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

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Abstract

The political economy literature defines a lender of last resort as seeking to mitigate financial crises through ample liquidity provision. Notwithstanding its mandate of global financial stability, we develop the notion of the International Monetary Fund (IMF) as a lender of partial resort because of its institutional constraints, or its insufficient resources to fulfill this mandate. Compared to a central bank that freely seeks to quell systemic risk, the IMF must constrain the size of its balance sheet to mitigate moral hazard. Not only does this temper its ability to fulfill its role as a lender-of-last-resort, but also often compels an early exit from its lending relationships. In this paper, we examine this understudied phenomenon of IMF withdrawal, finding that IMF lending is conditioned by global contagion. Employing a comparative content analysis of IMF decision-making in two of its largest borrowers, Argentina and Greece, we show the IMF provides extensive liquidity to stabilize systemic risks during periods of high global contagion. However, when the IMF perceives minimal contagion risk, it focuses on moral hazard, and willingly cuts its lending relations to preserve its reputation and resources for future crises. These findings have important implications for international institutions in the face of public contestation and global crises.

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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 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

[1] “Wanted: Chief Firefighter” *The Economist*, June 4th, 2011.
[2] Reinhart and Rogoff 2009.
[3] Buenos Aires Times 2019.
[4] Buenos Aires Times 2020.
[5] Ibid.

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 develop the concept of the IMF as a 'lender of *partial* resort,' or a lender that offers crisis liquidity, but in limited volume due to institutional constraints. 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 its ability to fulfill its mandate.[6] The size of the Fund's balance sheet has shrunk extensively as a share of the global economy since its inception. The IMF's core institutional mission has also gravitated over time, to sustained crisis lending rather than short-term liquidity provision. We contend that this institutional evolution has created a mismatch between the IMF's mandate and its available resources today, making it more likely that the IMF exits early from its lending relationships.

As an aspiring lender-of-last-resort, the IMF must balance the tensions between systemic risks and moral hazard. In the face of a domestic financial crisis, a central bank readily acts by providing large volumes of liquidity to quell the crisis. The monetary authorities expose the national balance sheet to a moral hazard problem, or higher credit risk resulting from the most systematically important financial institutions not adjusting their financial behavior. Compared to the central bank's quandary of sustaining institutions that are "too big to fail";[7] however, we argue that the IMF instead struggles with a "too big to bail" problem. Without a sufficient volume of resources to absorb such credit risk, the Fund must strategically allocate its resources to mitigate high internal balance sheet risk. The IMF's crisis lending tends to disproportionately flow to large, systematically important economies, which tempers its ability to fulfill its role as a lender-of-last-resort and often compels an early IMF exit.

To preserve its reputation as a crisis manager and an ILLR, we expect the IMF to mitigate its balance sheet risk based on its perceptions of the global investment climate. The Fund employs conditionality, or policy targets such as budget discipline, to help deter against moral hazard (and ensure debt repayment). At times, however, we find that the IMF withdraws from a debt-ridden

[6] McDowell 2017
[7] Mishkin 2000.

country that has yet to stabilize financially to protect its balance sheet. We suspect that such swift changes in IMF lending stances often coincide with market volatility that poses a risk to 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 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 resource and reputational constraints prompt 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 important scholarly contributions. First, it engages with the extensive literature on the IMF, explaining 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. Additionally, compared to most IMF studies that employ cross-sectional statistical correlations,[8] we conduct a longitudinal study that traces the causal pathways of IMF lending behavior. Employing these methods and taking a

[8] Steinwand and Stone (2008).

cue from the "seeing like an IO" approach, we develop the IMF's institutional agency.[9] We analyze the conditions under which the IMF prioritizes its "technocratic" goals,[10] complementing an important IMF scholarship that has shown the Fund's decision-making often reflects the balance of prevailing sovereign interests.[11] We argue that IMF technocrats direct its leadership's attention to balance sheet risk, a crucial factor in preserving its reputation. Our findings also show the Fund's internal limitations to sustaining its ILLR commitments, raising important implications for the capacity of the international community to deal with financial fallout from the pandemic. Beyond the IMF literature, this study also adds insights to the literature on the popular backlash against globalization. We highlight how institutional constraints, an oft-overlooked factor in globalization studies, lead to the suboptimal performance of international organizations, which may ultimately contribute to public dissatisfaction with IOs.

The manuscript unfolds as follows. We first develop our argument by explaining the conditions under which the IMF fulfills its international financial stability mandate, and when it instead safeguards its own financial resources as a lender of partial resort. Subsequently, we provide empirical support for these priors using primary and secondary data from Argentina (1998-2001) and Greece (2010-2015). Finally, we conclude with discussion and implications.

