# International Institutions and State Leverage:

# IMF Program Design and Implementation in Argentina, 1991–2002

by


**GUO JIN DARYL ENG**


**PRIMARY THESIS ADVISOR: PROFESSOR JONATHAN EATON**
**Department of Economics and The Watson Institute for International Studies**

**SECONDARY THESIS ADVISOR: PROFESSOR MARK BLYTH**
**Department of Political Science and The Watson Institute for International Studies**

**HONORS SEMINAR INSTRUCTOR: PROFESSOR CLAUDIA J. ELLIOTT**
**The Watson Institute for International Studies**

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Date__________________ ___________________________________
Jonathan Eaton, Thesis Advisor

Date__________________ ___________________________________
Mark Blyth, Second Reader

**Approved by the International Relations Program**

Date__________________ ___________________________________
Dr. Claudia J. Elliott
Director/Associate Director,
International Relations Program

## ABSTRACT

What factors determine IMF program design and implementation in borrower countries? Scholars tend to focus on the *ex post* effects of programs, while comparatively little attention is paid to the design and implementation of program conditionality. Understanding the problems programs are designed to address and the circumstances behind their interruption or completion, however, is essential for an accurate evaluation of their effects. In contrast to existing explanations that dichotomize factors influencing the IMF and those influencing borrower countries, I argue that a more nuanced approach which incorporates the interaction between these factors is required. Synthesizing theories of functionalism, structuralism, and principal-agent relationships with a domestic political economy approach, I offer a dynamic framework that evaluates the importance of political, institutional, and economic variables under varying circumstances. Applying this framework to the case of Argentina (1991-2002), I find that the IMF's institutional priorities gave Argentina enormous leverage over the IMF. Therefore it maintained support for Argentina despite non-compliance until deteriorating economic conditions indicated a collapse was inevitable. This thesis sheds new light on the IMF's decision-making process, and has wider implications for the future study of conditionality as well as policy-making at the national and international level.



**Keywords:** International Monetary Fund, conditionality, compliance, Argentina, crisis

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There was a certain irony in the stance of the IMF. It tried to pretend that it was above politics, yet it was clear that its lending program was, in part, driven by politics.

—Joseph Stiglitz, *Globalization and its Discontents*

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# CHAPTER ONE

## WHITHER CONDITIONALITY?

> We need to stick to conditionality in our lending operations but at the same time work to enhance real ownership of programs. We have learned that the effectiveness of members in confronting their economic difficulties depends critically on the vigorous implementation of appropriate stabilization and reform measures. This comes only when the country's authorities are seeking to implement measures that they see as responsive to their needs and capable of securing domestic support.
>
> —Horst Köhler, Annual IMF Meeting, 2000

The International Monetary Fund (IMF, also known as the Fund) is one of the most established and powerful international institutions, having expanded from 29 founding countries in 1945 to its current 188 member states, as of end 2013.[1] It has $362 billion in quotas[2] and an additional $1 trillion in pledged funds,[3] and these resources are expected to double after the next quota review in order to increase emerging market

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[1] International Monetary Fund, *IMF Annual Report 2013* (Washington, D. C.: International Monetary Fund, 2013), http://www.imf.org/external/pubs/ft/ar/2013/eng/pdf/ar13_eng.pdf.

[2] International Monetary Fund, "Factsheet: IMF Quotas," *International Monetary Fund*, October 3, 2014, http://www.imf.org/external/np/exr/facts/quotas.htm. Quota subscriptions form the central component of the IMF's financial resources. When a country joins the IMF, it is assigned a quota based on its GDP, openness, economic variability, and international reserves. Quotas are denominated in Special Drawing Rights (SDRs) and determine a country's financial commitment to the IMF, its voting power and its access to financing.

[3] International Monetary Fund, "The IMF at a Glance," September 18, 2014, http://www.imf.org/external/np/exr/facts/glance.htm.

representation in the Fund.[4] A total of 725 lending programs were approved from 1970 to 2000[5] and more than 50 are currently in effect.[6] For every single year in the last decade, more than one billion people have lived in countries under IMF supervision.[7] As the guardian of such a tremendous amount of financial assets and with such a broad reach across the globe, the IMF is unique even in the realm of influential international organizations.

The IMF first attached conditions to its loans in the form of broad macroeconomic targets in 1952,[8] when its purpose was to maintain international exchange alignment.[9] As its focus shifted to addressing debt problems and financial crises in the 1980s and 1990s,[10] the number of conditions it imposed increased dramatically and grew more specific.[11] These loan conditions, known broadly as *conditionality*, were not part of the IMF's original mandate.[12] When the international fixed exchange-rate regime ended, however, the IMF lost one of its primary functions in the international system—the

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[4] International Monetary Fund, "IMF Overhauls Lending Framework," Press Release (Washington, D. C., March 24, 2009), https://www.imf.org/external/np/sec/pr/2009/pr0985.htm.

[5] Robert J. Barro and Jong-Wha Lee, "IMF Programs: Who Is Chosen and What Are the Effects?," *Journal of Monetary Economics*, Journal of Monetary Economics, 52, no. 7 (2005): 1245–69.

[6] International Monetary Fund, "Lending by the IMF," *Lending by the IMF*, accessed December 11, 2014, http://www.imf.org/external/about/lending.htm.

[7] Michael Breen, *The Politics of IMF Lending*, International Political Economy Series (Palgrave Macmillan (Firm)) (Houndmills, Basingstoke, Hampshire: Palgrave Macmillan, 2013).

[8] Erica R. Gould, *Money Talks: The International Monetary Fund, Conditionality, and Supplementary Financiers* (Stanford, Calif.: Stanford University Press, 2006).

[9] International Monetary Fund, "Lending by the IMF."

[10] Barry Carin and Angela Wood, *Accountability of the International Monetary Fund* (Aldershot, U.K.: Ashgate, 2005).

[11] Gould, *Money Talks*. Examples of specific conditions in a 1990 IMF arrangement with Uruguay include increasing the value added tax by 1 percent, raising the basic income tax by 3.5 percent, and increasing the basic import duty by 5 percent. For more, see James Raymond Vreeland, *The IMF and Economic Development* (New York: Cambridge University Press, 2003).

[12] Margaret Garritsen De Vries, *The IMF in a Changing World, 1945-85* (Washington, D. C.: International Monetary Fund, 1986).

maintenance of exchange rate stability. To make up for it, the agency moved into a new developmentalist role that brought these conditions to the forefront, primarily as an effort to compel countries to adjust their economic policies in order to resolve the problems that led them to solicit aid in the first place.[13]

As a result, the IMF has been the source of much controversy as well as the target of fierce protests. Citizens in countries with IMF arrangements have long protested the organization's interference in their domestic affairs. In addition to large numbers of demonstrations and riots in Latin America, Africa and Eastern Europe in the 1980s and 1990s, the turn of the new millennium saw violence erupt against Fund action in many countries, including Argentina, Bolivia, Brazil, Colombia, Costa Rica, Kenya, Nigeria, and Zambia.[14] Often accompanied by general strikes, these incidents almost always resulted in massive disruptions to daily life as well as injuries and deaths when protesters clashed with the authorities. As recently as 2014, citizens in Greece, Iceland, Spain, Portugal, and Ireland staged massive public demonstrations in response to IMF-led

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[13] For a comprehensive account of the origins and evolution of IMF conditionality, see Ibid.; Margaret Garritsen De Vries, *The International Monetary Fund, 1966-1971: The System Under Stress* (Washington, D. C.: International Monetary Fund, 1976); Margaret Garritsen De Vries, *The International Monetary Fund, 1972-1978: Cooperation on Trial*, vol. 2 (Washington, D. C.: International Monetary Fund, 1985); Harold James, *International Monetary Cooperation Since Bretton Woods* (Washington, D. C.: International Monetary Fund, 1996); James M. Boughton, *Silent Revolution: The International Monetary Fund, 1979-1989*. (Washington, D. C.: International Monetary Fund, 2001).

