Global Contagion and IMF Credit Cycles: A Lender of Partial Resort?

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Abstract

The International Monetary Fund (IMF) has an incomplete governance architecture characterized by insufficient resources to fulfill its global financial stability mandate. We argue this institutional incompleteness influences how the IMF balances tensions between systemic risks and moral hazard, and when it surprisingly exits lending relationships. During high global contagion periods, the IMF targets stabilizing systemic risks to fulfill its mandate, granting large loans and overlooking non-compliance with conditionality. However, when the IMF perceives minimal contagion risk, it focuses on moral hazard, extending smaller loans with stricter conditionality, and willingly cuts financial ties to preserve its reputation and resources for future crises. Employing a comparative case analysis of IMF decision-making for Argentina (1998-2001) and Greece (2010-2015), we find evidence supporting our theoretical priors from content analysis of IMF executive board meeting minutes, complementary archival evidence, and field research interviews. These findings have important implications for the IMF, institutionalism, and development.

Abstract word count: 149 words

Manuscript word count: 12,415 words

Introduction

"The lender of last resort must lend in periods when no other lender is either capable of lending or willing to lend in sufficient volume to prevent or end a financial panic."

– Walter Bagehot (1873)

The International Monetary Fund (IMF) has been called the world's "financial crisis firefighter,"[1] entrusted by its 190 members to prevent financial infernos from igniting neighboring nations. Surprisingly, however, financial backdraft has repeatedly left the globe in the blazes of successive crises,[2] notwithstanding the IMF's efforts. Why might the IMF not be able to fulfill its role as an international lender of last resort (ILLR)?

In contrast to national central banks' often sustained liquidity commitments during crises, we observe that the IMF often repeatedly shifts its lending behavior. For example, in June 2018, the IMF extended a $57.1 billion loan to Argentina, which included extensive conditionality in light of its known default history. However, by September 2019, the IMF had suspended its loan disbursements to Argentina because of Managing Director Kristalina Georgieva's concerns about the "fiscal viability"[3] of the incoming Alberto Fernández administration.

After its initial 180-degree lending turn, the IMF yet again changed its creditor course less than one year later amid the pandemic. Not only did the Fund play a "decisive" role in facilitating Argentina's August 2020 debt restructuring, but it also worked to develop a new IMF program. Despite President Fernández's reluctance to reform economically, saying he was "not in a position

[1] "Wanted: Chief Firefighter" *The Economist*, June 4th, 2011.
[2] Reinhart and Rogoff 2009.
[3] *Buenos Aires Times* 2019. Available at: https://www.batimes.com.ar/news/economy/macri-spent-most-of-imf-loan-on-paying-off-external-debt.phtml

to accept any conditionality,"[4] Director Georgieva stated that the IMF had "no intention of putting pressure on Argentina."[5]

The IMF's interactions with Argentina during 2018-2021 illustrate that the Fund often varies its lending behavior over crisis periods rather than sustaining its financial position. What accounts for these sequential changes in the IMF's lending behavior? Why does the IMF strictly enforce conditionality during some periods, but ease austerity reforms on other occasions? Why does it sometimes 'exit' a debt-ridden country before fulfilling its role as the ILLR? In other words, why might the world's firefighter leave before stabilizing financial foundations?

In this paper, we offer an explanation based on the incompleteness of the IMF's governance architecture.[6] As with other lenders-of-last-resort such as national central banks, the IMF aims to offset systemic risk and restore financial stability. Compared to central banks, however, the IMF's limited resources and reputational concerns often constrain these institutional aspirations.[7] The size of the Fund's balance sheet has shrunk extensively as a share of the global economy since its inception. At the same time, the IMF's core institutional mission has gravitated over time, to sustained crisis lending, rather than short-term liquidity provision, with greater organizational competition internationally as a crisis manager.

[4] *Buenos Aires Times* 2020. Available at: https://www.batimes.com.ar/news/economy/argentina-will-not-accept-any-conditions-from-imf-warns-fernandez.phtml
[5] *Buenos Aires Times* 2020. Available at: https://www.batimes.com.ar/news/economy/fernandez-georgieva-confident-argentina-will-seal-new-imf-deal.phtml
[6] Jones, Keleman, and Menieur 2016 apply the notion of incomplete governance to the Euro crisis.
[7] McDowell 2017

The IMF's institutional foundations thus resemble an "incomplete contract." While it would have been "prohibitively difficult to specify all contingencies at the time of its creation,"[8] the IMF's institutional history has created a mismatch between its mandate and resources today.

We argue that the institutional incompleteness influences how the IMF balances the tension between systemic risks and moral hazard. In the face of a potential domestic financial crisis, a central bank readily acts as a lender-of-last-resort by providing liquidity, while monetary authorities simultaneously work to contain the moral hazard problem among the most systematically important financial institutions that are deemed "too big to fail."[9] By comparison, we argue that the IMF instead struggles with a "too big to bail" problem. Given that its crisis lending disproportionately flows to large, systematically important economies, the Fund contends with high internal balance sheet risk.

To preserve its reputation as a crisis manager and an ILLR, we contend that the IMF must prioritize the soundness of its balance sheet. The Fund employs conditionality, or policy targets such as budget discipline, to help deter against moral hazard (and ensure debt repayment).[10] At times, however, we find that the IMF withdraws from a debt-ridden country that has yet to stabilize financially to protect its balance sheet. We suspect that such swift changes in the IMF's lending position often reflect its perceptions of the global investment climate, particularly whether further volatility poses a risk to market sentiment, and thus its reputation as a financial guardian.

Our theoretical framework thus conditions IMF lending choices on the likelihood of global market contagion. During periods of high global financial contagion, the IMF targets global

[8] Helmke and Levitsky 2004.
[9] Mishkin 2000.
[10] Fischer 1999; Mishkin 2000.

financial stability as an ILLR. The Fund willingly prioritizes liquidity provision over compliance with its policy conditions and even its own financial health. In other words, it places greater emphasis on mitigating systemic risks than moral hazard.

However, when the IMF perceives minimal global contagion risk – and thus little threat to its core mission of global financial stability – its institutional incompleteness prompts the Fund to instead focus on moral hazard. The IMF is willing to cut financial ties and save its resources for future crises to preserve its reputation as a global financial guardian. The Fund also extends smaller loans with stricter conditionality enforcement, often employing policy non-compliance as a rational for ceasing its lending programs.

Testing the theoretical priors about the IMF's perceptions of global contagion risks requires close examinations of the rationales and context behind each decision. Thus, we employ a comparative case study analysis of IMF decision-making in two of its largest borrowers over time: Argentina and Greece. To assess the IMF's evaluations of global financial contagion risk, we conduct a content analysis of its policy discussions using Executive Board Meeting minutes, and also examine the Fund's formal publications. We supplement this archival evidence with our field research interviews with IMF economists and government officials to trace the causal logic of IMF's more informal channels of policymaking.

This article makes several important scholarly contributions. First, it explains why the IMF might exit and renew its lending relationships over a short period of time. Despite a rich literature on the initial determinants of IMF lending, there is a dearth of studies investigating IMF withdrawals and renewals. This article also offers a supply-side explanation for IMF lending choices, examining the Fund's institutional agency. Compared to most IMF studies that employ

cross-sectional statistical correlations,[11] we conduct a longitudinal study and trace the causal pathways of IMF lending behavior. Employing these methods and taking a cue from the "seeing like an IO" approach, we develop the IMF's institutional agency.[12] We emphasize that the IMF is not merely an aggregation of prevailing sovereign interests, but also a "technocratic" institution.[13] In this regard, we advance the literature by arguing that Fund's technocrats direct the IMF leadership's attention to its balance sheet risk, a crucial factor in preserving its reputation. Our findings also demonstrate the Fund's internal limitations to sustain its ILLR commitments, raising important implications for evaluating the capacity of the international community to deal with financial fallout from the coronavirus pandemic. Finally, this article offers new insights into the IMF's continued commitment to conditionality. Despite its controversial history, conditionality is the Fund's way of mitigating financial vulnerabilities on its balance sheet.

The manuscript unfolds as follows. We begin with a review of the IMF literature. We then develop our argument by explaining the conditions under which the IMF fulfills its mandate of preserving international financial stability, and when it instead safeguards its own financial resources. In the subsequent section, we provide empirical support for these theoretical priors using primary and secondary data from Argentina (1998-2001) and Greece (2010-2015). We then use these insights to interpret another high-profile case of IMF borrowing in Brazil (1993-1994). Finally, we conclude with discussion and implications.

[11] See Steinwand and Stone (2008) for a review.
[12] Broome and Seabrooke (2012) suggests that studying IOs from insides out and adopt "seeing like an IO" approach, we can increase our understanding of how IOs seek to achieve their goals.
[13] Momani 2005; Martin 2006; Kaya 2015.

Explaining Why the IMF Exits its Lending Relationships

Over the last three decades, the political economy scholarship has significantly enhanced our understanding of IMF lending decisions. A large body of work has found that ideational and geopolitical factors jointly influence the IMF's loan size and conditionality.[14] Some scholars find that borrowers with geopolitical ties to the IMF's major shareholders receive favorable lending terms,[15] while others ascribe the Fund's lending choices to the disproportionate influence of neoliberal ideas in the Fund's global policymaking network.[16] Relatedly, public choice models claim that the Fund leverages crisis demand for IMF loans to increase conditionality and maximize its global policy influence.[17] Garnering less attention, however, are shifts in IMF lending behavior and conditionality over time, particularly when and why the IMF exits its lending relationships.

To the extent that the scholarship has examined the Fund's enforcement of conditionality, it has emphasized demand-side factors originating from borrowing countries. For example, borrowers with strategically-important relations with IMF's major shareholders, particularly the U.S., are subject to less rigorous conditionality.[18] Borrowing governments with shared ideational beliefs and professional ties with the IMF are also associated with more lenient loan conditions and weaker program enforcement.[19] Relatedly, domestic politics in debtor countries affect the IMF's enforcement of conditionality.[20] Finally, the few studies investigating IMF program

[14] See Steinwand and Stone 2008 for a review of recent IMF studies.
[15] Momani 2004; Copelovitch 2010
[16] McNamara 2008; Moschella 2010; Gallagher 2014; Helleiner 2017
[17] Dreher and Vaubel 2004; Vaubel 1994
[18] Stone 2004; Chapman et al. 2017
[19] Nelson 2014; Chwieroth 2015
[20] Caraway, Rickard and Anner 2012

interruption are also centered on borrower characteristics, specifically compliance rates and political power.[21]

Notwithstanding these important contributions, the current research does not examine within-country variation, particularly sequential changes in IMF lending. As we observed earlier, the IMF has at times swiftly shifted from extending lofty credit lines to withdrawing financial safety nets in crisis countries such as Argentina. Why?