Explaining Why the IMF Exits its Lending Relationships

Over the last three decades, a large body of scholarship has found that ideational and geopolitical factors jointly influence the IMF's loan size and conditionality.[12] Some scholars find that borrowers with geopolitical ties to the IMF's major shareholders receive favorable lending terms,[13] while others ascribe the Fund's lending choices to the disproportionate influence of neoliberal ideas in the Fund's global policymaking network.[14] Relatedly, public choice models claim that the Fund leverages crisis demand for IMF loans to increase conditionality and maximize its global policy

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[9] Broome and Seabrooke (2012).
[10] Momani 2005; Martin 2006; Kaya 2015.
[11] Stone 2004; Copelovitch 2010
[12] See Steinwand and Stone 2008.
[13] Momani 2004; Copelovitch 2010
[14] McNamara 2008; Moschella 2010; Gallagher 2014; Helleiner 2017

influence.[15] 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.[16] Borrowing governments with shared IMF ideational beliefs and professional ties are also associated with more lenient loan conditions and weaker program enforcement.[17] Relatedly, domestic politics in debtor countries affect the IMF's enforcement of conditionality and program performance.[18] Finally, the few studies investigating IMF program interruption are also centered on borrower characteristics, specifically compliance rates, veto players, and political power.[19]

Notwithstanding these important contributions, the current research pays little attention to within-country variation, particularly sequential changes in IMF lending. To fill this gap, 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.[20] Building on this seminal literature, we show the Fund safeguards its limited resources and preserves its ILLR reputation by conditioning its lending on global contagion risk.

Global Contagion, IMF Financial Risk and Lending Behavior

"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 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

[15] Dreher and Vaubel 2004; Vaubel 1994
[16] Stone 2004; Chapman et al. 2017
[17] Nelson 2014; Chwieroth 2015
[18] Caraway, Rickard and Anner 2012; Shim 2022
[19] Edwards 2009; Dreher 2003, 2006; Joyce 2006; Arpac et al. 2008
[20] Stein and and Stone (2008)

In his 2004 remarks about the role of 21st century Bretton Woods institutions, former Treasury Secretary Timothy Geithner, identified the IMF's 'lender of partial resort' problem. It has institutional agency as a lender-of-last-resort, 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. Leveraging secondary 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.[21]

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 by January 2021, equivalent to 18 percent of its total assets, or one-fifth of the IMFs quota financing-system ($702 billion). In the event of an unexpected payment shock, the Fund only held 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.

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

[21] Broome 2010

"The IMF is not a lender-of-last-resort in the traditional sense; it isn't capable of providing an unlimited amount of financing."[22]

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."[23] We contend that the IMF is prioritizing its reputation as a viable ILLR, which depends on its ability to strategically manage its financial limitations. Unlike central banks, the IMF's main financing source is its quota system, in which nations pay a financial contribution based on their relative global economic position. 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 financial risks. 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 international bailouts. 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.[24] Moreover, the Biden administration's eventual approval of an SDR enhancement occurred more than a year-and-a-half into the pandemic,

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 in developed countries often earn their authority as crisis managers by creating money to stabilize the domestic financial system. In many emerging and developing countries, however, dollar shortages leave central banks without sufficient liquidity to address balance of payment crises. The IMF willingly supplies crisis liquidity but is more constrained than a central bank in the United States, Europe, or Japan. Bounded by limited resources, 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 central banks in many

[22] Truman 2006
[23] IMF's Articles of Agreement, Article 1, section 5.
[24] Gallagher, Ocampo, and Volz 2020.

developed countries, 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.[25]

Global Contagion Risk and the IMF

What determines whether the Fund prioritizes its internal balance sheet, and opts to exit its lending relationships? We expect the IMF to condition its lending on the likelihood that national financial volatility spills into global markets. When the Fund perceives little contagion risks in global markets, it should be more likely to cease funding. Having 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."[26] When there is a financial or economic shock, international investors often aim to 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."[27]

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."[28]

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 macroeconomic stability,"[29] the IMF views such national lending as central to its fundamental mission of global financial stability.

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[25] Bagehot 1873; Fischer 1999; Mishkin 2000.
[26] Claessens and Forbes 2001.
[27] Author's interview, August, 2019.
[28] Ibid.
[29] IMF Conditionality Factsheet, March 30, 2020.

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.[30] 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? The IMF is an institution with both political and technocratic goals. A rich IMF literature has shown sovereign stakeholders are likely to prioritize crisis lending when there is high banking exposure to crisis countries in their domestic financial systems.[31] Its stakeholders may even prioritize lending because of their geopolitical calculations.[32] We complement this seminal literature, showing that the IMF also often acts technocratically to preserve its ILLR role. The Fund expands its balance sheet during global crises when cross-national banking systems are most exposed to contagion risk. Given its constrained resources, the IMF must also strategically preserve its credit to maintain its future ILLR credibility, even when its borrowers struggle with 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.

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."[33] In other words, conditionality is designed to help prevent moral hazard and increase the likelihood of borrower repayment. In another interview, a senior IMF

[30] Broome 2010.
[31] Copelovitch 2010
[32] Thacker 1999; Stone 2004
[33] Authors' interviews, July 2017; June 2019.

official emphasized "whether a country repays to the Fund is the criteria of a successful program,"[34] suggesting the idea that debtors have to repay loans is deeply embedded in the Fund's culture.[35]

In practice, we expect the Fund varies its enforcement of conditionality based on its assessment of global contagion. If borrowers do not comply with IMF 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 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).

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)

By contrast, when the Fund deems contagion unlikely, the IMF is more risk averse as an ILLR, limiting the size of its loans 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 ILLR, without fretting about fomenting financial

[34] Author's interview, July 2017.
[35] Lütz et al. 2019.

turmoil in other regions. Under these conditions, the IMF uses stringent conditionality as an exit strategy to justify reducing its 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.