[14] John K. Walton and David Seddon, *Free Markets and Food Riots: The Politics of Global Adjustment* (Hoboken, N.J.: John Wiley & Sons, 2008); Mark Ellis-Jones and Jessica Woodroffe, *States of Unrest: Resistance to IMF Policies in Poor Countries* (London: World Development Movement Report, n.d.), http://www.wdm.org.uk/cambriefs/DEBT/unrest.htm; George Caffentzis and Silvia Federici, "A Brief History of Resistance to Structural Adjustment," in *Democratizing the Global Economy*, ed. Kevin Danaher (Monroe, M.E.: Common Courage Press, 2001).

austerity measures in the wake of the 2008 global financial crisis, forcing governments to hold early elections or step down completely.[15]

Economists, policy-makers, civil society activists, and even top IMF officials have called for a reversal of the expansion in conditionality over the past decades.[16] The Meltzer Commission, a US congressional report published in 2000, denounced conditionality as having "given the IMF a degree of influence … that is unprecedented for a multilateral organization [… and undermining] national sovereignty," and accused it of hindering "the development of responsible, democratic institutions" in member states.[17] As Treasury Secretary, Lawrence Summers called for the IMF to lend only on a short-term, emergency basis, as outlined in its original Articles of Agreement, and sharply reduce its long- and medium-term lending.[18] Even Horst Köhler, the Fund's managing director from 2000 to 2004, believed that conditionality had gone too far and urged the IMF to "reduce the conditions it attaches to its lending.[19] Yet the recent IMF-led bailouts of troubled European economies, which were contingent on fiscal and monetary reforms, indicate that conditionality is not about to become a thing of the past.

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[15] Lilja Mósesdóttir, "The IMF's Toxic Bail-Out Of Greece And Iceland," *Social Europe Journal*, November 7, 2013, http://www.social-europe.eu/2013/07/the-imf%c2%b4s-toxic-bail-out-of-greece-and-iceland/; Aggelos Skordas, "General Strike from Greek Labor Unions on November 27," *Greek Reporter*, October 24, 2014, http://greece.greekreporter.com/2014/10/24/general-strike-from-greek-labor-unions-on-november-27/; Valentina Pop, "Portugal Announces 'Clean Exit' from EU-IMF Bailout," *EU Observer*, May 5, 2014, http://euobserver.com/economic/123999.

[16] Gould, *Money Talks*.

[17] International Financial Institution Advisory Commission and Allan H. Meltzer, *Report of the International Financial Institution Advisory Commission to the US Congress* (Washington, D. C.: International Financial Institution Advisory Commission, 2000).

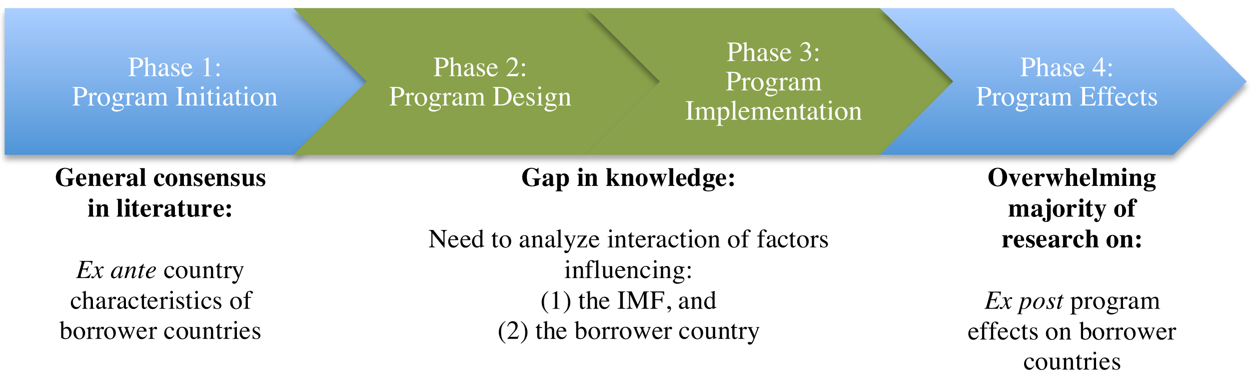
[18] Lawrence H. Summers, "Treasury Secretary Lawrence H. Summers Remarks to the IMF Advisory Committee," Press Release (Washington, D. C., December 18, 2000), http://www.treasury.gov/press-center/press-releases/Pages/ls1081.aspx.

[19] Joseph Kahn, "The I.M.F. Will Revamp Its Lending," *The New York Times*, September 16, 2000, sec. Business, http://www.nytimes.com/2000/09/16/business/the-imf-will-revamp-its-lending.html.

This thesis addresses the following question: What determines IMF program design and implementation in borrower countries? Given the IMF's deep and continued involvement in the governance of its borrowing members and the extreme reactions its policies often engender, it is essential for academics, policy-makers and citizens the world over to understand how the Fund reaches decisions regarding its loan arrangements. To answer this question, I analyze the events and conditions affecting IMF policy decisions in the case of Argentina. More specifically, what factors determined the design and implementation of IMF arrangements in Argentina from 1991 to 2002? I find that the interests of major shareholders, the IMF's institutional priorities, economic and political conditions in the borrower country, and the global environment were all pertinent factors. Further, I find that when a country is systemically important and the IMF's credibility is tied to its success, it holds enormous leverage over the IMF, which means that the IMF is unlikely to insist on stringent conditions or punish non-compliance.

As I illustrate in Figure 1.1, there are four stages of IMF conditionality. In general, current scholarship has reached a consensus regarding the *ex ante* characteristics of countries that initiate programs. While a hard consensus has not yet been reached on the *ex post* effects of programs on borrower states, the overwhelming majority of research on the IMF focuses on this area. In contrast, this thesis analyzes the two stages in between, focusing on the design and implementation of IMF agreements with borrower countries. Most current research on these two stages dichotomizes the factors determining program design and implementation into those that influence the IMF and those that influence the borrower country, without demonstrating how these factors interact with each other. These interactions matter because both parties, the IMF and the borrower country, are deeply involved in the process of negotiating an arrangement as well as in subsequent decisions regarding the disbursement of funds. The actions of one party impacts the decision-making process of the other and thus it is important to take these interactions into account in any analysis of the design and implementation phases.

**Figure 1.1:** Gaps in the Literature on IMF Conditionality




The literature is also dominated by quantitative studies that are plagued by measurement problems and do not analyze or explain the relationships among different variables, such as the IMF's institutional imperative, powerful shareholders' interests, and domestic political economy factors. In terms of policy design, this thesis explains how these variables interact in the negotiation process between the IMF and a borrower country to determine the size of the loan disbursed and the breadth and depth of conditions imposed. With regard to policy implementation, this thesis illustrates how factors determining the compliance of borrower governments interact repeatedly with factors determining the IMF's response to determine the eventual outcome of a program. By learning about these interactions, we gain a more holistic understanding of IMF conditionality.

## CONDITIONALITY

The IMF has four main types of arrangements that encompass conditionality: (1) the Stand-By Arrangement (SBA), (2) the Extended Fund Facility (EFF), (3) the Structural Adjustment Facility (SAF), and (4) the Enhanced Structural Adjustment Facility. SBAs are by far the most common type of arrangement that borrower countries enter into with the IMF[20] and are typically supposed to last between twelve and twenty four months. This study does not differentiate between these arrangements, as their fundamental objectives are the same, with only the conditions, timing, and the size of their loan disbursements varying slightly.[21]

Conditionality comprises three basic components—(1) "Prior actions" that need to be completed before a loan is approved, (2) "Performance criteria" that is quantified and determine whether a country can draw on subsequent phases of IMF credit, and (3) a "Letter of intent" that includes more qualitative policy reforms that a government has agreed to undertake.[22] I analyze conditionality in IMF programs by dividing it into two phases: (1) policy *design* and (2) policy *implementation*. Policy design happens when a country first approaches the IMF and continues through mutual negotiation until an agreement is signed. Policy implementation involves the IMF regularly monitoring a country's compliance with its performance criteria and, in the case of non-compliance,

