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# The politics of IMF-EU co-operation: institutional change from the Maastricht Treaty to the launch of the euro

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## Abstract

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# INTRODUCTION

To understand why co-operation between the International Monetary Fund (IMF) and the European Union (EU) in the eurozone debt crisis has assumed the forms that it has, contemporary explanations need to be grounded in the evolution of IMF-EU co-operation that preceded the introduction of the euro in 1999. The objective of this article is to examine how changes in regional governance arrangements affect the process of global governance. The article does not examine the contemporary dynamics of IMF-EU bailout packages for distressed eurozone economies, nor does it seek to establish why the fiscal rules set up to govern Economic and Monetary Union (EMU) in Europe broke down after the euro was introduced (Heipertz and Verdun [2010](#); Hodson [2009](#), [2011](#)). Instead, the article focuses on understanding how the institutional spillover effects that regionalism generates led to incremental change in the process of global governance.

The article proceeds as follows. The first section addresses the question of who controls change in international organizations (IOs) through reviewing existing literatures on the dynamics of global governance and the external relations of the European Union. The second section disaggregates the key policy challenges that EMU presented for the IMF, which in turn were addressed at multiple levels.

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authority is increasingly organized in 'variegated hierarchies' constructed across different policy domains to facilitate co-ordination among multiple actors (Lake [2009](#): 175). The existing literatures on international organizations and the external role of the EU provide two sets of competing explanations that address this question, both of which centre on how bureaucratic organizations at the regional and global levels work.

The first set of competing explanations is concerned with the location of power in global governance and the institutional processes through which power is exercised. From a principal-agent (P-A) perspective, international and regional organizations are conceived primarily as instruments of statecraft. They remain dominated by their most powerful member states, with limited autonomy for taking independent action if this would cut across those states' interests (Hawkins et al. [2006](#); Stone [2011](#): 2). When it comes to the politics of the 'purse strings', state control over funding for IOs provides a potent instrument for setting agendas and shaping policy priorities at the global level, as well as for mandating formal limits on the scope of an organization's responsibilities. This can involve domestic political institutions that decide on funding for international bodies – such as the United States (US) Congress – playing a critical role in advocating for or against specific policies in global governance (Lavelle [2011](#): 18-19). Seen from this perspective, powerful states remain capable of 'calling the shots' in IOs, despite the growing population of non-state actors and institutions that seek to shape global policy-making.

In contrast to P-A approaches, from a constructivist perspective the rules and routines that form the institutionalized culture of an IO provide bureaucratic actors with the means to... (Barnett and Finn... institutional resource... influence over how... and Seabrook... institutional change... linked to exist... structure behavior... kept on a tight lea... interplay between... advocates' can mak... ous condition... 2010:



The second set of competing explanations relate to how governance dynamics work across multiple levels in a globalized era where markets for trade in goods, services and capital are internationally integrated. When scholars working within this literature examine the external impact of the EU, it is usually found to be influential in global governance processes only when it ‘speaks with a single voice’ in a specific policy domain, with the exemplar being EU negotiations in the World Trade Organization (Meunier [2005](#)). On macroeconomic policy, the EU is generally assumed to remain more fragmented and less successful in achieving common preferences among its members or in gaining joint representation in global macroeconomic policy forums (Cohen [2009](#); McNamara [2008](#); McNamara and Meunier [2002](#)).

Much of the work in this area has focused on the formal mechanisms through which the EU operates as a ‘global actor’, with less attention paid to the informal processes that might allow the EU to be influential in shaping global governance outcomes. This dichotomous understanding of the sources of influence captures only part of the dynamics of institutional change, because of the potential for codified rules and formal institutional designs to exert a constitutive effect on the norms and social environments that shape informal governance processes and vice versa (Abdelal [2007](#): 17–18). Research on European policy co-ordination during the global financial crisis, for example, suggests that EU member states are making greater use of informal mechanisms for maximizing the EU's influence in forums such as the Group of Twenty, as well as within the IMF (Hodson 2011: 96–7). This chimes with some of the more recent work that has been done from a P-A perspective, which has focused on understanding the informal mechanisms state actors use to shape policy agendas in international forums.