Scope Conditions: Systematically Important Borrowers

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. We classify financial importance according to whether or not a country is included in JP Morgan's Developed Market Index or Emerging Market Index, which are typical indicators of having internationally integrated, sizable, and important financial markets.[36]

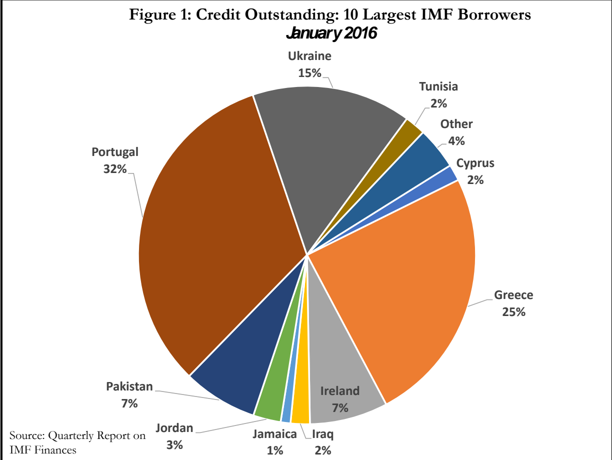


Figure 1: Credit Outstanding: 10 Largest IMF Borrowers
January 2016

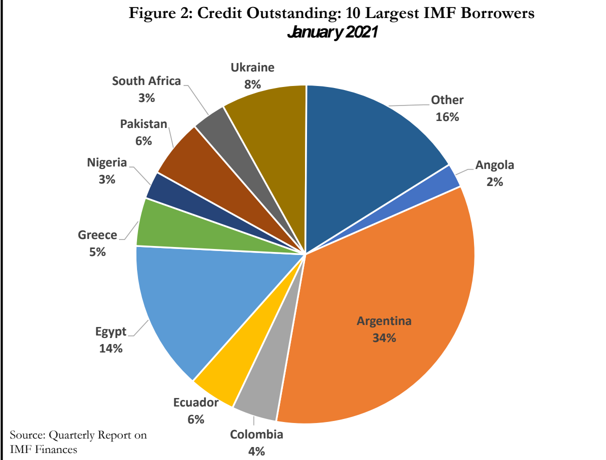


Figure 2: Credit Outstanding: 10 Largest IMF Borrowers
January 2021

Notably, the IMF's balance sheet exposure is heavily weighted toward such systematically important countries. 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. 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. In fact, over the last five years, seven of the IMF's top-ten borrowers changed national identities (see Figures 1 and 2), showing that our theory applies to many different large IMF borrowers over time.

[36] These indices include countries whose debt instruments have a minimum outstanding value of $500 million.

By comparison, 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 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.

Generalizability

IMF exit is not a rare event. Given its global financial stability mandate, the IMF's balance sheet is consistently exposed to substantial financial risk from systematically-important countries that are capable of igniting global contagion . For example, high or upper middle-income countries accounted for 240 programs, or one-third of all IMF programs approved between 1980-2015, with an average price tag of $1.6 billion (or double their IMF loan quotas). Importantly, 41 percent of these programs were either temporarily or permanently interrupted.[37] The Argentine and Greek cases, examined in this study, thus represent a common phenomenon, with about one-fifth of all IMF programs experiencing interruptions. In the appendix, we provide a plausibility probe of another high-profile case, Brazil (1993-1994), to further confirm the generalizability of our argument.

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 (1998-2001) and Greece (2010-2015). They are both middle-to-high income democracies with sizable and internationally integrated markets[38] meeting our scope conditions of financially-important countries whose instability threatened global financial stability. During their peak crisis periods, Argentina and Greece accounted for a whopping one-sixth and one-fifth share of the IMF's credit outstanding. These cases also maximize the variation in the main independent variable, global contagion risk. 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. Finally, the high-profile nature of these

[37] Author's calculation based on Reinsberg et al. 2021.
[38] Both are listed in JP Morgan's Emerging Market Bond Index.

cases have generated considerable data, including rich internal reviews (e.g. rare, IMF post-program evaluations), that are critical to testing our argument about IMF decision making.

Key Measures: IMF Financial Risk and Global Contagion Risk

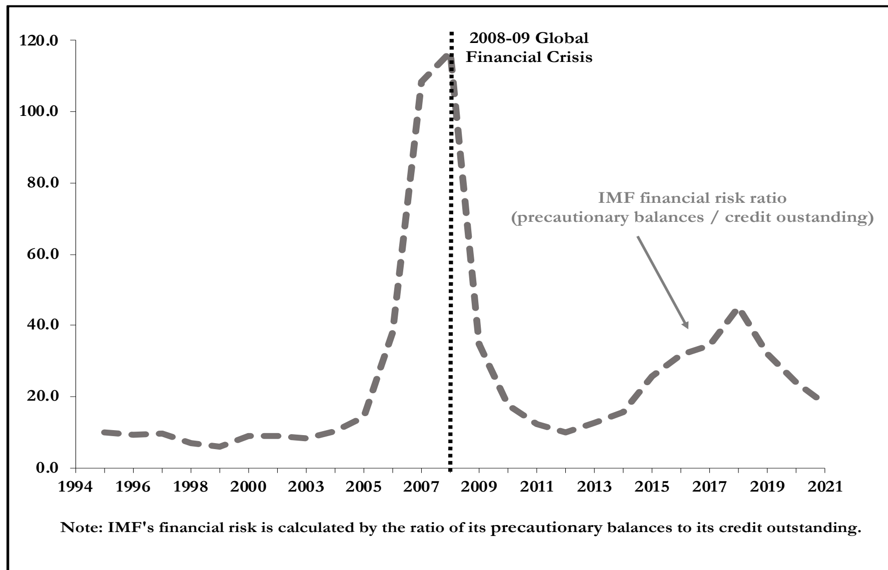
To measure the Fund's *financial risk*, we employ the ratio of the IMF's precautionary balances to its total credit outstanding; the same ratio the Fund uses in its annual risk management report. A burgeoning literature shares our intuition about the IMF's budget constraint, finding that barriers to receiving a program are higher in low IMF liquidity years.[39] 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 low financial risk in the mid-2000s (see improved financial risk ratios in Figure 3), this period falls out of the scope of our comparative analysis.

