Recalibrating Conventional Wisdom: Romania-IMF relations under scrutiny

Cornel Ban (Boston University) I Daniela Gabor (UWE Bristol)
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- The IMF and the central bank (BNR) share the same narrative of macroeconomic developments in Romania: that BNR controls monetary (and to some extent financial) conditions through its inflation-targeting regime. This narrative enables the IMF to construct balance of payment crises as crises of state intervention in the economy and the BNR to deny responsibility for economic crises.
- The same narrative suggests that while the transnational vulnerabilities of the Romanian market model should be reduced, the orderly transition to a local banking model should be achieved by market means rather than via regulatory interventions.
- By using liquidity management instruments to manage capital flows, and not for inflation targeting, the central bank is not in compliance with the IMF's views. While recognizing the shortcomings of the central bank's policy framework, the IMF is reluctant to push for change because improvements would require a radical re-think of the role and activities of foreign banks in Romania.
- On fiscal policy, Romanian governments have not made the most of the IMF's doctrinal transformation.
- The Fund's research and official doctrine on taxation and expenditure policy allow for a fairer distribution of the costs of fiscal consolidation that the 2010 loan program with Romania suggests.

Executive summary

■ This study proposes a critical evaluation of Romania-IMF relations by focusing on financial, monetary and fiscal policy choices. As such, the study has two pillars. First, Daniela Gabor scrutinizes the IMF's take on the Romanian central bank's monetary and financial stability policies. Gabor finds that the central bank and the IMF have constructed and reproduced the fiction that the central bank controls monetary (and to some extent financial) conditions in the economy through its inflation-targeting regime. This fiction is useful for the central bank to deny responsibility for domestic economic developments, and for the IMF to construct balance of payment crises as crises of state intervention in the economy. Moreover, the central bank uses liquidity management instruments (standing facilities, open market operations) for the purpose of managing capital flows, and not for inflation targeting, as the IMF demands. Finally, both the central bank and the Fund share the belief that a gradual, orderly transition to a local banking model is to be achieved by market means rather than via regulatory interventions. This market-driven approach enables transnational banks to forge alliances with the central bank in order to oppose government-initiated measures by narrating them as measures that pose serious risks to financial stability.

■ Next, Cornel Ban's analysis of Romania's relations with the Fund makes two claims. First, it shows that the fiscal consolidation measures adopted by Romania in 2010 has had deleterious consequences for the country's growth and social inclusion objectives. Second, by looking at the Fund's own official fiscal policy doctrine and at the research conducted by Fund staff, Ban suggests that Romanian policymakers could have found support in the Fund's own research and official doctrine for a fairer and less growth-unfriendly fiscal consolidation.

I. The IMF's position on monetary and financial policies in Romania

Introduction

The program did not include any conditionality to improve the operation of the central bank's inflation targeting framework.
IMF 2014 (p.13).

Conventional discussions of the IMF's presence in Romania typically portray the government as the (often reluctant) negotiation partner. When the economy hits a balance of payments crisis, as it so often did since 1989, the IMF sits down at the negotiating table to work out a program for structural reform and macroeconomic stability that persuades politicians to undertake unpopular, if deeply necessary, fiscal adjustments and privatizations. This is how IMF country reports have defined the policy challenges in Romania both before and since the crisis (IMF, 2014). Tellingly, Christine Lagarde's Bucharest speech in July 2013 highlighted the structural (privatization and liberalization) and fiscal reforms necessary to join, as Lagarde put it, the European family.

In contrast, the relationship between the IMF and the Romanian central bank (BNR henceforth) receives less attention, as if BNR's actions have little relevance for the build-up of vulnerabilities before and the unfolding of the crisis. This microcosm of money neutrality, the theory that monetary policy cannot have 'real' effects, should be examined more carefully peculiar because balance of payments problems can have both real and/or monetary causes; and because commitments under IMF agreements are signed by both the prime minister and the governor of the central bank.
The purpose of this contribution is to investigate the key concerns that IMF country reports have expressed towards the Romanian central bank's monetary and financial stability policies. These are grouped in three distinct themes:

- The inflation-targeting regime: how effective are the policy instruments?

- Liquidity management: are central bank's interventions in money and currency (fx) markets consistent with the inflation-targeting regime?

- Financial stability: what should be the post-crisis rethink of the cross-border banking paradigm and the increasing importance of portfolio inflows (capital account management)

In answering these questions, two observations are important as methodological underpinnings for this contribution. First, there is no one-to-one relationship between the theoretical concerns that the IMF outlines in its country reports and its policy advice. The contribution approaches such instances where analysis and policy advice do not align closely as windows into the political economy of the IMF's engagement with monetary-financial issues at country level. There is a second point of disjuncture, between the IMF's advice and the BNR's policy decisions. Put differently, although scholars and Romanian public discourses typically focus on the politics of disagreement between governments and the IMF, the Romanian central bank has made policy decisions that run contrary to IMF advice. The report maps out these contradictions, and reflects on why it may be easier for the central bank to have policy autonomy during IMF agreements than it is for governments. Is it about the nature of disagreements, on detail rather than substance? Or about the IMF's perceptions that the central bank is its most 'sympathetic interlocutor' on the domestic policy scene, an interlocutor that merits certain policy autonomy?

In exploring the questions above, the contribution makes three arguments:

- The BNR and the IMF have together constructed, and continuously reproduce, the fiction that the central bank controls monetary (and to some extent financial) conditions in the economy through its inflation-targeting regime. This fiction is useful for the central bank to deny responsibility for domestic economic developments, and for the IMF to construct balance of payment crises as crises of state intervention in the economy.

- The BNR uses liquidity management instruments (standing facilities, open market operations) for the purpose of managing the capital account (capital flows), and not inflation targeting, as the IMF advises it to do.

■ The BNR and the IMF share the belief – inscribed in the Vienna Initiatives - that a gradual, orderly transition to a local banking model is the answer to the systemic risks generated by transnational banking. The orderly transition is to be achieved by market means rather than regulatory interventions. This enables transnational banks to create alliances with the central bank in order to oppose government-initiated measures (such as the Ordonanta 50) by narrating them as measures that pose serious risks to financial stability.

Catching up with finance: a brief look at the economics of IMF conditionality

For the past 10 years, the IMF has fought hard to change its public image as an institution ideologically subservient to powerful member states (the dominant voices on the Executive Board) and theoretically stuck in 1980s ideas about money neutrality and the virtues of free capital movement. Three important shifts are worth mentioning. In mid 2000s, it embraced inflation targeting as the new policy regime to structure conditionality and policy dialogue. In 2010, it recognized, through the voice of its influential chief economist Olivier Blanchard, that finance had to be put at the core of its theoretical macroeconomics, endeavour that needed to be matched by better skills and expertise of its staff, trained in finance-free general equilibrium (Blanchard et al 2010). That same year, it endorsed the use of capital controls for countries exposed to large and volatile capital flows. Put differently, the post-crisis paradigm for the IMF is 'finance matters', both theoretically and in policy, echoing similar moves by central banks to put macroprudential policy and endogenous financial instability on par with monetary policy, and to recognize the cross-border dimension of financial stability in light of growing international financial spillovers from unconventional monetary policies in high-income countries (see Mohanty 2014).

On close scrutiny, it is difficult to find traces of the new 'finance-matters' paradigm in the Stand-By agreements (SBA) that the IMF signed with Romania since 2009. Conditionality criteria are overwhelmingly defined around structural and fiscal issues. For instance, the 2011 precautionary SBA specified 19 fiscal, 20 structural (liberalization/privatization) and 1 (one!) financial (allowing the use of the deposit guarantee fund for bank rescues) prior actions and structural benchmarks. The quantitative performance criteria in both the 2009 SBA and the 2011 SBA include one target for the central bank – a (traditional) foreign reserves level - and three criteria on government finances. The performance of the inflation-targeting regime may trigger consultations but does not count for program success. This absence of finance in SBA conditionality is rather striking given that the IMF itself described the post-Lehman Romanian crisis as a crisis of interconnected banking, driven by foreign-owned banks that funded credit and consumption booms from cross-border sources (IMF 2009)[1].

Inflation targeting: Is it the right policy framework?

The Romanian banking system has a history of structural excess liquidity and deviations of money market rates from policy rates, prompting some observers to question the effectiveness of monetary policy...
IMF 2012 (p. 40)

Staff also stressed that minimizing the divergence between interbank rates and the policy rate, through open market operations, is important to strengthen the interest rate transmission mechanism.
IMF 2013 (p. 20)

In 2005, the BNR adopted inflation targeting. This policy framework creates a narrow mandate for central banks: move the policy interest rate in order to achieve the inflation target. Politically, the mandate appealed to BNR since it enshrines the principle of double neutrality, from both governments' (potentially populist) priorities and from financial markets. Before adopting inflation targeting in 2005, BNR had relied on controversial (for the IMF) interventions in currency markets, and often came under pressure to extend preferential credit

1. Jeffrey Franks, the IMF's mission chief to Romania, described the crisis as follows: 'GDP growth averaged over 6½ percent per year from 2003 to 2008. This rapid growth was made possible by foreign direct investment and capital inflows, a lot of them facilitated by foreign banks that had set up subsidiaries in Romania. All this foreign capital fueled consumer spending and led to an investment boom by local companies.'

to economic sectors backed by governments. In contrast, under inflation targeting, BNR committed to only intervene on one market segment, the interbank money market, with the sole purpose of ensuring that market rates move in line with its policy rate decisions. This would determine the cost of funding for banks and providing signals for asset prices and other long-term interest rates (the transmission mechanism). In doing so, BNR would shape the dynamics of aggregate demand and inflation.

