

Global Contagion Risk and IMF Credit Cycles: Emergency Exits and Revolving Doors

Abstract

Why does the International Monetary Fund (IMF) exit its lending relationships before member states have resolved their financial crises? It is particularly surprising given that the IMF often resumes its lending shortly after its withdrawal. We argue that IMF withdrawals are conditioned by global contagion risk. The tension between the IMF's mandate of global financial stability and its limited financial resources compels the IMF's early exit from its lending relationships. During periods of high global contagion, the IMF prioritizes its mandate by continuing its lending despite noncompliance. However, when the IMF perceives minimal contagion risk, it focuses on moral hazard, and willingly cuts its lending ties to preserve its reputation and resources for future crises. Employing a comparative analysis of IMF decision-making in two of its largest borrowers, Argentina and Greece, we find supportive evidence for our claims.

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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)

For national economies, central banks fulfill the role of lender-of-last-resort, a function that the International Monetary Fund (IMF) assumes globally as the international-lender-of-last-resort (ILLR). In contrast to central banks’ often sustained liquidity commitments during crises, however, we observe that the IMF often repeatedly shifts its lending behavior. For example, during the 2008 Global Financial Crisis, the Fund varied its lending behavior toward Ukraine and Pakistan, two of the IMF’s largest borrowers, which accounted for more than one-fifth of the Fund’s overall credit outstanding. Within one year, the IMF approved a new \$16.4 billion Ukrainian program in August 2008 before later suspending its loans for non-compliance in the fall of 2009. Ironically, during the next year, the IMF had restarted its lending despite Ukraine’s lack of reform progress, approving a new \$15.5 billion loan in July 2010 following the Greek crisis. The IMF’s lending stance to Pakistan shows a similar pattern, with the IMF approving a \$7.6 billion loan in November 2008, before suspending financing prior to the program’s end. These early exits are not unique to the 2008 Global Financial Crisis, with Pakistan needing an IMF program 13 times in 30 years.

What accounts for these sequential changes in the IMF’s lending behavior toward the same borrower? Even IMF officials have noticed this puzzling behavior. For example, when discussing the IMF’s newly approved loan to Ukraine in 2010, an Austrian executive director inquired about “the attitude of the Fund,” asking why the “program was interrupted in the fall,”

only to create “the surprise: the Fund offers a new program and everything is forgiven...why does this change come about?”¹

In this paper, we explain the sequential within-country changes in the IMF’s lending behavior by focusing on the IMF’s institutional constraints and global contagion risk. As with other lenders-of-last-resort such as national central banks, the IMF aims to offset systemic risk. Compared to central banks, however, the IMF’s limited resources and reputational concerns constrain its ability to fulfill its mandate (Fischer 1999; McDowell 2017).² The size of the Fund’s balance sheet has shrunk extensively as a share of the global economy since its inception.³ This institutional evolution has increased tension between the IMF’s mandate of global financial stability and the need to safeguard its limited resources. We argue that the IMF shifts its lending decisions based on its perception of contagion risk in global financial markets. During periods of high financial contagion, we expect the IMF to target global financial stability as an ILLR and prioritize liquidity provision over compliance, and even its own financial health. However, when the IMF perceives minimal global contagion risk – and thus little threat to its core mission of global financial stability – we argue that the Fund’s resource and reputational constraints prompt it to focus on moral hazard. We expect the Fund to strictly enforce its conditionality and willingly cut its lending ties, employing policy noncompliance as a rationale for ceasing its programs.

¹ IMF’s EBM minutes 10/78-4.

² For example, during the IMF’s 60th anniversary, U.S. officials recognized these institutional challenges as a key global governance concern in the wake of the emerging market crises of the late 1990s. See 2004 [speech](#) to the Bretton Woods Committee by New York Federal Reserve Bank President Timothy Geithner.

³ The IMF’s balance sheet as a share of the global economy has contracted by about one-half over the last sixty years, accounting for a mere 0.5 percent of world GDP (US\$) today (Calculated from the 1960 and 2022 IMF annual reports, and the 2023 CEIC database). For a broad overview of IMF resources over time, see McDowell (2017).

Testing the theoretical priors about the IMF's perceptions of global contagion risks requires close examinations of its technocratic choices and policy context. To demonstrate the importance of global contagion in determining IMF exit, we distinguish the IMF's intentional early exits from other program interruptions (e.g. borrower-driven withdrawals). Qualitative tools, including contextualization and process tracing, are key to demonstrating this logic of IMF intentionality. We thus employ a comparative case study analysis of IMF decision-making in two of its largest borrowers over time: Argentina (1998-2001) and Greece (2010-2015). We view the IMF's institutional choices as an aggregation of two primary actors: the IMF's Executive Board directors and technical staff. Accordingly, we evaluate evidence from both actors through a content analysis of its policy discussions, using Executive Board Meeting minutes, and an examination of the Fund staff'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 the IMF's informal channels of policymaking.

The analyses provide robust evidence in support of our claims. In both countries, we find that the IMF is more likely to suspend programs when global contagion risk is dissipated, using a lack of conditionality compliance as a rationale for exit. Conversely, the IMF tends to overlook a borrower country's noncompliance and continue financing when global contagion risk is high. We adjudicate our findings against a series of alternative explanations, including the effect of domestic politics, geopolitical dynamics, and bureaucratic incentives on IMF lending. We view these factors as complementary explanations for the IMF's general lending behavior, but show they are not sufficient for understanding why the IMF exits its lending relationships.

This article makes several important scholarly contributions. First, it engages with an extensive IMF scholarship and explains why the IMF exits and renews 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. Our findings also help address an outstanding puzzle from the IMF compliance literature by clarifying the conditions under which the Fund resumes its lending to noncompliant borrowers. We identify the importance of global contagion risk, and its relevance to the IMF's mandate, as an understudied factor in the literature. Additionally, compared to most IMF studies that employ cross-sectional statistical correlations, we conduct a longitudinal study that traces the causal pathways of IMF lending behavior through textual analysis of IMF documents. We analyze the conditions under which the IMF prioritizes its technocratic goals, complementing an important IMF scholarship that has shown the Fund's decision-making often reflects the balance of prevailing sovereign interests. Our findings 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 adds insights to the study of international organizations by highlighting how institutional constraints, an often-overlooked factor in globalization studies, lead to suboptimal performance.

Explaining IMF withdrawals

Throughout its programs, the IMF has ample chance to cut lending with sovereign borrowers. Every three months, the IMF is required to complete a program review before disbursing a new loan "tranche." To successfully secure the total amount of an approved IMF loan, a borrowing government must either meet all the required conditions or secure waivers for unmet conditions, otherwise the program automatically stops. The IMF's Articles of Agreement explicitly notes that "*whenever* the Fund is of the opinion that any member is using the general resources of the

Fund in a manner contrary to the purposes of the Fund..., the Fund may limit the use of its general resources by the member.”⁴

We define IMF withdrawals, or early exits, as Fund-driven program suspensions before sovereign borrowers resolve their financial crises. Counterfactually, a financially unconstrained Fund would behave similarly to national central banks that oversee ‘normal exits’ by injecting liquidity until resolving crises. For instance, the IMF withdrew from Greece in 2014 despite the ongoing crisis, creating an early exit. In contrast, the European Central Bank (ECB) – an unconstrained lender of last resort – financed Greece notwithstanding its non-compliance until its 2018 recovery. Notably, however, noncompliance is not a sufficient condition for early exits because the IMF may nonetheless grant program waivers to countries. Early exits require a deliberate IMF withdrawal decision, differentiating them from other borrower-driven interruptions.

Initially, we use the quantitative measure of program interruptions to help identify the domain of IMF early exits, given that they are a subset of interruptions. Through our qualitative analysis, we use process tracing to contextualize and operationalize IMF’s withdrawals, and find they are not a rare event. Dreher (2003) classifies 70% of non-concessional IMF programs during 1969-1998 as interrupted. Extending this analysis, we find that 41 percent of IMF programs to high or upper middle-income countries (which account for the majority of the IMF’s outstanding credit) were either temporarily or permanently interrupted between 1980-2015.⁵ Interruptions can result from other factors beyond IMF withdrawals, including onerous policy conditions and structural reforms (Reinsberg et. al. 2022a; 2022b), or a borrowing government’s

⁴ See <https://www.imf.org/external/pubs/ft/aa/pdf/aa.pdf>. Italics ours.