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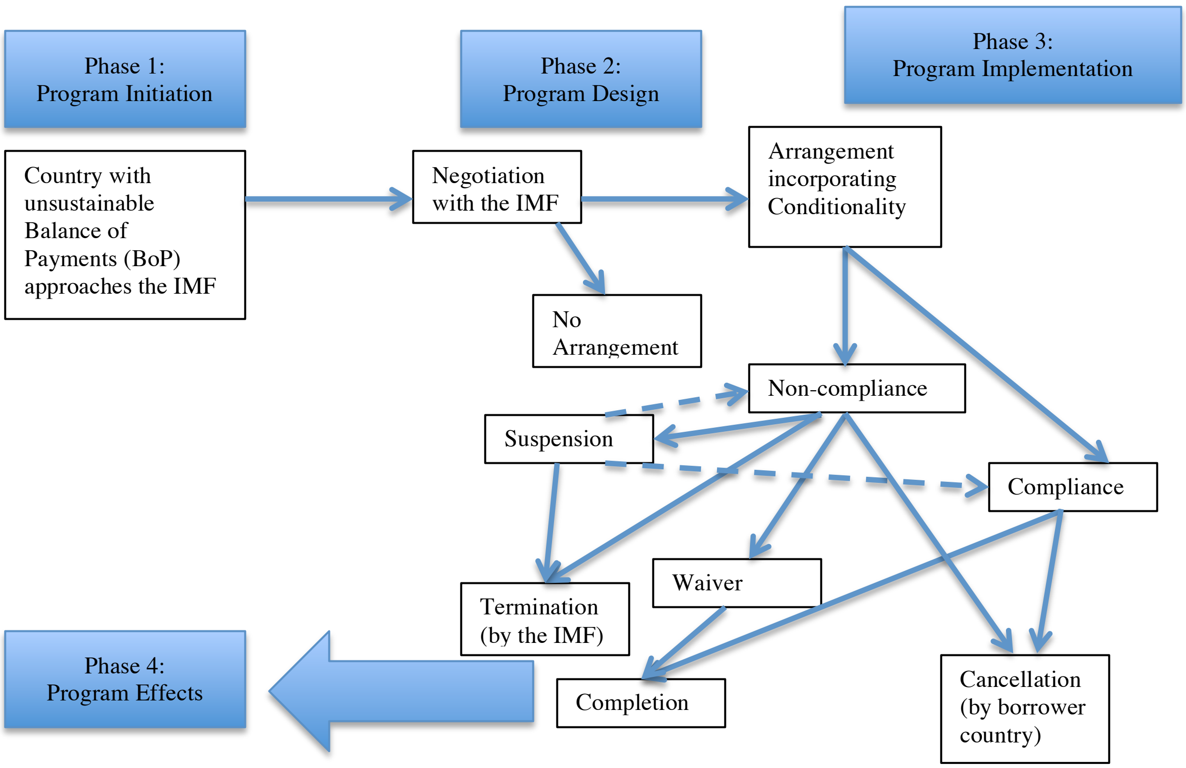
[20] In a survey of 678 agreements in the post-1970 period, 598 (88%) of them are SBAs. See Adam Przeworski and James Raymond Vreeland, "The Effect of IMF Programs on Economic Growth," *Journal of Development Economics* 62, no. 2 (2000): 385–421, doi:10.1016/S0304-3878(00)00090-0.

[21] For more, see Jacques J. Polak, *The Changing Nature of IMF Conditionality*, OECD Development Centre Working Paper (OECD Publishing, 1991), https://ideas.repec.org/p/oec/devaaa/41-en.html.

[22] Miguel Savastano and Michael Mussa, "The IMF Approach to Economic Stabilization," *NBER Macroeconomics Annual* 14, no. 1 (2000): 79–122.

deciding whether to suspend or terminate a program, or grant a waiver.[23] The four phases in the life-cycle of an IMF program are illustrated in Figure 1.2.

**Figure 1.2**: The Life-Cycle of an IMF Program




I initially distinguish between the two phases of program design and program implementation because, theoretically, the factors at work during each phase are slightly different; however, in reality, an arrangement is generally negotiated and agreed upon while a previous one is still in effect. It can therefore be difficult to pinpoint exactly which factors determine one phase and not the other when there is an overlap between the two phases. Thus, in my Critical Framework, I outline macro-level factors that affect both

[23] Joseph P. Joyce, "Adoption, Implementation and Impact of IMF Programmes: A Review of the Issues and Evidence," *Comparative Economic Studies*, Comparative Economic Studies, 46, no. 3 (2004): 451–67.

phases to illustrate what happens when the implementation of an existing arrangement overlaps with the negotiation of a new one.

## Logic Behind My Critical Framework

I argue that any model of IMF program design and implementation needs to address the complex, multifaceted series of political factors affecting the IMF at the international level and the borrower country at the national level. In addition, it must capture endogenous and exogenous economic factors that have an impact on how both parties respond to their respective political circumstances as well as to each other. Lastly, it has to take into account the cyclical nature of the two phases, as well as the fact that they often overlap. I propose, illustrate, and elaborate on my framework at the end of Chapter 2.

Through the course of my argument, I seek to understand the extent to which the IMF serves its original purpose of promoting international monetary stability and sustained economic growth by providing impartial guidance and financial assistance to countries in crisis, or whether domestic and international drivers have an undue influence on the Fund's decision-making process. The purpose of this thesis is to create a new, dynamic model that incorporates the interaction of factors affecting both the IMF and borrower countries in both the program design and implementation phases. My Critical Framework allows for the analysis of the relative importance of the factors determining IMF motivations and those determining borrower countries' motivations and compliance. In doing so, I contribute to scholarship on IMF conditionality by enabling other scholars to analyze other case studies using this framework.

## SIGNIFICANCE

### THEORETICAL SIGNIFICANCE

There are four main bodies of theory pertaining to IMF program design and implementation—(1) the functionalist approach, (2) structural relations, (3) principal-agent relations, and (4) the domestic political economy approach—which determine how the IMF and borrower countries interact and produce outcomes.

Most of the literature on program design are quantitative studies that are unable to explain exactly *why* differences in the severity of conditions arise or analyze the relative importance of these different factors. Because they limit their analysis of the dependent variable to the number of conditions imposed (where a larger number of conditions equals a more restrictive design), most existing studies do not take into account the type and severity of individual conditions imposed. They also do not factor in the type of problems faced by borrower states that the conditions are designed to address. For example, it would not be fair or accurate to compare a country facing hyperinflation of several thousand percent per year to another facing high but persistent inflation of close to a hundred percent a year based only on the number of conditions in their respective loan agreements, and even more so when comparing them to yet another state whose fixed exchange rate is depleting its foreign reserves. In other words, the economic conditions in borrower states and the type of conditions eventually imposed need to be taken into account for a study to accurately compare the relative importance of different factors in determining IMF policy design.

In terms of implementation, most studies are quantitative ones that restrict their analysis of program implementation to the suspension, termination, or completion of programs. While they do so in order to measure the same variable across a large sample of countries, this method fails to take into account the circumstances behind each program's eventual outcome. For example, while the Fund might suspend or terminate an arrangement due to a borrower's non-compliance, interruption can also happen because the existing arrangement is superseded by a new one or the borrowing country decides to stop taking IMF loans. Similarly, the fact that a country completes its program does not mean it complied with the conditions set by the IMF. The Fund might have issued waivers to facilitate uninterrupted lending in spite of non-compliance. Therefore, if a borrower state votes against the US in the UN and its agreement with the IMF is terminated soon after does not automatically mean that the two events are related, even though many existing studies would consider that to be the case. The borrower state could have, instead, voluntarily chosen to end the program or negotiated another arrangement that superseded it. This thesis makes up for this flaw by analyzing the relative importance of the interests of powerful shareholders as well as the IMF's own priorities, and the changing economic and political circumstances in a country, while taking into account the impact conditionality has on these circumstances. I do so by analyzing the exact circumstances behind the eventual outcome of an arrangement.

In essence, I advance a more nuanced approach to this topic by analyzing the strictness of conditionality in IMF programs and the stringency of IMF program implementation based on the specific problems they were designed to address and the exact circumstances behind each eventual outcome, not statistical correlations between factors that could potentially result in misleading or divergent conclusions.

