Conceptualising the EU-IMF Financial Assistance Negotiation Process

Samuel Dahan, LLM
University of Cambridge, England
ESSEC-IRENE, France
(Institute for Research and Education on Negotiation)

- **Objectives of the Project**
  - Analysis of Complex Negotiations and better understanding of this complex multilateral process
  - Do not claim that ‘Best interaction model does not exist’

- **Methodology and Challenges of the Project**
  - No general theory of the ‘*politics of adjustment*’
  - Reliance on field work

Financial Assistance Negotiation Framework Analysis

- Aim of the framework: what ultimately shapes strategies and outcomes?

- 3 major tensions influence the negotiating strategies and ultimately the result of the programme

    1 – Negotiator's Dilemma

    2 – Methodological Dilemma

    3 – The Structure of the Process

1 – Negotiator's Dilemma: Tension between Competition vs. Cooperation

- The tougher the negotiators' behaviour is, the less likely they are able to achieve any outcome but if they do achieve one, the more likely they are to gain a larger share of the outcome
- The softer the negotiators behave, the more likely they are to reach an agreement but the less likely they are to gain a large portion of the agreed outcome

EU/IMF financial assistance possible strategies and outcomes

Lender

Debtor

	Assertive/Flexible Strategy (Cooperation)	Rigid Approach (Competition)
High Adjustment (Cooperation)	Successful adjustment (lenders help to deliver the key objectives of the programme while preserving other key aspects e.g. growth/social), country back on its feet, loan eventually repaid	Forced adjustment, risk of internal political fall out, subsequent collapse of the programme, animosity towards lenders
Low Adjustment (Competition)	Loan risks turning into a Bail-out: funds are received but debt may not be not repaid as the country does not recover from the crisis	Deadlock (negative outcome for both parties), no funding, country goes in negative spiral, debt explodes and growth collapses, contagion

2 – Methodological Dilemma: Formula of Multilateral Negotiation

- Two Components to any negotiation process: the ***<u>formula</u>*** or overarching framework that defines the agreement and the ***<u>details</u>*** that govern distribution of the value

    - This first phase is in principle more cooperative by nature
    - Second phase is more conflict-prone. It deals with difficult details established by the formula

    → Crucial to define the formula before entering into the details

- **Financial assistance negotiations formula**

    - The amount of money needed and available, the size of the loan
    - The overall direction of the programme: joining the euro
    - Lending frameworks under which money is borrowed such as BoP, the EFSF, the ESM