We offer an institutional explanation grounded in the IMF's technocratic priorities. Typically, the IMF is treated as a geopolitical agent, a mirror of powerful IMF shareholder nations, or a functionalist lender-of-last resort. However, we argue that such scholarly approaches do not offer a comprehensive portrait of the IMF because they heed little attention to the Fund's technocratic interests. Building on public choice models, we show that the IMF confronts a core dilemma when aiming to fulfill its ILLR mandate. Plagued by its institutional incompleteness, the IMF strategically lends to safeguard its limited resources and preserve its reputation as a credible ILLR. Given these reputational concerns and resource constraints, we expect the IMF to condition its lending choices on global contagion risk.

Theoretical Framework

"The Fund, from its inception, was burdened by a mismatch between its aspirations of its architects, and the authority and instruments they gave the institution to pursue those ambitions. Its authority over the policies of its members was limited. Its resources were small, and the facilities established to deploy those resources were modest relative to the problems they were designed to address."

–Timothy Geithner, U.S. Treasury Secretary, 2009-2013

[21] Edwards 2009; Dreher 2003, 2006; Joyce 2006

In his 2004 remarks about the role of Bretton Woods institutions in the 21st century, former Treasury Secretary Timothy Geithner, put his finger on the IMF's core institutional dilemma. It has agency, given its mission to promote global financial stability. However, its limited resources (particularly relative to the size of crises) make it difficult to meet these policy objectives without jeopardizing its reputational authority.

In other words, the Fund has the financial capacity, but not necessarily the willingness, to draw from an array of secondary lines of bilateral, multilateral, and private credit totaling $540 billion. If the IMF were to rely heavily on such resources, national governments might question the IMF's capacity to be a global financial stalwart. Leveraging lines of credit to address its own balance-of-payment problems could undermine its ability to act as a credible policy advisor for member countries with similar difficulties. Scholars have found that when the Fund instead invests in its reputation authority, the IMF enhances its credibility as a competent crisis manager.[22]

Rather than relying on these contingent financial backstops, the IMF has thus emphasized prudent financial choices by pro-actively hiking its precautionary balances, or loan-loss funds covering non-payment. For example, following the 2020 global pandemic, the Fund's credit outstanding on its loans nearly doubled to Special Drawing Rights (SDR) 92.9 billion ($137 billion) in January 2021, equivalent to 18 percent of its total balance sheet assets, or one-fifth of the IMFs quota financing-system ($702 billion). In the event of an unexpected payment shock, however, the Fund only held SDR 16.6 billion ($24.5 billion) in precautionary reserves. With estimates of the pandemic's financial fallout tallying as much as $2 to $3 trillion, resource strains are endemic to being the world's financial guardian.

[22] Broome 2010

For borrowers from Benin to Bosnia, the Fund has sufficient resources to sustain its lending to small countries that represent a tiny share of the IMF's overall balance sheet. However, several large and systematically important IMF borrowers – who are the object of our study – represent a disproportionate share of the Fund's balance sheet.

Lending to these borrowers creates an intractable tension between mitigating financial contagion, and safeguarding IMF resources. Institutionally incomplete from its inception, the Fund is more prone to exit its lending relationships with financially important institutions.

The bottom line is that the IMF is more sensitive to financial risk than a central bank, which is the typical national lender-of-last-resort. Central banks earn their authority as crisis managers by creating money to stabilize the domestic financial system. Bounded by limited resources, however, the Fund's reputational authority reflects its ability to safeguard its resources from one crisis to the next, strategically optimizing its balance sheet risk. Compared to a central bank, the Fund is thus more likely to exit its lending relationships early before restoring domestic financial stability because of its concerns about internal balance sheet risks. [23]

Why the IMF Emphasizes Financial Risk

The Fund's management and staff have been attuned to these balance sheet risks posed by its largest borrowers, often publicly addressing the limits of the IMF's support. In 2004, former IMF Managing Director Horst Köhler, warned that:

> "The IMF is not a lender-of-last-resort in the traditional sense; it isn't capable of providing an unlimited amount of financing."[24]

[23] Bagehot 1873; Fischer 1999; Mishkin 2000.
[24] Truman 2006

His successor, Manager Director Rodrigo de Rato, regularly championed the same theme:

> "[W]e clearly need a Fund that can say 'No' selectively, perhaps more assertively, and, above all, more predictably than has been the case in the past."[25]

Indeed, the IMF's Articles of Agreement specify that the Fund should have "adequate safeguards" on its lending, which provide "members with the opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity."[26] Why does the IMF have such a high concern for its balance sheet limitations when the Fund both enjoys preferred creditor status[27] and extensive credit access? We contend that the IMF is prioritizing its reputation as a viable ILLR, which depends on its ability to strategically manage its financial limitations as an institution. Unlike central banks, the IMF's main financing source is its quota system, in which nations pay a subscription quota, or financial contribution, based on their relative position in the world economy. With a 190-country membership, these quotas account for 90 percent of the Fund's total liabilities.

Many national governments expect the Fund to be a safe repository of national investments and avoid any undue risks with their resources. Enlarging a state's quota is thus politically very challenging because member governments must respond to thrifty domestic citizens who are often reluctant to contribute to financial bailouts internationally. For example, the former Trump administration nixed a proposal to enhance IMF liquidity during the pandemic which would have allowed cash-strapped nations to access additional reserves through SDRs.[28]

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[25] Rodrigo de Rato, "The IMF at 60—Evolving Challenges, Evolving Role." *IMF/Bank of Spain Conference*. June 14, 2004.
[26] See IMF's Articles of Agreement, Article 1, section 5.
[27] The norm of preferred creditor status endows the IMF with a priority position in sovereign debt repayment.
[28] See Gallagher, Ocampo, and Volz 2020.

Global Contagion Risk and the IMF

What determines whether the Fund prioritizes its internal balance sheet, and opts to exits its lending relationships? We expect the IMF to condition its lending on the likelihood that national financial volatility spills into global markets. In other words, the Fund should be more likely to cease funding when it perceives little contagion risks in the global markets; and therefore, when it has achieved its core mission of financial stability. The IMF instead conserves its resources to help mitigate future global volatility.

Global contagion is defined as a "significant increase in cross-market linkages after a shock."[29] When there is a financial or economic shock, international investors often aim to enhance their liquidity and protect their profitability by selling other high-risk assets with similar asset class characteristics in their investment portfolios. For example, Argentine central bank director, Horacio Liendo, claimed that his country's 2018 financial turbulence was a reflection of broader emerging market asset sales.

"I believe it wasn't related to Argentina specifically, so I think you cannot understand the sudden stop if you see the Argentine numbers or behavior before the sudden stop. I think it was related to the whole emerging markets."[30]

As put even more succinctly by former Vice Finance Minister Miguel Braun in our 2019 interview, "anytime there is uncertainty, there is flight to quality, and that's bad for Argentina."[31]

When countries are experiencing such capital flight and currency volatility, the IMF is willing to supply liquidity to mitigate potential spillovers into other financial markets, financial institutions, and economies throughout the globe. By "restoring balance-of-payments viability and

[29] Claessens and Forbes 2001.
[30] Author's interview, August, 2019.
[31] Author's interview, August, 2019.

macroeconomic stability,"[32] the IMF views such national lending as central to its fundamental mission of global financial stability.

If it did not offer such a funding backstop, the IMF could incur reputational risk that undermines its credibility as the global guarantor of financial stability.[33] IMF bureaucrats have openly voiced such institutional concerns, but they are also shared by the IMF Executive Board (EB)'s country representatives who fret about the material cost of financial volatility flowing across their borders. For example, in 2010, the EB modified its "exceptional access criteria," which historically conditioned lending on debt sustainability, to nevertheless extend credit to contain Greek contagion.

The IMF as a Cyclical Lender of Partial Resort

How does global contagion risk affect the IMF's lending behavior? In the following pages, we argue that the IMF's incomplete governance architecture[34] has created a financial catch-22: it strives to be an ILLR but its institutional structure impedes its capacity to completely fulfill this mission. Given its constrained resources, the IMF must strategically preserve its resources over time to maintain its credibility to intervene as an ILLR in the future, even amid ongoing domestic financial instabilities.

The IMF thus seeks to meet its financial stability mandate by mitigating global contagion, but not necessarily its domestic roots. To overcome this inherent tension between its financial health and institutional mission, the IMF employs policy conditionality to help foment domestic economic reform: it extends credit provided that borrowing governments follow the Fund's policy advice.

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[32] IMF Conditionality Factsheet, March 30, 2020.
[33] Broome 2010.
[34] Helmke and Levitsky 2004; Jones, Keleman, and Menieur 2016.

Importantly, however, the Fund also employs conditionality to hedge financial risk. As explained by senior IMF economists during our 2017-2019 interviews, the Fund offers "a co-insurance pool that's enforced with conditionality," whose "implementation is critical because we (the IMF) want to be repaid."[35] In other words, conditionality is designed to help prevent moral hazard and increase the likelihood of borrower repayment. In another interview, a senior IMF official emphasized "whether a country repays to the Fund is the criteria of a successful program,"[36] suggesting the idea that debtors have to repay loans is deeply embedded in the Fund's culture.[37]

In practice, we expect the Fund varies its enforcement of conditionality based on its assessment of global contagion. If borrowers do not comply with the IMF's recommendations, the policy drift provides a rationale for the Fund to exit its lending relationship. However, if the prospect of contagion risks upsetting international financial stability, the Fund has the flexibility to extend national-level waivers on policy targets, or loosen policy conditions to inject further liquidity. In other words, the IMF exploits its agency, or its zone of discretion, in managing its lending relations.