These findings have important implications for the wider, more extensive debate on the *ex post* policy effects and general effectiveness of IMF programs. It is clear that IMF programs are not identical but exhibit wide variation due to differences in the problems they were designed to address and the type and number of conditions they include.[24] As a result, it would be unreasonable to expect them to have identical effects. It would also be unfair to judge them based on the same criteria. After all, how can the results of a program be accurately compared to another when the problems they were designed to address vary so much? Furthermore, even if two programs have the same design, they may be implemented very differently. Therefore any assessment that does not correct for borrower compliance will risk mistaking the detrimental effects of *non-compliance* for the detrimental effects of a *program's design*.

To make things worse, in certain complicated cases—i.e., where a borrower is not totally compliant but the IMF grants a waiver and continues to disburse funds—we must make the distinction between the effects of the loan, the effects of measures that were complied with and the effects of non-compliance. In order to make the right policy recommendations, we must first know how to accurately assess the effects of various programs by differentiating between the effects of a program's design and the level of implementation. My thesis contributes to the field by creating a framework within which the factors determining program design and implementation are analyzed.

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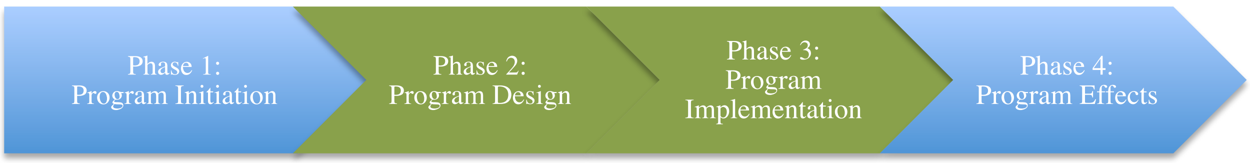
[24] Martin C. Steinwand and Randall W. Stone, "The International Monetary Fund: A Review of the Recent Evidence," *The Review of International Organizations* 3, no. 2 (2008): 123–49.

Figure 1.3 shows how my proposed framework fits into the broader literature on IMF programs in general. Together, these four pieces create a holistic understanding of IMF programs.

**Figure 1.3:** Filled Gaps in the Literature on IMF Conditionality




**General consensus in literature:**

*Ex ante* country characteristics of borrower countries

**My thesis:**

1. Powerful shareholders' interests
2. The IMF's institutional priorities
3. Economic and political conditions in the borrower country
4. Global environment

**Design as criteria & implementation → more accurate assessment of:**

*Ex post* program effects on borrower countries

## PRACTICAL SIGNIFICANCE

The study of IMF program design and implementation has practical implications for the Fund, states, and citizens alike. I analyze this topic at the international, institutional and national levels, allowing all the actors involved to understand their influence on the IMF's decision-making process and subsequently formulate policies to promote political, economic and social stability in both the global and domestic spheres.

The establishment of the Independent Evaluation Office (IEO) in 2001 suggests that the IMF has a desire to strengthen its credibility and undertake internal reforms in order to better achieve its mandate.[25] My study contributes to a better understanding of

[25] Independent Evaluation Office, "Origins of the IEO," *Independent Evaluation Office of the International Monetary Fund*, accessed December 16, 2014, http://www.ieo-imf.org/ieo/pages/Origins.aspx.

the IMF's decision-making mechanisms in order for policy-makers to propose more efficient and equitable ways of structuring and implementing loan arrangements.

The need for greater understanding is particularly pertinent with the planned inception of the New Development Bank (NDB), a multilateral development bank being established by the five largest emerging market economies—Brazil, China, Russia, India, and South Africa—and expected to begin functioning by the end of 2015.[26] Since its founding almost 70 years ago, the IMF's role and influence in the world economy have never been challenged by another institution. Together with the China-backed Asian Infrastructure and Investment Bank (AIIB) launched in 2014, however, the NDB poses a challenge to the current dominance of the U.S.- and European-centric World Bank and IMF. In order for the Fund to retain its influence, it needs to maintain the support of its member states, many of whom are dissatisfied with the way its arrangements are currently designed and implemented. This study enables the Fund to re-examine its decision-making mechanisms so that it will be able to negotiate and rebalance the interests of both creditor and debtor states, which will in turn enable it to remain relevant in the future.

Finally, the recent global financial crisis precipitated a fierce debate on the future of regulation of the international financial services sector. It also resulted in an unprecedented upsurge in IMF lending activity, with loans vastly exceeding regular limits arranged with countries including Portugal (78 billion euros), Ireland (67.5 billion euros),

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[26] *Agreement on the New Development Bank – Fortaleza, July 15*, Press Release (Fortaleza, Brazil: VI BRICS Summit, July 15, 2014), http://brics6.itamaraty.gov.br/media2/press-releases/219-agreement-on-the-new-development-bank-fortaleza-july-15.

and Greece (240 billion euros, also the largest rescue effort in financial history).[27] My study explains how international institutions coordinate responses to financial crises, which contributes to our understanding of what global architecture is necessary to safeguard international economic stability.

## RESEARCH DESIGN

I use Stephen Van Evera's concept of the case study, where the case method serves to test existing theories and "yield important data that is otherwise inaccessible."[28] I conduct an in-depth study of a single case over an extended period of time, using the process-tracing method to analyze within-case variance.

### CASE SELECTION

I conduct a case study of Argentina in my empirical chapters. There are three reasons why I select Argentina as my case. First, Argentina had three Stand-By Agreements (SBAs) and two Extended Fund Facilities (EFF) with the IMF between 1991 and 2002.[29] After the preliminary success of the establishment of its currency board arrangement in 1991, Argentina had to rely on the IMF's endorsement and sporadic financing through this series of SBAs.[30] From 1999 to 2001, Argentina experienced an economic downturn, a sovereign debt crisis and a banking crisis, before it defaulted on its

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[27] Breen, *The Politics of IMF Lending*.

[28] Stephen Van Evera, *Guide to Methods for Students of Political Science* (Ithaca, N.Y.: Cornell University Press, 1997), 30.

[29] Anna Gelpern and Brad Setser, "Pathways Through Financial Crisis: Argentina," *Global Governance* 12, no. 4 (October 1, 2006): 465–87.

[30] Ibid.

foreign debt and abandoned its fixed exchange regime at the beginning of 2002. On the surface, Argentina appears to be emblematic of Latin American countries that were affected by the Third World debt crisis of the 1980s, after which the IMF began lending primarily to countries facing currency and capital crises.[31] For instance, it was one of many countries in the region to undergo a process of neoliberal reform in the 1990s. This indicates that some of its antecedent conditions are similar to those of other countries in the region such as Brazil, Chile, and Uruguay.

Argentina, however, is unique in several ways. Due to its dependence on a generally inward-looking import substitution model from 1914 to 1991, Argentina did not trade extensively with the developed world or pose a systemic threat to the global economy at the time.[32] Yet many developed countries saw it as a poster child for the economic policies embodied in the Washington Consensus[33] and promoted by the IMF.[34] Therefore, the Fund had an institutional interest and the U.S. had a political interest in seeing Argentina succeed.[35] According to Anne Krueger, an ex-deputy managing director, in 1991, "the IMF was initially unwilling to lend to Argentina. But the United States was

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[31] Graham Bird, "The IMF: A Bird's Eye View of Its Role and Operations," *Journal of Economic Surveys* 21, no. 4 (2007): 683–745, doi:10.1111/j.1467-6419.2007.00517.x.

[32] Flavia Fiorucci and Marcus Klein, eds., *The Argentine Crisis at the Turn of the Millennium: Causes, Consequences and Explanations*, CEDLA Latin American Studies (CLAS) Series, no. 92 (Amsterdam: Aksant, 2004).

[33] The term "Washington Consensus" refers to a set of market-based, neoliberal policy prescriptions that were applied to many developing countries in Latin America over the 1990s. For more, see John Williamson, "A Short History of the Washington Consensus," *Law and Business Review of the Americas* 15 (2009): 7.

[34] Caroline Silva-Garbade, *Determinants of National IMF Policy: A Case Study of Brazil and Argentina*. (Frankfurt am Main: Peter Lang, 2010).