⁵ Author’s calculation, Reinsberg 2022a.

program cancellation (Bird 2008). However, the IMF's intentional withdrawals account for a substantial portion of interruptions. For instance, in 1983, the IMF suspended all new negotiations in the wake of its cash shortages.⁶ More recently, the IMF exited from Argentina in 2001, Greece in 2015, Mozambique in 2016, and Pakistan in 2020 before the countries resolved their crises. The IMF is not reticent about such exits; recently threatening to cut Ukraine's loans in 2016 due to corruption concerns.⁷

Despite a large body of scholarship on IMF lending behavior, the IMF's exit (and credit renewals) has garnered little attention. Over the last three decades, scholars have found that ideational and geopolitical factors jointly influence the IMF's formal structure (Kaya 2015), including its loan size and conditionality. Some argue that borrowers with geopolitical ties to the IMF's major shareholders receive favorable lending terms (Stone 2004; Momani 2004; Copelovitch 2010), while others ascribe the Fund's lending choices to the disproportionate influence of neoliberal ideas in the Fund's global policymaking network (McNamara 2008; Moschella 2010; Gallagher 2014; Helleiner 2017). Relatedly, public choice models claim that the Fund leverages crisis demand for IMF loans to increase conditionality and maximize its global policy influence (Dreher and Vaubel 2004; Vaubel 1994).⁸ However, these studies focus on the initial terms of IMF agreements, which provides little explanation for the IMF's changing attitude toward a borrowing government over a program's life cycle.

Understanding the IMF's exits (and renewals) requires examining how the IMF approaches its conditionality enforcement. If the IMF demanded complete compliance for all program

⁶ Rowen 1983

⁷ Elliott and Wintour 2016

⁸ See Steinwand and Stone (2008) for a literature overview.

reviews, then the IMF's exits and renewals should be fully explained by cycles of noncompliance and compliance. However, studies have shown that the IMF varies the strictness of its conditionality. For example, borrowers that are geopolitically important to the IMF's major shareholders, particularly the U.S., are subject to less rigorous conditionality (Stone 2004; Chapman et al. 2017; Ray et al. 2022). By extension, countries that are geopolitically important to the U.S., Germany, and France should be less susceptible to IMF exits because those creditors are unlikely to withdraw bilaterally during contagion (Schneider and Tobin 2020). Other studies find that borrowing governments with shared IMF ideational beliefs and professional ties are associated with more lenient loan conditions and weaker program enforcement (Nelson 2014; Chwieroth 2015). Relatedly, domestic politics in debtor countries (Caraway et al. 2012; Shim 2022) and state level diplomatic agency (Cooper and Momani 2005) also affect the IMF's conditionality and program performance. Finally, studies investigating IMF program interruptions are centered on borrower characteristics, specifically compliance rates, geopolitical relations, veto players, and political power (Dreher 2003, 2006; Stone 2004; Joyce 2006; Arpac et al. 2008; Edwards 2009). Notwithstanding these important contributions, existing studies pay little attention to within-country variation, particularly sequential changes in IMF lending. For example, scholarship focusing on a borrowing country's characteristics, such as U.S. geopolitical importance, cannot explain why the IMF continued financing Argentina in the 1990s but suddenly withdrew its support in 2001, or why the IMF was reluctant to lend to Brazil in 1993 before offering a bailout in late 1994-95.⁹

Reinsberg et al. (2022a) and Roos (2019) are noteworthy exceptions that examine the IMF's longitudinal interaction within a country. Reinsberg et al. find that structural conditionality raises

⁹ For further details, see the Appendix.

IMF dependency by increasing the likelihood of noncompliance and program interruption, which undermines investor confidence. Similarly, Roos argues that financial institutions in core countries pressure official lenders, including the IMF, to provide more loans when global contagion risk is higher. By comparison, we examine the IMF's institutional constraints and mandate, finding that its enforcement of conditionality reflects the extent of global contagion.

IMF Financial Risk, Global Contagion, and IMF Lending Behavior

“The Fund, from its inception, was burdened by a mismatch between its aspirations..., authority and instruments...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

In his 2004 remarks about the role of 21st century Bretton Woods institutions, former Treasury Secretary Timothy Geithner, identified the IMF's key institutional dilemma. It has institutional agency as a lender-of-last-resort, given its mission to promote global financial stability. However, its limited resources (relative to the size of crises) make it difficult to meet these objectives without jeopardizing its reputational authority. For example, following the 2020 global pandemic, the Fund's credit outstanding nearly doubled by January 2021, equivalent to one-fifth of the IMF's quota financing-system (\$702 billion). As insurance against unexpected payment shock, the Fund only holds \$24.5 billion in precautionary reserves. With estimates of the pandemic's fallout reaching \$2-\$3 trillion, resource strains are endemic to the IMF.

Importantly, the Fund has financial capacity to draw from an array of secondary lines of bilateral, multilateral, and private credit totaling \$540 billion. However, the IMF is not necessarily willing to leverage secondary lines of credit to address its own balance-of-payment problems because such actions could undermine its authority as a credible policy advisor for member

countries with similar difficulties. At the same time, it is difficult to expand the IMF's resource pool. The IMF's main financing source is its quota system, in which 190 member states pay a financial contribution based on their relative global economic position. Enlarging a state's quota is politically challenging. Domestically, member governments must respond to thrifty domestic citizens who are often reluctant to contribute to international bailouts. Internationally, states are not willing to support a quota hike from other states because it increases the voting power of potential rivals within the IMF. Despite the growing size of emerging economies, especially China, the IMF has struggled to raise its quota beyond 2011's incremental shareholder reforms. Rising powers have also confronted a range of challenges to increasing their IMF voting shares, including U.S. resistance¹⁰ and a lack of alternative institutions.¹¹

Given the stickiness of its quota system, the IMF must strategically manage its own financial limitations to preserve its reputation as a viable ILLR. Indeed, the IMF's Articles of Agreement specify that the Fund should have "adequate safeguards" on its lending to account for internal financial risk.¹² For example, the IMF recently created a new department – the Office of Risk Management, tasked with managing the IMF's financial and reputational risks – whose director has extensive experiences in enterprise risk management. The IMF thus faces an inherent tension between its mandate of mitigating systemic risk and preserving its ILLR resources and reputation.

Global Contagion Risk and the IMF

We argue that such tensions prompt the IMF to condition its lending on global contagion, which is commonly defined as a "significant increase in cross-market linkages after a shock"

¹⁰ Kaya 2015

¹¹ Lipsey 2015

¹² IMF's Articles of Agreement, Article 1, section 5.

(Claessens and Forbes 2001). In this study, global contagion reflects any systemic risk that could potentially threaten global financial stability. Ranging from regional economic and political instability (i.e., major defaults or wars) to high global uncertainty (i.e., Covid pandemic), shocks can upset international markets. Importantly, risks do not have to be regionally confined as investors use a range of heuristics beyond geography, including economy size and shared international organization membership (Brooks et al. 2015; Gray 2013). When confronting a shock, international investors aim to protect their profitability by selling other high-risk assets with similar asset class characteristics in their investment portfolios (Brooks et al. 2015; Park and Shim 2023). For example, Argentine central bank director, Horacio Liendo, claimed that Argentina’s 2018 financial turbulence was a reflection of broader emerging market asset sales.

“It wasn’t related to Argentina specifically, you cannot understand the sudden stop if you see the Argentine numbers.... It was related to the whole emerging markets.”¹³

Former Vice Finance Minister Miguel Braun put it more succinctly, “anytime there is uncertainty, there is flight to quality,”¹⁴ meaning that uncertainty stemming from a single country can shun away investors from other similar countries. Whether a borrowing country is an origin of, or susceptible to contagion risk is not the IMF’s primary concern. As an institution whose core mandate is to promote global stability, the IMF’s major objective is to quell contagion.

We argue that when the Fund is concerned that global contagion risk threatens this mandate, it tends to emphasize emergency liquidity. The Fund extends larger loans with more lax enforcement of conditionality. If it did not offer such a funding backstop, the IMF could incur reputational risk that undermines its credibility as an international-lender-of-last-resort (ILLR).