More generally, when the Fund's stakeholders are concerned about global contagion, we expect the IMF is more risk acceptant as an ILLR, emphasizing emergency liquidity. It extends larger loans with more "lax" enforcement of conditionality, which may intensify moral hazard (see Table 1).

By contrast, when the Fund deems contagion unlikely, the IMF is more risk averse as an ILLR, limiting the size of loans in its portfolio and more stringently enforcing conditionality. When financial volatility is contained, the Fund pays attention to its own balance sheet risk, fortifying its reputation as both a safe financial repository and the ILLR, without the worry of generating further

[35] Authors' interviews, July 2017; June 2019.
[36] Author's interview, July 2017.
[37] Lütz et al. 2019.

financial turmoil in other regions. Under these conditions, the IMF uses stringent conditionality as an exit strategy to justify reducing its own financial exposure and even dissolving financial ties with non-compliant borrowers. Ironically, the Fund thus sometimes acts more like an international investor, ebbing and extending its financial ties based on market volatility.

Table 1. The IMF: A Cyclical Lender of Partial Resort

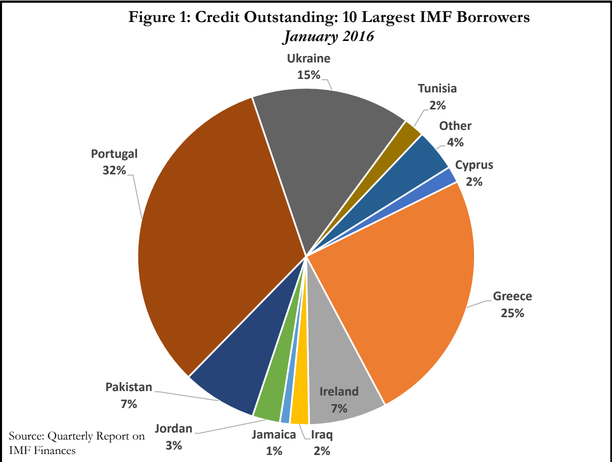
	IMF stance	
	Risk-acceptant (high contagion risk)	Risk-averse (low contagion risk)
Loan size	Large	Small-medium
Enforcement	Weak enforcement (to prevent global fallout)	Strong enforcement (to prevent moral hazard and to be able to 'exit' lending relations)

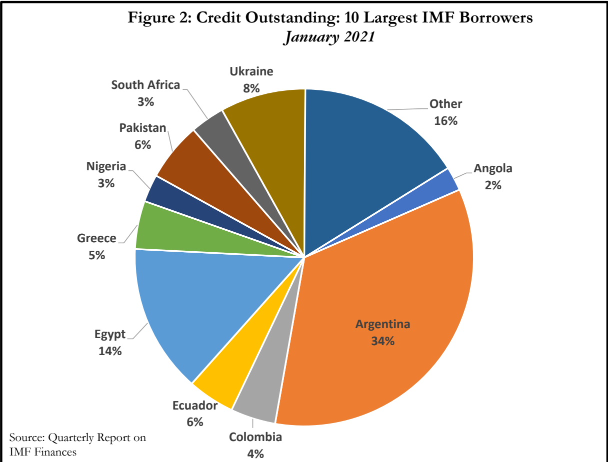
Scope Conditions: Systematically Important Borrowers

We have argued that the IMF's budget constraint catalyzes the tension between systemic risk and moral hazard in its crisis lending decisions. The IMF provides crisis liquidity until moral hazard problems threaten the soundness of its internal balance sheet. But, with almost two-hundred sovereign nations with access to IMF funding, which type of borrowers pose such moral hazard risks? Importantly, our argument only applies to large and financially important countries with sizable enough financial markets and banking sectors that can potentially create contagion risk such as Argentina, Egypt, Greece, and Pakistan. In fact, IMF loans are often concentrated among several large borrowers, creating a high level of risk for the IMF's balance sheet. In January 2021,

the Fund's ten largest borrowers accounted for 84 percent of its total credit outstanding, while the remaining 42 countries amounted to 16 percent of outstanding credit.

Notably, however, the composition of these financially important countries shifts over time, with seven of the IMF's top-ten borrowers changing national identities over the last five years (see Figures 1 and 2). Moreover, with high- and upper middle-income countries representing 56 percent of the IMF's 190 members, the prospect of financial contagion from any of these systematically-important countries casts a perpetual shadow over the IMF's balance sheet.





On the other hand, smaller crisis countries, from Honduras and Kosovo to Somalia, have a minor share of IMF credit, and their potential financial fallout has limited impact on other economies. The IMF can thus renew or cut these financial commitments without much concern for the IMF's balance sheet risks or global contagion risks. We thus exclude smaller economies from our framework.

In summary, we argue that the Fund's ability to act as an ILLR during bad economic times is contingent on its financial prudence during good economic times. Without occasionally bolstering its financial soundness, the IMF could incur reputational risk that undermines its credibility as the global guarantor of financial stability. Ironically, this pattern implies the IMF might be most likely

to address its moral hazard problem during good times, meaning that most financially-important economies may have little incentive to reform when the stakes are the highest globally.

Comparative Case Evidence

To test these theoretical priors, we conduct a comparative case study analysis of IMF decision-making over time in two of the Fund's historically largest and most high-profile debtors: Argentina and Greece. These two countries are both middle-to-high income democracies that have been major IMF borrowers: they accounted for a whopping one-sixth and one-fifth share of the IMF's credit outstanding during their peak crisis periods at the turn of the 21st century. However, these cases maximize the variation in the main independent variable: global contagion risk.[38]

Recall that we expect the Fund's lending to be conditional on the likelihood of global market contagion. We thus limit the domain of the study to periods of high IMF financial risk and examine the variation in global contagion risk, which allows for a better understanding of the institutional limits of the Fund's willingness to be an ILLR.

Key Measures: IMF Financial Risk and Global Contagion Risk

To measure the Fund's *financial risk*, we employ the ratio of the IMF's precautionary balances to its total credit outstanding; the same ratio the Fund uses in the risk management section of its annual report. A burgeoning literature shares our intuition about the IMF operating under a budget constraint, finding that barriers to receiving a program are higher in low IMF liquidity years.[39]

[38] King, Keohane, and Verba 1994.
[39] Lang 2020; Stubbs et al. 2020.

Throughout the study's time period, the IMF's financial risk is consistently high, allowing us to evaluate its lending decisions under such balance sheet constraints. Despite a period of low financial risk in the mid-2000s (see the sharply improved financial risk ratio in Figure 3), this period falls out of the scope of our comparative analysis in Argentina (1998-2001) and Greece (2010-2015). Nonetheless, it shows how the variation in financial risk affects the IMF's lending position. With fewer demands for Fund resources, the IMF was willing to renew loans for long-standing borrowers, such as Bolivia in 2006 despite concerns about the government's fiscal sustainability.[40] However, if the Fund's financial risk ratio had instead deteriorated, we surmise the IMF would have considered terminating its Bolivian lending relationship.

To gauge the IMF's *perceptions* of global contagion risk, we employ several measures.[41] First, we conduct a content analysis of EB meeting minutes, anticipating that a higher frequency of such words as contagion and spillover signify that the IMF is concerned about contagion risks. To corroborate these findings, we employ primary interviews with IMF directors and national government officials (see online appendix for field research design, including interview selection process and confidentiality measures), and secondary archival evidence from IMF staff reports to gauge the IMF's assessment of contagion. Finally, we also examine descriptive financial market statistics regarding credit risk (i.e. sovereign debt premiums) as another indicator given that the IMF monitors emerging market asset movements to help gauge the extent of financial contagion.

We then use process tracing within each case study[42] to examine the internal determinants of IMF lending decisions. Formally, these policy choices are discussed during IMF Executive Board

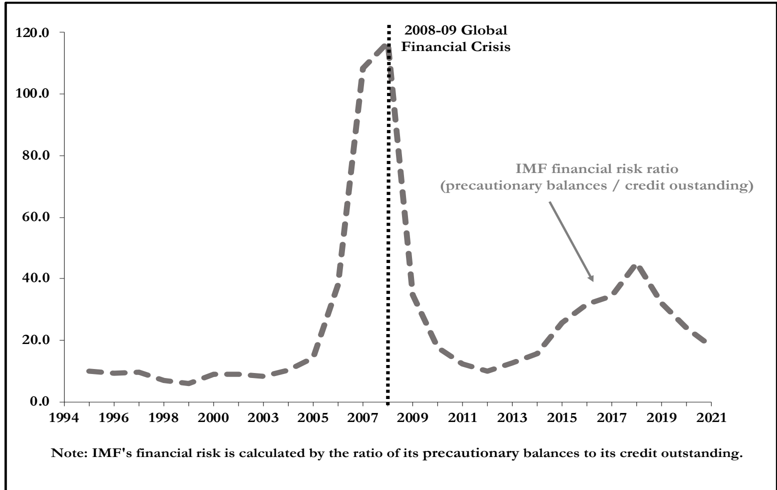
[40] 2006 Bolivian Article IV IMF Consultation.

[41] Our theory hinges on the IMF's *perception* of global contagion risk rather than the actual risks, although two are likely to be highly correlated.

[42] Gerring 2007; Bennett 2008.

meetings (EBMs). Informally, outside of EBMs, IMF officials consult with borrowing government officials on program design and funding decisions. Employing both archival evidence from EBM minutes to track the formal channel, and primary interviews with IMF staff and national government officials to evaluate the informal channel of IMF decision making, we find that the Fund's lending is conditional on the likelihood of global financial contagion.

Figure 3. IMF's Financial Risk, 1994-2021



I. Argentina and the Revolving IMF Door: 1998-2001

Argentina's long and turbulent history with the IMF sets the stage for a fascinating puzzle. During the late 1990s, why did the Fund lend extensively and continuously to Argentina despite the country's non-compliance, but then terminate Argentina's program in 2001? We show that the Fund approved Argentine loans during periods of high contagion risk, but suspended existing programs when contagion risk had stabilized (see Table 2).