To gauge the IMF's perceptions of global contagion risk, we employ several measures.[40] 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 interview details), and secondary archival evidence to gauge the Fund's contagion assessments. Finally, we also examine descriptive market statistics about credit risk, given that the IMF monitors emerging market asset movements to help assess the extent of financial contagion.

We then use process tracing within each case study[41] to examine the internal determinants of IMF lending decisions. Formally, these policy choices are discussed during IMF Executive Board meetings (EBMs). Informally, 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.

[39] Lang 2021; Stubbs et al. 2020.
[40] We examine IMF's *perception* of contagion risk, which we expect is highly correlated with actual risk.
[41] Gerring 2007; Bennett 2008.

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



Note: IMF's financial risk is calculated by the ratio of its precautionary balances to its credit outstanding.

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 its 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, and September 2001.[42] In each meeting, IMF executive directors and relevant staff (e.g. the mission chief and functional department representatives) exchange their views about the program.

Employing a text-as-data approach,[43] 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 implementation (Table 3).[44] 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.

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

[42] We chose these texts primarily because of their availability, but they provide annual coverage, allowing us to plot IMF's stances over time.

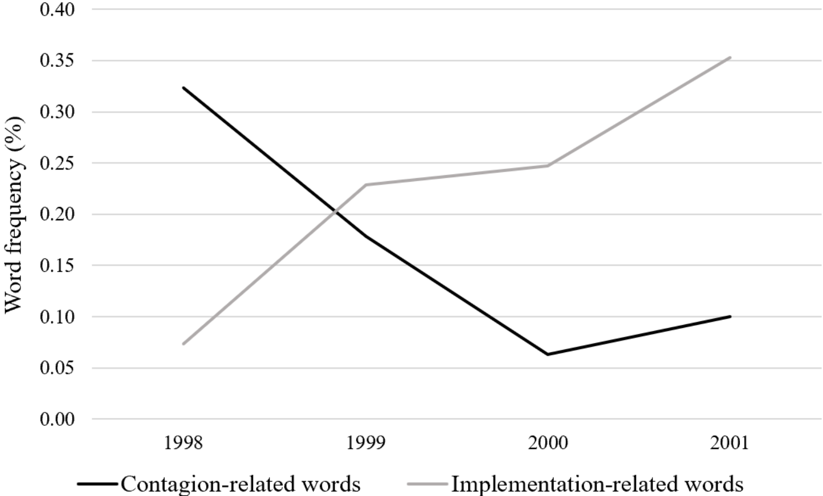
[43] Grimmer and Steward 2013.

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

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 frequency spikes for words "implementation" and "credibility."

Given the heterogeneous minute lengths within these EB proceedings, we also measure the proportion of relevant words to the total vocabularies per minute. The results (Figure 4) show that IMF directors used words related to contagion risk less frequently over time, while they paid increasing attention to the program's implementation and credibility. In the next section, we complement these findings with secondary archival evidence examining the determinants of the IMF's decisions regarding Argentina.

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

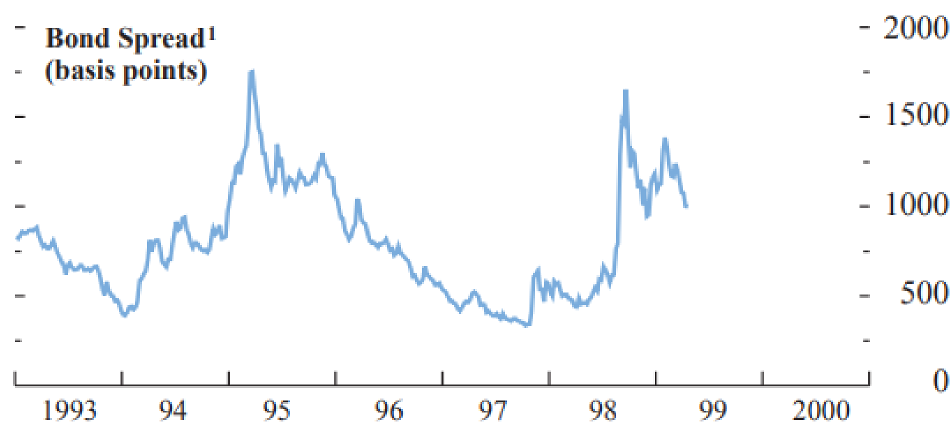


Early 1998: Low Contagion Risk and IMF Program Suspension

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."[45] Emerging market risk 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), which was the culmination of negotiations that had begun during the 1997 East Asian crisis to help contain Argentina's financial risk. President Carlos Menem had a strong political incentive to maintain the IMF's financial backing. Without IMF insurance, Argentina would be subject to capital withdrawal and potential dollar shortages that could break convertibility. Not only was Argentina dubbed the IMF's 'poster child' under Menem, but his political success reflected the viability of the convertibility system, which pegged the peso to the U.S. dollar. According to Menem, convertibility had 'pulverized inflation' in the early 1990s.[46]

[45] IMF 1998

[46] Kaplan 2013.