¹³ Author’s interview, August 2019.

¹⁴ Ibid.

The IMF thus prioritizes offsetting systemic risk over mitigating moral hazard. Given its constrained resources, however, the IMF must also strategically preserve its credit to maintain its future ILLR credibility. Thus, we expect when global contagion risk is low, the IMF is willing to cut its lending relations, even when its borrowers struggle with ongoing financial stabilization.

Although the IMF prioritizes offsetting systemic risks during periods of global contagion risk, the IMF cannot ignore moral hazard given its lack of unlimited funds. Rather, the IMF staff – including Kenneth Rogoff, its former research director – have examined the role of moral hazard in IMF lending in research papers over the last few decades,¹⁵ noting that such concerns have been “influential in policy circles since the emerging market crises of the 1990s.”¹⁶ The IMF defines moral hazard as “encouraging borrowers and lenders to take imprudent risks” where “the prospect of possible Fund support in the event of a crisis, makes a crisis more likely.”¹⁷ In managing moral hazard risk, the IMF employs policy conditionality to ensure that its financial support is “used to facilitate rather than postpone needed adjustments”.¹⁸

We thus expect that the Fund uses its policy conditionality to hedge its financial risks. IMF conditionality is a multi-faceted tool, with such longstanding goals as helping member states solve balance of payment problems. Importantly, conditionality’s role in ensuring debt repayment is also deeply embedded in the Fund’s culture. In our interviews with senior IMF officials, they stated that “whether a country repays the Fund is the criteria of a successful program.”¹⁹ They also noted that the Fund offers “a co-insurance pool that’s enforced with

¹⁵ Bulow and Rogoff 1988; Lane and Phillips 2000, 2002; Kim 2007.

¹⁶ Rogoff 2002.

¹⁷ Lane and Phillips 2000, IMF 2007. See Bird 2007 for greater moral hazard discussion.

¹⁸ Lane and Phillips 2000

¹⁹ Author’s interview, July 2017.

conditionality,” whose “implementation is critical because we [the IMF] want to be repaid.”²⁰ In this regard, IMF staff reports also use debt repayment capacity in their lending formulas and emphasize the importance of conditionality in providing “appropriate safeguards to preserve the revolving nature of Fund resources.”²¹ The IMF’s official website also underscores the role of conditionality in safeguarding its finances.²²

To ensure IMF debt repayment and achieve its core international financial stability mandate, we expect the Fund’s enforcement of conditionality to vary with global contagion. In other words, our theoretical framework suggests the IMF exploits its agency, or its zone of discretion, in managing its lending relations based on its perception of global contagion risk. When high contagion risks upsetting international financial stability, the Fund provides extensive liquidity to alleviate credit risk, but it also extends national-level waivers on unmet policy targets. By contrast, when the Fund deems global contagion unlikely, the IMF provides less liquidity as an ILLR and more stringently enforces its conditionality. By adding more conditionality, it also increases the likelihood of noncompliance.²³ The IMF can thus use conditionality as an exit strategy to justify reducing its financial exposure and even dissolving financial ties with non-compliant borrowers. Notwithstanding the IMF’s mission of mitigating sovereign risk, the Fund often acts more like an international investor, ebbing and extending its financial ties based on market volatility. Ironically, the Fund’s concerns about managing its financial risk and credibility hinder its ability to perform optimally as an ILLR. Table 1 summarizes these theoretical priors,

²⁰ Authors’ interviews, July 2017; June 2019.

²¹ IMF 2018 (p.42, p.39)

²² See <https://www.imf.org/en/About/Factsheets/Sheets/2023/IMF-Conditionality>

²³ Reinsberg et al. 2022a; 2022b.

while Table 2 and 4 illustrate the within-country variation for global contagion risk in the comparative case study section.

Table 1. IMF lending behavior by global contagion risk

	High contagion risk	Low contagion risk
Loan size	Large (quelling contagion risk)	Small-medium (safeguarding IMF resources)
Conditionality Enforcement	Weak (ongoing financing to prevent global fallout)	Strong (preventing moral hazard and allowing potential IMF withdrawals)

Scope Conditions: Systematically Important Borrowers

Importantly, our argument applies to large and financially important countries (e.g. Argentina, Egypt, Greece, and Pakistan) with sizable financial markets and banking sectors that can potentially create contagion risk. For smaller economies from Benin to Bosnia, the Fund has sufficient resources to sustain its lending, and their potential 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 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.

Several large and systematically important IMF borrowers – who are the object of our study – represent a disproportionate share of the Fund’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. 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. Over the last five years, seven of the IMF's top-ten borrowers changed nationalities (see Figures 1 and 2), showing that our theory applies to many different large IMF borrowers over time.

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

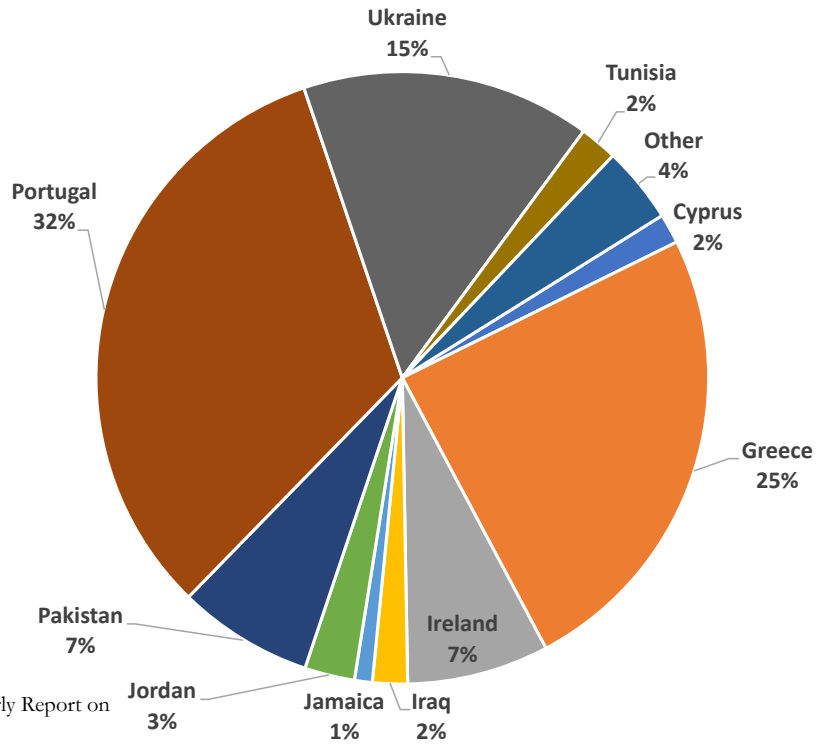
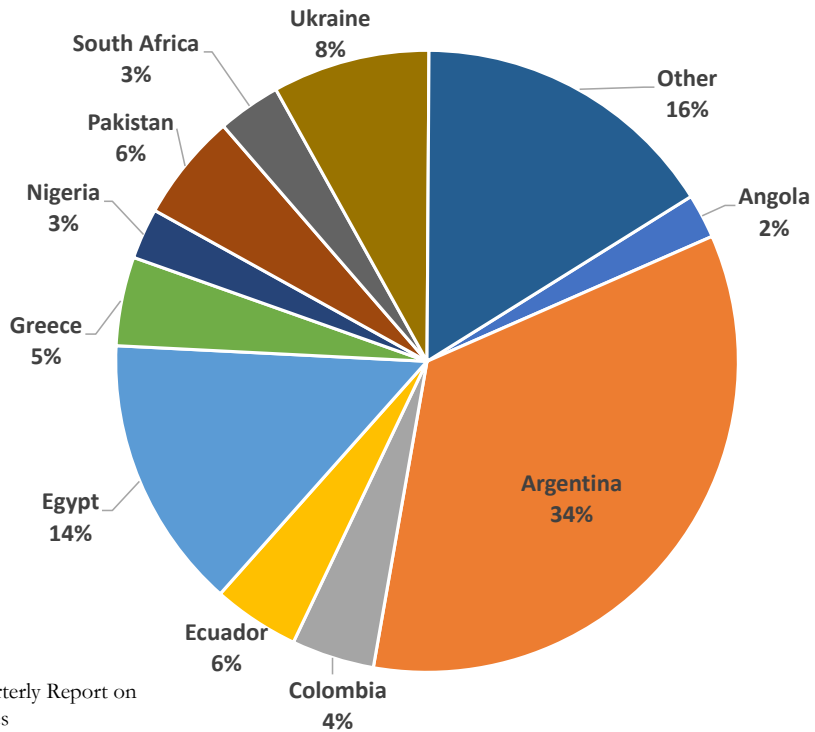


Figure 2: Credit Outstanding: 10 Largest IMF Borrowers
January 2021



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). During their peak crisis periods, Argentina and Greece accounted for one-sixth and one-fifth share of the IMF's credit outstanding. They are both middle-to-high income democracies, with sizable and internationally-integrated markets, that maximize the variation in the main independent variable, global contagion risk. We focus on the periods of high IMF financial risk to better examine the effect of varying global contagion risk. The saliency of these cases has also generated considerable data, including rich internal reviews such as IMF post-program evaluations. Both cases have full variation on the independent variable, moving from low to high contagion risk in Table 1, which is also important for testing our argument.