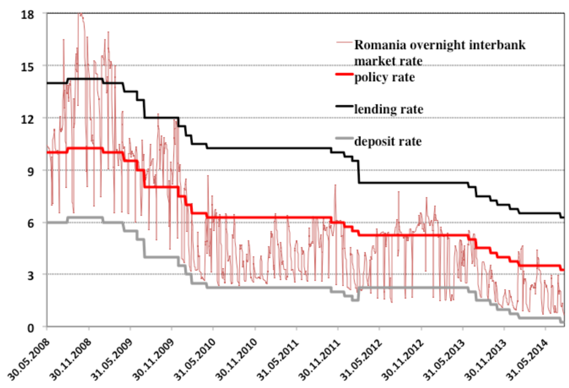
The theoretical models that guide inflation targeting regimes have been sharply criticized since the crisis, including by IMF staff, for ignoring finance (see Blanchard et al 2010). Yet in the IMF's evaluations of the Romanian inflation-targeting regime, it is not the BNR's theoretical treatment of finance that matters, but rather, as the quote above suggests, the effectiveness of the policy instrument, the policy rate. Since 2009, various country reports repeatedly raised one issue: the gap between the money market rate and the policy rate created by excess liquidity on the interbank money market.

Figure 1 illustrates that concern. In part, the volatility of the market rates is due to the fact that the Romanian central bank operates a large standing facilities corridor - 800 basis points before March 2012, 600 since then. In comparison, both the US Federal Reserve and the ECB's set that corridor at maximum 50 basis points.

The starting point is to clarify how policy rate decisions are implemented in practice. In inflation targeting models, the banking sector has an aggregate deficit of reserves. This creates demand pressures on the interbank money market, where banks trade reserves. Unless the central bank accommodates this demand, through open market operations, interest rates will increase above the policy rate. The upper limit is set by the interest rate at the direct lending facility of the central bank (the discount window), since no central bank would refuse to lend to banks for fear it may trigger a banking crisis.

Central banks prefer to inject reserves through direct market interventions (buying assets from commercial banks permanently or temporarily, through repos) because discount window borrowing caries a stigma for commercial banks, raising doubts about their ability to tap market funding. Since inflation targeting is expected to work both through interest rates and credibility, banks' recourse to the discount window may ultimately undermine the credibility of the policy regime. Thus, central banks prefer to actively engage in money markets, where they are net lenders to commercial banks.

Figure 1. Romanian money market and policy rates



Source: data from www.bnro.ro

This theoretical intuition does not hold for Romania. Since the late 1990s, with few exceptions (as in late 2008), BNR has been a net borrower from the Romanian banking sector (see IMF 2009, 2012, 2013). Put differently, the interbank money market has a structural excess of reserves (excess liquidity) that pushes money market rates to the lower bound of the standing facilities corridor, the deposit facility where commercial banks take excess reserves overnight. For instance, since June 2010, overnight market rates fluctuate consistently below the policy rate, sign of excess liquidity. By middle of 2014, money market rates in Romania trended closer to the ECB's policy rate than the BNR's policy rate.

Why does this matter for the IMF? It first throws into question the BNR's ability to influence monetary conditions in the Romanian economy, since: 'excess liquidity, in turn, weakens interest rate transmission because policy rate changes are unlikely to cause movements in credit supply when liquidity is abundant' (IMF 2012: 46). By IMF calculations, policy rate decisions influence lending rates 'slow…with only 60% showing up during the first two months following the policy change' (IMF 2012: 47). In other words, policy rate decisions may not have the expected impact on aggregate demand and inflation since the BNR cannot effectively implement those decisions in the interbank money market. Without a credible monetary policy, banks and borrowers shift to foreign currency debt, as the rapid growth in foreign currency indebtedness before 2008 suggests. BNR's difficulties in targeting inflation may sharpen systemic risk, throwing into questions its ability to deliver financial stability.

In light of these concerns, how does the IMF interpret BNR's policy rate decisions? Paradoxically, the concerns that pervade theoretical discussions disappear from policy advice. In its advice, the IMF evaluates policy rate changes as if the transmission mechanism works well. For instance, country missions expressed doubts about BNR's decision to lower policy rates in 2009-2010 and 2013-2014 (see IMF 2012, 2013, 2014), warning that inflation may get out of hand, setting aside pressing growth concerns in a country severely affected by the global financial crisis. While typically critical of easing decisions, the IMF supported or advised rate hikes, pointing to the volatile global environment and exchange rate volatility[2]. Despite this reluctance, BNR appears to enjoy substantial autonomy from the IMF in deciding the path of the policy rate. The absence of monetary criteria strictly defined through the policy framework in the IMF agreements supports this autonomy, regardless of how IMF staff judge interest rate decisions.

Although not directly binding, IMF pronouncements on interest rate decisions feed the public perception that the BNR controls monetary conditions through its inflation targeting framework, and that its performance should be judged upon delivering on the inflation targets. The political intention behind this is to (re)produce the image of the BNR as the apolitical technocratic institution that can be trusted to discipline governments into the necessary fiscal and structural reforms, the real target of the IMF's conditionality. This far, the exercise has been successful although, paradoxically, inflation has been above target on repeated occasions. Save for a few critical voices, the Romanian public opinion places more trust in the governor of the central bank than in the Orthodox Church.

This puts the Romanian central bank into stark contrast with most of its peers. Central banks across the world have recognized the limits of their pre-crisis models, their responsibility for failing to see the crisis, and the necessity to learn from past mistakes. BNR in turn has refused such opportunities for reflexivity. For example, in a 2014 presentation, Mugur Isarescu argued that 'monetary policy was counter-cyclical both before and after the crisis outbreak', laying the blame for the 2008 crisis squarely at the feet of governments (through real wage growth and expansionary fiscal policy).

The question that arises is why doesn't the central bank address the concerns raised in the IMF reports? The next section turns to address it.

Liquidity management: are central bank's interventions in money and fx markets consistent with the inflation targeting regime?

Since the end of the 1990s, foreign exchange inflows represented the NBR's most important money creation instrument. The NBR steadily accumulated foreign reserves while liquidity effects were only partly offset through absorbing open market operations. IMF 2012 (p.41)

However, overall, monetary conditions loosened substantially as abundant liquidity kept the interbank rate significantly below the policy rate for extended periods of time. This in part reflected the central bank's concerns with its own profitability and an implicit reluctance to use repos operations to mop up excess liquidity.
IMF 2014(p.26)

IMF reports advise two methods for BNR to improve control over money market rates: (i) a more 'active use of open market operations' and (ii) tighter standing facilities (lending and deposit) corridor around the policy rate. To understand why BNR seems little inclined to do either, it is important to understand the mechanisms and actors that generate excess liquidity (reserves).

Central banks can create (and destroy) reserves in two ways: through the money market (described earlier) and through currency markets.

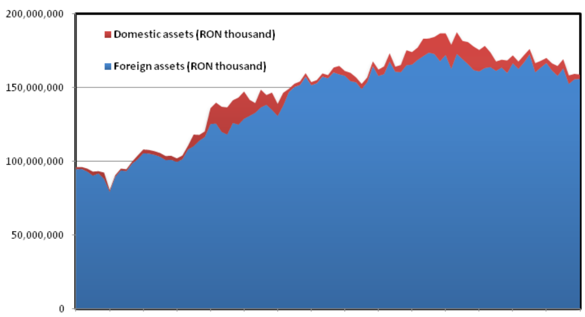
Central banks create reserves when they buy foreign currency and pay for it in domestic reserves

2. October 2012: tighten monetary policy to address potential inflation risks + capital outflows and exchange rate pressures

(for example, to meet the IMF conditionality on net foreign assets). For the past 15 years, as the IMF quote above and Graph 2 suggest, the Romanian central bank has mostly deployed the second method to create high-powered money. Foreign assets dominate the BNR's balance sheet on the asset side. Domestic assets (lending to banks) amounted to less than 5% of the overall balance sheet before October 2008, increasingly to around 10% in early 2009, as banks became reluctant to lend to each other under highly uncertain conditions preceding the April 2009 agreement with the IMF. From a balance sheet perspective, the BNR creates money through capital flow management.

The BNR is not alone in this approach. It is the experience of central banks in countries of East Asia, Latin America, Eastern Europe or Africa confronted with large capital inflows (see Mohanty and Berger 2013). Just like those countries, the main activity of the BNR is not to manage closely the interbank money market, as the inflation targeting story would have us believe, but to manage the complex link between capital inflows and domestic money market liquidity. BNR absorbs capital inflows into its reserves, either directly through interventions in currency markets, or by exchanging EU funds disbursed to the Romanian public sector. It also intervenes in currency markets, to protect the RON from rapid depreciations at the height of the crisis. As any other central bank confronted with large and volatile capital flows, BNR does capital flow management first, inflation targeting (maybe) later. This entails (political) preferences about the exchange rate level that the central bank exercises without a mandate or explicit concern for growth.

Figure 2. Assets of the central bank of Romania, 2007-2014

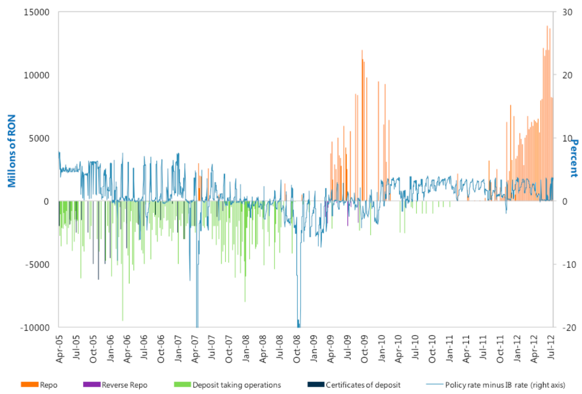


Source: data from www.bnro.ro

Why has the BNR been 'reluctant', as the IMF(2014) put it in the quote above, to 'use repos to mop up excess liquidity'? If it followed the IMF's advice, BNR could simply buy/borrow those excess reserves back from commercial banks while simultaneously tightening the standing facilities corridor around the policy rate. This would make its policy rate set the cost of liquidity for banks, and its control over aggregate demand conditions closer to inflation targeting theories.