Table 2. Overview of global contagion risk and IMF decisions regarding Argentina, 1998-2001

	1998		1999		2000		2001	
	1st half	2nd half	1st	2nd	1st	2nd	1st	2nd
IMF financial risk	←				HIGH			→
Global contagion risk	LOW	←			HIGH		→	LOW
Key market event	Asian Countries' Recovery	Russian Default			Developed Country Recession			'Decoupling' Argentina
IMF decisions regarding Argentina	Program Suspension	←			Continued Lending		→	Program Suspension

In line with this study's domain, the Fund faces high balance sheet risk during this entire period. The IMF increased its ILLR operations in response to successive emerging market crises, including extending the largest loan ($58.4 billion) in IMF history to South Korea (1997) and $22 billion in financing to Argentina during its crisis (1998-2001). Given these outlays, the IMF's total credit outstanding nearly doubled in the late 1990s, weakening its financial risk ratio (Figure 3), and prompting its Board of Governors to express serious concern over the IMF's financial health.

To examine whether the IMF's perceived contagion risk varies during this period, we conduct a content analysis on the IMF EB meeting minutes for 1998-2001, focusing on the minutes from September 1998, May 1999, March 2000, September 2001.[43] In each meeting, IMF executive directors and relevant staff (e.g. the mission chief and functional department representatives) exchange their thoughts regarding the program.

Employing a text-as-data approach,[44] we leverage EB meeting minute vocabulary to measure the extent of the Fund's concerns on global contagion risk. After filtering each text, we created the list of vocabularies that were related to (i) global contagion risk and (ii) Argentina's program

[43] We chose these texts primarily for data availability reasons, but they provide annual coverage, allowing us to plot gradual changes in the IMF's stances over time.

[44] Grimmer and Steward 2013.

implementation (see Table 3).[45] We subsequently counted the frequency of pre-determined vocabularies for global contagion risk and program implementation, assuming that these frequencies capture the relative priorities of IMF EB directors.

This analysis supports our main claims. We find the words related to global contagion risks such as "contagion", "spillover" and "turbulence (in international financial markets)" appeared repetitively in 1998 when the IMF approved a large loan for Argentina. However, they were spoken much less frequently in the September 2001 meeting. Instead, IMF directors became more vocal about Argentina's poor implementation records and the Fund's deteriorating credibility, as shown in the spikes of the frequencies for words "implementation" and "credibility."

Table 3. Word frequency in EBM minutes on Argentina, 1998-2001.

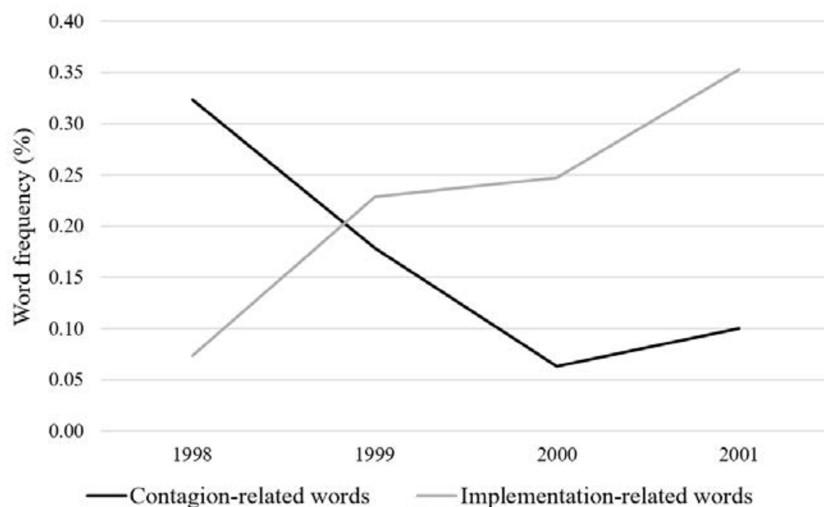
	Contagion related words				Implementation related words		
	Contagion	Spillover	Emerging market (economies)	Turbulence (in int'l financial markets)	Compliance	Implementation	Credibility
1998	8	3	12	21	2	6	2
1999	4	3	14	4	3	15	14
2000	2	0	9	1	19	24	4
2001	4	1	12	2	5	38	24

Given the heterogeneous minute lengths within these EB proceedings, we also measure the proportion of contagion- and implementation-related words to the total vocabularies per minute. The results (Figure 4) show that IMF directors spoke words related to contagion risk less frequently over time, while they paid increasing attention to the program's implementation and credibility.

[45] We removed punctuations and stop words, which resulted in four bodies of texts with approximately 13,600 and 19,000 vocabularies.

In the following paragraphs, we complement these findings with secondary archival evidence to examine the determinants of the IMF's decisions regarding Argentina.

Figure 4. Word frequency (proportion of total texts in EBM minutes on Argentina, 1998–2001)



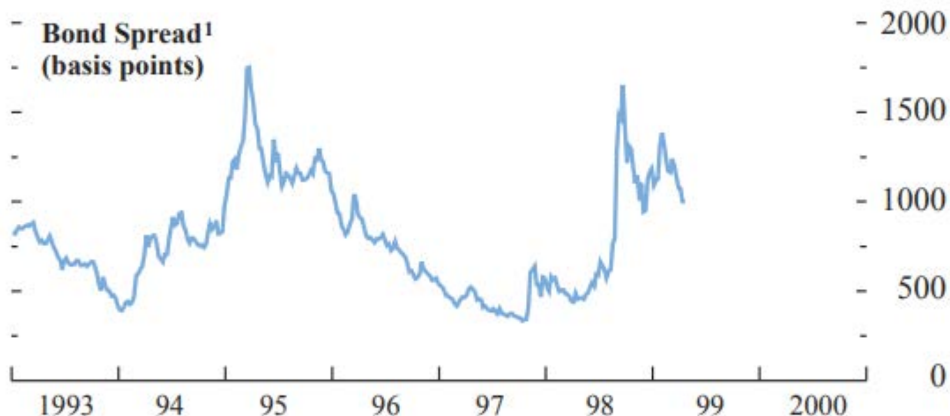
Early 1998: Low Contagion Risk and IMF Program Suspension

According to our theoretical priors, low financial contagion risk in early 1998 should have enabled the Fund to prioritize its financial health, and thus maintain its long-term reputation as a viable ILLR. By comparison, during periods of high contagion risk, including both the 1998 Russian default and the 2000-01 developed country recession, the IMF should lend most readily, and with fewer conditions, to contain potential financial spillovers. We find robust evidence of these patterns. By early 1998, global financial markets had stabilized against the backdrop of successful IMF reforms in South Korea and Thailand. In its May 1998 report, the IMF noted this improved outlook, saying that "the financial turmoil in Asia that erupted in mid-1997 has abated since January... and confidence should recover gradually during 1998."[46] Emerging market risk

[46] IMF 1998

premiums had also declined considerably from their previous peak prior during the 1994-95 Mexican Peso Crisis (see Figure 5).

Figure 5. Financial Conditions in Emerging Market, 1993-1999



Data: JP Morgan Emerging Market Bond Index (EMBI) spread relative to comparable U.S. Treasuries.

In February 1998, as the world was emerging from financial contagion, the IMF approved an Extended Fund Facility (EFF) to help debt-ridden Argentina contain its financial risk. Although negotiations had begun during the 1997 East Asian crisis, our theory suggests that the IMF should become less risk-tolerant as global volatility subsides, shifting to a more stringent loan enforcement stance. Indeed, there was wide-ranging skepticism within the IMF about the program's feasibility, with the Research, Policy Development and Review, and Fiscal Affairs departments all lobbying for a program with a shorter duration than the EFF.[47] Only the Western Hemisphere department believed "on balance, the risks [were] still acceptable."[48]

By July 1998, and in line with our theoretical priors, the IMF cancelled Argentina's program because of its conditionality breaches and lack of reforms. Not only had the Menem government

[47] Internal memo to top IMF management, April 28, 1997.
[48] IMF 2004, 37.

missed its fiscal targets, but it had also balked on promised labor reforms. Proposed labor legislation – backed by the IMF – would have resulted in government cost savings. However, it also meant job and wage cuts, a prospect that Menem's plummeting popularity could not afford.[49]

The Fund could suspend Argentina's program because it did not impose substantive risks to other economies. Counterfactually, however, if global contagion risk had been higher, we surmise that the outcome of the IMF's program would have been much different. The Fund would have likely adhered to conditionality less stringently, or helped Menem build a reform consensus. For example, the IMF's Independent Evaluation Office (IEO) found that when Argentina missed its fiscal reform targets, the Fund "did not employ all the available tools to bring about reforms."[50]

In summary, by strictly enforcing conditionality during low financial contagion, the Fund was not only able to preserve the soundness of its balance sheet, but also maintain a politically-feasible exit strategy. When global financial conditions improved, the Fund could demand full compliance, and cloak its loan withdrawal in its non-compliance concerns. Ironically, however, the Fund's decision to disengage with Argentina to protect its financial soundness and reputation led to more serious fallout for both Argentina and the Fund during the 2001 crisis.

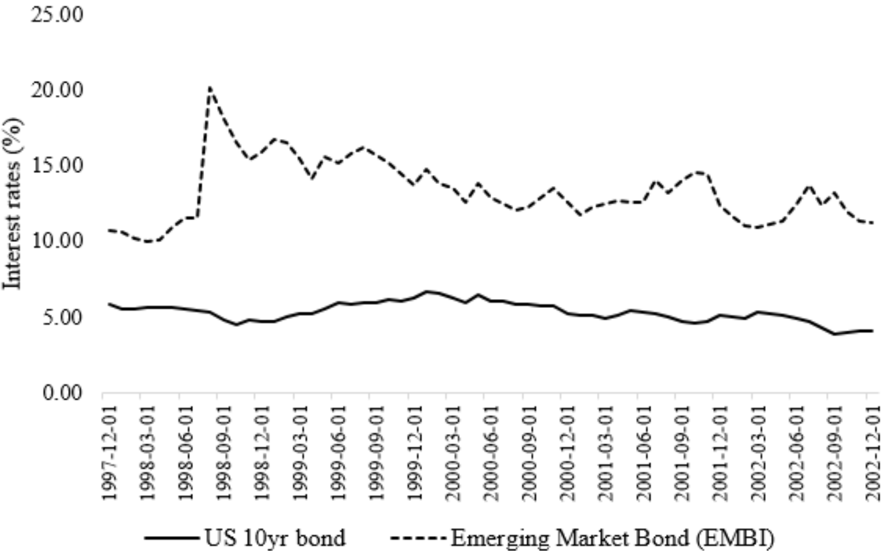
Late 1998-early 2001: High Contagion Risk and the IMF as a Lender of Last Resort

In August 1998, the Russian debt default unleashed a bout of global financial turbulence that uprooted the economic recovery within emerging market economies. The yield on emerging market bond spreads more than tripled in the month following Russia's default, showing the rapid loss of global investor confidence (Figure 6). Investors re-allocated their emerging market bond

[49] By early 1998, Menem had a 26 percent approval rating, with a 15 percent unemployment rate.
[50] IMF 2004.

holdings into developed country assets, and continued to demand higher risk premiums for emerging market assets throughout the 2000 and 2001.