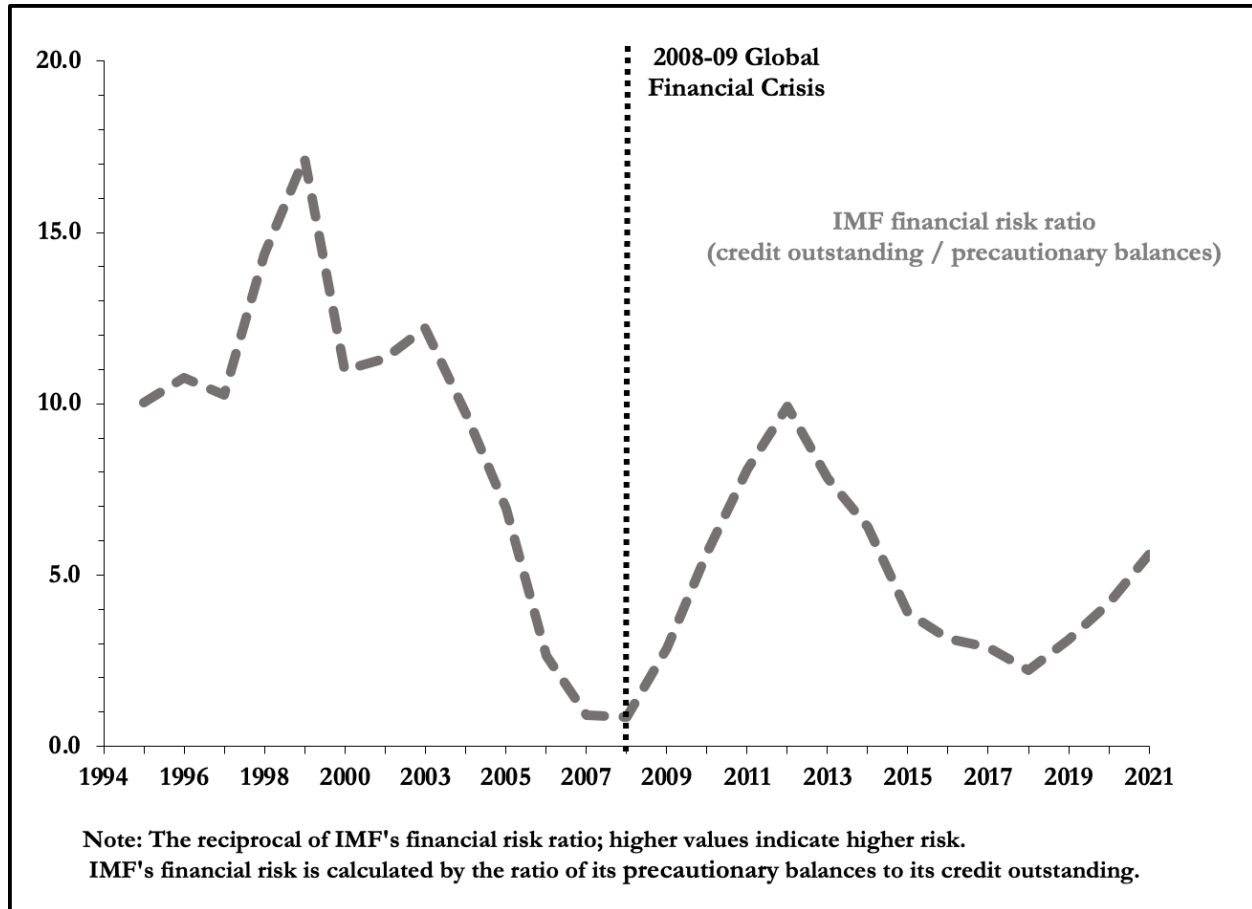
Domain: IMF Financial Risk

We employ the IMF's financial risk to help classify the study's scope conditions, or the domain of cases where the IMF has a high budget constraint. Recall that compared to national central banks, the IMF cannot limitlessly issue its own liabilities, creating an important budget constraint during periods of high financial 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 (See Figure 3).²⁴ A burgeoning literature shares our intuition about the IMF's budget constraint, finding that barriers to receiving a program are higher in low IMF

²⁴ Figure 3 uses the reciprocal of the IMF's risk ratio, with higher values indicating higher risk.

liquidity years.²⁵ Throughout the study’s time-period, the IMF has consistently high financial risk, allowing us to evaluate its lending decisions under such balance sheet constraints.

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



Independent Variable: Global Contagion Risk

Recall that the IMF varies its lending behavior conditional on its perception of global contagion. The institution acts as a lender of last resort during high contagion periods, but is more likely to emphasize containing its balance sheet risks, and preventing moral hazard during

²⁵ Lang 2021; Stubbs et al. 2020

low contagion periods. To measure the independent variable, the IMF's perceptions of global contagion risk, we employ several measures. First, we follow the burgeoning literature utilizing textual analysis and conduct a content analysis of EB meeting minutes. We anticipate that a higher frequency of such words as *contagion* and *spillover* signifies that the IMF is concerned about contagion risks. To corroborate these findings, we employ primary interviews with IMF directors and national government officials, and secondary archival evidence to gauge the Fund's contagion assessments.²⁶ Finally, we also examine descriptive market statistics about credit risk to assess if our IMF perception measure of contagion risk is consistent with financial market developments.

We then use process tracing within each case study to examine the internal determinants of IMF lending decisions. Formally, these policy choices are discussed during IMF Executive Board meetings (EBMs), which tend to reflect the EB's evaluations of IMF staff analysis and publications. 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.

²⁶ For interview details, see Table A1 in the Appendix.

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, the Fund lent extensively and continuously to Argentina despite the country’s non-compliance, but then terminated 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).

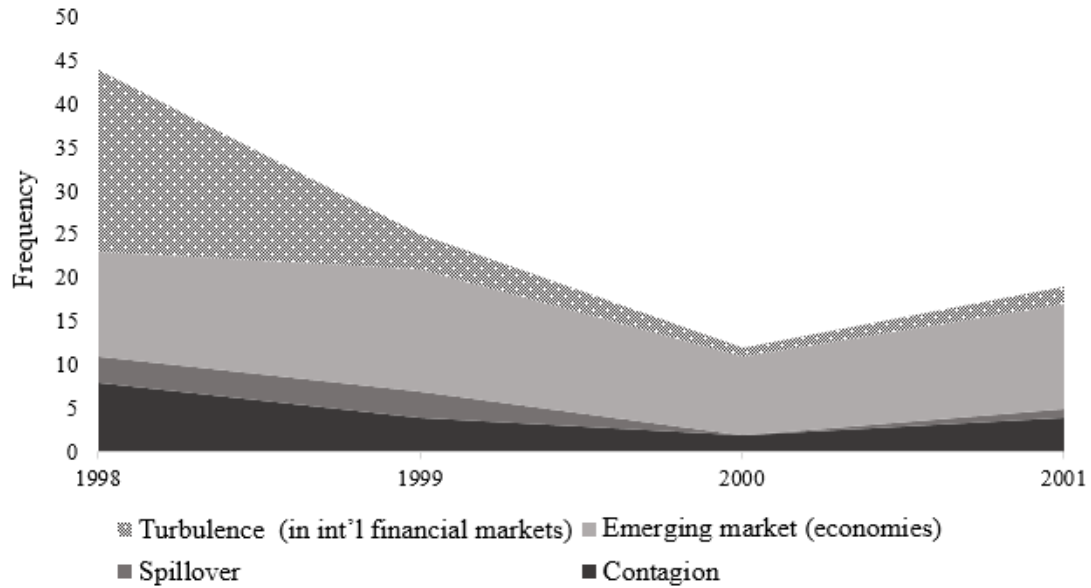
Table 2. Overview of global contagion risk and IMF decisions regarding Argentina, 1998-2001