Informal mechanisms are a more flexible and less visible way of operating than formal processes. They are often based on personal relationships and shared norms, and can be more effective in achieving outcomes than formal processes.

The key to understanding informal mechanisms is to look at the actors involved and the context in which they operate. Informal mechanisms can be used by a wide range of actors, from individual states to international organizations. They can be used to influence formal processes, or they can be used to bypass them. Informal mechanisms can be used to achieve a wide range of objectives, from the promotion of trade to the resolution of disputes. Informal mechanisms can be used to influence the behavior of states, or they can be used to influence the behavior of international organizations. Informal mechanisms can be used to influence the behavior of individuals, or they can be used to influence the behavior of groups. Informal mechanisms can be used to influence the behavior of states, or they can be used to influence the behavior of international organizations. Informal mechanisms can be used to influence the behavior of individuals, or they can be used to influence the behavior of groups. Informal mechanisms can be used to influence the behavior of states, or they can be used to influence the behavior of international organizations. Informal mechanisms can be used to influence the behavior of individuals, or they can be used to influence the behavior of groups.

The approach in this article is situated within constructivist scholarship on European integration and global governance that is analytically eclectic rather than paradigmatic (Jabko [2006](#); McNamara [1998](#)). The article argues against recent principal-agent perspectives, which pay insufficient attention to how international bureaucracies can use informal mechanisms to set global policy agendas that cut across state preferences. It adds to the existing literature by illustrating how incremental institutional change at the global level is enacted informally ‘behind the scenes’ in response to regional dynamics through a process of ‘co-evolution’ between institutions with overlapping bureaucratic responsibilities. Through a process of ‘layering’, actors ‘work within the existing system by adding new rules on top of or alongside old ones’, or they may ‘convert’ existing rules to address new functions or goals by interpreting them in different ways (Mahoney and Thelen [2010](#): 17). This logic of incremental change suggests that when they are faced with transformations in governance arrangements at a regional level that fit within their existing mandate, bureaucratic actors within IOs ‘will act creatively as they rearrange old organizational notions and import or invent new ones to solve pressing policy problems’ (Barnett and Finnemore [2004](#): 19).

## THE IMF AND THE CHALLENGES OF EMU

International bureaucracies often evolve in response to exogenous changes in the policy domains that are covered by their institutional mandates, but reforms in the process of institutional change are often incremental, achieved through rule changes. Bureaucratic actors within IOs to focus on existing rules are interpreted by member states. Institutional structure effectively blocks the ability to exercise a high level of discretion (Mahoney and Thelen [2010](#): 52).

The Maastricht Treaty established the European Central Bank (ECB) because it

question of how the IMF should respond to the creation of a single European currency area was clouded by ambiguity. In the early period following the signing of the Maastricht Treaty, the potential for the IMF to expand its involvement with the EU was strongly resisted by a small group of national decision-makers and officials. Some national actors were opposed to further European integration in general (Baun [1995](#): 609–10), and sought to resist the prospect of the IMF treating the EU ‘like a state’ with respect to economic surveillance and policy dialogue in particular. Other actors, including EU officials, preferred to insulate the EU from IMF oversight and potential criticism (Thygesen [1997](#): 529). Crafting the IMF's response to preparations for the euro during the 1990s therefore posed significant legal, economic and political challenges for the organization.

The delegation of monetary sovereignty to the EU impacted upon the role of the IMF by stimulating a process of ‘co-evolution’. This created a ‘cross-border sequencing effect’ (Posner [2010](#): 648–9) in which the IMF reacted to regional institutional changes in Europe, thereby prompting ‘counter-reactions’ at the EU level, which cumulatively changed the nature of IMF–EU institutional co-operation in the context of EMU. The key policy challenges that EMU presented for the IMF following the ratification of the Maastricht Treaty can be grouped into the following four categories:

- management of the existing IMF reserve positions of EMU members;
- the impact of EMU on international monetary stability;
- access by EMU members to the IMF's financial resources; and
- the representation of EMU members and EU institutions in the IMF.