Before October 2008, BNR's liquidity management aligned closer with the IMF's advice. It actively used deposit-taking operations and issued certificates of deposit to mop up reserves (aside from varying reserve requirements). Yet it did not sterilize the money market fully, since rates on that market continued to diverge systematically from the policy rate (see Figure 3). What changes markedly after 2008 is that BNR reduces dramatically sterilization operations to abandon them altogether since 2012, even if it continued to increase liquidity in the system via fx purchases (see Figure 2). The only active interventions are repo operations, through which BNR injects reserves into the banking system. Banks can still deposit their excess liquidity with the central bank, but receive the standing facility deposit rate, currently set at 0.25%.

Figure 3. Open market operations, BNR

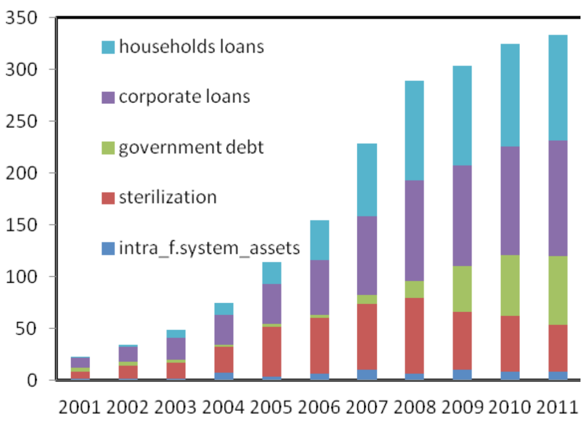


Source: IMF Romania country report, 2012.

To understand why BNR changed strategy from significant (if partial) sterilization before 2008 to no sterilization, it is useful to think of the counterparties to BNR's operations, resident banks. BNR purchases in currency markets distribute liquidity in the system to the banks that have access to cross-border funding sources. For those banks, the active intermediation of capital inflows is a profitable activity. A 2004 IMF paper described this as 'sterilization games': resident banks borrow from the parents or from international money markets (see Christensen 2004), exchange those loans with BNR and thus obtain domestic reserves without paying the interest rate that the BNR attempts to set in the money markets. Rather, resident banks place those reserves in the BNR sterilization operations, at high interests rate and low risks. As Figure 4 indicates, up to a third of the Romanian banking sector's balance sheet was generated by BNR sterilizations before 2008.

Thus, resident banks are able to circumvent the (liquidity) price constraints that the BNR tries to set with its policy rate according to its inflation-targeting regime. For these commercial banks, the 'true' cost of RON liquidity is the interest rate at which they borrow from the parent, rather than the interest rate set by the BNR (see Bruno and Shin 2014 for a formal treatment, also Gabor 2014). The BNR policy rate thus becomes one of the many yields that those commercial banks can choose from (in comparison to, for example, the return on government debt), while global liquidity conditions play a crucial role in determining domestic monetary conditions (see Mohanty 2014).

Figure 4. Banking sector assets, Romania



Source: www.bnro.ro

The 2012 IMF country report noted the puzzle that: 'most recently, banking sector fragmentation led to situations in which the NBR acted as a net lender to the system although money market rates signaled abundant liquidity in the system as a whole' (IMF 2012:42). However, the report makes no analytical connection between the 'structural liquidity surplus' it identifies and resident banks' strategies. Had it done so, the IMF would have had to recognize the trade-off that the BNR confronts in its inflation targeting strategy: it if sterilizes, the sterilization instruments create incentives for banks to bring further capital inflows, increasing pressures on the central bank to intervene in currency markets, creating new liquidity and so on and so on. If it does not sterilize, then money market rates deviate consistently from the policy rate, rendering the inflation targeting strategy meaningless.

Before 2008, BNR chose the first option[3]. Afterwards, it gradually eliminated sterilizations, an implicit recognition that these validated banks active intermediation of capital inflows for short-term profitability. This also explains the wide standing facilities corridor: BNR accepts deposits from banks with excess liquidity, but remunerates them at very low interest rates. If it tightened the corridor, as the IMF suggests, banks would find the deposit facility attractive, particularly given the low interest rate environment in home countries. Thus, the reluctance that the IMF attaches to BNR's liquidity management approach may signal important lessons that the central bank has learnt with Lehman's collapse: that encouraging banks to pursue short-term yield opportunities funded through cross-border sources is, for central banks, a self-defeating strategy and that countries whose banks actively intermediate capital inflows in short-term search for yield tend to suffer worse from sudden stops in capital inflows, as Romania did immediately after Lehman.

3. As it switched to inflation targeting in 2005, BNR tried unsuccessfully to abandon sterilizations. It explicitly identified commercial banks' demand for sterilization instruments as speculative practice linked to currency trading and warned that it would only offer sterilizations to banks that obtained excess reserves from retail deposit activity. In Ziarul Financiar, Mugur Isarescu stressed that 'We will resume sterilizations when placements will reflect deposit-taking activity rather than currency trading. When I sterilize, I check three elements of the balance sheet: liabilities, assets and volumes bid for sterilization – and I cannot accept sterilizations bids from banks with a very low deposit base' (see Gabor 2013, 142). But without profitable placement opportunities, capital flows slowed down, the exchange rate started falling, threatening inflation and the credibility of the newly instated policy regime. Two months later, BNR resumed sterilizations.

The IMF could have provided valuable advice in this respect. Consider its 1997 publication on Capital Flow Sustainability and Currency Attacks, written in the immediate aftermath of the East Asian crisis. The IMF (1997) questioned the typical response to sudden stops that involves raising interest rates and defending the currency through foreign reserve sales that squeeze domestic liquidity. If the central bank re-injects that liquidity into money markets, the IMF argued, it becomes the unwitting (ultimate) counterparty of short-sellers. Yet by doing nothing, it tightens interbank liquidity, thus punishing non-speculative demand from banks that need reserves for lending to the real economy. In both the 1998/1999 and the 2008 crisis, BNR chose this response (see Gabor 2013), failing to consider sufficiently the impact on domestic banks with longer-term horizons. Yet to date the IMF has not produced any substantive analysis of either these episodes - including the contested claims that resident banks enabled a speculative attack on the RON in October 2008 - or of its failure to warn Romanian authorities about the specific types of vulnerabilities associated with banks' active intermediation of capital flows.

Financial stability: cross-border interconnectedness

With respect to financial stability, IMF reports focused on two potential sources of vulnerability: the cross-border exposures of resident banks, and the increased foreign participation in local bond markets, mainly in the government segment (portfolio inflows).

Thus, the 2014 country report stresses that: 'cross-border banking exposures remain central to assess financial sector vulnerability even in a post-crisis environment. One of the lessons from the Romanian experience after the 2008-09 global financial crisis is the need to pay special attention to the risks arising from cross-border banking linkages and fx exposures of the banking, and in more general terms, of the overall financial sector' (IMF 2014, p.28). It recommended three avenues to curtail these risks: coordination between home and host regulators, careful macroprudential policies, and better data disclosure from transnational banks.

On these first two issues, the Romanian central bank has a poor policy record and the IMF a poor advice record.

First, the global financial crisis demonstrated that regulatory frameworks, both in the national provision and cross-border cooperation, were ill equipped to mitigate the risks specific to transnational banking. Both home and host central banks allowed transnational banks to centralize funding and liquidity decisions, so that resident banks' lending and investment decisions depended more on group-wide considerations (internal capital markets) than on the BNR's interest rate decisions. Rather than BNR's policy rate, parent banks priced loans to subsidiaries depending on internal prime rates (reflecting broader funding conditions for the group), expected relative profitability across subsidiaries, and arbitrage opportunities across the distinctive regulatory frameworks in the jurisdictions where subsidiaries operate[4]. BNR documented such instances before 2008, for example when resident banks were externalizing loans to circumvent regulatory caps on foreign currency credit or to take advantage of cheaper funding conditions[5] abroad (BNR, 2010). Yet it treated such instances as unavoidable consequences of EU membership. Since the crisis, little has changed. The ad-hoc Vienna Initiative framework has not been institutionalized into a formal cooperation mechanism, with questions deferred to the European Banking Union plans. Furthermore, in the Vienna Initiative, one of the key priorities for parent banks was to ensure that host regulators would not introduce policies that curtail the free flow of liquidity within the group. The IMF supported this position by encouraging banks to design their own strategies for the transition to a local banking model, rather than consider the benefits and drawbacks of plans to segment cross-border banking across national lines into highly autonomous, separately capitalized national subsidiaries reliant on the rules and markets of the host-country.

4. Banks were forced to switch to a more transparent pricing mechanism based on a market rate (LIBOR) rather than internal prime rates during the local implementation of the European Directive on Consumer Credit in 2010.

5. According to the central bank, the practice of loan externalization took two distinctive forms. Banks transferred loans from their balance sheet, usually to the parent or other counterparty in the same group. This constituted the predominant form of externalization, with a share of 70% of total loans externalized, estimated at around EUR 10bn in September 2009.