	1998		1999		2000		2001	
	1 st half	2 nd half	1st	2nd	1st	2nd	1st	2 nd
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

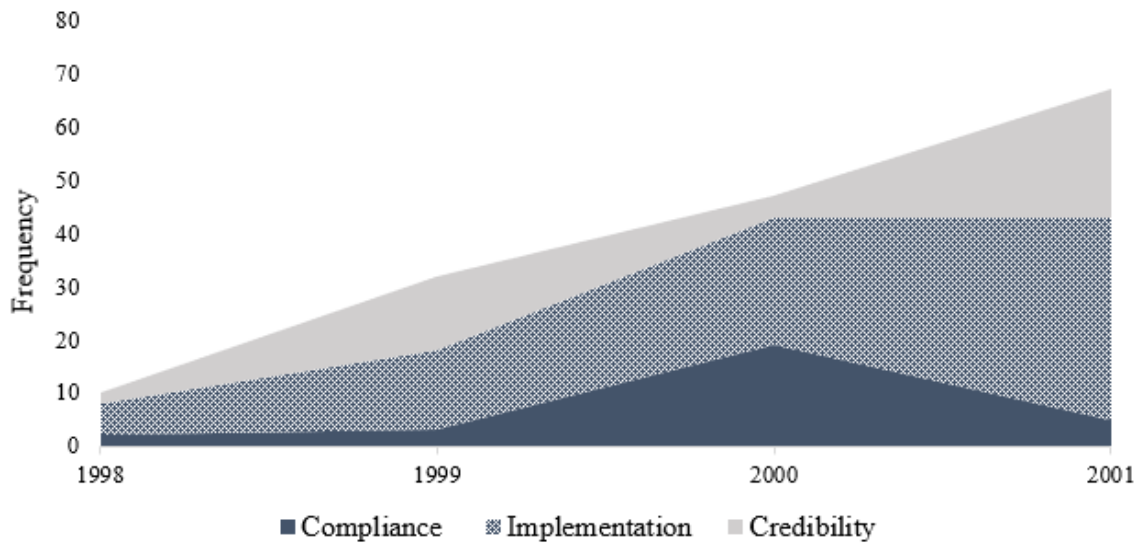
In line with this study’s domain, the Fund faces high balance sheet risk during this entire period. The IMF increased its ILLR operations in response to successive emerging market crises, including extending the largest loan (\$21 billion) in IMF history to South Korea and \$22 billion in Argentine financing. The IMF’s total credit outstanding nearly doubled in the late 1990s, heightening its financial risk ratio (Figure 3), and prompting its Board of Governors to express serious concern over the IMF’s financial health.

Figure 4. Word frequency in EBM minutes on Argentina, 1998-2001.

Contagion related words



Implementation related words



To examine whether the IMF's perceived contagion risk varies during this period, we conduct a content analysis on the IMF's EB meeting minutes. Textual analysis is an increasingly popular methodological tool that is used to capture nuanced and multi-dimensional concepts such

as polarization, bias, and uncertainty.²⁷ With the IMF publishing huge volumes of reports and meeting minutes, scholars are increasingly studying the IMF utilizes textual analysis techniques. For example, Ramos et al. (2021) employs textual analysis on IMF’s surveillance reports to construct a climate risk index. Hernandez (2020) and Broome (2015) use content analysis of IMF reports finding the Fund’s adherence to fiscal conditionality is consistent over time. Kaya and Reay (2019) deploy content analysis of historical IMF documents to show how its institutional discourse changes over time. IMF staff has also used textual analysis to build a sentiment index of national receptiveness to Article IV consultations (Fayad et al., 2020).

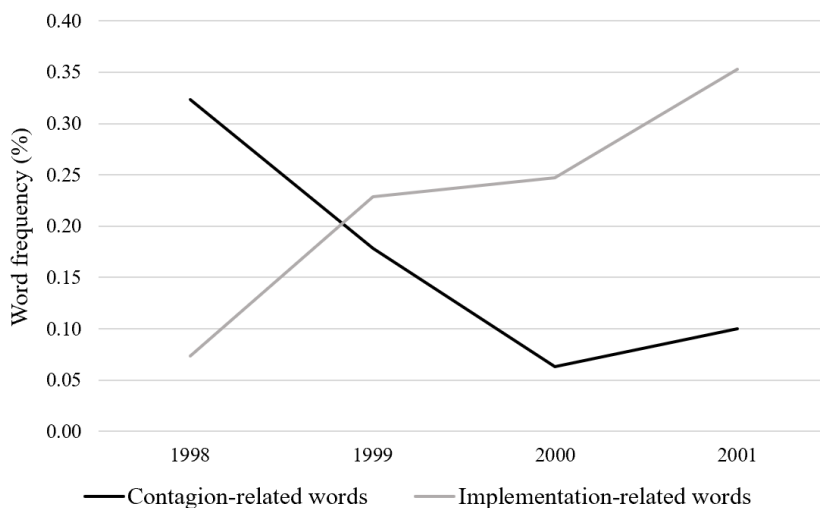
We utilize textual analysis of EB meeting minutes on Argentina from September 1998, May 1999, March 2000, and September 2001 to assess IMF attention to global contagion risk over time. In each meeting, IMF executive directors and relevant staff (e.g. the mission chief) exchange their views about the program. After filtering each text, we created the list of vocabularies related to (i) global contagion risk and (ii) Argentina’s program implementation, and counted the frequency of pre-determined vocabularies, assuming that they capture the EB directors’ relative priorities (Figure 4).

The results in Figure 4 support our main claims. We find the words related to global contagion risks such as “contagion”, “spillover” and “turbulence (in international financial markets)” appeared repeatedly in September 1998, right after the Russian default, 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

²⁷ See Grimmer and Stewart (2013) and Gentzkow et al. (2019).

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, and the results are substantially unchanged (Figure 5). In the next section, we complement these findings with comparative case study evidence sequentially tracing the link between the IMF’s perception of global contagion risk and its lending decisions in Argentina.

Figure 5. Word frequency (proportion of total texts in EBM minutes on Argentina, 1998–2001)

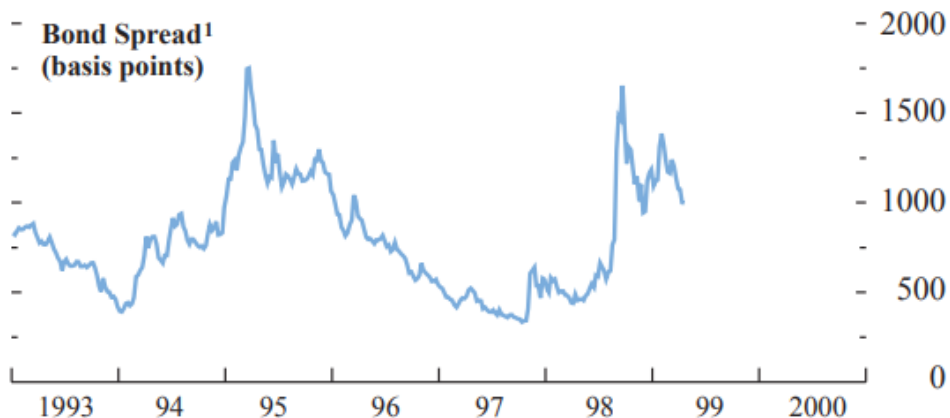


Early 1998: Low Contagion Risk and IMF Program Suspension

In February 1998, the IMF approved a \$2.8 billion (138% of Argentina’s quota) Extended Fund Facility (EFF), which reflected Argentine President Carlos Menem’s strong political incentive to keep the IMF’s financial backing to preserve convertibility, which had ‘pulverized inflation’ by pegging the peso to the U.S. dollar (Kaplan 2013). By early 1998, however, the global financial market had stabilized substantially given 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” (IMF 1998). This perception was consistent with developments on the

ground. Emerging market risk premiums had declined considerably from their previous peak prior during the 1994-95 Mexican Peso Crisis (see Figure 6).