The major challenges that EMU presented for the IMF can be grouped into four categories, of which the first three are discussed in Table 1, each of which impacted on the IMF's role in the context of EMU. The fourth category, the representation of EMU members and EU institutions in the IMF, is discussed in Table 2. The first category, the management of the existing IMF reserve positions of EMU members, is discussed in Table 3. The second category, the impact of EMU on international monetary stability, is discussed in Table 4. The third category, access by EMU members to the IMF's financial resources, is discussed in Table 5. The fourth category, the representation of EMU members and EU institutions in the IMF, is discussed in Table 6. The Maastricht Treaty held and



control of EMU members' IMF reserves, thereby transferring legal authority over individual countries' reserve assets to the ECB and diminishing the individual rights of EMU states as members of the IMF.

Table 1 The policy challenges of EMU for the IMF

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Without enacting formal institutional changes in the relationship between the EU, EMU member states and the IMF, it was unclear how the IMF could conduct effective economic surveillance over the second most important currency area in the international monetary system. Of equal importance, European monetary integration introduced uncertainty over how the IMF should respond to future requests from individual EMU members to draw on the IMF's financial resources in the event of a financial crisis. The latter point was especially significant because the Maastricht Treaty provided for EMU members to lose their right to access EU balance of payments support, which would continue to exist only for EU states that remained outside of EMU. No Western economies borrowed from the IMF after the UK in 1976 and Italy in 1977 until the financial meltdown in Iceland in 2008 (Broome [2010](#)). Instead, from the late 1970s onwards European states such as France (1983), Greece (1985, 1991), and Italy (1993) turned to the EU for balance of payments support through the EU's Medium-Term Financial Assistance Facility, as well as for resources to finance currency market interventions from the Short-Term Exchange Rate Support arrangements, both of which were initially established in 1971 (Deleak [1997](#): 506).

In an effort to coordinate the actions of these institutions with international institutions, the EU has as to enforce the Maastricht Treaty included a national central banks financing needs 'I hazard' deficits, the inclusion of a default on and growth the likelihood

especially in the event of a systemic financial crisis, at the same time as throwing into doubt with whom the IMF should negotiate in the case of an EMU member that sought access to IMF resources (Maystadt [1997](#): 151). In addition to these concerns, the Maastricht Treaty raised questions over the existing representation of EMU members in the IMF, with the eurozone economies unable to either speak with a single voice within the IMF or to enjoy the benefits of veto power over major IMF decisions that accrue to the United States (Bini Smaghi [2009](#); McNamara and Meunier [2002](#): 857–8).

## INFORMAL INFLUENCE AND IMF-EU CO-OPERATION

In the initial stages of preparing for EMU, the ramifications of the European single currency for the international monetary system and for the IMF's global roles were slow to be fully appreciated by the Executive Board. For example, Japan's IMF executive director Hiroo Fukui described the proposal by IMF Managing Director Michel Camdessus to schedule an informal Executive Board seminar on the wider implications of the Maastricht Treaty as 'a low priority' for the organization in 1992. Despite a lack of support from the Executive Board, the Managing Director quickly initiated an informal process of 'regional consultation' with the Economic and Financial Council of the European Communities (ECOFIN) in the aftermath of the signing of the Maastricht Treaty (IMF [1992](#): 3). When the Executive Board first debated the question of how the organization should respond to the Maastricht Treaty and the implications of EMU for IMF surveillance policies in May 1992, the US executive director Thomas Dawson promoted the idea of a 'regional consultation' with the European Communities. In Europe, the IMF's role in surveillance and in the representation of EMU members for IMF surveillance was not apparent, therefore, the IMF's role in politically sensitive issues and its role in the international monetary system on the Executive Board. The primary issue was the issue of the IMF's role in the enhancement of the international monetary system has long been recognized (Bini Smaghi [2002](#)).





Economic and Monetary Union hardened even further with the Exchange Rate Mechanism (ERM) crisis seven months later, when sterling was forced out of the ERM on 'black Wednesday'. In response to growing domestic political opposition to European integration, the UK sought to constrain moves by the IMF's senior managers and staff towards enhanced co-operation and formalized relations with EU institutions.