Secondly, BNR made crucial regulatory errors before 2008, errors that worsened financial vulnerability. In mid-2000s, while it was removing the last obstacles to the free flow of capital (as part of the EU accession plan), BNR introduced a comprehensive range of counter-cyclical (what would now be called macroprudential) measures to constrain banks' lending to households, in particular. These included a maximum monthly payment commitments to 35% of net income for borrower and family; a loan-to value-ratio of 75% for both purchases of existing dwellings or cost estimates for building new ones; a collateral to loan value of at least 133%; ceiling on lenders' exposure to currency credits of 300% of own funds for credit to un-hedged borrowers.

By the end of 2006, BNR reported that the average mortgage loan registered values well below the average house price, and that over 65% of all mortgage loans remained below the average value (BNR, 2006). But in January 2007, it decided to eliminate these provisions, even though household lending, particularly in foreign currency, was growing rapidly. The philosophy of prudential regulation became (as in Basel II), that banks could self-discipline through carefully designed risk assessment models. BNR's regulatory retreat, proven costly only fifteen months later, at the time signalled optimism about European financial integration, a shared belief in the necessity to minimize the regulatory burden for banks and a poorly understood division of regulatory responsibilities that saw home and host regulators relying on the other to contain the systemic risks associated with transnational banking. In this, IMF advice helped little.

The IMF Mission to Romania in March 2007 agreed with BNR, noting that 'on prudential and administrative measures, the mission cautions that administrative measures are often less and less effective over time, and are generally ill-suited to addressing a macroeconomic stabilization problem.' Having recognized the build-up of cross-border vulnerabilities, the IMF urged the government to tighten fiscal and wage policies rather than BNR to tighten prudential regulation.

Since the crisis, the IMF has remained reluctant to advise structural reform measures that would directly address the specific vulnerabilities that large European banks create through their presence in the Romanian banking system. The spectre of 'disorderly deleveraging', invoked during the Vienna Initiative negotiations or the Ordonanta 50 negotiations (see Gabor 2013), has consistently discourages critical reflection on how foreign-owned banks may be reformed and be asked to contribute their fair share to the costs of the crisis for which, the IMF recognizes, they were largely responsible. Contrast this with the IMF's repeated insistence on structural reforms in the state-owned sector (for instance transportation and energy), sectors that may well need reform but are hardly behind Romania's vulnerabilities to global financial tensions. Instead, the BNR and the IMF agree that an orderly transition to a local banking model must be achieved on banks' terms rather than through direct regulatory interventions. What local authorities can do, according to the IMF, is to ensure that banks can repair their balance sheets (affected by non-performing loans) by providing a stable macroeconomic environment, and crucially, by providing the legal framework that would allow banks to fund locally. For instance, the IMF has strongly encouraged Romanian authorities to accelerate legislation for covered bonds, arguing that banks' ability to issue long-term debt would reduce their dependency on cross-border funding. In this, the IMF is inconsistent: its analysis of domestic liquidity conditions, documented in detail in the previous section, clearly indicates that the Romanian banking sector has a structural excess of funding, be it asymmetrically distributed. The covered bonds market may be strategic in light of Romania's stated ambitions to join the Eurozone, and the European Commission's current Capital Union plans, but will do little to change the funding terms of the domestic banking system.

Indeed, for the IMF, what the Romanian financial sector needs to build sustainable foundations is further financial liberalization. As before the crisis, it continues to downplay its dangers. Consider its position on portfolio inflows. Since the global financial crisis, a key concern for central banks across emerging countries has been the increased foreign interest in equities and bonds in an environment of ultra-low interest rates in high-income countries. Yet portfolio inflows can reverse rapidly when interest rates in the countries where these investors funds rise, threatening again financial stability (see Mohanty 2014).

The IMF's advice could be crucial given that national policy makers have little incentive to stem portfolio inflows: for BNR, portfolio inflows offset banking outflows, whereas for governments, inflows lower borrowing costs. In the 2013 Country report, the IMF notes that 'new sources of external risk have emerged as capital flows to emerging economies have recently become more volatile', and that non-resident investors' share of RON securities increased rapidly once tensions in the Eurozone subsided, to around 25%. Yet neither that report, nor subsequent ones offer any substantive analysis or policy recommendations beyond the standard advice of macroeconomic stability. Similar to its pre-crisis behavior, the IMF has little to offer on the substantive issues that confront the Romanian central bank. Its analytical energy is instead spent on fiscal and structural questions, on the underlying assumption that private ownership is the only desirable goal for Romania's economic reform.

Conclusion

This section reflected on the constraints that the IMF places on the actions of the Romanian central bank, in both monetary policy and financial stability. Beyond the formal performance criteria in the stand-by agreements related to the accumulation of foreign reserves, the Romanian central bank enjoys considerable policy autonomy. In part, this is because the IMF and BNR often share a common understanding of policy problems and solutions for the Romanian economy, focused on the detrimental role of government intervention. Stand-By agreements are constructed to 'correct' government failures, rather than to engage with the pressing challenges that the BNR is facing as the central bank of a country with an open capital account, with no room for capital controls, with a foreign owned banking sector that engages in regulatory arbitrage and short-term yield pursuit and with a growing presence of volatile portfolio investors that may exit rapidly when global liquidity conditions tighten. It is against these serious (and by no means unique) constraints that the BNR decided to ignore the IMF's advice on how to 'improve' its inflation-targeting regime. It should continue to do so, in light of the IMF's reluctance to engage with the substantive issues of Romania's integration in cross-border financial networks.

II. Renegotiating austerity by drawing on the IMF's fiscal policy doctrine

Was there an alternative to the 2010 austerity package?

Fiscal policy, the making of decisions about how states collect and spend money to influence the economy, is at the heart of democratic politics itself (Levi 1988; Blyth 2013). Yet for a very long time fiscal policy decisions have not been the sole domain of the domestic political sphere. Rather, sovereign bond markets and international economic organizations like the International Monetary Fund constrain domestic fiscal policy in significant ways (Mosley 2003; Woods 2006; Pop-Eleches 2009). This is particularly important during recessions, when policy makers are under pressure to help deliver improved growth and employment figures.

The package of drastic public spending cuts adopted in 2010 as part of the agreement with the IMF had deleterious macroeconomic and social consequences that have been extensively documented. The conventional wisdom is that there was no alternative to it, given that the country was effectively in a balance of payments crisis. If you don't have fiscal space, you can't avoid fiscal consolidation, irrespective of what your politics is. This reasoning sounds sensible but it obscures more than it uncovers.

This report claims that while a fiscal expansion would have been difficult considering the lack of budget surpluses and the constraints posed by the Troika and international bond markets to a country unable to finance its budget deficit, the design of the 2010 program could have been less detrimental to growth and social solidarity had Romanian policymakers drawn on some of the IMF's own ideas about fiscal policy in recessions triggered by financial crises. To this end, the report calls on policymakers to pay closer attention to what the IMF headquarters are saying, as often they can be surprised by how much more room for maneuvering they can find there.

In brief, although it was open about the use of automatic stabilizers where governments had fiscal space, for more than three decades preceding the Lehman Crisis, the IMF upheld the view that fiscal policy is not very useful in most countries and contexts (Heller 2002). Nevertheless, in 2008 the IMF surprised its critics by endorsing the use of a wider array of fiscal tools for a broader spectrum of countries to overcome the greatest crisis that capitalism had known since the Great Depression. Moreover, when most European policymakers stated that austerity was not just necessary to lower debt, but could even lead to growth, the IMF begged to differ. The evolving views of the Fund on fiscal policy were also clear to emerging and developing economy policy elites surveyed by the Fund's Internal Evaluation Office. A common view among them was that "the IMF has tempered its emphasis on fiscal adjustment and is now more attuned to the social and economic development needs."[6] As one acerbic critic of the IMF put it, this unorthodox thinking was part of an "interregnum pregnant with development opportunities" (Grabel 2011).

The analysis begins with a bit of context. To this end, it emphasizes that Romania's sovereign debt crisis was closely connected with Romania's variety of financial capitalism. Next, through a comparison of Spain and Romania, the report shows that not all fiscal consolidations are equal and that domestic political preferences are key. The bulk of the paper undertakes a systematic analysis of the IMF's official fiscal policy doctrine as it evolved during the crisis. The evidence suggests that if indeed the IMF doctrine carries any weight in loan program design, Romanian governments could have extracted a less socially punishing and growth-retarding fiscal adjustment package from the Fund.

The trap of dependent finance and the power of conditionality

Like in many other European countries, Romania's fiscal crisis came through the financial channel. But while the crisis in the Eurozone originated in an over-developed financial sector marked by the merger of collateral and sovereign debt markets (Gabor and Ban 2012), Romania's economy was ravaged by a different kind of dynamic. Indeed, in the fall of 2008 the country had a low degree of financial intermediation, thin financial markets and a very undeveloped market for derivatives (Voinea 2012). What powered the crisis in this country was as much the government's pro-cyclical fiscal policy and the decisions of the Western banks that controlled its financial sector.

Specifically, the extensive transnationalization of ownership of the Romanian financial increased the current account deficit to levels that made the Romanian state particularly vulnerable country in times of crisis. If during the 2000s banks from the EU "core" made fortunes in Southern Europe largely through wholesale markets that boomed under the impetus of euro convergence (Gabor and Ban 2012), in Romania and Eastern Europe more generally they simply bought existing state-owned institutions. As a result, over 80 percent of credit originated from the Eurozone. As Blyth put it, by doing this many east European countries effectively "privatized the money supply" (Blyth 2013).This structural transformation was meant to have economic and political benefits[7]. In reality, foreign ownership in the financial industry blew a huge consumer credit bubble and made only a marginal contribution to industrial investment, whose growth was largely connected to the integration of Romanian industry into Western supply chains. Indeed, rather than get their finance from the local subsidiaries of Western banks, foreign firms brought their credit lines with them. Since easy credit benefited mostly an emerging middle class (about 20 percent of the population by most estimates)(Gabor 2013) whose consumption patterns revolved around imports, the local subsidiaries of foreign banks assembled together the main engine of the East European crisis: gaping current account deficits.