Figure 6. Financial Conditions in Emerging Market, 1993-1999



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

As global volatility subsided, our theory suggests that the IMF should shift to a more stringent loan enforcement stance. Internally, many IMF departments (including Research, Review, Policy Development, and Fiscal Affairs) were skeptical about the Argentine program’s feasibility.²⁸ Only the Western Hemisphere department believed “on balance, the risks [were] still acceptable” (IMF 2004, p.37). By July 1998, 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 during an election year.²⁹

²⁸ Internal memo to top IMF management, April 28, 1997.

²⁹ By 1998, Menem faced a 26 percent approval rating, and 15 percent unemployment.

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” (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 unexpectedly 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.

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 have less stringent 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.”³⁰

³⁰ Blustein 2003.

In particular, the EB directors were concerned that the ongoing program suspension 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].”³¹

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”.³² 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,³³ 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 “maintain(ed) a cautious stance to weather the danger of contagion” over requiring full compliance.³⁴ 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.”³⁵

Given these views about contagion’s resurgence, the IMF completed its program review, while continuing and eventually augmenting its financing. The Fund demanded more conditionality over time to hedge its increasing financial risk (Table 3), but notably it was more

³¹ IMF’s EBM minutes 98/103.

³² Directors from Belize, France, Malawi, Morocco, and Poland. IMF Archives EBM 98/103.

³³ See directors’ statements from Germany, U.S., India, Italy, Mexico, South Korea, and Estonia. EBM 98/103.

³⁴ IMF’s EBM minutes 98/103.

³⁵ IMF’s EBM minutes 99/56.

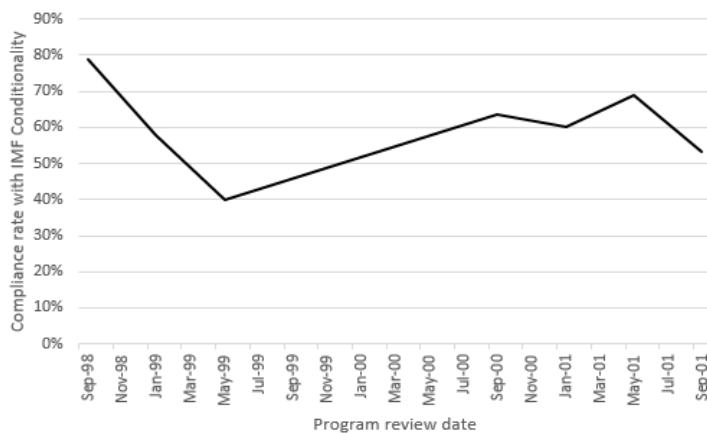
willing to excuse Argentina’s non-compliance in 1999 than during June 1998 (Figure 7).³⁶ For example, the final program review in May 1999 showed that Argentina had only met five out of twenty-four of IMF lending conditions, but the program continued.

Table 3. Number of Conditionalties 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 IMF program averages for each year.
Data: Kentikelenis *et al.* (2016).

Figure 7. Argentina’s compliance with IMF conditionality³⁷



The Fund’s emphasis on emergency liquidity over moral hazard continued from 2000 to mid-2001, a period characterized by heightened emerging market credit risk. Despite the 1999 election of Argentine President Fernando de la Rúa, his evaporating popularity had quickly stalled any reform progress (see Figure 7). However, the Fund overlooked Argentina’s non-

³⁶ Argentina’s October national elections may have also been a factor.

³⁷ Authors’ calculation, IMF MONA dataset.

compliance because it fretted about the potential spillover effects of a default (IMF 2004). Rather, the Fund made a series of large and risky loans, amounting to \$17 billion (818% of Argentina' quota, or 5% of its GDP). The Fund stated that these disbursements “allow(ed) the government to purchase the undrawn amount under the SBA immediately, *regardless of the review status*” (IMF 2004, p.40). The IMF thus prioritized liquidity to prevent market panic rather than conditionality to ensure 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. During the EB meeting 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.”³⁸ 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 EB voting power, 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.”³⁹

In response, dissenting directors compromised by saying “the board's concerns should remain private,” while underscoring the importance of “unqualified support”.⁴⁰ The IEO later

³⁸ IMF's EBM minutes 01/53

³⁹ Ibid.

⁴⁰ Ibid.

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 (IMF 2004, p.47). The IEO also found the program posed tremendous financial risks for the IMF. Yet, 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” (IMF 2004, p.49) The promise of new IMF funds to a previously non-compliant borrower, however, created moral hazard risk and potential future debt problems.

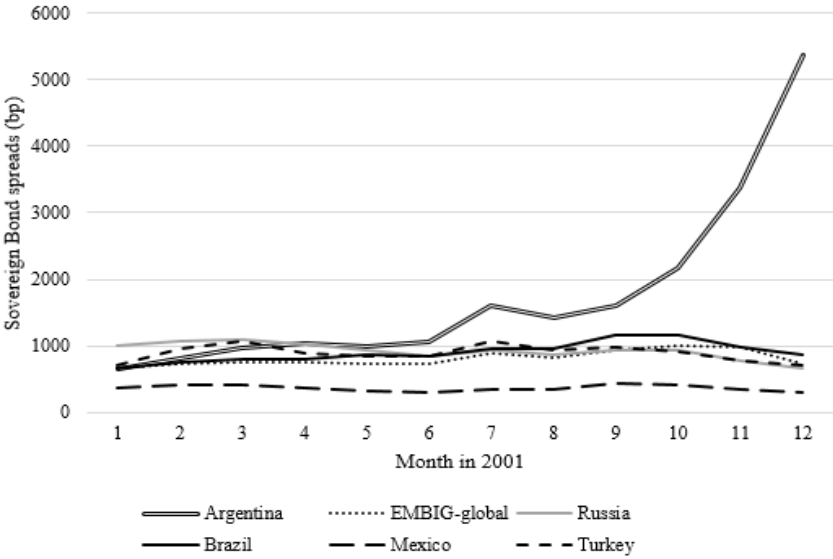
Late 2001: Decoupling Argentina and IMF’s Restoration of its Balance Sheet

By the 2001 summer, emerging market sentiment 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. 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 partly discounted by markets” (IMF 2004, p.52). In October 2001, the Fund noted that the “the potential for future contagion is less than it was in the past” (IMF 2001). These sentiments were echoed in global financial markets (see Figure 8). 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 (see Figures 4 and 5), the IMF began to shift its position. In November, Argentine economy minister Domingo Cavallo tried multiple times to visit the IMF’s headquarters only to discover 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 argue that had the global economy been vulnerable to financial turmoil in late 2001, the Fund would have likely followed a different path. Its stated reason for program suspension was Argentina’s non-compliance: the government had breached its fiscal deficit target by \$2.6 billion. 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 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 international and domestic leadership turnover, 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 loan approval timing; 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 IMF's 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. Similarly, domestic leadership turnover does not explain the IMF's lending decisions as the Menem and de la Rúa administrations experienced both program approvals and suspensions during their tenures.

Another alternative explanation for the IMF's growing emphasis on policy implementation over time is the IMF learned about Argentina's increasing noncompliance. Examining the interactions between the IMF and Argentina lenders offers little support for the learning argument. Between 1991-2001, the IMF had extended five successive lending arrangements to Argentina, which dispatched about fifty country missions.⁴¹ 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 also find little utility in a learning explanation. Rather than entering with a bailout-first approach, the IMF was circumspect about lending to Brazil initially, given the lack of global contagion. However, consistent with our argument, we find that the IMF changed its stance toward Brazil when the Mexican Peso crisis erupted in 1994, endangering global financial stability.