Figure 6. Emerging market sovereign bond (EMBI) spreads over comparable U.S. bonds



Given the heightened global risk, our theoretical framework anticipates that the IMF returns to focusing on its core mission of preserving global financial stability. We also expect that the Fund will not stringently enforce conditionality because it cannot credibly exit its lending relationship, without jeopardizing global financial stability. Indeed, it helps explain why the IMF would fund the Menem government again, even though it had only lost more political popularity, and thus reform capital, since failing to comply with its IMF program a few months earlier.

A careful examination of the Fund's internal decision-making offers strong support for these theoretical priors. For example, the Fund's research department sent a memorandum to the EB emphasizing the importance of its ILLR role, notwithstanding Argentina's stalled labor reforms.

"We realize that management opted for completing the review despite the staff's suggestion it be conditional on…approval of …labor market reforms, which has not occurred…We see merit in

the argument that current turmoil in international markets justifies the continuation of Fund support."[51]

In particular, the EB directors were concerned that the ongoing suspension of the program would make Argentina and other countries susceptible to contagion risks from the Russian default. The directors argued that "rather than wasting its scarce resources on a country [Russia] that would not follow Fund's advice, it might be better to instead spend those resources on other countries who face potential contagion [Argentina]."[52]

Notably, there were some dissenting opinions about resuming Argentina's program. A few IMF directors, representing middle- or low-income countries that were less affected by the crisis (e.g., Middle East, Eastern Europe and Central Asia), were cautious about the program, saying that the staff report is "too sanguine".[53]

Despite such concerns, representatives from high income countries and emerging economies that were most susceptible to the crisis (e.g. U.S., Mexico, and India) outnumbered these voting blocks,[54] and highlighted contagion risk as their chief reason for supporting Argentina. Eventually, the EB resumed the Argentine program in September 1998. Due to the "uncertainties regarding the duration of the current turmoil in international financial markets," the IMF decided to prioritize helping Argentina "maintain cautious stance to weather the danger of contagion" over requiring full compliance.[55] In later explaining the Fund's decision to restart Argentine financing, IMF Deputy Managing Director, Murilo Portugal, highlighted the linkages between global contagion and Argentina's IMF program:

[51] Paul Mason, Research Department's senior advisor. Cited in Blustein (2003)
[52] IMF Archives EBM 98/103.
[53] Statements from Mr.O'Loughlin (Belize). Further cautious-stance statements came from Mr. Milleron (France), Munthali (Malawi), *Dairi* (Morocco), and Szczuka (Poland)., IMF Archives EBM 98/103.
[54] See statements from Mr. Donecker (Germany), Lissakers (U.S.) Sivaraman (India), Grilli (Italy), Guzman-Calafell (Mexico), Kwon (South Korea), and Lehmussaar (Estonia) in EBM 98/103.
[55] IMF Archives EBM 98/103.

"In certain circumstances, authorities' best efforts and the solidity of the macroeconomic situation may not be sufficient to contain pressures resulting from market over-reactions and contagion. In those circumstances, it is essential that the international financial community stand ready to provide support."[56]

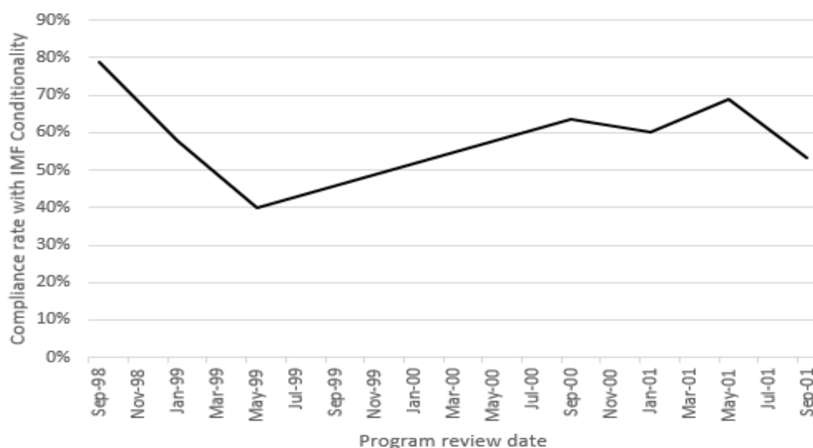
Given these views about contagion's resurgence, and in line with our priors, the IMF shifts to a more risk-tolerant lending stance with Argentina, offering larger loans and enforcing conditionality less stringently, although it demanded more conditionality over time to hedge its increasing financial risk (Table 4). Notably, the IMF is more willing to excuse Argentina's non-compliance in 1999 than during June 1998 (Figure 7).[57] For example, the final program review in May 1999 showed that Argentina had only met five out of twenty-four of IMF lending conditions.

Table 4. Number of Conditionalities in Argentina IMF Programs

	1998	1999	2000	2001
Total number of conditions	28 (43)	35 (44)	35 (40)	58 (42)
Binding conditions	20 (30)	24 (28)	26 (27)	28 (29)

Note: Numbers in parenthesis are the averages in all the IMF programs in the given year.
Data: Kentikelenis *et al*. (2016).

Figure 7. Argentina's compliance with IMF conditionality[58]



[56] IMF Archives EBM 99/56.
[57] The Fund may have accepted some non-compliance because of Argentina's October national elections.
[58] Authors' calculation from the IMF MONA dataset.

These patterns continued over the course of 2000 and the first-half of 2001, a period characterized by heightened emerging market credit risk. In particular, the Fund had fretted about the potential spillover effects of an Argentine default.[59] Consequently, from 2000 until late 2001, the Fund made a series of large and risky loans, which ultimately amounted to $17 billion, or more than 5% of Argentina's GDP.

Importantly, the Fund stated that these lofty disbursements "allow(ed) the government to purchase the undrawn amount under the SBA immediately, regardless of the review status."[60] The Fund was thus prioritizing liquidity to prevent market panic, rather than conditionality to ensure Argentina's debt repayment.

Throughout the course of this lending cycle, there were some dissenting opinions, but the IMF's lending decision ultimately reflected arguments about the reputational risk of disregarding potential contagion signs. For example, during the EBM in May 2001, multiple directors questioned if the Argentine crisis posed sufficient contagion risk to warrant the investment, with Stephen P. Collins (U.K.), highlighted that,

"The program remains fraught with risks.... the Fund should therefore, in its public statement, be circumspect in reference to the risks."[61]

Similarly, Jean-Claude Milleron (France) showed a cautious stance:

"Clearly, the risk of fall-out is something,…. I would appreciate hearing from the staff what countries, beyond Brazil, they see as the most susceptible to a contagion crisis."[62]

[59] IMF 2004.
[60] IMF 2004, 40.
[61] IMF Archives EBM 01/53
[62] Ibid.

Nonetheless, the Board eventually approved a loan in May 2001. Despite the U.S. and Western Europe's disproportionate voting power within the EB, it was African, Southern European, and Asian directors that persuaded them to support Argentina. For example, one African director said:

> "I was a little puzzled by Mr. Collin's suggestion that we should be circumspect about the risks. On the contrary, at this delicate juncture, we should fully support what we are doing right now in Argentina in order to avoid any negative perception."[63]

In response, both the U.K. and France directors compromised by saying "the board's concerns should remain private," while underscoring the importance of "unqualified support."[64] The IEO later acknowledged that "the importance of Argentina's stability for the region and emerging market economies in general" was the main reason the IMF granted Argentina waivers during 2000-2001.[65] The IEO also found that the program imposed tremendous financial risks for the IMF. Specifically, "in the event of a nonpayment of principal, the IMF's precautionary balances would not be sufficient to cover the total amount of arrears."[66] Yet, the EB discussions did not emphasize these internal financial risks, as they were afraid that "withholding support at this junction [2001] was tantamount to shying away from the mandate of the IMF."[67] The promise of new IMF funds to a previously non-compliant borrower, however, created a moral hazard problem, sowing the seeds for future debt problems.

Late 2001: Decoupling Argentina and IMF's Restoration of its Balance Sheet

By the summer of 2001, emerging market credit risk began improving amid growing sentiment that Argentina's default risk would be contained financially. While the Fund had allowed

[63] Ibid.
[64] Ibid.
[65] IMF 2004, 47
[66] Ibid, 61.
[67] Ibid. 49.

Argentina to access another $8 billion in August, its management had increasingly viewed emerging economies as showing signs of normalization.

For example, the IMF's research department concluded that contagion from an Argentine default would "likely be limited because a 'credit event' was already widely anticipated and had been partly discounted by markets."[68] In October 2001, the Fund noted that the "the potential for future contagion is less than it was in the past."[69]

These sentiments were echoed in global financial markets. For instance, Deutsche Bank's Scudder Investment, the fourth-largest asset manager globally, highlighted markets had "price(d) in the default risk…the decoupling or separation of Argentina," meaning that "any impact from a real default would be a knee-jerk reaction."[70]

Figure 8 shows this emerging market normalization pattern. Sovereign bond spreads for Russia, Brazil, Mexico, and Turkey, and aggregate emerging market risk (EMBIG) all stabilized in the last quarter of 2001. By contrast, Argentina's sovereign risk premium spiked higher, showing signs that other economies were "de-coupling" from Argentina.

Cognizant of this altered Argentine market sentiment (as reflected in its EB discussions in Table 3 and Figure 4), the IMF began to shift its position, becoming a more stringent lender. In November, Argentine economy minister Domingo Cavallo tried multiple times to visit the IMF's headquarters only to find out that the Fund would not receive him. On December 3, the IMF refused to complete the fifth review, cut its funds, and completely withdrew its Argentine mission.