Second, when financial crises increase the pressure to resort to deleverage in the financials sector, the most affected economies will be those that are most exposed to deleveraging panics: periph-

6. Internal Evaluation Office, "The Role of the IMF as Trusted Advisor," http://www.ieo-imf.org/ieo/pages/ieohome.aspx#

7. This transformation supplied governments with an additional economic source of domestic legitimacy. Consumption levels depressed during the early transition by restrictive macroeconomic policies of dubious benefit for the economy as a whole (Gabor 2012) recovered as a result of credit.

eral countries whose financial sectors are owned by foreign banks overexposed in third markets. In such circumstances, "mother banks" face daunting pressures to cut their loses in these third markets by cutting down on their investments in peripheral financial systems. This is exactly what happened in Romania in the aftermath of the Lehman crisis. During this critical juncture the foreign banks that owned the financial sectors started to deleverage at home and considered pulling out to supply funds to their mother French, Austrian, Greek, German and Italian banks hit by the Lehman crisis. To make matters worse, the countries where most Romanian remittances originated (Italy, Spain, Ireland) faced a dramatic surge in unemployment.

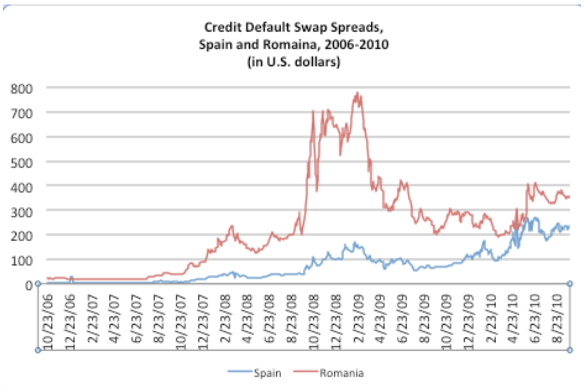
In early 2009 international banks reduced their cross-border loans to ECE banks, with the greatest reductions affecting the most liquid of them (Slovakia and the Czech Republic), in a move that a BIS report saw as indicative of the fact that "some parent banks may have temporarily used these markets to maintain liquidity at home" (Dubravko Mihalijek 2009, p. 4). In relative terms, the reduction in cross-border banking flows as a percentage of GDP was about as big for ECE in 2008-2009 as it was for Asian countries in 1998-1999 (p.7). To alleviate the liquidity crunch, in 2009 central banks in Hungary, Poland and Romania tried to convince the ECB to broaden the list of eligible collateral for its monetary operations by including government bonds issued in local currency in exchange for haircuts to these non-euro government bonds. The ECB rejected the suggestions[8].

The panic in early 2009 was so intense that foreign banks were prepared to overlook the potential for expansion of the Romanian lending market: it was only worth around 40 per cent of GDP, compared to 150 per cent elsewhere in the region[9]. As the figure 20 suggests, this effectively priced the Romanian government out of sovereign bond markets.

8. "And justice for all: in emerging Europe," Financial Times, November 7, 2011.

9. Interview with Vlad Muscalu, economist at ING Romania, Financial Times, February 13, 2012.

Figure 5. CDS spreads in Spain and Romania



Source: Author's calculations based on Datastream

With its coffers emptied by pro-cyclical tax cuts before the crisis, the government had no resources to act counter-cyclically even in the unlikely event that it wanted to.

At this point, the E.U. and the IMF intervened and orchestrated a massive bailout of the financial systems and embattled sovereigns of Romania, Latvia, Hungary, Bosnia and Serbia. Ironically, it was in Vienna, the starting point of the Great Depression, where an agreement between banks, the European Central Bank, the European Commission, the EBRD, the IMF and the states in question was signed in 2009. The core of the agreement was that West European banks committed to stay if ECE governments reiterated commitments to austerity and stabilization of the banks' balance sheets. The IMF and the E.U. in turn would hand the bill (fiscal austerity, high interest rates, constraints on mortgagees' rights, recapitalization I.M.F./E.U. loans deposited with the central bank) to the states[10].

The Vienna Agreement established an international financial regime in which the IMF, the EU and the banks exercised a form of shared control over the policy decisions of Romania, reinforcing the dependent status of its variety of capitalism. For the government, this meant reliable buyers of its bonds. For the banks, it meant protection against the col-

10. It was no surprise then that as the West European sovereign debt crisis hit, another major vulnerability emerged: that foreign banks in Eastern Europe could become the transmission belts for the troubles of Western sovereigns. Following Greece's tailspin and Austria's downgrading in the spring of 2012, S&P turned Romanian bonds into junk status because the Romanian banking sector had too much Greek and Austrian financial capital.

lapse in domestic demand made even more dramatic by the austerity included in the bailout package. It also meant protection against the attempts made by consumer organizations in 2010 to lend erga omnis value to court rulings finding abusive clauses in bank contracts. Faced with the prospect of hundreds of millions of euros a year in loses[11], banks demanded and obtained IMF and central bank protection against Romanian courts[12].

These material and institutional constraints were important in shaping crisis responses, but they do not explain why fiscal consolidation almost always meant mostly regressive spending cuts rather than a more progressive distribution of the burden via progressive wage cuts in a highly unequal public sector workforce, tax increases on the wealthy and the corporate sector, as was suggested by some (Piketty and Saez 2006; Diamond and Saez 2011; Piketty and Saez 2013; Alvaredo et al 2013; IMF 2013; Piketty 2014). As illustrated in the table below, even by the narrow criteria of the Troika there was still some room to adopt a more balanced distribution of the costs of fiscal consolidation. Indeed, it is not every day that one hears the managing director of the IMF charged with being an ideologue of the left[13] and a proponent of "state capitalism" traceable to his communist youth[14]. Yet this is exactly what happened in Romania in 2010, after Dominique Strauss Kahn asked the Romanian government to spread the costs of austerity more evenly[15] and the IMF team designing the austerity package asked for more reliance on revenue measures than on spending cuts[16].

11. In 2013 the Romanian Banking Association (RBA), the financial sector lobby, estimated loses at 600 million euro a year in case new legislation allowed court rulings to have erga omnes power in cases where at issue were abusive contract clauses. Ziarul Financiar, November 21, 2012; http://www.zf.ro/banci-si-asigurari/ingrijorare-printre-bancheri-privind-intrarea-in-vigoare-a-codului-de-procedura-civila-arb-roaga-bnr-sa-intervina-pentru-ca-bancile-sa-nu-piarda-sute-de-milioane-de-euro-pe-an-10340113

12. The in-house report of the RBA explicitly acknowledged the role of the IMF and the central bank in limiting court jurisdiction and regulatory moves deriving from court jurisprudence. Ziarul Financiar, November 21, 2012; http://www.zf.ro/banci-si-asigurari/ingrijorare-printre-bancheri-privind-intrarea-in-vigoare-a-codului-de-procedura-civila-arb-roaga-bnr-sa-intervina-pentru-ca-bancile-sa-nu-piarda-sute-de-milioane-de-euro-pe-an-10340113

13. Statement by presidential adviser Sebastian Lazaroiu, May 25, 2010, http://www.mediafax.ro/politic/basescu-daca-strauss-kahn-are-dubii-ii-transmit-personal-documentul-cu-mandatul-fmi-la-bucuresti-6173752

14. Tom Gallagher, "Grija domnului Strauss-Kahn faţă de România," Romania libera, June 6, 2010. Tom Gallagher sat on the board of Institutul de Studii Populare, the think-tank of the president's party.

15. "«If you have to save, increase taxes, and especially taxes on the richest. The Romanian government responded, "No, the decision is ours"/Si vous avez besoin de faire des économies, vous augmentez les impôts, notamment pour les plus riches.Le gouvernement roumain nous a répondu : "Non, c'est nous qui décidons."»Statement by Dominique Strauss Kahn on French TV channel France 2, cited in Liberation, June 10, 2010, http://www.liberation.fr/economie/2010/06/08/la-colere-en-roumanie_657449

16. An IMF official stated the following about the controversy: "There are of course different combinations of expenditure cuts and tax increases that can deliver a particular amount of adjustment, a particular fiscal deficit, and the government chose to focus primarily on the expenditure side—and in particular on wage cuts. That was the government's decision. And of course there are no easy options when there are budget cuts, and we have been clear that in Romania, as elsewhere, it's important to protect the most vulnerable and to have measures that limit the impact on society and can get the most ownership within society." https://www.imf.org/external/np/tr/2010/tr052010.htm

Policy discretion and constraints in Troika reports

Conditionality	Discretion
4. Reduce the public debt ratio to restore market confidence. This process should be expenditure driven. 5. Limit general government current primary spending, but let automatic stabilizers operate in full 6. Limit municipality arrears 7. Limit arrears of key public enterprises 8. Limit infrastructure spending 9. Limit general government cash balance, government and social security arrears 10. Reduce budgetary shortfalls in the healthcare sector and adopt a mean-tested co-payment 11. Non-accumulation of external debt arrears 12. Improve tax collection and expand the tax base 13. Expenditure-based fiscal rules 14. Increase EU funds absorption 15. Limit general government guarantees and lower subsidies to public entities 16. Deregulate electricity and gas prices 17. Privatizations of key public enterprises 18. Make labor and product markets more flexible. Labor market deregulation should include fixed-term contracts and be done within the limits of ILO guidelines. 19. Reduce state involvement in the transportation sector, particularly the railways. 20. Increase retirement age and end the indexation of public pensions to consumer prices 21. Increase the budget and quality of R&D expenditures	Spending cuts could have been reduced through higher royalties on the extraction of natural resources, financial transaction taxes, progressive real estate tax, repression of tax evasion offshore and the adoption of a wealth tax. The flat tax could have been replaced with a progressive tax. Public sector wages could have been cut in a progressive, rather than fixed rate fashion, factoring in multiplier effects Automatic stabilizers did not have to be cut Healthcare sector reforms did not have to include the partial privatization of key services and budgetary shortfalls could have been covered through better collection of healthcare contributions The public pension deficits could have been reduced trough the nationalization of private pension funds (as in Poland). There was no pressure to cut R&D spending