[35] Silvia Marchesi and Laura Sabani, "IMF Concern for Reputation and Conditional Lending Failure: Theory and Empirics," *Journal of Development Economics* 84, no. 2 (November 2007): 640–66, doi:10.1016/j.jdeveco.2007.01.001.

adamant that the Argentine government […] should be supported."[36] Furthermore, major international banks had a vested interest in influencing the IMF to continue lending, as their investments and profits depended on the continuous purchase of Argentine bonds.[37] Theoretically, this would have allowed Argentina to negotiate for looser conditions relative to other, less trumpeted countries. One would also expect the IMF and the US in particular to sustain their support even when Argentina did not comply with policy conditions in order to preserve their image and financial interests, which they did for a period of time in the late 1990s.[38] In December 2001, however, the IMF suspended its arrangement with Argentina and cut off financial support to the government.

What happened here? What explains this turn of events after a decade of continuous, uninterrupted support? Understanding this switch in policy is essential in shedding light on the interaction of variables affecting Argentina over this period. As such, the case of Argentina allows me to conduct strong tests[39] because Argentina has characteristics of a critical case. According to Stephen Van Evera, a critical case is one with "extreme values on the independent variable," which offers strong tests because "the theory's predictions about the case are certain and unique."[40]

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[36] Anne O. Krueger, *Economic Policies at Cross-Purposes: The United States and Developing Countries* (Washington, D. C.: Brookings Institution Press, 1993), 100.

[37] Paul Blustein, *And The Money Kept Rolling In (and Out): Wall Street, the IMF, and the Bankrupting of Argentina*, 1st ed. (New York: PublicAffairs, 2005), 81.

[38] Blustein, *And the Money Kept Rolling in (and Out).*

[39] According to Van Evera, a strong test is "one whose outcome is unlikely to result from any factor except the operation or failure of the theory." In other words, theories that pass the test can be considered relatively robust.

[40] Evera, *Guide to Methods for Students of Political Science*, 60, 77.

Secondly, the data available for Argentina is rich. Argentina was one of the most affluent countries per capita in the world at the end of the 19th century.[41] As a result, there are numerous universities and think-tanks in the country dating back to that period. They provide a wealth of literature covering all periods of Argentine economic history. Furthermore, there has been sustained scholarly interest into how this once-prosperous country deteriorated over the past century, contributing further to the wealth of scholarship on the country.

Lastly, the case of Argentina is significant in its timeliness. A minority of hold-out creditors who refuse to accept Argentina's debt restructuring offer filed a lawsuit against the country in 2012, which has kept it in the public spotlight.[42] When a New York judge made a controversial ruling that blocked Argentina from paying its restructured debt until it paid its holdouts, this decision triggered a "selective default" on the part of Argentina as it could not afford to pay all its creditors in full.[43] The ongoing saga has its roots in the 2001 crisis, after Argentina defaulted on US$95 billion in government bonds and holders of about 92 percent of the bonds accepted restructurings but, as mentioned

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[41] María Inés Barbero, "Argentina: Industrial Growth and Enterprise Organization: 1880s–1980s," in *Big Business and the Wealth of Nations*, ed. Alfred D. Chandler, Franco Amatori, and Takashi Hikino (Cambridge: Cambridge University Press, 1999), 368–93.

[42] Benedict Mander, "Argentina Faces Pressure to Strike Deal with 'Hold-Out' Creditors," *Financial Times*, December 15, 2014, http://www.ft.com/cms/s/0/34d75f86-83a9-11e4-8a84-00144feabdc0.html#axzz3M58QsTb0.

[43] Drew Benson and Patricia Hurtado, "Argentine Funds Can't Be Seized by Bond Holders, Judge Says," *Bloomberg*, March 29, 2012, http://www.bloomberg.com/news/2012-03-28/u-s-judge-vacates-2-2-billion-order-in-argentine-bond-case.html; Peter Coy, "What Happens Now That Argentina Is in 'Selective Default,'" *Bloomberg Business*, July 30, 2014, http://www.bloomberg.com/bw/articles/2014-07-30/what-happens-now-that-argentina-is-in-selective-default.

earlier, a group of hedge funds rejected the offer and filed a lawsuit instead.[44] My study sheds light on this topical issue by analyzing the events that led to the current situation.

## Time Frame

I examine the Fund's policies in Argentina from April 1991 to January 2002. Argentina's establishment of a fixed exchange rate regime on April 1, 1991 marks the starting point of my analysis, as it was the cornerstone of the broad, neoliberal economic reforms ushered in throughout the decade. It was on this foundation that Argentina requested a new SBA (Stand-By Arrangement) several months later. The end point is marked by the suspension of Argentina's fifth successive arrangement at the end of December 2001 and the eventual collapse of the convertibility regime in January 2002. The timeframe covers program design and implementation for four separate SBAs.

## Methods and Sources

I use the case study method to answer my research question because the variables under study and the relationships between them are complex. According to Lipson, the case study allows me to explore the "subtle interaction among variables" and observe "causal processes at work."[45] In other words, variables are not simply dichotomized into 'yes' or 'no' components, but can be analyzed closely for intricacies and nuances. And in order to evaluate the influence of various drivers on program design and implementation, we need to go beyond such yes/no categories to offer more nuanced explanations for

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[44] Coy, "What Happens Now That Argentina Is in 'Selective Default.'"

[45] Charles Lipson, *How to Write a BA Thesis: A Practical Guide from Your First Ideas to Your Finished Paper* (University of Chicago Press, 2005), 101.

existing theories. This augments the statistical relationships that the quantitative studies dominant in the field offer, helping to explain how and why these relationships arise.

A criticism often leveled at the single-case study is its not being generalizable to other cases. Even if a theory sails through a single-case-study test, it may have atypical and undiscovered antecedent conditions that severely limit its usefulness in explaining other cases.[46] This weakness, however, can be overcome by doing more case studies using the same independent and dependent variables. While I do not do analyze other case studies in this thesis, I build a theoretical framework that other researchers can use to investigate other cases and overcome this weakness.

In addition, according to Van Evera, the case study is a strong method of testing theories because it tests predictions that are rather unique and it explains clearly how the independent variable causes the dependent variable.[47] For both phases, the independent variables of my study are: (1) powerful shareholders' interests, (2) the IMF's institutional priorities, (3) the economic and political conditions in a borrower country, and (4) the global environment; for the design phase, the dependent variable is the design of IMF programs (measured in terms of the size of the loan as well as the breadth and depth of conditions) while for the implementation phase, the dependent variable is the implementation of these programs in borrower countries (measured in terms of borrower compliance/non-compliance and the IMF's decision in response).

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[46] Evera, *Guide to Methods for Students of Political Science*, 53.

[47] Ibid., 57.

I use process tracing to explore "the chain of events or the decision-making process by which initial case conditions are translated into case outcomes."[48] I seek evidence of the causal links between the independent and dependent variable in the "sequence and structure of events and/or in the testimony of actors explaining why they acted as they did."[49] In other words, I use process tracing to establish and explain the causal links between my independent and dependent variables in order to support or undermine existing theories.

For my sources, I evaluate primary documents such as IMF Executive Board meeting minutes, country reports prepared by IMF staff, Letters of Intent signed by borrower countries as well as congressional debate records and reports from the US and Argentina. I also analyze secondary scholarship to ground my research in existing theory and to corroborate my findings with other scholarly work.

## General Limitations

First, I am unable to conduct interviews with IMF directors or Argentinean policy-makers for a firsthand account of events due to resource and time constraints. Hence, I rely on interviews that others have conducted as well as other primary documents such as speeches and press releases that are available in the public domain. As a result, I am unable to ask specific questions pertaining to my study, but have to rely on what is publicly available. In addition, some sensitive materials in the IMF Archives are only open to researchers after a 20-year moratorium has passed. Thus, I am unable to

[48] Ibid., 64.

[49] Ibid., 65.

access the Executive Board meeting minutes on December 5, 2001, when the arrangement with Argentine was suspended. As a result, I rely on secondary documents for accounts of the decision-making process on that day.