One of the main avenues for institutional learning and incremental change within an international organization like the IMF is bureaucratic reviews of operational practices and policies. Such reviews are often precursors to the process of expanding or revising an organization's existing rules, or changing how current rules are interpreted in organizational practices (Mahoney and Thelen [2010](#): 16–18). By creating space for debate on the efficiency, appropriateness and interpretation of existing rules, reviews expand the opportunity structures for internal actors to promote their own preferences for institutional adaptation. While states may seek to exercise back-door influence over these processes (Stone [2011](#): 55–7), international bureaucracies with substantial administrative capacities and technocratic expertise, which IMF staff possess, can maintain considerable autonomy in the design of institutional changes as well as controlling how alternative options for reform are presented, ranked in order of preference and justified in reference to an organization's existing mandate.

In the case of the Maastricht Treaty, the first such opportunity for institutional learning came with the biennial review of IMF surveillance policy at the beginning of 1993, less than four months after the ERM crisis, when IMF staff floated a proposal for enhanced policy dialogue with EU institutions regarding European economic integration and a

greater role for the executive directors in the surveillance of EU member states. The bilateral Article IV consultations and Seabrook's criticizing the 'mis-macro' case ... both fiscal central bank. While the



policy co-ordination and co-operation that already operated between core EU members and ignored the systemic changes in economic governance that the Maastricht Treaty had mandated. Despite accepting the justification for informal contacts between IMF staff and the European Commission, the UK executive director sought to dissuade Board members from formalizing such discussions by keeping them ad hoc rather than on a regular annual cycle. In particular, Peretz argued that 'There should certainly be nothing that could be interpreted as an Article IV-type consultation with the Community.' This point prompted the Board discussion to descend into a debate about the linguistic definitions of the terms that were used to characterize the roles of EU institutions, such as 'oversight', 'surveillance' and 'co-ordination'. In the course of this debate, IMF staff drew on the organization's mandate to put the question to executive directors of why it was appropriate for the IMF to engage in policy dialogue with EU agencies with respect to external trade issues but not on monetary issues, when the latter comprised the core business of the organization (IMF [1993](#): 29–30).

In mounting the argument for the IMF to restrict its formal policy dialogue and surveillance processes to individual European economies, the UK executive director was not alone, although he put the case against establishing formal institutional co-operation in the strongest terms. The German executive director, Stefan Schoenberg, also argued that there should not be any formal Article IV-type consultations with regional institutions, and that it must be made clear that the results of any informal discussions 'should not have the same weight' as discussions with individual states (IMF [1993](#): 33). Other European executive directors who expressed support for this position included representatives from Spain, as well as France, whose executive director

established a supportive of formal co-operation with executive directors from Italy, who were offering cautious support.

Rhetoric of the opposition to the static members, and a narrow agenda, to push a formal discussion of the Board's agenda.

macroeconomic surveillance. The clear fit between the creation of a single European currency and the IMF's surveillance mandate in the international monetary system provided space for the organization to informally promote greater institutional co-operation with EU institutions. During this period IMF staff and senior managers cultivated informal contacts and policy discussions with EU officials and national policy-makers alike, which gradually led to the development of an internal bureaucratic consensus on the future form of IMF-EU relations as the organization sought to craft formal institutional changes to accommodate EMU.

Bureaucratic actors within the IMF have a high level of administrative capacity and are often able to exercise a large degree of autonomy from member state shareholders. As a consequence, IMF staff can potentially engage in incremental change 'under the radar' of member states on the Executive Board. From 1994, the IMF continued with an informal process of institutional adaptation by commencing an annual process of 'proto-consultation' with the European Commission, which initially focused directly on progress towards the achievement of EMU convergence criteria but soon expanded to cover a wide range of policy issues. This was analogous to an Article IV consultation, with minor differences to defuse the political sensitivities among executive directors of appearing to treat the Commission 'like a state'. Specifically, these adaptations to the standard Article IV process included discussion of staff reports on EMU at the Executive Board level in informal seminars rather than formal meetings, and communication of the views of the European Commission to the IMF's Executive Board via the medium of a letter from its Director-General for Economic and Financial Affairs (from 1996 onwards), compared with the common practice of the executive director representing a particular member state (Polak [1997](#): 499). Such changes were implemented steadily from the mid-1990s onwards, and further changes were made in the early 2000s.