Source: IMF Article IV Consultations (2009-2013); EC memoranda (2009-2013)

Politics matters

Spain and Romania were thoroughly embroiled in the political drama that was the European sovereign debt crisis. Amidst the ongoing furor, both countries made policy choices that would expose greater portions of society to the whims of the market. Spain was the largest economy in the battered Eurozone periphery. Romania the largest of the East European economies that experienced drastic balance of payments crises after Lehman. Faced with bond market pressures, both countries experienced drastic fiscal retrenchment since 2010. Both adopted public expenditure cuts and tax increases that enabled them to reduce budget deficits. Social welfare spending (including child benefits and birth grants) and public employment were cut while pensions were frozen in both. Spending cuts shaved off comparable percentages of the government's share of GDP (figure 18), drastically cutting deficits. For both Bucharest and Madrid, tax-based retrenchment relied on a five percentage points increase in the regressive value added tax.

In both countries the government adopted policies meant to lower wages and reduce workers' leverage. According to Eurostat, together with Greece, Portugal, Ireland and the Baltic countries, Romania and Spain were the only EU member states that experienced a significant compression of labor's share of GDP[17]. Both Romania and Spain deregulated the labor market extensively, going furthest when conservative parties were in government. Collective bargaining was largely reduced to the firm level and unionization became a lot harder. It was made easier for employers to fire employees and to make use of precarious fixed-term contracts[18]. By contrast, corporate profits in both countries were sheltered against higher taxation and banks were defended against popular outrage.

17. Contrary to conventional wisdom, the labor share in GDP across the EU increased slightly between 2008 and 2013, from 48.8 to 49.4 percent (Eurostat).

18. See Fishman 2012; García 2013; Dubin and Hopkin 2014; Cardenas 2014 for Spain; Ban 2013; Domnisoru 2013; Trif 2013 for Romania).

Figure 6. Government expenditure as percentage of GDP

	2009	2010	2011	2012
Romania	38,469	38,705	35,503	34,047
Spain	46,065	45,439	43,586	42,034

Source: Eurostat

The political decisions made by the governments of these two peripheral countries after the Lehman crisis weakened the state's mediation of the tension between market and society. At the end, Spain would became more like Romania. Romania, as the next section shows, would become more disembedded.

The deepening of neoliberal transformations in Spain has caused significant pain, but in crisis-ridden East European countries like Romania they amount to an amputation. Beyond the general direction of policy lay differences between the two countries that were increasingly marked over time as governments came under external pressure to deepen austerity and structural reforms.

First, Spanish governments made top income earners contribute a lot more than their Romanian counterparts did. The tax on capital income in Spain was increased from 18 percent to two tax bands of 19 percent for up to 6,000 a year and 21 percent over that limit. Low-income Spanish taxpayers received tax credits and experienced no increase in their income tax rate. In contrast, the income taxes for the wealthiest individuals (over 120,000 euros a year) went up to 44 percent. Moreover, in 2012 even the conservative government adopted a rate increase in capital taxation from 19-21 percent to 21-27 percent. In 2012, the same conservative government introduced an additional tax bracket for the wealthiest (54 percent rate for incomes over 300,000), while increasing rates progressively for all other income groups except for the bottom income percentile. Finally, in contrast to Spain, in Romania there was no significant increase in property tax. In short, while the Spanish tax system became more progressive, the Romanian one maintained its regressive "flat tax" fundamentals that protect top income earners disproportionately. Finally, as figure 19 shows, marginal income taxes went up a lot in Spain, while they remained the same in Romania.

Figure 7. Basic statutory tax rates in Spain and Romania

		2008	2009	2010	2011	2012	2013
Spain	Corporate Income	30	30	30	30	30	30
Romania	Corporate Income	16	16	16	16	16	16
Spain	VAT	16	16	18	18	21	21
Romania	VAT	19	19	24	24	24	24
Spain	Marginal Income	43	43	43	45	52	52
Romania	Marginal Income	16	16	16	16	16	16

Source: Eurostat

Spanish policy makers cut far less from benefits and social services and made cuts more progressively than did the Romanians. Cuts to public sector wages did not average more than 7 percent in total even at the peak of the conservative government's austerity drive. In contrast, their Romanian counterparts endured a flat 25 percent cut at the outset of the crisis. This "flat tax"-style spending cut was so harsh that IMF managing director Dominique Strauss Kahn flew to Bucharest and delivered a speech in the Romanian Parliament asking for cuts that shifted a greater part of the burden onto those more able to pay[19]. Moreover, while Spanish governments hesitated to cut unemployment benefits until 2012, the government in Bucharest the government did not. The unemployed saw their allowances slashed by 15 percent and made harder to access, despite the much lower (official) unemployment rate in Romania. Spain's health care system executed spending cuts mainly through pricing pressure on drug suppliers and the introduction of a nominal copay. In Romania this essential public service was decimated by extensive hospital closures and deep cuts, leading to a mass exodus of physicians from the country.

As a result of such measures, the repression of labor costs was a lot larger in Romania. While in 2008 these costs were 42 percent of GDP, in 2013 they shrunk to 33 percent. At a constant rate of unemployment, in Romania employers saved 11 billion in wage costs. In relative terms, together with the Baltic countries Romania accounted for the largest cut of labor share in GDP across the entire EU. While Spain was also among the countries that saw a cut, its size was much smaller, dropping from 49.4 percent in 2008 to 45.5 percent in 2013. If the internal evaluation designed by the IMF-EC-ECB troika worked anywhere in a spectacular way, it was in Romania and the Baltics, more so than in in the "Western" periphery (Greece, Spain, Portugal, Ireland). Here, less than 5 percent of the population could boast solid middle class status as a result of their wages. According to the head of the Romanian employers' association, austerity and labor market deregulation led to the mass lay-off of older, more experienced workers and their replacement with less well-skilled but cheaper workers[20].

Third, the onslaught on unions and workers' rights was both more reluctant and more limited in Spain. In 2010, the Zapatero government tried to defend embedded neoliberalism through labor market

19. Most wealth in the Romanian boom-years came not from wages, but from corporate profits and (untaxed) real estate transactions. However, several hundreds of thousands of wage earners make ten times the minimum wage and, while not being "rich", they could more easily take a tax increase than can low income workers. Moreover, some of the country's millionaires and billionaires (some with companies on the Fortune 500 list) operate businesses that pay the same "flat" 16 percent on corporate profits. While these people are indisputably "rich," no one in the government seems to want to tax them. Author interview with Ministry of Finance economist, December 18, 2012.

20. Statement by Cristian Pârvan, chairman of AOAR, Ziarul Financiar, June 30, 2014.

reforms that balanced security and flexibility by incentivizing firms to provide more permanent contracts and explicitly constraining the use of short-term contracts while also easing the conditions under which firms experiencing difficulties could opt out of the wage levels decided in collective bargaining. The reform was consistent with the embedded neoliberal principle of negotiating a compromise between credibility with the markets and society's demand from protection against the market. As Zapatero's economic advisor put it, "the prime minister tried to do a balancing act between signaling to financial markets that Spain was serious about structural reforms while expressing his belief that the precariousness of those on short-term contracts, most of them young people, was a national tragedy."[21]

It was only under extreme EU pressure in 2011 that the Zapatero government strengthened the pro-market side of the bargain, yet even then corporatist institutions and pro-worker courts were left to handle the details. In line with the state-coordinated logic of Spanish embedded neoliberalism, after organized labor and capital failed to agree on further reform, the government adopted a raft of measures that encouraged firm-level bargaining and promoted arbitration as an alternative to labor conflicts. But as Hopkin and Dubin showed, the devil was in the details because "the reform either delegated the development of the proposed measures to the social partners or else left the sectoral bargaining partners with the ability to limit the development of questions like firm-level opt-outs."(2013: 37). It was only with the arrival in the Moncloa government palace of the conservative Partido Popular government that further deregulation went from the Socialists' flexisecurity paradigm, to "flexi-insecurity," whereby the bargaining power of labor was dramatically scaled back (Hopkin and Dubin 2013: 41). Even so, PP's changes have been deemed in compliance with ILO conventions and the unilateral modification of labor conditions remains subject to judicial review.

Romania offers a sharp contrast to Spain in this regard as well. The conservative government of Emil Boc used an emergency procedure in the Parliament to undertake the most extensive deregulation of Romanian industrial relations on record. National level bargaining was simply eliminated, labor-capital relations were reduced to the firm level, union representatives lost their protections, firing became easy and temporary contracts and work conditions were freed from union intervention and court procedures (Domnisoru 2012; Trif 2013; Ban 2014). Moreover, the new law on social dialogue adopted in 2011 was so restrictive of unionization that it was deemed by the ILO to be in breach of one of its core conventions[22].