Despite growing concerns about Argentina's rising unemployment, only one-tenth of the population supported a debt default that was expected to follow the end of convertibility.[47]

As global volatility subsided, however, our theory suggests that the IMF should become less risk-tolerant, shifting to a more stringent loan enforcement stance. Internally, many IMF departments (including Research, Review, Policy Development, and Fiscal Affairs) were skeptical about the program's feasibility.[48] Only the Western Hemisphere department believed "on balance, the risks [were] still acceptable."[49]

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 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, especially when an election was approaching in a year.[50]

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 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."[51]

In summary, by strictly enforcing conditionality during low financial contagion, the Fund maintained a politically-feasible exit strategy. When global financial conditions improved, the Fund could demand full compliance, and cloak its loan withdrawal in 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 during the 2001 crisis.

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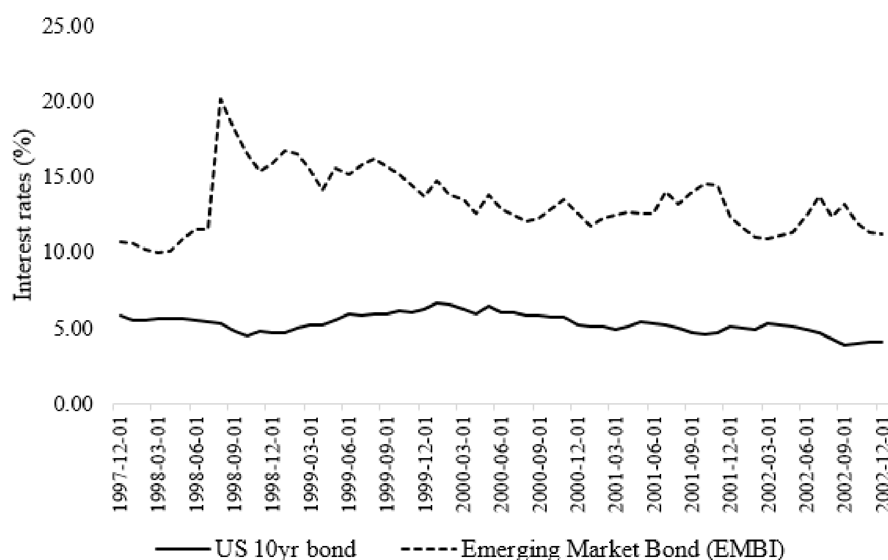
[47] Tomz 2001.
[48] Internal memo to top IMF management, April 28, 1997.
[49] IMF 2004, 37.
[50] By 1998, Menem faced a 26 percent approval rating, and 15 percent unemployment.
[51] IMF 2004.

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. Emerging market bond spread yields 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 holdings into developed country assets, and continued to demand higher risk premiums for emerging market assets into the early 2000s.

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



Given the heightened global risk, our theoretical framework anticipates the IMF shifts to 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.

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."[52]

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]."[53]

Notably, a few IMF directors, representing middle- or low-income countries that had less crisis exposure (e.g., Middle East, Eastern Europe, and Central Asia), were cautious about the program, saying that the staff report is "too sanguine".[54] Despite such concerns, representatives from high income countries and emerging economies that had high crisis exposure (e.g. U.S., Mexico, and India) outnumbered these voting blocks,[55] 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.[56] Later, IMF Deputy Managing Director, Murilo Portugal, highlighted the linkages between global contagion and Argentina's IMF program:

"In certain circumstances, authorities' best efforts … 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."[57]

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

[52] Paul Mason, Research Department's senior advisor. Cited in Blustein (2003). Mason also expresses concern for the credibility costs of weakening conditionality, but is willing to extend funds due to global contagion.
[53] IMF Archives EBM 98/103.
[54] 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.
[55] 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.
[56] IMF Archives EBM 98/103.
[57] IMF Archives EBM 99/56.