Secondly, the largest limitation of this study is a limitation that is characteristic of any study of state and international actors: these actors often have an interest in hiding their self-interest. For example, I seek to uncover any interference the U.S. may have in the IMF's decision-making process in granting a country waivers despite evidence of non-compliance. The U.S. government, however, would likely want to keep evidence of its influence private in order to preserve the image of the IMF as an impartial arbiter. Thus, finding direct evidence of developed countries' interference may prove difficult. To overcome this limitation, I triangulate by drawing on multiple sources, including Executive Board meeting minutes, congressional records, and details of interviews in secondary sources, to make up for the potential biases or omissions in any single one.

## CHAPTER SUMMARY

Chapter Two evaluates and critiques the existing scholarship on IMF program design and implementation in order to highlight the gaps in current knowledge and establish the need for my study. Chapter Three explains the historical relationship between the IMF and Argentina, establishing the context within which they interact from 1991 to 2002. Chapter Four and Chapter Five analyze the factors determining IMF decision-making from 1991 to 2002 using my Critical Framework for IMF Program Design and Implementation. In Chapter Six, I conclude by drawing implications from the findings of this analysis for theory and practice.

# CHAPTER TWO

## THE STATE OF THE ART ON IMF CONDITIONALITY

> Decisions [at the IMF] were made on the basis of what seemed a curious blend of ideology and bad economics, dogma that sometimes seemed to be thinly veiling special interests … Open, frank discussion was discouraged—there was no room for it.
>
> —Joseph Stiglitz, *Globalization and its Discontents*

There are four existing bodies of theory that address my research question: (1) the functionalist approach to international institutions, (2) structural relations in international institutions, (3) principal-agent relationships, and (4) the domestic political economy approach. The first three are slight modifications to Steinwald and Stone's classifications of theoretical expectations regarding international institutions in their thoughtful review of current quantitative research about the IMF.[1] Here, I use them to analyze the factors governing the IMF's motivations during the phases of program design and implementation. I supplement them with a fourth body of theory that governs the borrower state's bargaining power during the phase of program design as well as its ability and will to comply with conditionality during the implementation phase. I then explain the need for my proposed framework and use Robert Putnam's theory on two-

[1] Steinwand and Stone, "The International Monetary Fund: A Review of the Recent Evidence," 125.

level games[2] to synthesize these four bodies of theory into my Critical Framework for IMF Program Design and Implementation.

### (1) The Functionalist Approach

The functionalist approach to international institutions is fundamentally concerned with collective interests in cooperation.[3] According to this approach, international institutions emerge as solutions to "collective action problems" in the political marketplace.[4] Otherwise exorbitant transaction costs are overcome through interstate cooperation.[5] The IMF, charged with maintaining the stability of the international monetary system, accomplishes this by pooling contributions from member nations and using these funds to provide loans to countries with temporary balance of payments crises. Shocks to the global economy are thus tempered through the collective contributions of all participating members. This approach is crystallized in the IMF's Articles of Agreement, which state that the IMF exists to "promote international monetary cooperation" by providing a platform for member states to collectively solve problems and allow them to make use of Fund resources "to correct maladjustments … without resorting to measures destructive of national or international prosperity."[6]

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[2] Robert D. Putnam, "Diplomacy and Domestic Politics: The Logic of Two-Level Games," *International Organization* 42, no. 3 (June 1988): 427–60, doi:10.1017/S0020818300027697.

[3] Robert O. Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy* (Princeton, N.J.: Princeton University Press, 1984), 246.

[4] Mark S. Copelovitch, *The International Monetary Fund in the Global Economy: Banks, Bonds, and Bailouts* (Cambridge University Press, 2010), 62.

[5] Barbara Koremenos, Charles Lipson, and Duncan Snidal, eds., *The Rational Design of International Institutions* (New York: Cambridge University Press, 2004), 22.

[6] International Monetary Fund, *Articles of Agreement of the International Monetary Fund* (Washington, D. C.: International Monetary Fund, April 28, 2008), https://www.imf.org/external/pubs/ft/aa/#art1.

According to this approach, conditionality is viewed as an integral tool to enforce the reforms required to achieve the desirable effects of IMF programs.[7] Scholars argue that the conditions in IMF loan arrangements work to cut down delays in debt rescheduling and facilitate debt agreements by signaling borrower countries' commitment to reforms.[8] This plays out during the phases of program design and implementation in the following ways.

*Program Design*

In this phase, the functionalist approach implies impartiality on the part of the IMF in determining the number and type of conditions in a loan arrangement. Taken alone, however, this approach offers little explanatory or analytical power as to why conditionality varies across different countries. Evidence from the IMF's Independent Evaluation Office, which conducted a cross-section analysis of 133 programs in 70 countries over the period from 1993 to 2001, indicates that even in core areas of conditionality such as fiscal adjustment, there has been considerable variation in the degree of fiscal adjustment required, whether reforms on the expenditure or revenue side are required, and the depth of structural reform needed.[9]

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[7] Steinwand and Stone, "The International Monetary Fund: A Review of the Recent Evidence," 135.

[8] Charles Lipson, *Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries* (Berkeley, Calif.: University of California Press, 1985); Vinod K. Aggarwal, *Debt Games: Strategic Interaction in International Debt Rescheduling* (New York: Cambridge University Press, 1996); Silvia Marchesi and Jonathan P. Thomas, "IMF Conditionality as a Screening Device," *The Economic Journal* 109, no. 454 (1999): 111–25.

[9] Independent Evaluation Office, *Fiscal Adjustment in IMF-Supported Programs* (Washington, D. C.: International Monetary Fund, 2003).

By itself, the functionalist approach is insufficient in explaining the variance in program design across countries; however, it is useful when considered as one of the factors motivating the IMF when it conducts negotiations with borrower states. For example, the IMF's purpose of maintaining international monetary stability informs its insistence on the number and type of conditions in an arrangement depending on the systemic importance of the borrower state to the world economy. The more systemically important a borrower country is to the stability of the global financial system, the less likely the IMF is to insist on strict conditions, fearing that the rejection of an arrangement would lead to an economic collapse with detrimental effects on the world economy.

*Program Implementation*

Similarly, in this phase, the functionalist approach implies fairness and objectivity on the part of the IMF in deciding whether to grant a waiver, suspend or terminate a program. Borrower non-compliance with a program's performance criteria should result in the suspension or termination of the program in order to preserve the integrity of IMF conditions to signal borrower commitment. These reprisals would also serve to reduce debtor moral hazard,[10] which occurs when countries pursue reckless, over-expansionary fiscal policies that increase the likelihood of an economic crisis occurring because they know they can draw on Fund resources in times of trouble.[11] Yet several studies find that even in countries with extremely low rates of compliance with loan conditionality, the

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[10] For more on debtor moral hazard, see Roland Vaubel, "The Moral Hazard of IMF Lending," *World Economy* 6, no. 3 (1983): 291–304, doi:10.1111/j.1467-9701.1983.tb00015.x.

[11] Bird, "The IMF: A Bird's Eye View," 693.

IMF continued to lend to these delinquent debtors, even when prior programs had been terminated for non-compliance.[12]

Again, taken alone, this approach is insufficient in explaining why the IMF treats some countries differently from others, continuing to grant them waivers or negotiating new programs despite their non-compliance with Fund conditions. It can, however, be incorporated into our understanding of the IMF's perspective during program implementation. Just as in the design phase, the IMF has to consider its institutional priority as an international lender of last resort during the implementation phase. A systemically important country would therefore be granted much more leeway by the Fund despite evidence of non-compliance.

### (2) STRUCTURAL RELATIONS

This body of theory draws on the realist school of international relations theory[13] by emphasizing the international distribution of power and divergence of national interests.[14] A fundamental conflict arises in the IMF between rich, developed nations that tend to be the Fund's creditors and poor, developing states that tend to be the Fund's debtors. In general, the former profit disproportionately from increased trade and

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[12] John Spraos, "IMF Conditionality: Ineffectual, Inefficient, Mistargeted," *Essays in International Finance* 166 (1986), http://www.princeton.edu/~ies/IES_Essays/E166.pdf; Strom C. Thacker, "The High Politics of IMF Lending," *World Politics* 52, no. 1 (1999): 38–75; Martin S. Edwards, "Investor Responses to IMF Program Suspensions: Is Noncompliance Costly?," *Social Science Quarterly*, Social Science Quarterly, 86, no. 4 (2005): 857–73.