To conclude, while the politics of the crisis loosened Spanish neoliberalism's connection to broader social concerns, Romanians suffered an all-out onslaught on the basic functions of government. The next section will establish that while Troika and bond market constraints made fiscal consolidation possible, the Romanian government could have used fiscal policies that were less detrimental to growth and social solidarity without going against the IMF's official fiscal doctrine. Of course, the IMF's work in "the field" may reflect different preferences than those of the headquarters but to govern efficiently and legitimately in times of internationally coerced fiscal consolidation Romanian governments have to work harder to demonstrate to their citizens that they indeed had no choices and that they extracted the most policy space by mobilizing the very economic doctrines upheld by international actors. The next sections show that far from being a neoliberal bunker, on fiscal policy at least the IMF's views not only offered significant wiggle room, but they also represent an opportunity to undertake a deep transformation of Romania's taxation system towards a more progressive distribution income.

The importance of being earnest about fiscal policy

During the 1980s the IMF emerged as a global "bad cop," demanding harsh austerity measures in countries faced with debt problems. Has the Great Recession changed all that? Is there more room to negotiate with the Fund on fiscal policy?

The answer is yes. If we take a close look at what

21. Author interview with Carlos Mulas, Zapatero's economic advisor, June 2012.

22. See statement by the International Trade Union Confederation, November 21, 2012. Available at http://www.ituc-csi.org/imf-and-ec-apply-behind-the-scenes?lang=en

the IMF researchers say and what its most influential official reports proclaim, then we can see that there has been a more "Keynesian" turn at the Fund. This means that today one can find arguments for less austerity, more growth measures and a fairer social distribution of the burden of fiscal sustainability. The IMF has experience a major thaw of its fiscal policy doctrine and well-informed member states can use this to their advantage.

These changes do not amount to a paradigm shift, a la Paul Krugman's ideas. Yet crisis-ridden countries that are keen to avoid punishing austerity packages can exploit this doctrinal shift by exploring the policy implications of the IMF's own official fiscal doctrine and staff research. They can cut less spending, shelter the most disadvantaged, tax more at the top of income distribution and think twice before rushing into a fast austerity package.

This much is clear in all of the Fund's World Economic Outlooks and Global Fiscal Monitors published between 2009 and 2013 with regard to four themes: the main goals of fiscal policy, the basic options for countries with fiscal/without fiscal space, the pace of fiscal consolidation, and the composition of fiscal stimulus and consolidation.

Mapping out stability and change

One should not expect large international organizations to change overnight and radically. The IMF is the case in point. Table 1 shows the extent of changes in the IMF's fiscal doctrine. The text in italics indicates post-crisis changes that capture the revisionist (rather than paradigmatic) transformation of fiscal policy doctrine. The table tells us that there to be no dichotomy between a pre-crisis "neoliberal" line and a post-crisis "Keynesian" one, the former emphasizing balanced budgets at all times and the latter centered on counter-cyclical fiscal stimulus packages in the case of recession.

Instead, before 2008 the Fund was already open to selective Keynesian insights such as the counter-cyclical use of automatic stabilizers and even discretionary spending in countries like Japan, the US or China. It is clear, however, that the applicability of these insights became significantly broader after 2008.

Such broadening falls parallel with changes in advice about the timing and composition of fiscal consolidation that generally reduce a recession's pro-cyclical effects and spread the social costs more broadly than before. Although these findings do not necessarily point towards a paradigm shift, the apparent "edits" are quite extensive when compared with the pre-crisis doctrinal script.

TABLE 1: Pre- and Post-Crisis Themes in IMF Analyses

Pre-crisis	Post-crisis
The main goals of fiscal policy are growth and the reassurance of sovereign bond markets through credible fiscal sustainability policies.	The main goals of fiscal policy are growth and the reassurance of sovereign bond markets through credible fiscal sustainability policies.
Only high-income economies with fiscal space (stronger fiscal positions, lower public debt) should let automatic stabilizers operate in full, even at the cost of deficits.	All economies with fiscal space (stronger fiscal positions, public debt) should let automatic stabilizers operate in full, even at the cost of deficits. Given the smaller increase in their debts, most developing countries are less likely than wealthy countries to experience substantial increases in debt service over the medium term as a result of their fiscal expansions.
Only high-income countries with fiscal space but weak welfare states (US, Japan) should also use discretionary spending to stimulate the economy even at the cost of deficits. This spending should be directed at tax cuts.	All economies with fiscal space should also use discretionary spending to stimulate the economy even at the cost of deficits. This spending should be directed at public investment in infrastructure and should avoid tax cuts.
All expansionary measures should be accompanied by medium-term frameworks that reassure bond markets that debt and deficits will be cut after the recession ends. The credibility of these measures is supported by commitment to public debt thresholds, fiscal rules and expenditure ceilings.	All expansionary measures should be accompanied by medium-term frameworks meant to reassure bond markets that debt and deficits will be cut after the recession ends. The credibility of these measures is supported by commitment to public debt thresholds, fiscal rules and expenditure ceilings, independent fiscal councils, financial transaction taxes, carbon taxes, higher taxes on wealth and the curbing of off-shore tax opportunities.
Countries for whom fiscal consolidation is the only option should prefer spending cuts over revenue increases.	Countries for whom fiscal consolidation is the only option should balance spending cuts and revenue increases. Fiscal consolidations based solely on spending cuts are less likely to be sustainable.
The cuts should be targeted at public job programs, social transfers, public sector wages, employment, housing and agricultural subsidies. Public investments should not be adopted because they crowd out private investments.	The spending cuts should be targeted at public job programs, social transfers, public sector wages, employment, housing and agricultural subsidies. Public investments should be prioritized, as they do not crowd out private investments in the conditions of the Great Recession.
If fiscal consolidation is in order, it should always be introduced immediately (frontloading). Fiscal consolidation is likely to have expansionary effects on output.	If fiscal consolidation is in order, it should be introduced gradually (backloading), unless the country faces collapse in confidence on sovereign bond markets. Fiscal consolidation is unlikely to have expansionary effects on output.
The best tax policy package reduces marginal income taxes, expands the tax base, increases reliance on flat consumption taxes, enforces the neutrality of the tax system.	The best tax policy package reduces marginal income taxes, expands the tax base, enforces the neutrality of the tax system, increases taxes on dividends and the estates of the wealthy, adopts financial transaction and environmental taxes, aggressively pursue off-shore wealth.
Low-income countries for whom fiscal consolidation is the only option should prefer revenue increases over spending cuts, particularly cuts of health and education outlays.	Low-income countries for whom fiscal consolidation is the only option should prefer revenue increases over spending cuts, particularly cuts of health and education outlays.

Not all changes are equal

These are important revisions but their depth and span varies over time. There was a great deal of fiscal policy optimism in 2008 and 2009, but by 2010 the tone changed in favor of an earlier exit from stimulus. The 2010 GFM report applauds the unwinding of the discretionary stimulus in all countries with fiscal space and turn to consolidation. Yet the 2010 report also reflects support for continued stimulus in fast-growing emerging markets with excessive external surpluses and low debt. The bumper sticker is: "a down payment on consolidation now with continued gradual tightening over the medium term" (GFM 2010).

This advice is based on optimistic projections that consolidation has a low fiscal multiplier that is less than 1 and on the assumption that medium and long-term fiscal measures are not sufficient to reassure markets. Nevertheless, the departmental reports leave the door open to expansion in wealthy countries with fiscal space, should economic activity fall short of WEO projections. The reports also caution against an "abrupt fiscal withdrawal" (a cut in the deficit greater than 1 percent a year) and state that the output cost of a 1 percent of GDP fiscal consolidation can double to 2 percent for a small open economy where the interest rate is at the zero lower bound and consolidation is done by almost all countries at the same time.

In 2011 the reports swing to a more orthodox line. The IMF documents praise Europe's strong front-loading of austerity and make optimistic projections of its effects on credibility. Moreover, based on a FAD study showing that bond yields in emerging markets are very sensitive to global risk aversion, they counseled for low and middle-income economies to rebuild fiscal buffers and cut spending despite the fact that they were facing less market pressure than developed countries. The report contains an unambiguous denunciation of the expansionary austerity thesis.

Subsequent reports qualify this doctrinal retrenchment. The 2012 GFM and WEOs acknowledge that fiscal multipliers of consolidation were much larger than the Fund realized and therefore advised slower adjustment in countries with low credibility. The reports also stress the importance of expansion in countries with credibility and criticize the harsh spending cuts in the U.S. and the Eurozone. Critically, both reports warn that austerity could be self-defeating as its negative effects on output have already increased public debt in countries that implemented the most aggressive spending cuts. Also in 2012 and 2013 in the GFMs and WEOs emerge call for tax reforms that shift some of the burden of consolidation onto the wealthy.

What do we make of this? If you look closely, these changes can be traced to IMF staff research. So know your IMF staff research to increase your leverage in negotiations with the Fund

Staff research is not just an exercise in intellectual futility. The defining moment of the Fund's intellectual evolution was the publication on December 29, 2008 of a joint RED-FAD staff position paper (Spilimbergo, Symansky, Blanchard, and Cottarelli 2008). The paper was co-authored by Blanchard and Cotarelli among others and laid down the groundwork for macroeconomic policy during recessions: "[a] timely, large, lasting, diversified, and sustainable fiscal stimulus that is coordinated across countries with a commitment to do more if the crisis deepens" (Spilimbergo et al. 2008, 2).

Its reasoning went as follows: given the collapse in private demand, states should not only let automatic stabilizes run, but also ramp up public investments and expand the reach of income transfers to those who were more likely to spend (the unemployed and poor households). Against the Fund's pre-2008 policy line, the authors stressed the role of public investments and downplayed the expansionary virtues of tax cuts. To this end they deployed the Keynesian argument that tax cuts are more likely to be saved. The authors also dismissed once-fashionable IMF policy advice such as exclusive reliance on activist monetary policy and export-led recovery. They also spurned as irrelevant the well-worn orthodox objection that spending increases have long lags. Given the Fund's mission to ensure relative stability in the sovereign bond market, there were also big caveats. The paper stressed that only countries with fiscal space could afford a stimulus and that expansionary measures should be reversible. Expansionary measures should also be announced in parallel with measures that ensure fiscal sustainability such as permanent cuts in healthcare and pension budgets in the medium and long term.