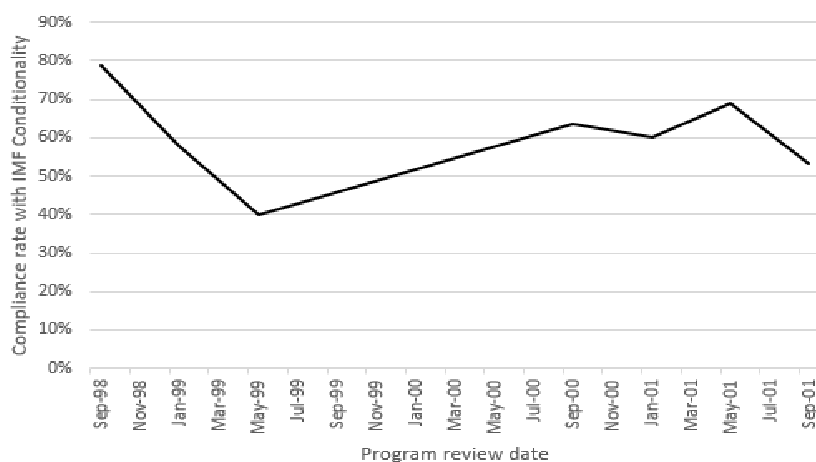
increasing financial risk (Table 4). Notably, the IMF is more willing to excuse Argentina's non-compliance in 1999 than during June 1998 (Figure 7).[58] For example, the final program review in May 1999 showed that Argentina had only met five out of twenty-four of IMF lending conditions.

Table 4. Number of Conditionalities in Argentina IMF Programs

	1998	1999	2000	2001
Total 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[59]



These patterns continued in 2000 and the first-half of 2001, a period characterized by heightened emerging market credit risk. Despite the 1999 election of Argentine President Fernando de la Rua, his evaporating popularity had quickly stalled any reform progress (see Figure 7). However, the Fund overlooked Argentina's non-compliance because it fretted about the potential

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

spillover effects of a default.[60] The Fund made a series of large and risky loans, amounting to $17 billion (or more than 5% of Argentina's GDP).

Importantly, the Fund stated that these disbursements "allow(ed) the government to purchase the undrawn amount under the SBA immediately, regardless of the review status."[61] 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 its concerns about the reputational risk of disregarding contagion. 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.), saying,

"The program remains fraught with risks.... the Fund should therefore, in its public statement, be circumspect in reference to the risks."[62]

Others, including Jean-Claude Milleron (France), showed similar cautious stances.

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

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

2000-2001.[65] The IEO also found that the program imposed tremendous financial risks for the IMF. 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."[66] 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 2001 summer, emerging market sentiment increasingly expected Argentina's default risk to be contained financially. While the Fund had allowed Argentina to access $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."[67] In October 2001, the Fund noted that the "the potential for future contagion is less than it was in the past."[68]

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."[69]

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 Table 3 and Figure 4), the IMF began to shift its position. With little hope of successful reform after President de la Rua's party lost Argentina's legislative elections, the IMF became a more stringent lender. In November,

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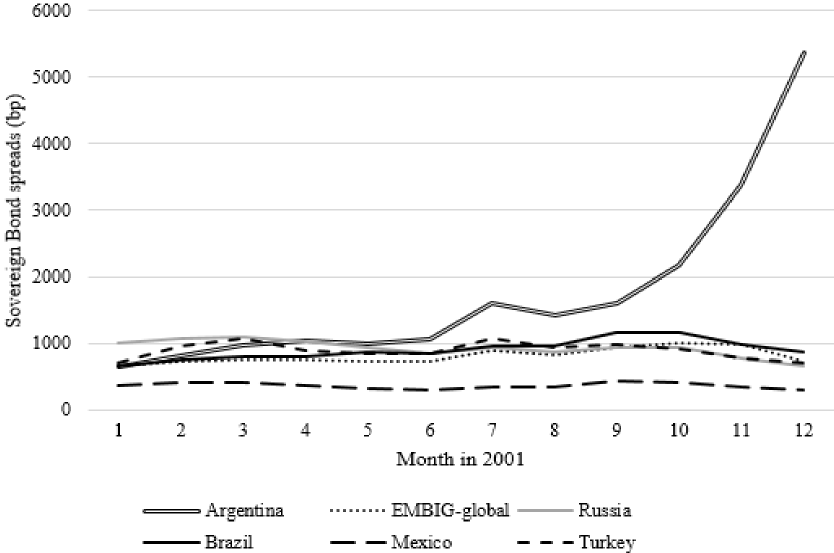
[65] IMF 2004, 47
[66] Ibid. 49.
[67] Ibid. 52.
[68] IMF 2001.
[69] Yoon Cho. "Outlook for Emerging Market Debt" *The Street*. Dec 12, 2001.

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.

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 Argentine path. 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 Argentine mission.

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.[70] By 1998, the IMF had sufficient information to have learned about Argentina's implementation struggles. However, for over three years, the IMF *chose* to disregard non-compliance because the Fund feared its withdrawal could intensify global turmoil.

Similarly, in evaluating the Brazilian case (see the appendix), we find little utility in a learning explanation of the IMF's crisis relations. Rather than entering with a bailout-first approach, the IMF was circumspect about lending to Brazil initially, given the lack of global financial contagion. However, consistent with our argument, we find that the IMF changed its stance when the Mexican Peso crisis erupted in late 1994, endangering global financial stability.

Finally, might domestic politics instead account for IMF lending decisions? Certainly, domestic politics plays an important role in IMF relations. For example, in July 1998, the Menem government disregarded IMF warnings, threatening to cancel its program without greater reform progress, because of upcoming elections. However, the IMF resumed its lending following the Russian crisis, despite little change in Argentina's reform prospects, showing the limitations of domestic explanations. Similarly, between 1999 and 2001, the de la Rua administration had a constant need for IMF financing, but the IMF shifted its lending position based on global contagion.