[13] For more on the realist school, see Jack Donnelly, "The Ethics of Realism," in *The Oxford Handbook of International Relations*, ed. Christian Reus-Smit and Duncan Snidal (Oxford: Oxford University Press, 2008).

[14] Stephen D. Krasner, *Structural Conflict: The Third World against Global Liberalism*, Studies in International Political Economy. (Berkeley, Calif.: University of California Press, 1985), 75.

financial flows, while the latter suffer much more when crises strike.[15] According to this theory, the IMF is a tool of developed countries to serve their interests and conditionality is the means by which they impose their desired policy reforms on borrower nations. A striking array of literature supports this view.[16]

At first glance, this perspective seems particularly plausible, considering the institutional structure of the Fund itself. The weighted voting system, in which a country's voting power is proportionate to its quota contribution, means that rich, developed countries control the lion's share of votes. For example, the G-5 countries alone control nearly 40 percent of the total votes, with 17.5% in the hands of the US alone.[17] The G-5 countries' vote share can amount to over 60 percent of voting power when the potential winning coalitions that can be formed are taken into account.[18] Moreover, with important decisions requiring a voting majority of 85%, the US effectively holds veto power in the IMF.[19] Moreover, the Executive Board, which

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[15] Steinwand and Stone, "The International Monetary Fund: A Review of the Recent Evidence," 126.

[16] Robin Wells, "Tolerance of Arrearages: How IMF Loan Policy Can Effect Debt Reduction," *The American Economic Review* 83, no. 3 (1993): 621–33; Stephen T. Easton and Duane W. Rockerbie, "What's in a Default? Lending to LDCs in the Face of Default Risk," *Journal of Development Economics* 58, no. 2 (1999): 319–32, doi:10.1016/S0304-3878(98)00116-3; International Financial Institution Advisory Commission and Meltzer, *Report of the International Financial Institution Advisory Commission to the US Congress*; Randall W. Stone, *Lending Credibility: The International Monetary Fund and the Post-Communist Transition* (Princeton, N.J.: Princeton University Press, 2002); Joseph E. Stiglitz, *Globalization and Its Discontents* (New York: W.W. Norton, 2003); Silvia Marchesi, "Adoption of an IMF Programme and Debt Rescheduling: An Empirical Analysis," *Journal of Development Economics*, Journal of Development Economics, 70, no. 2 (2003): 403–23; Jeffrey D. Sachs, "The FP Memo: How to Run the International Monetary Fund," *Foreign Policy* 143 (July 1, 2004): 60–64; Thomas Oatley and Jason Yackee, "American Interests and IMF Lending," *International Politics* 41, no. 3 (2004): 415–29, doi:10.1057/palgrave.ip.8800085; Randall W. Stone, "The Political Economy of IMF Lending in Africa," *American Political Science Review* 98, no. 4 (2004): 577–91, doi:10.1017/S000305540404136X; Axel Dreher and Nathan M. Jensen, "Independent Actor or Agent? An Empirical Analysis of the Impact of US Interests on IMF Conditions," *The Journal of Law & Economics* 50, no. 1 (2006): 105–24.

[17] Vreeland, *The IMF and Economic Development*, 16.

[18] Ibid.

[19] Thacker, "The High Politics of IMF Lending," 41.

approves conditionality agreements, operates based on "consensus," with the managing director "surmising" the collective decision.[20] This arguably further strengthens the position of more developed states, as they can dictate the terms of the conversation without relying on pure voting power.

As evidence, many scholars establish the link between IMF program initiation and the geopolitical interests of countries that contribute the most resources to the Fund.[21] Whether measured in terms of political affinity with regard to voting patterns in the United Nations or foreign aid received, numerous studies show that close links to the US significantly increase the probability of IMF lending. For example, in an econometric analysis of 87 developing countries from 1985 to 1994, Thacker found empirical support that movement towards the US, measured in terms of UN voting patterns, significantly increased a country's chances of receiving an IMF loan.[22] Using data covering 130 countries from 1975 to 2000, Barro and Lee also identified significant positive associations between the probability and size of IMF loans with a borrower country's political and economic proximity to the G-5 countries, as measured in UN voting patterns and bilateral trading volume.[23] This highlights the robust finding that program initiation is

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[20] Joseph Gold, *Voting and Decisions in the International Monetary Fund: An Essay on the Law and Practice of the Fund* (Washington, D. C.: International Monetary Fund, 1972); Gould, *Money Talks*, 7.

[21] Thacker, "The High Politics of IMF Lending"; Barro and Lee, "IMF Programs"; Barry Eichengreen, Ashoka Mody, and Poonam Gupta, *Financial Markets Volatility and Performance in Emerging Markets* (Washington, D. C.: International Monetary Fund, 2006); Steinwand and Stone, "The International Monetary Fund: A Review of the Recent Evidence"; Grigore Pop-Eleches, *From Economic Crisis to Reform : IMF Programs in Latin America and Eastern Europe* (Princeton, NJ: Princeton University Press, 2009).

[22] Thacker, "The High Politics of IMF Lending," 51.

[23] Barro and Lee, "IMF Programs."

significantly shaped by the geopolitical preferences of the Fund's largest shareholders, particularly the US.

*Program Design*

In this phase, structural relations in international institutions imply that the size of IMF loans should be positively correlated, and the breadth and depth of conditions negatively correlated, to the interests of powerful shareholder countries. Oatley and Yackee, using a sample of IMF programs over the period 1986 to 1998, find evidence that the IMF offered larger loans to countries whose governments were closely allied to the US since the end of the Cold War, and who were more heavily indebted to American commercial banks.[24] Dreher and Jensen's panel data analysis of 206 letters of intent from 38 countries over the period 1997 to 2003 also reveals that the number of conditions on an IMF loan decreases when a borrower country is a close ally of the US and other G-5 countries.[25] Stone, too, supports this hypothesis, finding that countries that enjoy the strong support of the US accept fewer categories of conditions in his analysis of IMF programs from 1992 to 2002.[26]

These econometric analyses corroborate strongly with qualitative studies that suggest powerful shareholders exert influence over conditionality agreements. In the 1994 Mexican crisis, for example, the IMF approved a $17.8 billion loan (amounting to an unprecedented 688 percent of Mexico's quota) after intense lobbying by the US

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[24] Oatley and Yackee, "American Interests and IMF Lending."

[25] Dreher and Jensen, "Independent Actor or Agent? An Empirical Analysis of the Impact of US Interests on IMF Conditions."

[26] Randall W. Stone, "The Scope of IMF Conditionality," *International Organization* 62, no. 4 (2008): 589–620.

government. This was particularly notable because the Clinton administration did not even give the customary minimal notice to executive directors before pushing through approval, resulting in some European directors abstaining from the vote in protest.[27] In another example, Blustein details how the US Treasury collaborated with the IMF to approve a loan of even more record-breaking proportions to South Korea at the end of 1997, which totaled $21 billion (and 1757 percent of its quota).[28] An even more explicit connection can be found in US Congressional records. Up to 2001, at least 60 legislative mandates had been passed by the US Congress requiring the American representative at the IMF to use conditionality agreements to achieve specific American objectives.[29]

Even though it is abundantly clear that the US and other powerful shareholders exert an influence over the size of IMF loans and the number of conditions the Fund imposes, I argue that existing studies are inadequate in addressing exactly *why* these loans and conditions vary across countries. Often, the full picture of a country's importance to the US or other developed countries cannot be captured solely using statistics on UN voting patterns or foreign aid. As Oatley and Yackee recommend, "using case studies to fill in the precise political dynamics at work will strengthen our confidence … and deepen our understanding" of exactly how powerful shareholders influence the process of negotiation between the IMF and borrower states.[30]

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[27] Anne O. Krueger, *Whither the World Bank and the IMF?*, Working Paper (National Bureau of Economic Research, December 1997), http://www.nber.org/papers/w6327.