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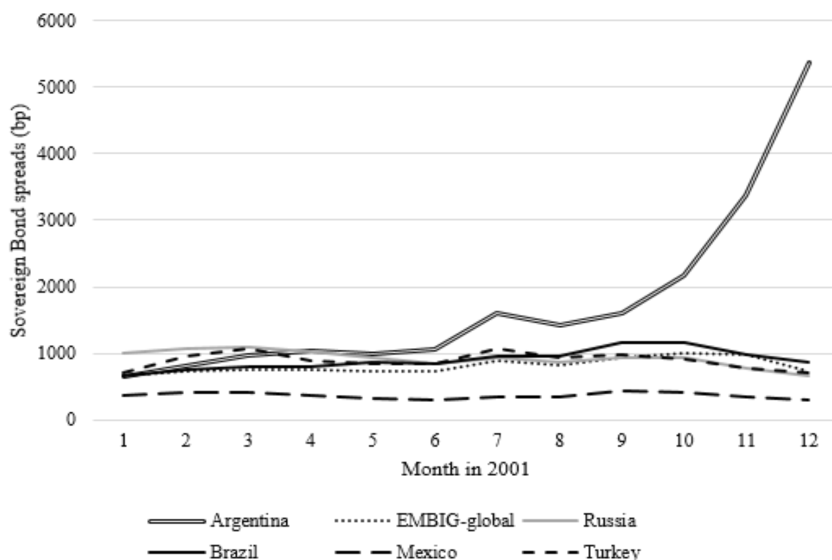
[68] Ibid. 52.
[69] IMF 2001.
[70] Yoon Cho. "Outlook for Emerging Market Debt" *The Street*. Dec 12, 2001. Available at: https://www.thestreet.com/personal-finance/meet-the-street-the-outlook-for-emerging-market-debt-10005241

Figure 8. Sovereign Bond Spreads in Emerging Economies in 2001



We opine that had the global economy been vulnerable to financial turmoil in late 2001, the Fund would have likely followed a different path with Argentina. Its stated reason for not completing the review was Argentina's fiscal non-compliance: the government had breached its fiscal deficit target by $2.6 billion, intensifying Argentina's debt problem. However, this was the first time during 2000-2001 that non-compliance had led to a program cancellation. Ironically, Figure 7 shows that Argentina's non-compliance was actually worse in 1999 than 2001. Yet, the IMF had provided Argentina with numerous waivers until the last quarter of 2001, when it was confident it could contain the regional fallout from Argentina's default.

Adjudicating the Alternatives

The Argentine case also helps us navigate a couple of alternative explanations about leadership turnover in the U.S. and the IMF, including arguments that the IMF cancelled the Argentine program in 2001 due to thrifty economic leanings of the new Republican George W. Bush administration and the new center-right IMF chief, Horst Köhler (who replaced the left-of-center

Michel Camdessus in 2000). A close reading of the timing of the loan approvals; however, indicates otherwise. If U.S. partisanship or IMF leadership shifts had influenced the Fund's decision, then we should have observed a shift in the IMFs lending stance in January 2001. However, the Bush administration and Horst Köhler initially allowed the IMF to support Argentina throughout much of the year. It was only when other emerging economies showed signs of stabilization that the IMF withdrew its mission from Argentina.

To what extent, however, might the IMF increasingly emphasize conditionality over time as it gains more information about program implementation? Notably, the IMF's willingness to repeatedly lend to Argentina over the course of several decades (since 1982), notwithstanding Argentina's non-compliance on key domestic reforms, shows that the learning argument has little explanatory power. Between 1991-2001, the IMF had extended five successive lending arrangements to Argentina, which dispatched about fifty country missions.[71] By 1998, the IMF had sufficient information to have learned about Argentina's struggles with implementation. However, for over three years beginning at the end of 1998, the IMF *chose* to disregard non-compliance because the Fund feared its withdrawal could intensify global financial turmoil.

In summary, the Fund's lending stance toward Argentina from 1998-2001 reflects the variation in global contagion risk. Despite its vigilance about the high risk associated with Argentina's IMF programs, the Fund lent to Argentina whenever its default posed a potential contagion risk globally. These conditions ironically intensified the IMF's moral hazard problem, where its willingness to supply Argentina with funds to buttress global stability weakened its commitment to conditionality. However, Argentina's expanding indebtedness eventually prompted an IMF exit once global

[71] IMF (2004) 9.

markets had stabilized. The Fund halted its program in November 2001, following the emergence of clear signs that Argentina's credit risk was de-coupling from other economies in October 2001.

II. The IMF's Underwriting U-turn in Greece: 2010-2015

The 2010 Greek Sovereign Debt crisis also illustrates how varying global contagion risk influences IMF lending decisions. From early January 2010 (when the Greek Prime Minister first inquired about IMF loans) until July 2015 (when the Fund refused to lend new funds), the IMF nearly depleted its usable resources. Due to high demand for IMF funds after the 2008 financial crisis, the Fund's ratio of precautionary balances to credit outstanding hit all-time lows between 2010 and 2015 (Figure 3). In a public release, the IMF noted it had needed to borrow funds to lend during 2010-2014.[72]

Despite its high internal financial risk, the IMF approved unprecedentedly large loans in 2010 and 2012 because of its concerns about the financial spillover from Greece to the rest of Europe. It aimed to hedge its lending with an ambitious set of conditions. However, it then disregarded Greece's non-compliance because it fretted that cutting lending might foment global instability. In contrast, when regional credit markets stabilized in 2013-14, the IMF shifted its focus to its internal financial risk and demanded full compliance with conditionality. When Greece did not adhere to conditionality, the IMF ceased disbursing new money, and refused to join later Eurozone-orchestrated rescue packages (see Table 5).

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[72] IMF 2018.

Table 5. Global contagion risk and IMF decisions regarding Greece, 2010-2015

<table>
<tr><th></th><th>2010</th><th>2011</th><th>2012</th><th>2013</th><th>2014</th><th>2015</th></tr>
<tr><td>IMF financial risk</td><td colspan="6">← HIGH →</td></tr>
<tr><td>Global contagion risk</td><td colspan="3">← HIGH →</td><td colspan="3">← LOW →</td></tr>
<tr><td>Key market events</td><td colspan="2">Eurozone Crisis</td><td>Europe's Recovery</td><td colspan="2">Ireland, Spain, Portugal's 'exit' from bailout programs</td><td></td></tr>
<tr><td>IMF decisions regarding Greece</td><td colspan="3">Loan approval & continued lending</td><td colspan="2">Delayed Reviews</td><td>Refused to bailout</td></tr>
</table>

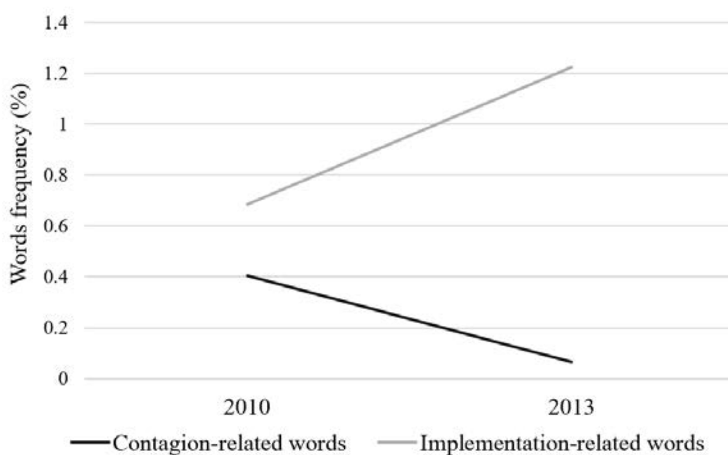
To examine the IMF's varying concerns regarding contagion risk, we again scrutinize the word frequency from IMF EB meetings. Table 6 compares the word frequencies for 'spillover', 'contagion', and 'Eurozone' during the EB meeting in May 2010 with the May 2013 meeting. Consistent with our theoretical priors, the analysis finds that their frequencies decline substantially over time in contrast to the stickiness of 'fiscal', 'debt', and 'growth'.[73] These patterns hold when accounting for varying word volumes of each meeting (see Figure 9). The proportion of contagion-related words to the total word counts was high in May 2010, while the ratio reached almost zero three years later. In the following pages, we explore how contagion affected the Fund's strategic management of its resources more extensively.

Table 6. Word frequency in EBM minutes on Greece, 2010 and 2013.

	Contagion-related words			Implementation-related words		Greek economy-related words			
	Spillover	Contagion	Eurozone	Reform	Implementation	Fiscal	Debt	Growth	Tax
2010	47	20	22	101	50	179	156	61	5
2013	4	4	0	106	41	109	130	85	83

[73] We are unable to conduct the same analysis for the 2011 and 2012 meetings because the IMF restricts access to these minutes.

Figure 9. Word frequency (proportion of total texts in EBM minutes on Greece, 2010 and 2013).



2010-2012: Contagion Risk in Europe and the IMF as a Lender of Last Resort

In response to Greece's request for a bailout in May 2010, the IMF along with the European Union (EU) and the European Central Bank (ECB), announced a €110 billion loan in exchange of an extensive list of reforms. For the IMF, its €30 billion commitment was highly risky because of both Greece's questionable debt sustainability and its deteriorating domestic political outlook tarnished by eroding government support and increasingly violent riots.

Notwithstanding these vulnerabilities, contagion risk compelled the Fund to act as an ILLR. During the May 2010 meeting, several IMF directors emphasized that Greece's program was a "very challenging program" given the Fund's own financial situation and Greece's high debt.[74] Nonetheless, contagion fears outweighed the Fund's internal financial risk. Many directors emphasized spillover risk repeatedly (Table 6) and agreed that "given the growing concern of contagion from Greece,...we have no other choice but to support the program."[75] Given the

[74] For example, Paulo Nogueira Batista (Brazil) warned that the Fund should not ignore "the credit risk for the Fund." IMF Archives EBM 10/45-1

[75] Ibid. Directors from India, Singapore, Philippines, Japan and Switzerland were one of many showing serious concerns for potential contagion.

importance of the Greek crisis for global stability, they concluded that "the Fund must address the issues related to debt resolution in a time-bound manner." Others championed the same theme of "putting all our forces in finding a solution that can contain the spillovers."[76]

As contagion risk materialized in Southern Europe in the wake of the Greek crisis, the Fund revised its "exceptional access criteria." which had mandated a "high probability" of debt sustainability as a prerequisite for extraordinary large loans. In its May 2010 meeting, Fund officials exempted Greece from these criteria, "given *the high risk of international systemic spillovers*."[77] For instance, the 10-year government bond yields for Spain, Ireland, Portugal and Italy, had already spiked in the wake of the Greek crisis (Figure 10).