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

[70] IMF (2004) 9.

programs, the Fund lent to Argentina whenever its default posed a 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 after global 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, underscoring its constraints as a lender of partial resort. 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 borrowed funds to lend during 2010-2014.[71]

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).

[71] IMF 2018.

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

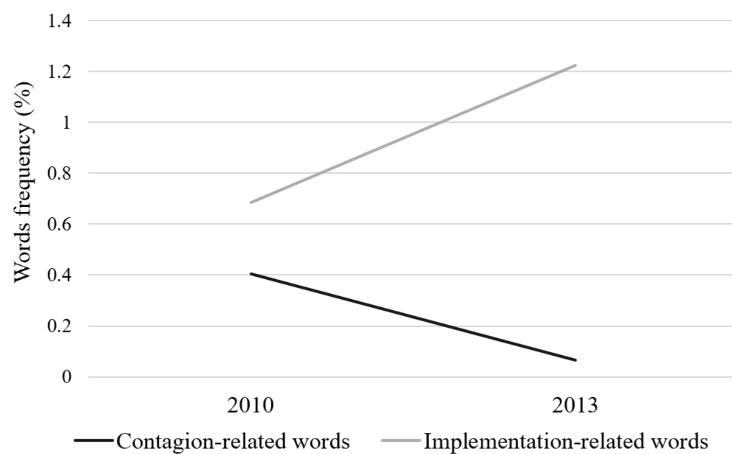
	2010	2011	2012	2013	2014	2015
IMF financial risk	← HIGH →					
Global contagion risk	← HIGH →			← LOW →		
Key market events	Eurozone Crisis		Europe's Recovery	Ireland, Spain, Portugal's 'exit' from bailout programs		
IMF decisions regarding Greece	Loan approval & continued lending			Delayed Reviews		Refused to bailout

To examine the IMF's varying concerns about 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'. 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

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 Partial Resort

In response to Greece's May 2010 bailout request, the IMF, the European Union (EU), and the European Central Bank (ECB), announced a €110 billion loan linked to extensive reforms. For the IMF, its €30 billion commitment was highly risky because of both Greece's questionable debt sustainability and its eroding government support amid 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.[72] 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."[73] In light of the 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."[74]

As Southern European contagion risk materialized following the Greek crisis, the Fund revised its "exceptional access criteria" which had mandated a "high probability" of debt sustainability as

[72] Paulo Nogueira Batista (Brazil) fretted about "the credit risk for the Fund." IMF Archives EBM 10/45-1
[73] Ibid. These included directors from India, Singapore, Philippines, Japan and Switzerland.
[74] Ibid.

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*."[75] 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 approving its Ireland and Portugal arrangements, the IMF had thus emphasized that "systemic concerns inevitably were paramount"[76]

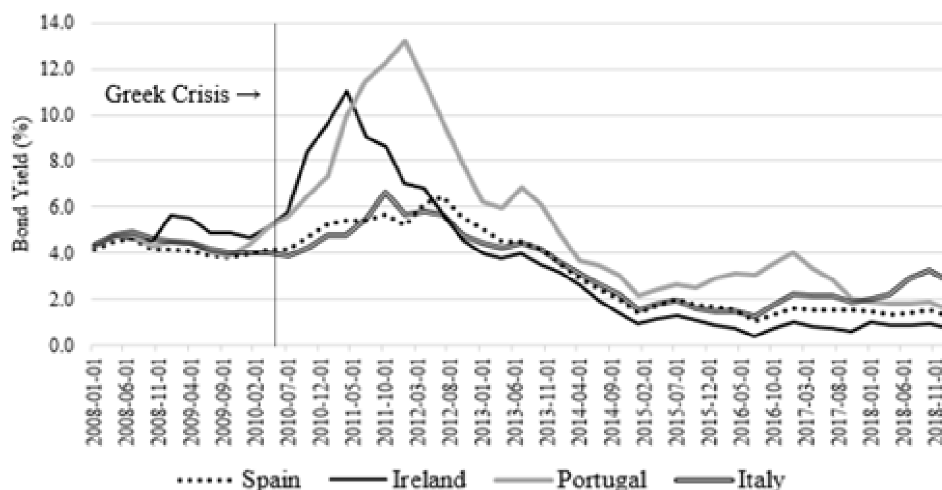
In line with our argument, the Fund, therefore, prioritized global stability over mitigating its internal financial exposure and enforcing its conditionality. The IMF granted waivers for all of Greece's unmet conditionality from 2011-2012, even after initially requiring more conditionality (to hedge its risk) than other IMF programs (see Table 7).[77] 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 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. Kentikelenis *et al*. (2016).

Figure 10. 10-year Government Bond Yields. 2008-2018.



[75] Ibid.
[76] IMF 2016. P.57
[77] In 2011, the Greek authorities missed several reform targets, but received IMF waivers.

2014- 2015: The IMF as a Greek Banker

With Europe's recovery between 2013-2015, the Fund increasingly enforced Greece's policy conditions. The restructuring and near-elimination of Greek debt held by private investors in spring 2012 substantially alleviated fears about contagion. Investor confidence further improved in July 2012 when ECB President Mario Draghi declared that "the ECB is ready to do *whatever it takes* to preserve the Euro."[78] 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), in the prelude to 'graduating' their bailout programs in spring 2014. Recall that the IMF was cognizant of these dissipating contagion pressures (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 risks on its biggest-ever loan" and "the Fund must take extraordinary action to protect its interests."[79] Given 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.[80]

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, a lender of partial resort, with an 'exit' option from Greece's program.