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others were repeatedly carried over to subsequent Executive Board meetings. The IMF determined that EMU decisions or policies that were 'incompatible' with the organization's rules could not exempt member states from their IMF obligations '... or deprive them of their rights' (IMF [1997](#): 2-3). The IMF clarified that the only circumstances in which regional integration would impact upon individual countries' IMF membership, rights and obligations would be in the case of 'a merger of two [or more] Fund members that gives rise to a successor state' (IMF [1997](#): 3). This effectively drew a line between monetary integration and political integration while reinforcing the legal doctrine of *res inter alios acta*, which states that an agreement between others cannot adversely affect the rights of an organization that is not party to it.

The IMF made a clear judgment on the provisions of the Maastricht Treaty which granted the ECB the authority to manage or pool individual countries' IMF reserve assets. The IMF's Legal Department stated unambiguously that 'the quotas of euro-area members in the Fund could not be amalgamated or pooled' because they directly relate to a bundle of individual membership rights including the size of a member's subscription, IMF voting rights, allocation of Special Drawing Rights and access to IMF lending resources (IMF [1997](#): 5, 1998a: 5-6, 22-3). The IMF also confirmed that EMU membership would not impact upon the right of member states to individually request use of the IMF's lending resources – nor would an EMU member or group of members be able to veto the use of IMF resources by another EMU member on the grounds of the Maastricht Treaty's 'no bail out' provisions (IMF [1998a](#): 24). Without an amendment to the organization's Articles of Agreement, the creation of a single constituency in the IMF to represent eurozone economies would only be possible if the IMF were to

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As the process of negotiating change within the IMF advanced towards a decision on the framework for future co-operation with EU institutions, staff communicated to the Executive Board a clear preference for future eurozone surveillance to operate within a formal Article IV consultation rather than maintaining the previous more ad hoc and informal approach. This was justified on the grounds that ‘The move to EMU will require intensifying discussions with EU institutions to fulfil the Fund’s surveillance mandate’ (IMF [1998b](#): 3). IMF staff argued for surveillance to cover not only monetary and exchange rate issues, trade, labour market and competition policies, but also the fiscal position of the eurozone economy as a whole as well as the stability of the eurozone financial system. The staff sought to attract Board support for IMF surveillance of eurozone fiscal policies on the basis that overall fiscal surveillance would be essential for assessing monetary and exchange rate policies (IMF [1998b](#): 4-5). In order to shape the parameters of deliberations on institutional options in Executive Board debates, IMF staff defined the content of key questions for executive directors to address in ways that favoured responses in line with their preferences and excluded alternatives (such as: ‘Do Directors prefer that these discussions [with EU institutions] be given a more formal status and be included as part of the Article IV consultation process with EMU members?’) (IMF [1998b](#): 10). In effect, IMF staff from the European Department and, to a lesser extent, the Legal Department sought to influence the design of the IMF’s institutional response to EMU through formulating options for institutional change that could be implemented within the existing mandate.

## In this article



framework for the eurozone, contending that fiscal policies should only be discussed in bilateral policy dialogue with individual eurozone states (IMF [1998c](#): 15, 19). However, strong support for formalizing the IMF's eurozone surveillance and expanding the coverage to include the fiscal position of the eurozone as a whole – in line with staff preferences – came from the United States executive director Karin Lissakers and her alternate Barry Newman (IMF [1998c](#): 5). Despite continuing opposition from key European members, support for the preferences of IMF staff had gradually consolidated over successive meetings. In summing up the Board discussion in September 1998, for example, Deputy Managing Director Shigemitsu Sugisaki, who was Acting Chairman, concluded: ‘most Directors noted that discussions at the EU level would also need to evaluate the fiscal position of the euro area as a whole in order to assess the stance of monetary and exchange rate policies and the coherence of macroeconomic policies’ (IMF [1998c](#): 52). By rhetorically establishing surveillance over the eurozone's fiscal position as essential for achieving effective surveillance over monetary policies and exchange rate issues, IMF staff had boxed national actors opposed to a formal system of surveillance into a corner by appealing to the organization's core principles articulated in its Articles of Agreement.