In line with our argument, the Fund, therefore, prioritized global stability over mitigating its internal financial exposure and enforcing its conditionality. The IMF granted waivers for all of Greece's unmet conditionality from 2011-2012, even after initially requiring more conditionality (to hedge its risk) than other IMF programs (see Table 7).[78] However, its strict conditionality paved the way for its eventual exit a few years later when global financial conditions stabilized.

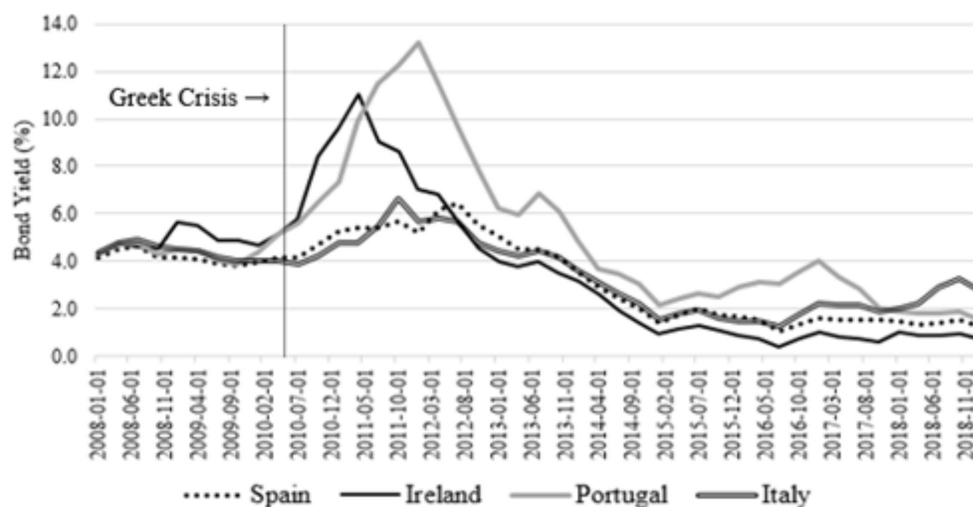
Table 7. Number of Conditionalities in the Greek IMF Programs

	2010	2011	2012	2013	2014
Total number of conditions	34 (32)	52 (32)	62 (32)	53 (34)	61 (39)
Binding conditions	19 (20)	37 (19)	37 (18)	30 (19)	44 (21)

Note: Numbers in parenthesis are the averages in all the IMF programs in the given year.
Data: Kentikelenis *et al*. (2016).

[76] Ibid. Another factor contributing to the IMF's enthusiasm for Greece in 2010 was the IMF's decade-long inactivity that created doubts about the institution's relevance in the global economy (Blustein 2016).
[77] Ibid.
[78] For example, in 2011, the Greek authorities missed its targets for civil service, fiscal, and privatization reforms, but received IMF waivers and the program continued.

Figure 10. 10-year Government Bond Yields. 2008-2018.[79]



2014- 2015: The IMF as a Greek Banker

With Europe's recovery between 2013-2015, the Fund increasingly enforced its policy conditions underlying the Greek program. The restructuring and near-elimination of Greek debt held by private investors in March/April 2012 substantially alleviated fears about contagion over Europe. Investor confidence again improved in July 2012 when ECB President Mario Draghi declared that "the ECB is ready to do *whatever it takes* to preserve the Euro."[80] For example, the 10-year government bond yields for Spain, Ireland, Portugal and Italy all returned to pre-Greek crisis levels by mid-2013 (see Figure 10), and all of them 'graduated' bailout programs by spring 2014. The IMF was cognizant of these dissipating contagion pressures. Recall that the frequency of EB comments about contagion declined significantly between its 2010 and 2013 meetings (Table 6 and Figure 9).

Without contagion, IMF financial resources became less essential to Europe's financial stability, endowing the Fund with more flexibility to strengthen its own balance sheet. The IMF's internal discussions reflected this shift. IMF staffers highlighted "the Fund was taking imprudent financial

[79] OECD 2019.
[80] Wilson, Wigglesworth and Groom. 2012. "ECB 'ready to do whatever it takes,'" *Financial Times*, [Italics ours].

risks on its biggest-ever loan" and "the Fund must take extraordinary action to protect its interests."[81] In light of such concerns, the IMF became increasingly combative toward its European partners, as well as Greece, openly advocating for another round of debt restructuring in late 2012.[82]

Amid the signs of crisis abatement, the Fund became less risk tolerant toward Greece, requiring more conditionalities (see Table 7). These binding conditions eventually provided the Fund with an 'exit' option from Greece's program.

By mid-2014, the Greek government had hoped to 'graduate' its IMF-EU program and receive its final €7.2 billion loan installment. However, during the review process, Greece missed several program targets including sales tax implementation and union bargaining. In contrast to earlier in the program, the Fund did not grant Greece any waivers, and refused to release the tranche.

During the November 2014 negotiations, the Fund was "the most immovable among the creditor institutions [ECB and EU]."[83] European policymakers wanted the IMF to continue its Greek lending to help with burden sharing economic and politically. However, to those Greek and Europeans involved in the program discussions, it appeared that "the Fund had resolved to block approval, period."[84] Some Fund officials fretted that rigid demands for Greece could backfire, warning "plans for the primary fiscal surplus… could threaten social cohesion and wreck any prospect of economic recovery."[85] However, the Fund did not allow any program adjustments in and instead delayed the review by extending the program into 2015, without disbursing any money.

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[81] Blustein 2016, 357

[82] For example, the Fund's October *World Economic Outlook* challenged strict adherence to austerity, advocating for softer austerity demands on Greece. Additionally, the IMF Managing Director contended that the only way to sustain Greek debt was to lessen the debt owed to European governments and institutions. The European policymakers, not surprisingly, opposed those ideas (Blustein 2016, 349-354).

[83] Blustein 2016, 386

[84] Ibid. 388

[85] Reza Moghadam, 2015, "Halve Greek debt and keep the eurozone together," *Financial Times*, January 26.

After Greece defaulted on the IMF's loan in June 2015, the Fund continued to protect its balance sheet amid relative global financial stability. Greece's initial default of $1.5 billion was manageable, but a prolonged default could have cost the Fund as much as $26 billion.[86] High-profile debt arrear cases could also create reputational risk by undermining the Fund's credibility as a 'super-safe repository' of member states' money.[87] The Fund announced it would no longer bailout Greece, who did not meet the IMF's exceptional access criteria this time, lacking both the "institutional and political capacity" for reforms, and a "high probability" of debt sustainability.[88]

Some Greek and other European officials pressured the Fund for greater flexibility. Yanis Varoufakis, the former Greek finance minister, argued that the Fund could modify its lending rules because "they've already violated their rules twice to do so."[89] When the IMF last waived Greece's exceptional access criteria in 2010, however, there was a high risk of global contagion.

By contrast, there was little fear of contagion in 2015. According to a "confidential summary" of the July 2015 EBM leaked to the press, the lack of contagion risk influenced the board's decision.

"In 2010, the systemic waiver was applied as a restructuring of the debt in hands of the private creditors was needed to restore debt sustainability, which could have caused major contagion…. Currently, a restructuring of official debt is required and staff could think only of a few instances in which public debt restructuring could create contagion."[90]

Consistent with our theory, the variance in the Fund's lending decisions reflects shifts in contagion risks. While the Greek program had always posed risks to the Fund's balance sheet, the

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[86] Steil and Walker, 2015, "A Full Greek IMF-Debt Default Would Be Four Times All Previous Defaults Combined", *Council of Foreign Relations*, June 24.
[87] Ibid.
[88] Peter Spiegel, 2015, "Greece disqualified from new IMF bailout, board told." *Financial Times*, July 30.
[89] Ibid.
[90] Ibid.

Fund nonetheless extended loans and overlooked non-compliance amid high contagion fears. Once they dissipated, however, the Fund refused to lend unless Greece adhered to its conditionality.

Adjudicating Against the Alternatives

We contend that global contagion risks were a key causal factor, albeit not the only determinant of IMF decisions during 2010 and 2015. Other conditions, including Greece's 2012 debt restructuring, its 2015 political turnover, and discord between the IMF and European partners may have also influenced IMF lending choices. For example, powerful private financial interests had less stakes in the game after the 2012 debt restructuring transferred the majority of Greece's outstanding debt into public hands, while rising expectations of a Syriza victory slowed economic reform in the prelude to 2015 elections. Similarly, European partners' hesitancy to accept the IMF's recommended official debt restructuring could have also compelled the Fund's exit.

However, by examining the timing of IMF lending choices and credit evaluations, we observe the importance of global contagion risks in IMF decision-making. The Fund did not suspend its loan disbursements until late 2014, more than two years after Greece completed its 2012 debt restructuring suggesting it did not have a direct impact on IMF lending choices. Evaluating the content of these meeting minutes has also shown that contagion risks had been an important IMF focal point, while there was not a single mention of Syriza in any of the EBM minutes or public staff reports in 2014. Finally, the IMF had been consistently lobbying for an official debt restructuring after the 2012 private debt restructuring to protect its reputation as a crisis manager. However, it was only when European contagion fears subsided in 2014 that the IMF decided to mitigate its balance sheet exposure, and its crisis responsibility, by dissolving its lending relationship.

Conclusion

Under what conditions might the IMF, despite its ILLR role, either cut its lending or refuse financing to a troubled government? Employing the Argentine and Greece cases, we show that the IMF's willingness to lend is often conditioned by global contagion risk. Balancing global systematic risk against its reputational concerns about borrower moral hazard, the IMF tends to behave like a private investor shifting its lending position based on market volatility. For example, IMF financing ebbed and flowed in the summer of 1998 along with global market conditions, with the Fund first cancelling Argentina's program following the East Asian recovery before renewing it a mere month later in the wake of the August 1998 Russian default. In Greece from 2011-12, the Fund extended sizable loans to help alleviate market panic in the wake of the European sovereign debt crisis. With Europe's recovery, however, the IMF refused to join further bailout programs, using Greece's non-compliance as a rational for allocating its finite resources elsewhere.