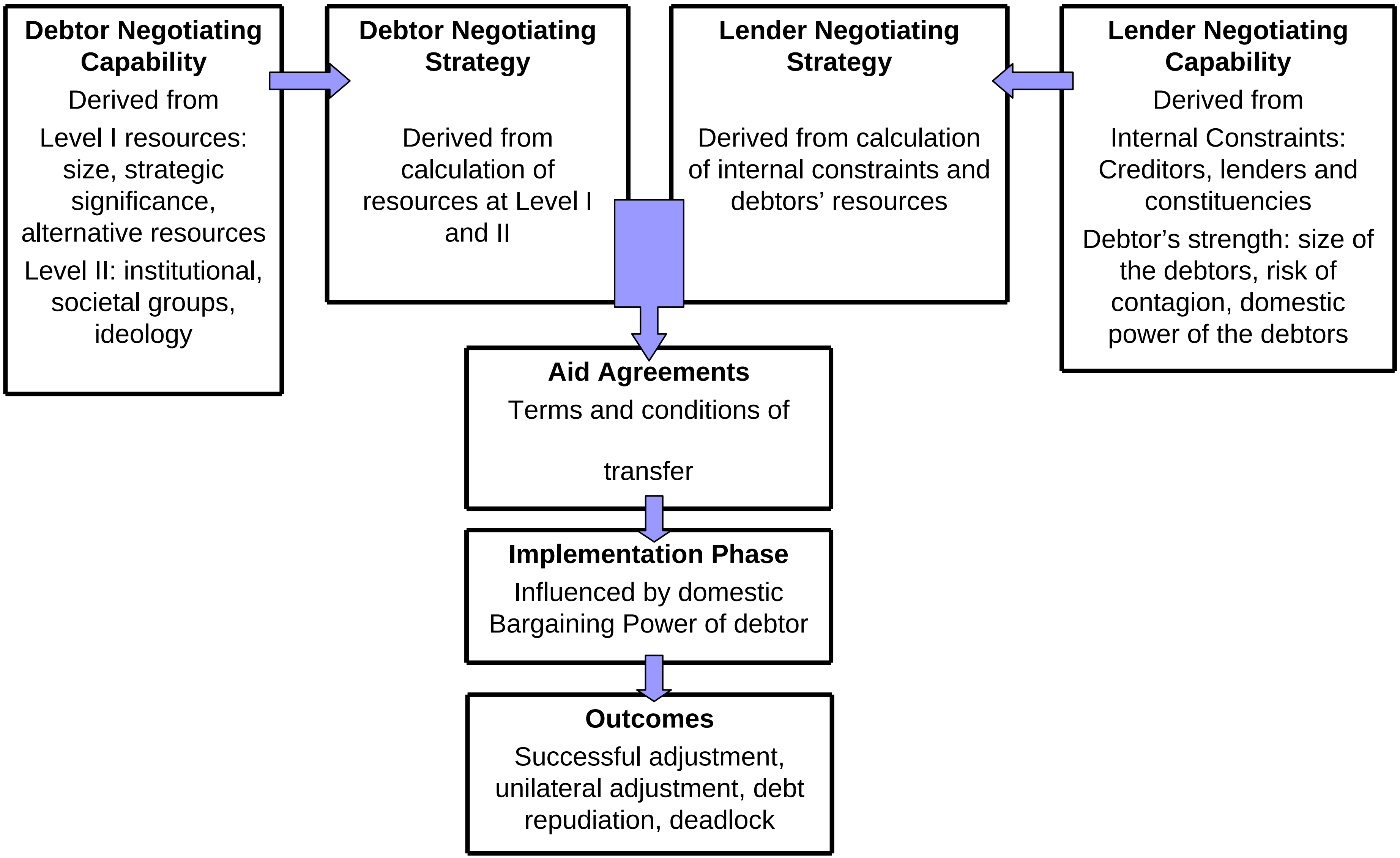
3 – The Structure of the Process: Two-level Strategy

- **Negotiating Capabilities: Two-level Resources and Constraints**
  - Debtors and lenders build their strategy based on ‘assets’ and ‘constraints’
  - They possess resources at international level (Level I) but also at internal level (Level II)

- **Under a two-level analysis**
  - Debtor governments represent their constituencies
  - Lenders represent other creditors, other lenders, and their own constituencies usually consisting of other sovereign countries

- **Implications for strategy**
  - Debtor states must address the concerns of international creditors as well as of domestic interest groups
  - Lenders must address debtors concerns but also address the concerns of their own constituencies

Simplified Model of Aid Negotiation



Latvian Capabilities: Two-Level Resources

- **Level I – Leverage at International Level:** Several sets of resources such as, *size, strategic significance, or non-conditional resources*
  - The ***smallness*** of the Latvian economy is a challenge
  - ***Strategic significance*** of Latvia to major creditors (i.e. mainly Sweden)
  - ***Risk of contagion*** constitutes a source of leverage to access to EU/IMF funding
- Limited resources at Level I

- **Level II – Internal Bargaining Space:** Shaped by power of *social groups, institutional factors, political factors* or even the *ideology of the people*
  - ***Flexible Labour***
  - ***Institutional capacity***
  - ***Political legitimacy of the government***
  - ***Ideology*** and ***public awareness*** of the gravity of the situation
- Flexible negotiation capability at Level II (domestic level) facilitating implementation

Implications for Latvian Strategy: Strategic Dilemma

- **Competitive approach**: the debtor may refuse to offer acceptable concessions by risking retaliation from the lenders

- **Cooperative approach**: or may accept the lenders' policy measures by risking political mobilisation by domestic groups