The Executive Board eventually agreed to sign off on the preference of IMF staff for a more formalized Article IV surveillance process for the eurozone, to encompass twice-yearly staff discussions with EMU institutions (including the ECB, the European Commission, and the Economic and Financial Committee). IMF surveillance would be organized within the framework of Article IV consultations, leading to the production of an IMF staff report on the eurozone to be formally debated by the Board, including the

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international monetary system and other agenda items that the IMF and the ECB agree are in their joint interest (IMF [1998e](#): 2). This decision by the Executive Board ratified an agreement reached by EU heads of state or government at the Vienna European Council meeting on 11–12 December on the ECB's status at the IMF. The extension of 'observer status' to the ECB was based on the precedent of the IMF's collaboration agreements with other international organizations – such as the World Bank and the World Trade Organization – whose representatives are regularly invited to attend Executive Board meetings on issues where they share a 'mutual interest' with the IMF (IMF [1998b](#): 8, fn. 13).

Observer status entitled the ECB to have a representative attend IMF Executive Board meetings broadly related to eurozone issues, who is granted permission to address the Board on a case-by-case basis by the Chairman, and to receive the agenda for all Board meetings as well as associated IMF documents for meetings the ECB is specifically invited to attend. This institutional adaptation by the IMF represented an attempt to go as far as permitted by its own legal constraints and those of EU institutions to incorporate the ECB within IMF surveillance and policy dialogue for the eurozone. This allowed the ECB a degree of input into IMF decision-making processes without granting 'full' membership with voting rights, which would require an amendment to the Articles of Agreement (Hornig 2005: 814–5).

For the IMF, the years preceding the third phase of EMU in 1999 were characterized by an incremental process of institutional change, whereby many of the organization's existing surveillance principles, constitutional rules and operational practices were

gradually... generated by the... the 'one country, EU co-op... of IMF-... rules, institution... shape... while... changes in



When bureaucratic agendas are promoted informally within an international organization, the opportunities for states to control the outcomes of formal decision-making processes are constrained. The pressures generated by regional integration can function as building blocks for incremental change in global governance – even in an institutional environment containing influential national actors who exhibit strong preferences for preserving the status quo. As this article has demonstrated, powerful member states within international organizations are not always able to prevent institutional changes that cut across their national preferences. At the same time, the evolution of IMF–EU relations from the signing of the Maastricht Treaty in 1992 to the launch of the euro at the start of 1999 illustrates how the dynamics of regionalism can reinforce the primacy of states' existing international obligations and rights as members of international organizations over regional commitments.

The challenges of adapting to EMU in the wake of the Maastricht Treaty contributed to institutional change within the IMF in four main ways. First, the exigencies of fulfilling the IMF's global mandate for fostering international monetary stability provided staff with a strong justification for adapting its institutional processes to encompass supranational actors when previously its primary unit of analysis was individual national economies. Second, EMU prompted the IMF to reassert the principle of 'one country, one membership', shutting the door on proposals for a single European constituency in the organization that could challenge the veto power wielded by the United States. Third, in an effort to enhance the policy credibility of EMU institutions with market audiences and to enforce fiscal discipline on EMU members, the provisions of the Maastricht Treaty greatly increased the likelihood of eurozone economies borrowing from the

of payment of balance of payments, the IMF's role in the 'Europe' of the 1990s, and the IMF's advocacy of a 'one country, one membership' principle. The IMF's powerful

This informal arrangement can use the IMF's constraints on the three sections, this suggests a critical



passively to the preferences of states, even those with high material capabilities. IO staff may actively develop informal ways to navigate around leading states, especially when states oppose changes which bureaucratic actors believe are justified by their existing mandate. As previous research has shown, the external influence of EU institutions in macroeconomic policy domains remains weak compared with other policy areas such as trade relations. This article suggests that in policy domains where the EU and international organizations undergo a process of co-evolution, the EU's external institutional presence may gradually become a natural part of the global governance landscape.


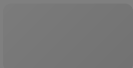
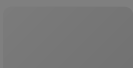
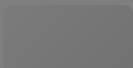
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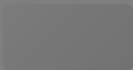
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