To examine whether the relationship between IMF lending and global contagion holds beyond Argentina and Greece, we briefly extend the analysis to another high-profile case: Brazil. Compared to Argentina and Greece, the IMF did not enter its crisis relations in Brazil with a bailout-first approach but rather a cautious stance given the lack of global financial contagion.

Case Extension: Brazil 1993-94

After its unsuccessful completion of its 1992 IMF program, Brazil hoped to receive a new program in 1993. The IMF was financially constrained (Figure 3); however, it could focus on its own fiscal soundness, rather than its mission of global financial stability, because there was little contagion threat. Notably, the Fund's reluctance to lend to Brazil from early in its relationship also suggests alternative learning explanations do not sufficiently explain IMF lending austerity. In Brazil, the

IMF's cautious lending stance was not a product of learning from IMF program implementation, but rather its desire to avoid reputational risk in a sound global environment.

At its July 1993 EBM, major IMF stakeholders, including U.S. Director Thomas Dawson who had veto power, balked at lending to Brazil because of its non-compliance history. Similar to the Argentina and Greece cases, the IMF thus used conditionality to hedge its balance sheet risk during relative global stability. Rubens Ricupero, who was the Brazilian Minister of Finance, recalled in our interview that Brazil's negotiation failed because of the Fund's "excess orthodoxy in demanding a fiscal position that was politically not feasible." [91] Notwithstanding continuous funding requests from Brazilian authorities, the Fund approved a staff-monitored program in March 1994 without any loans.

It is noteworthy that the Fund tried to support Brazil, but only to a degree that it would not risk the Fund's own balance sheet. According to Ricupero, "there was a sort of a tacit agreement," with the Fund informally helping Brazil reach a debt agreement with commercial banks:

"Although they [the IMF] did not support our plan,…they did not try to create difficulties. This is the basic reason we were able to sign with the commercial banks because I suppose the commercial banks, at some point, asked the IMF and they must have given them the green light."[92]

The Fund's stance shows how it was safeguarding its future resources as a partial ILLR while also trying to help a crisis country. This constrained ILLR attitude, however, changed when the Mexican Peso crisis erupted in late 1994. After the Mexican peso collapsed, foreign investors not only liquidated Mexican assets, but also fled from the emerging market asset class.

Given heightened contagion risk, the Fund shifted to being an ILLR. During its June 1995 meeting, the IMF executive directors emphasized that "the underlying effects of the Mexican crisis on the Brazilian economy remain of concern." They "welcomed the increased intensity of the

[91] Authors' interview, August 2017.
[92] Ibid.

dialogue between the Fund and the Brazilian authorities,"[93] and inquired "can we do anything besides giving advice?"[94] Without a formal request from Brazil, which was mired in national elections, the IMF could not lend. Yet, if Brazil had requested IMF support, the board meeting minutes suggest that the Fund was ready to support Brazil in 1994, unlike 1993.

The Brazilian government also noted such changes in the Fund's stance. Ricupero told us that "the interplay with international financial trends was very strong – with the Mexican crisis, the Russian crisis, and the Asian crisis of 1997. All those episodes had a strong impact (on the Fund's decision to grant us a program.)"[95] Indeed, the Fund extended a program to Brazil in 1998, when contagion pressure was high following the Asian and Russian crises.

Implications

Comparative politics scholars have found that institutions often resembled "incomplete contracts" because it is "prohibitively difficult to specify all contingencies at the time of its creation."[96] Similarly, we find that the IMF is an incomplete institution because its evolving mandate as a crisis manager and sustained liquidity provider is inherently at odds with its limited resources and institutionally constraining quota system. Compared to a central bank that freely seeks to quell systemic risk, the IMF must also mitigate moral hazard risk on its balance sheet, which tempers its ability to fulfill its role as a lender-of-last-resort.

These findings also offer important insights for the IMF literature, which has found that IMF lending decisions reflect a borrower's geopolitics, domestic politics, and technocratic networks. This article complements this literature by providing a supply-side explanation for IMF lending

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[93] IMF Archives EBM 6/21/1995
[94] Ibid.
[95] Authors' interview, August 2017.
[96] Helmke and Levitsky 2004; Jones, Keleman, and Menieur 2016.

choices that examines the Fund's institutional agency, including how global volatility affects the Fund's financial soundness and reputation as a global financial guardian.

This paper also offers a unique perspective from public choice models, which have found that IMF conditionality tends to expand with its loan portfolio. Public choice models argue that this pattern reflects IMF bureaucrats exploiting the opportunity to increase their prestige and power.[97] However, our findings show the positive association between conditionality and demand for IMF programs instead reflects the staff's desire to hedge the Fund's financial risk.

This research also advances existing knowledge about IMF lending and moral hazard. Recent scholarship points to IMF politics as a source of moral hazard, with borrowers with close ties to the Fund's major shareholders more likely to pursue imprudent policies.[98] By comparison, our study suggests that moral hazard is likely to be a product of the Fund's incomplete institutional architecture as an ILLR, with conditionality more likely to be waived amid high contagion risk. The IMF's willingness to cut financial ties, when there is little contagion threat, also risks contributing to national boom-bust cycles.

Returning to our opening puzzle about the IMF's stop-and-go lending to Argentina in recent years, we now see that the IMF has become a lender of partial resort. The Fund provides Argentina with liquidity during global downturns but exits before Argentina fully recovers, leaving the country mired in a partial-reform equilibrium. In 2018, the IMF extended a $57.1 billion loan to Argentina in part to avoid volatility in similar asset classes internationally, noting that contagion was one of the chief risks for emerging market countries.[99]

[97] Vaubel 1994; Dreher and Vaubel 2004.
[98] Lipscy and Lee 2019.
[99] IMF 2018.

By 2019, however, Argentina had again decoupled from other emerging market assets, with investors questioning the Macri government's incremental approach to economic governance amid currency depreciation and rising public indebtedness. The IMF's financial backstop and flexibility helped contain short-run global volatility. However, it also intensified Argentina's moral hazard problem when Alberto Fernández's unexpectedly won a sizable primary electoral victory against Macri in summer 2019. Argentina's financial decoupling limited the IMF's willingness to provide more liquidity without further reform guarantees.

Ironically, however, the IMF's shift from prioritizing liquidity today to conditionality tomorrow undermined its mission as an ILLR, creating a bureaucratic pathology.[100] Rather than simply fulfilling a functionalist ILLR role, we show that the IMF has constrained agency based on its technocratic interests. Credit risk is inherent in the IMF's operations, posing reputational risks for the Fund both as an ILLR, and a crisis manager. When evaluating the risk of its lending portfolio, the Fund's directors and staff thus consider not only the economic and political fundamentals of sovereign borrowers, but also the broader global environment and the Fund's own financial soundness.

The current coronavirus pandemic has intensified its institutional trade-off between mitigating systematic crises and borrower moral hazard, raising the reputational stakes of toggling between prioritizing liquidity and conditionality with its lending. With the massive financing necessary to resolve developing countries' spiraling debt problems, however, might there be better alternatives to financial risk management than conditionality mechanisms? Might IMF reform be necessary to ensure a sustained ILLR commitment?

[100] Barnett and Finnemore 1999.

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Appendix. Interviews

Selection process: We chose to interview (i) senior IMF economists who had extensive experiences in negotiating and monitoring IMF loans, and (ii) government representatives who had been involved in IMF negotiation. For IMF economists, we contacted the IMF's Communication Department and asked for qualifying interviewees. We were able to talk to six IMF economists, all of whom had worked as mission chiefs in various IMF lending. For government representatives, we determined who the key international negotiators were for IMF agreements during the relevant time periods, and leverage longstanding field research networks to secure the interviews with key ministry of finance and central bank officials. These interviews qualified for an IRB exemption given that were with public officials.

Sample: We had twelve interviews in total -- a convenient sample—and each interview lasted about 30 minutes to 1 hour. Importantly, we got consistent replies to our questions, which attenuates the need for additional interviews. We personally conducted all of the interviews.

Table A1. Interviews

ID	Interviewee	Date	Mode of contact
A	Senior IMF economist	7/17/2017	In-person interview, Washington DC United States
B	Senior IMF economist	7/18/2017	In-person interview, Washington DC United States
C	Senior IMF economist	7/18/2017	In-person interview, Washington DC United States
D	Senior IMF economist	9/5/2018	In-person interview, Washington DC United States
E	Senior IMF economist	9/5/2018	In-person interview, Washington DC United States
F	Senior IMF economist	9/10/2018	In-person interview, Washington DC United States
G	Roberto Lavagna (Argentine Minister of Economy)	1/10/2017	In-person interview, Buenos Aires, Argentina
H	Martin Lousteau (Argentine Minister of Economy)	1/30/2017	In-person interview, Washington DC United States
I	Affonso Pastore (Brazilian Central Bank President)	8/1/2017	In-person interview, Sao Paulo, Brazil

J	Rubens Ricupero (Brazilian Minister of Finance)	8/9/2017	In-person interview, Sao Paulo, Brazil
K	Miguel Braun (ArgentineVice Finance Minister)	8/6/2019	In-person interview, Buenos Aires, Argentina
L	Horacio Liendo (Argentine Central Bank Director)	8/27/2019	In person interview, Buenos Aires, Argentina

Methods: Interviews were open, semi-structured, and included these sample questions:

1) (For IMF officials) What is the goal of IMF programs, and what factors do you consider when you design and evaluate a program? How much are you concerned about regional and global factors (beyond a borrowing economy) as a mission chief? When do you give waivers for unmet conditionality?

2) (For government officials) What role did the IMF play in sovereign debt negotiations? What were the key determinants of conditionality in those negotiations? To what extent did the global economic environment affect these negotiations, or even the Fund's willingness to renew credit or extend IMF programs? What degree of autonomy did you have in designing your economic, fiscal, and policy goals under IMF programs?