By mid-2014, Antonis Samaras government, facing a political challenge from the extreme left Syriza party, had hoped to 'graduate' its IMF-EU program to boost its political popularity. 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 its final €7.2 billion installment.

[78] Wilson, Wigglesworth and Groom. 2012. "ECB 'ready to do whatever it takes,'" *Financial Times*, [Italics ours].
[79] Blustein 2016, 357
[80] The Fund's October *World Economic Outlook* challenged strict adherence to austerity, and the IMF Managing Director contended that the only way to sustain Greek debt was to lessen the debt owed to European governments. (Blustein 2016, 349-354).

During the November 2014 negotiations, the Fund was "the most immovable among the creditor institutions [ECB and EU]."[81] European policymakers wanted the IMF to continue its Greek lending to help with burden sharing. However, the Fund did not allow program adjustments, instead delaying the review by extending the program into 2015, *without* any disbursements.

After the new Syriza government defaulted on the IMF's loan in June 2015, the Fund continued to protect its balance sheet amid relative global 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.[82] 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.[83] 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.[84]

However, a "confidential summary" of the July 2015 EBM leaked to the press suggested it was the lack of contagion risk that 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."[85]

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 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 conditionality.

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[81] Blustein 2016, 386
[82] Steil and Walker, 2015, "A Full Greek IMF-Debt Default Would Be Four Times All Previous Defaults Combined", *Council of Foreign Relations*, June 24.
[83] Ibid.
[84] Peter Spiegel, 2015, "Greece disqualified from new IMF bailout, board told." *Financial Times*, July 30.
[85] Ibid.

Adjudicating Against the Alternatives

We contend that global contagion risks were a key causal factor, albeit not the only determinant of IMF decisions. Other conditions, including Greece's 2012 debt restructuring, its 2015 political turnover, and discord between the IMF and Europe may have also influenced IMF lending choices. For example, powerful private financial interests had less exposure 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, Europe's 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, 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 2014 EBM minutes or public staff reports. Finally, after the 2012 private debt restructuring, the IMF had been consistently lobbying for an official 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 ties.

Our findings show the IMF's role as a lender of partial resort, balancing its financial stability mandate against its own financial and reputational exposure by strategically shifting its lending stances based on global contagion. We also find that domestic and geo-politics affects IMF relations, with some sovereign shareholders supporting IMF liquidity extensions when they have high cross-border domestic banking sector exposure. Importantly, however, such internal politicking tends to wane as global contagion subsides. We also find that shareholders without such sovereign exposure have often successfully advocated for IMF lending to meet the Fund's financial stability mandate.

Conclusion

Under what conditions might the IMF, despite its ILLR role, either cut its lending 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. Ironically, this lending 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.

These findings have important implications for several literatures in international relations. By examining the Fund's institutional agency, these findings complement the IMF literature, which has found that IMF lending decisions reflect a borrower's geopolitics, domestic politics, and technocratic networks. While most of this scholarship focuses on the Fund's initial lending, this paper takes a longitudinal approach, helping better explain when and why the Fund exits its lending relationships. We show that global contagion risk affects the Fund's soundness and reputation as a financial guardian, and thus its lending choices. Additionally, compared to public choice models, which attribute the IMF's expanding conditionality and loan portfolio to bureaucratic power,[86] we instead find this pattern reflects the staff's desire to hedge IMF financial risk. This research also advances existing knowledge about IMF lending and moral hazard. Recent scholarship points to the influence of the IMF's major shareholders as a source of moral hazard.[87] By comparison, our study suggests that moral hazard is likely to be a product of the Fund's institutional agency.

[86] Vaubel 1994; Dreher and Vaubel 2004.
[87] Lipscy and Lee 2019.

Beyond the IMF literature, our findings also have implications for studies evaluating the recent popular backlash against globalization and the limits of international organizations. While existing studies identify domestic politics and economics as the sources of widespread popular discontent toward globalization,[88] our results suggest that international organizations could have long fomented hostile perceptions about international cooperation among the mass public. For example, the IMF's frequent shift in its lending positions, limited capacity to quell crises, and preference for "early" exit, may have impaired its public legitimacy in borrowing countries. These institutional deficiencies may have contributed to rising public dissatisfaction with IOs.

Importantly, institutional inefficiencies that lead to suboptimal performance are also present in other IOs, albeit in different forms.[89] For instance, Jones, Keleman, and Meunier (2015) argue that the EU has an incomplete governance architecture from its inception that has contributed to perceptions of perpetual EU crises. Similarly, Gallagher and Kozul-Wright (2021) demonstrates the limits of Bretton Woods institutions for cooperative global governance. We add further insights to this growing body of scholarship, showing the institutional incompatibility between the IMF's financial stability mission and its limited governance resources as a lender of partial resort.

The current coronavirus pandemic has intensified the limits of international organizations, testing the viability of the liberal international order. The IMF has experienced a heightened 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?

[88] Broz, Frieden, and Weymouth 2021; Walter 2021.
[89] Barnett and Finnemore 1999.

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