2009
- Rodríguez-Pose**, Andrés & **Kroijer**, Anne. 'Fiscal Decentralization and Economic Growth in Central and Eastern Europe'. LEQS Paper No. 12, October 2009
- Cheshire**, Paul C. & **Magrini**, Stefano. 'Urban Growth Drivers and Spatial Inequalities: Europe - a Case with Geographically Sticky People. LEQS Paper No. 11, October 2009
- McCrea**, Ronan. 'The Recognition of Religion within the Constitutional and Political Order of the European Union'. LEQS Paper No. 10, September 2009
- Bertola**, Guiseppe & **Mola**, Lorenza. 'Services Provision and Temporary Mobility: Freedoms and Regulation in the EU' LEQS Paper No. 9, September 2009
- Walker**, Neil. 'Multilevel Constitutionalism: Looking Beyond the German Debate'. LEQS Paper No. 8, June 2009
- Frankel**, Jeffrey. 'The Estimated Trade Effects of the Euro: Why Are They Below Those From Historical Monetary Unions Among Smaller Countries?'. LEQS Paper No. 7, June 2009
- Colomer**, Josep M.. 'On Building the American and the European Empires'. LEQS Paper No. 6, June 2009
- Boeri**, Tito. 'Immigration to the Land of Redistribution'. LEQS Paper No. 5, June 2009
- Jones**, Erik. 'They Have No Idea... Decision-making and Policy Change in the Global Financial Crisis'. LEQS Paper No. 4, May 2009
- Frey**, Bruno. 'A New Concept of European Federalism'. LEQS Paper No. 3, May 2009
- Chalmers**, Damian. 'Gauging the Cumbersomeness of EU Law'. LEQS Paper No. 2, May 2009
- Bellamy**, Richard. 'The Liberty of the Post-Moderns? Market and Civic Freedom within the EU'. LEQS Paper No. 1, May 2009



LEQS
European Institute
London School of Economics
Houghton Street
WC2A 2AE London
Email: euoinst.LEQS@lse.ac.uk

<http://www2.lse.ac.uk/europeanInstitute/LEQS/Home.aspx>