⁴¹ IMF 2004, p.9

Finally, although domestic politics play an important role in IMF relations, we find that such explanations are not sufficient. For example, in July 1998, the Menem government disregarded IMF warnings of program termination over noncompliance because of upcoming elections. However, the IMF resumed its lending following the Russian financial crisis, despite little change in Argentina's reform prospects or government composition. Similarly, between 1999 and 2001, the de la Rúa administration consistently needed IMF financing, but the Fund's lending position shifted based on global contagion.

In summary, we find that the variation in global contagion risk is key to understanding the Fund's lending stance toward Argentina from 1998-2001. Despite its vigilance about the high risk associated with Argentina's IMF programs, the Fund lent to Argentina whenever its default posed a contagion risk globally. These conditions, however, weakened Argentina's commitment to conditionality, and its 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. Due to high demand for IMF funds after the 2008 financial crisis, the Fund's ratio of credit outstanding to precautionary balances returned to mid-1990

levels between 2010 and 2015 (Figure 3). In a public release, the IMF noted it borrowed funds to lend during 2010-2014 (IMF 2018).

Despite its high internal financial risk, the IMF approved unprecedentedly large loans in 2010 and 2012. We find that financial spillover concerns from Greece were an important determinant of lending decisions. The IMF aimed to hedge its financial risk associated with Greek programs 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 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 (Table 4).

Table 4. 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

Figure 9. Word frequency in EBM minutes on Greece, 2010 and 2013.

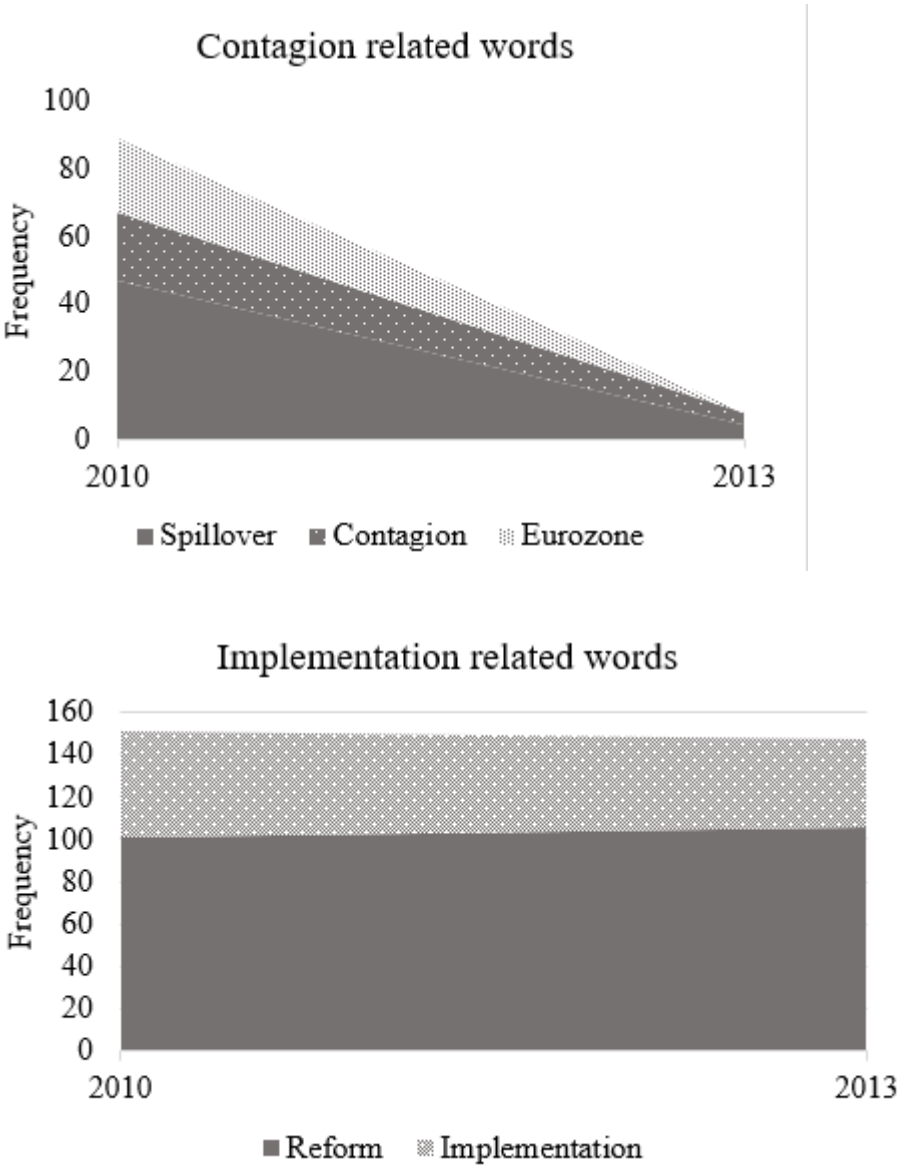
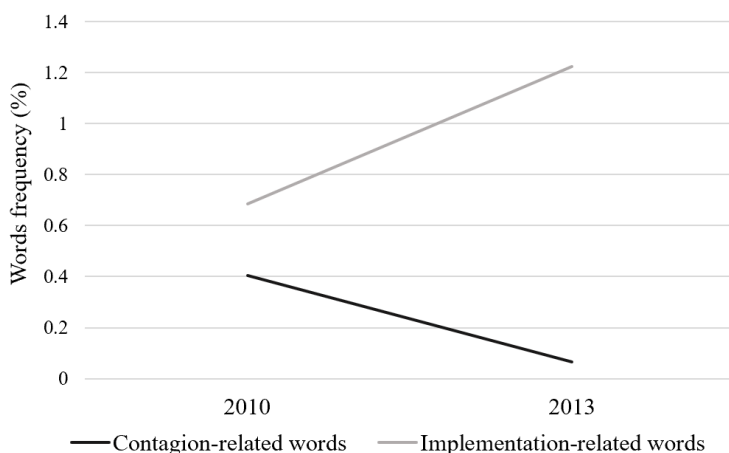


Figure 10. Word frequency (proportion of total texts in EBM minutes on Greece, 2010 and 2013).



To examine the IMF's varying concerns about contagion risk, we again scrutinize the word frequency from IMF EB meetings. Figure 9 compares the word frequencies for 'spillover', 'contagion', and 'Eurozone' in May 2010 and May 2013. Consistent with our theoretical priors, these frequencies decline substantially over time in contrast to the stickiness of 'implementation', and 'reform'. These patterns hold when accounting for varying word volumes per meeting (Figure 10). Notwithstanding a high proportion of contagion-related words as a share of total words in May 2010, the ratio reached almost zero three years later. Next, we explore how contagion affects the Fund's strategic resource management more extensively.

2010-2012: Contagion Risk in Europe and the IMF as an ILLR

In response to Greece's May 2010 bailout request, the IMF, the European Union (EU), and the ECB announced a €110 billion loan linked to extensive reforms. For the IMF, its €30 billion commitment (3,212% of Greece's quota, or 10.7% of GDP) was highly risky not only because it was the largest IMF loan historically, but also 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 “the credit risk for the Fund” and Greece’s high debt.⁴² Nonetheless, they advocated for “putting all our forces in finding a solution that can contain the spillovers, given the growing concern about Greek contagion,”⁴³ saying “we have no other choice but to support the program.”⁴⁴

As Southern European contagion risk materialized following the Greek crisis, the Fund revised its exceptional access criteria mandating 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*.”⁴⁵ Consistent with the Fund’s understanding, the 10-year government bond yields for Spain, Ireland, Portugal, and Italy had already spiked after the Greek crisis (Figure 11). In approving its Ireland and Portugal arrangements, the IMF had thus emphasized that “systemic concerns inevitably were paramount” (IMF 2016, p.57), which is in line with our priors. 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 (Table 5).

Table 5. Number of Conditionalties 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 IMF program averages for each year.
Data: Kentikelenis *et al.* (2016).

⁴² IMF’s EBM minutes 10/45-1

⁴³ *Ibid.*

⁴⁴ These included directors from India, Singapore, Philippines, Japan, and Switzerland.

⁴⁵ IMF’s EBM minutes 10/45-1. Italics ours.

Figure 11. 10-year Government Bond Yields. 2008-2018.