Such changes have had far-reaching consequences for the Fund's official doctrine. When the official fiscal policy pronouncements of RED and FAD came up in 2009 and 2010 evidence of the origins of doctrinal change and continuity in staff research was there for all to see. We now turn to five lessons that emerge from the IMF staff studies cited in the reports.

Austerity, growth and social fairness in five IMF lessons

1. Whenever possible, stimulate and tax.

In 2009, WEO uses staff research to call for a fiscal stimulus (Spilimbergo et al 2008; Decressin and Laxton 2009; Clinton, Johnson, Kamenik, and Laxton 2009; Cihak, Fonteyne, Harjes, Stavrev, and Nier 2009). The GFM does too and adds that in the context of the lower tax collection rates in a crisis-ridden environment, governments should strengthen tax institutions rather than cut taxes (Brondolo 2009). The report also renounces the claim that policies that make income taxes more progressive lead to a decline in revenues (Baunsgaard and Simansky 2009).

2. When you have to be austere, don't rush, try to tax financial transactions and if you do spending cuts don't expect expansions as a result.

In 2010, the year of the turn to austerity in Europe, a more qualified endorsement of fiscal stimulus is apparent. WEO cites studies warning of high debt and deficits' negative effects on output and market credibility (Baldacci and Kumar 2010; Kumar and Woo 2010), while the GFM reiterates arguments against extensive debt restructuring. Yet most of the cited studies contain anti-austerity implications. WEO asks countries to refrain from frontloading consolidation based on IMF research that finds high risks of deflation (Decressin and Laxton 2009). The studies cited in GFM find that beyond a certain threshold of adjustment spending cuts are no longer effective (Baldacci and Gupta 2010; Blanchard and Cotarelli 2010). Critically, WEO debunks an iconic study of the austerity camp (Alesina and Perotti 1997) and uses Blanchard's 2002 methodological innovations to show that fiscal stimulus packages have higher multipliers than consolidation and that the latter is contractionary and increases unemployment during recessions (Freedman et al 2009; Clinton et al 2010). The 2010 GFM's citations echo the December 28, 2008 paper (Spilimbergo et al 2008) and suggest that financial transaction taxes are an appropriate contribution to the fiscal sustainability effort (Keen et al 2010).

3. If the markets force you to be austere, make sure you turn this into an opportunity to reduce inequality.

The 2011 WEOs and GFMs cite IMF studies that try to balance austerity and stimulus while starting a discussion about how the costs of consolidation should be distributed. The WEO critiques existing medium-term adjustment plans for vagueness and renders them consequently incredible (Bornhorst, Budina, Callegari, ElGanainy, Gomez Sirera, Lemgruber, Schaechter, and Shin 2010). The 2011 report at the same time endorses front-loaded fiscal consolidation on the spending side in Southern Europe and Ireland (Bornhorst et al 2010). But other cites are less hawkish. The report cites research that stresses the importance of current account deficit reduction in debtor countries and expansion in surplus countries (Blanchard and Milesi-Feretti 2009; 2011; Lane and Milesi-Feretti). It also warns that countercyclical budget rules are better for fiscal sustainability than balanced budgets (Kumhof and Laxton 2009). The report is also ambivalent about the effects of fiscal consolidation on reducing the external deficit (Clinton et al 2010). The studies cited by GFM emphasize the importance of pairing fiscal consolidation and structural reforms (Allard and Everaert 2010) and warn about the fiscal risks of declining credit ratings (Jaramillo 2011; Jaramillo and Tejada 2011). WEO inveighs-yet again- against the expansionary austerity thesis of Alberto Alesina and colleagues at the time his followers were shaping fiscal policy in Europe (Blyth 2013). The 2011 WEO finally endorses IMF research that calls for a more progressive distribution of income and reproduces research that indicates that financialization boosts inequality and inequality contributes to unsustainable growth trends such as those that predated the Great Recession (Berg and Ostry 2011).

While still alert to sustainability issues, the 2012 report indicates an interest in IMF studies that warn about the risk of self-defeating austerity. One of the studies cited in WEO deplores growing inequality and unemployment and layers demands for more income redistribution on top of old IMF recipes (retraining, better education, increase productivity in the service sector) as the price that may be needed to avert a protectionist backlash (Dao and Loungani 2010). The emphasis on the inequality-unsustainable growth nexus is reaffirmed (Berg and Ostry 2011) and the cited studies go beyond conventional recipes to endorse more redistribution and to boost aggregate demand in the short term to help labor markets recover (Ball, Leigh, and Loungani 2011).

4. Harsh austerity can increase your debt levels, making it self-defeating so avoid it if you can.

Most importantly, although more research warns about the importance of medium-term fiscal frameworks for keeping debt in check (Berg and Ostry 2011; Kumar and Woo 2012), there is a resolute turn against frontloaded austerity in the 2012 WEO. There are warnings about the risk of deflation (Decressin and Laxton 2009) but what is particularly striking is that two new lines of attack appear. The most important is the finding that since 2008 the economic slack was so large, the interest rates so low, and fiscal adjustment so synchronized that fiscal multipliers were constantly well over 1. This finding implies that the IMF underestimated the negative effects austerity had on output because it assumed values of the fiscal multiplier that were too low (Batini et al 2012). This concern is echoed in IMF studies cited in the year's GFM (Baum, Poplawski-Ribeiro, and Webel 2012). Second, even as another cited study encouraged spending cuts in health, pensions and public employment in wealthy countries like Italy, its findings also stressed that fiscal consolidation had been ultimately self-defeating in the past because it increased public debt levels (Ball et al 2011). The same finding is echoed in studies cited in GFM that argue that consolidation when the multiplier is high erodes some of the gains in market credibility as a result of a higher debt ratio and lower short-term growth, which causes an increase borrowing costs (Cotarelli et al 2011; 2012).

5. Rather than focus on spending cuts, get serious about taxing real estate wealth, offshore wealth and financial transactions.

IMF research cited in the 2013 reports makes similar points but unprecedentedly emphasizes raising more revenue via more taxation of the wealthy. In WEO, deflation warnings from a 2002 paper are sounded yet again (Decressin and Laxton 2009) and the need for stimulus in countries that enjoy fiscal space is reaffirmed (Blanchard and Leigh 2013; Spilimbergo et al 2008; Kang et al 2013; Ostry and Ghosh 2013). Such ideas co-habit in the report with warnings about the growth-depleting effects of high debt (Kumar and Woo 2010). The GFM struggles to achieve a similar balance. It cites studies that establish the ineffectiveness of default (Das, Papaioannou, Gregorian and Maziad 2012; Borensztein and Panizza 2009) and inflation (Akitoby, Komatsuzaki, and Blinder 2013) as debt reduction strategies while stressing the importance of reducing debt. At the same time, the GFM cites studies that seem to represent a new taxation philosophy at the Fund. They certainly continue to endorse a few old recipes (the reduction of income taxes while increasing consumption, the scrapping of loopholes in personal and corporate income tax, the elimination of differential VAT rates, resistance to high marginal income tax, reduced employers' social contributions). Yet also advocate greater reliance on taxes targeted at the wealthy: property taxes targeted at the top 1 percent (a measure estimated to raise between 2-3 percent of the global GDP in new tax revenue), financial transactions tax, and a coordinated taxation of offshore incomes (Torres 2013; Acosta and Yoo 2012; Norregaard 2013). On this front, the IMF came close to the tax justice movement, which is in itself spectacular.

Conclusion

IMF loans come with a fiscal straitjacket but the Fund is no longer the harsh austerity juggernaut of the old days. While it has not become a full-fledged Keynesian superhero either, you can at least use its research to negotiate more fiscal space and more progressive redistribution outcomes.

The critical wrinkle in all of this is the Fund remain wedded to a creditor's view of fiscal policy: you can do a lot to ease the pain on your citizens but only as long you convince them that bond markets give you "fiscal space." You can squeeze the top one percent a bit more and even follow them in off-shore havens. You can drag your feet when it comes to the European push to see austerity leading to growth. You can spend on public infrastructures without worrying of the crowding out effects this has on the private sector. But, overall, it all depends on whether your decisions are thought by the Fund to be in the range of behaviors that sovereign bond traders approve of and that call is, of course, still in the exclusive province of the IMF.

When negotiating with the IMF, Romanian officials who proclaim that they care about the economic fate of the regular student, wage-earner, unemployed or pensioner should have a good understanding of the nuances of the IMF doctrine and economic research are. They should also seek advice and make political coalitions within the EU with countries that could also benefit from reforming the current EU fiscal policy regime, which may fit large export powerhouses like Germany. But most importantly, they should reconsider the reflex of making the lower and middle income brackets pay a lot more for macroeconomic and financial sector failures than the corporate sector and higher income brackets. This is not just a question of fairness but of the much vaunted “return to Europe” that everyone seems moved by in Romanian politics.

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About the authors

Cornel Ban is an assistant professor of political economy at the Pardee School for Global Studies at Boston University. His research focuses on international economic organizations, the diffusion of economic theories as well as the politics of economic crises and the development. He has a PhD from University of Maryland and was a postdoctoral fellow at Brown University.

Daniela Gabor is an associate professor at the Bristol Business School, University of the West of England. Her research focuses on shadow banking activities, transnational banks' involvement in policy deliberations around capital controls and crisis and the IMF's conditionality and advice on capital controls.

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