Limited structural power at Level I combined with flexible domestic resources at Level II

- **Latvian Government Strategy/Response**
  - ***Cooperative and committed strategy***
    - ***Stronghold on budgetary decisions:*** top-down approach by PM and MoF
    - ***Management of a diversified coalition***
    - ***Dialogue with social partners***
    - ***Clear communication*** to general public on the need to adjust

  - ***Creative Negotiation Tactics to soften conditionality*** (Tactics used on exceptional basis)
    - ***Defensive claiming:*** obtaining tranches, but delivering little consolidations efforts
    - ***Bypassing Mission Chiefs***
    - ***Onerous conditions*** accepted to get the loan tranches immediately but reopening discussion on detail
    - ***Playing off lenders***

Lenders' Capabilities: Two-Level Resources

- International Financial Institutions also play a two-level game (but fundamentally different)
- **Level I – Debtors Flexibility Domestic Level**
  - Latvian flexible bargaining space is a resource for lenders as the government had a strong legitimacy to implement sharp adjustment measures
- **Level II – Lenders Internal Bargaining Space**
  - ***Risk of contagion***
  - ***Strategic significance*** of Latvia for major creditors
  - ***Involvement of various creditors***
  - The Commission had a ***limited funding capacity*** before the crisis started
  - The Commission had a ***limited institutional capacity*** and ***experience*** in bail-out negotiation, IMF much more experienced and organised
  - ***Cooperation*** and ***coordination*** among lenders is a significant resource but can be challenging (June-August 2009)

Implications for Lenders Strategy: Strategic Dilemma

- **Competitive approach:** the lenders may adopt a hard line, with a risk of coalition implosion
- **Cooperative approach:** or make many concessions, with a risk of moral hazard

EU/IMF Strategy in Latvia

- ***assertive/flexible strategy*** managing the tension between excessive pressure and too many concessions
- Based on calculations of Lenders' internal constraints and Latvia domestic strength

1. **Raising Positive Expectations**

- Expectations regarding the predicted outcome may influence the actual result
- EU/IMF influenced Latvian expectations through *persuasion, stakeholder assessment*, *communication channels*

2. **Building Trust and Credibility of the Authorities through Persuasion**

- Showing understanding of the situation, using persuasion based on objective criteria instead of pressure
- EU/IMF engaged into a dialogue with key actors on the benefits of structural reforms (education, health welfare)

3. **Setting a Looming Deadline, stressing the cost of not reaching an agreement**

- Many actors: Lenders have to persuade debtors of the negative consequences of the status quo
- Set a *looming deadline* (real or self imposed) to offer real incentive to break the impasse

4. **Managing Public Negotiation in High Stake Context**

- The more negotiators go public the more they risk raising the stakes (drawing line in the sand ultimatum, threats)
- *Closed door negotiation* may help to build trust and reduce the pressure from media/public

Analysis of Latvian Assistance Outcome

EU/IMF

Latvia

	Assertive/Flexible Strategy (Cooperation)	Rigid Approach (Competition)
High Adjustment (Cooperation)	**Successful adjustment** (lenders help to deliver the key objectives of the programme while preserving other key aspects e.g. growth/social), country back on its feet, loan eventually repaid	Forced adjustment, risk of internal political fall out, subsequent collapse of the programme, animosity towards lenders
Low Adjustment (Competition)	Loan risks turning into a Bail-out: funds are received but debt may not be not repaid as the country does not recover from the crisis	Deadlock (negative outcome for both parties), no funding, country goes in negative spiral, debt explodes and growth collapses, contagion

- Too early to definitely qualify the Latvian Programme as a **successful adjustment, but the outcome for the moment is in the top/left quadrant**

Qualifying success in negotiation terms:

- **Satisfying motivations through *flexible/cooperative approach*** (upper left side of the table)
  - Deliver the adjustment while attempting to achieve key domestic aspects of the programme (i.e. social, growth)
- **Solution is clearly better that BATNA, *Best Alternatives to a Negotiated Agreement*,** such as: Debt default/repudiation; funding from other sources (impossible); abandoning the peg.