2013- 2015: Dissipated contagion risk and the IMF as a 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. The 10-year government bond yields for Spain, Ireland, Portugal and Italy all returned to pre-Greek crisis levels by mid-2013 (see Figure 11), in the prelude to ‘graduating’ their bailout programs in spring 2014.

Recall that the IMF was cognizant of these dissipating contagion pressures (Figures 9 and 10), endowing itself with more flexibility to strengthen its own balance sheet. The IMF’s internal staff discussions reflected this shift, highlighting “the Fund was taking imprudent financial risks on its biggest-ever loan” and “the Fund must take extraordinary action to protect its interests” (Blustein 2016, p.357). Given such concerns, the IMF became increasingly combative toward Greece and its European partners in late 2012, openly advocating for more debt restructuring despite initial ‘stiff resistance’ from the European partners (Moschella 2016). The Fund also required more

conditionalities (see Table 5), which eventually provided it with an exit option from the Greek program. By comparison, the ECB continued its support through Greek bonds purchases.

By mid-2014, Antonis Samaras government, facing a political challenge from the extreme left Syriza party, had hoped to ‘graduate’ the bailout program to boost its popularity. However, during its review, Greece missed several program targets, including sales tax implementation and union bargaining. In contrast to earlier, the Fund did not grant Greece any waivers and refused to release its final €7.2 billion installment. During the November 2014 negotiations, the Fund was “the most immovable among the creditor institutions” (Blustein 2016, p.386). European policymakers wanted the IMF to continue lending to Greece, but the Fund did not allow any disbursements or program adjustments, instead delaying the review into 2015.

After the new Syriza government’s IMF loan default in June 2015, the Fund continued to protect its balance sheet amid relative global stability. Greece’s initial \$1.5 billion default was manageable, but a prolonged default could have reached \$26 billion. 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. 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 (Spiegel 2015). 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” (Spiegel 2015).

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 political turnover in 2012 and 2015, and IMF-Europe discord may have also influenced IMF lending choices. For example, in 2012, powerful private financial interests – who reduced their Greece exposure after the country's debt restructuring – and a new reform-minded government could have both affected IMF's lending decisions. Similarly, rising expectations of a Syriza victory slowed economic reform in the prelude to 2015 elections. Finally, Europe's hesitancy to accept the IMF's recommended 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 directly affect IMF withdrawal. Similarly, after legislative elections ushered in a reform-oriented Samaras government, it should have paved the way for greater IMF cooperation with Greece. With contagion dissipating, however, the IMF began to require more stringent policy conditions, and reduce its financial exposure. In fact, the IMF's enthusiasm for Greece's prospects had already diminished prior to Samaras government's arrival. In March 2012, the majority of questions – six out of nine – during an IMF internal conference call focused on implementation and financial risks associated with the Greek program.⁴⁶ The IMF's shift in lending stance was associated with reduced global contagion, rather than a change in government. Similarly, political turnover is not a sufficient explanation of the IMF's withdrawal in 2014. Evaluating the content of 2014 EB meeting minutes (and public staff reports) shows that

⁴⁶ IMF 2012.

contagion risks were an important IMF focal point, while there was not a single mention of Syriza. Finally, after the 2012 private debt restructuring, the IMF had consistently lobbied for an official debt restructuring to protect its crisis management reputation. Nevertheless, it was only when European contagion fears subsided in 2014 that the IMF dissolved its lending ties.

In summary, our findings show the IMF navigates its institutional tensions, balancing its financial stability mandate against its own financial and reputational risks, by strategically conditioning its lending stances on global contagion. These institutional constraints often yield surprising sequential changes in IMF lending behavior over short time horizons. We also find that domestic and geopolitics affects IMF lending, with some financially-exposed shareholders supporting IMF liquidity extensions. Importantly, however, internal politics tend to wane as global contagion subsides. We also find that shareholders without such exposure have successfully advocated for IMF lending to meet its financial stability mandate.

Generalizability

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 catalyzing global contagion. For example, high and upper middle-income countries accounted for one-third of the \$1.6 billion in IMF programs approved between 1980-2015; and 41 percent of these programs were either temporarily or permanently interrupted.⁴⁷ The Argentine and Greek cases thus represent a common phenomenon. In the appendix, we provide a plausibility probe of another high-profile case, Brazil (1993-1995), to further confirm our argument's generalizability. The IMF cut its loan to Brazil for noncompliance in 1993 when there was little contagion risk. Less than a year later,

⁴⁷ Author's calculation, Reinsberg et al. 2022a.

however, the IMF shifted its position amid the Mexican peso crisis. Not only did the IMF extend a loan of \$17.8 billion, three-and-a-half times more than it had lent to any single country historically, but also it tried to financially support Brazil, asking “can we do anything besides giving advice?”⁴⁸ Consistent with our expectations, executive directors repeatedly noted the systemic importance of providing liquidity during board meetings, stating that “the potential for spillover – an extremely quick spillover – enormous”.⁴⁹

Conclusion

Why does the IMF often exit from countries in crisis, only to later renew its lending? Employing the Argentine and Greece cases, we show that global contagion risk often conditions the IMF’s lending stance. Balancing its mandate to preserve global systematic risk against its reputational and financial concerns, the IMF tends to behave like a private investor shifting its lending position based on market volatility. 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 after the August 1998 Russian default. In Greece from 2011-12, the Fund extended sizable loans to help alleviate market panic following 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 rationale for allocating its finite resources elsewhere. Ironically, this lending pattern implies the IMF is most likely to address moral hazard problems in good times, meaning that most financially important economies may have little incentive to reform when the stakes are highest globally.

⁴⁸ IMF’s EBM minutes 6/21/1995.

⁴⁹ IMF’s EBM minutes 9/5/11.

These findings have important implications for the IMF literature. While most of this scholarship focuses on the Fund's initial lending, this paper takes a longitudinal approach, helping better explain why the Fund exits and renews its lending relationships. This study also contributes to the IMF compliance scholarship, which has identified pressures from donor countries, private investors, and financial institutions to be key drivers of IMF program renewals despite noncompliance (Stone 2004; Roos 2019; Reinsberg et al. 2022a). Notwithstanding these external pressures, this article highlights the IMF has its own institutional incentives (i.e., quelling global financial instability) to overlook noncompliance. Conditioning its lending behavior on global contagion, however, risks intensifying moral hazard and encouraging further noncompliance. Compared to recent scholarship showing the IMF's major shareholders as a source of moral hazard (Lipsky and Lee 2019), our study suggests it is likely to be a product of the Fund's institutional agency, which lacks the necessary tools to be an effective ILLR (Fernandez, Arias, and Levy-Yeyati 2012). Finally, compared to public choice models, which attribute the IMF's expanding conditionality and loan portfolio to bureaucratic power (Vaubel 1994; Dreher and Vaubel 2004), we instead find this pattern reflects the staff's desire to hedge IMF financial risk.

Beyond the IMF literature, our findings also have implications for studies evaluating recent contestations over international organizations. While existing studies identify domestic political economy as sources of popular discontent toward globalization (Broz, Frieden, and Weymouth 2021), our results suggest that international organizations could have long-fomented hostile perceptions about international cooperation among the mass public. The IMF's frequent shift in its lending positions, limited capacity to quell crises, and preference for "early" exits, may have impaired its legitimacy in borrowing countries, contributing to its institutional inefficiencies and suboptimal performance as an international organization (Barnett and Finnemore 1999).

This study has focused on systematically-important economies, providing the foundation for future research that involves extending the domain to smaller economies. Our theory implies that the IMF should be less likely to exit its lending relationships in smaller economies, given their limited financial impact on the IMF's balance sheet. That said, there is greater scope for new theoretical development regarding policy conditionality in these small economies. With the removal of the IMF's budget constraint, global contagion is less likely to affect the Fund's approach to surveillance, raising the importance of both international and domestic politics. Finally, building on our findings that global contagion risk is a key determinant of IMF lending behavior, other institutional factors may also help us understand IMF lending choices under contagion. By exploring the IMF's institutional agency, future research endeavors could offer additional insight into the Fund's lending motivations. For example, internal constituencies within the IMF, coalescing around borrowing status, level of development, and regional identities, may further glean insight into how the IMF toggles between mitigating global contagion and avoiding moral hazard risks in its lending practices.

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