[28] Paul Blustein, *The Chastening: Inside the Crisis That Rocked the Global Financial System and Humbled the IMF* (PublicAffairs, 2003).

[29] General Accounting Office, *International Monetary Fund: Efforts to Advance U.S. Policies at the Fund* (Washington, D. C.: General Accounting Office, 2001).

[30] Oatley and Yackee, "American Interests and IMF Lending," 426.

Moreover, current scholarship overwhelmingly defines the size of loans or the number of conditions as the dependent variables, without accounting for the type and severity of conditions imposed. Apart from Gould, who differentiates between target conditions and procedural conditions—the former sets performance goals for certain macroeconomic measures while the latter not only designates targets but also dictates the exact policies to be implemented in order to achieve them—,[31] other studies do not systematically analyze the specificity of conditions imposed. I argue that the depth of conditionality is as important as the breadth in accurately measuring how strict conditions are. After all, fewer procedural conditions can be more restrictive than a larger number of target conditions, since the latter gives the borrowing government much greater flexibility in deciding what policies to pursue. For example, a target fiscal limit allows the government to decide what method to use to reach that target while a procedural condition may specify the exact steps a country needs to take to reform its social security system.

Given the robust evidence that powerful shareholders exert influence over the process of program design, I incorporate this factor as the primary one affecting IMF motivations. I elaborate more in the section explaining the need for my Critical Framework later in this chapter.

*Program Implementation*

With regards to implementation, there is a slight divergence among scholars over how much penalties for non-compliance are politicized. Most studies claim that US

[31] Gould, *Money Talks*, 27.

influence negatively impacts the IMF's credibility in withholding financing from countries that do not comply with performance criteria but in which the US has a vested interest. For example, in his cross-country statistical test on 47 countries in Latin America and Eastern Europe from 1980 to 2000, Grigore Pop-Eleches finds that those with similar UN voting patterns to the US have a lower probability of program interruptions.[32] In addition, using data on 106 developing countries between 1979 and 1995, Martin Edwards demonstrates that higher levels of US foreign aid correspond to lower probabilities of a program being suspended.[33] In a slight contradiction, Randall Stone finds, in a study of programs in post-Communist countries in the 1990s, that the IMF is more likely to suspend programs in more internationally significant countries, as measured by the size of their IMF quotas and US foreign aid, albeit for shorter periods of time. Yet this finding can be interpreted another way, in that shorter periods of program suspension can be taken as evidence that the IMF is more lenient towards them. Furthermore, Stone observes, in a similar study conducted on Africa, that substantial US foreign aid, membership in British- and French-sponsored post-colonial international institutions, and UN voting alignment with France, are all predictors of weak program enforcement.[34]

More importantly, though, despite the apparent robustness of these findings, I argue that these studies are hampered by their use of an over-simplified classification of implementation. The measurement of implementation is not as straightforward as it

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[32] Pop-Eleches, *From Economic Crisis to Reform*.

[33] Edwards, "Investor Responses to IMF Program Suspensions."

[34] Stone, *Lending Credibility*.

would initially appear to be. Earlier measures calculated the proportion of an IMF loan that was drawn by the borrower state to determine whether or not a loan was completed, but low disbursement could reflect either great economic success (and thus a reduced need for IMF resources) or program failure, two completely divergent results.[35] Most studies, including the ones mentioned above, measure whether or not a program was interrupted. This does not, however, take into account the circumstances behind program suspension, termination, or completion. While program interruption occurs mostly due to a borrower's non-compliance, it can also happen if the borrowing country decides to stop drawing on IMF resources or if the existing arrangement is superseded by a new one. For example, a country that has a change in government midway through a program may interrupt a program due to the new government's wariness of international institutions. Similarly, the fact that a country completes its program does not mean it complied with the conditions set by the IMF. The Fund might have issued waivers to facilitate uninterrupted lending in spite of non-compliance.

This measurement limitation applies to the subsequent bodies of theory and how they relate to program implementation as well. My thesis addresses this by considering the exact circumstances behind program outcomes, which is one of the reasons an in-depth case study is useful in supplementing these quantitative studies.

### (3) PRINCIPAL-AGENT RELATIONSHIPS

Principal-agent relationships are a key feature of public-choice theory, a branch of economics that has been applied to problems of political science and international

[35] Bird, "The IMF: A Bird's Eye View," 721.

relations. According to this theory, all agents—political parties, governments, and international organizations alike—are self-interested, seeking to maximize their own utility. When one entity—the "agent"—makes decisions on behalf of another—the "principal"—, a problem arises when the agent is inclined to operate in his own best interests instead of the principal's.[36] Roland Vaubel pioneered this approach in the context of international organizations in 1986, arguing that this was why political decision-making processes in these organizations often result in outcomes detrimental to the groups they are supposed to serve.[37]

In the context of the IMF, James Vreeland argues that there are at least five principal-agent relationships, most of which involve multiple principals and multiple agents:[38]

> 183 member state constituencies → their governments,
> these governments → the IMF managing director,
> the IMF managing director → the IMF staff,
> (chain of command through the IMF staff)
> the IMF staff → a government signing an agreement,
> this government → domestic policy makers.

Of these, the first three relationships can be taken in sum to form a more general relationship in which the IMF staff are the agents of the 183 member states, who are, in this case, the principals. While the member states expect the IMF and its staff to work towards a broad goal of international monetary stability, the Fund has a secondary objective of maintaining its influence relative to other international institutions.

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[36] Jean-Jacques Laffont and David Martimort, *The Theory of Incentives: The Principal-Agent Model* (Princeton University Press, 2009), 29–30.

[37] Roland Vaubel, "A Public Choice Approach to International Organization," *Public Choice* 51, no. 1 (1986): 39–57, doi:10.1007/BF00141684.

[38] Vreeland, *The IMF and Economic Development*, 157.

Due to the collapse of the Gold Standard in 1971, the IMF's institutional purpose in maintaining exchange rate stability was undermined. Dreher asserts that, in response, it took advantage of the Latin American debt crisis on the 1980s to facilitate debt rescheduling and give itself a new lease on life.[39] Furthermore, Abdelal argues that, up to today, the Fund attempts to maximize its own importance in relation to what could be considered its competition on the global stage, for example, the World Bank.[40] This claim is echoed by Przeworski and Vreeland, who use data covering 1024 annual observations of 79 countries in the post-1970 period to contend that the IMF is less likely to extend loans if many countries are currently participating in Fund programs.[41] This is due to its organizational need of disbursing loans being satisfied. Furthermore, Barro and Lee argue that the biases of IMF staff affect lending, demonstrating that the number of citizens employed by the IMF positively correlates to the incidence of IMF lending to their countries of origin across various model specifications.[42]

*Program Design*

In this phase, principal-agent relationships appear to affect the number of conditions the IMF imposes in relation to various factors, although the findings are not entirely conclusive. First, Dreher and Vaubel use data for 94 countries in 1975 to 1997 to

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[39] Axel Dreher, "A Public Choice Perspective of IMF and World Bank Lending and Conditionality," *Public Choice* 119, no. 3/4 (2004): 445–64.

[40] Rawi Abdelal, "Writing the Rules of Global Finance: France, Europe, and Capital Liberalization," *Review of International Political Economy* 13, no. 1 (2006): 1–27; Rawi Abdelal, *Capital Rules: The Construction of Global Finance* (Cambridge, Mass.: Harvard University Press, 2007).

[41] Przeworski and Vreeland, "The Effect of IMF Programs on Economic Growth"; Adam Przeworski and James Raymond Vreeland, "A Statistical Model of Bilateral Cooperation," *Political Analysis* 10, no. 2 (May 1, 2002): 101–12, doi:10.1093/pan/10.2.101.

[42] Barro and Lee, "IMF Programs," 1267.

demonstrate that the number of conditions the IMF imposes correlates positively with the number of World Bank loans a country receives, suggesting competition between the two.[43] In another study, they find that the number of conditions is also positively dependent on world interest rates.[44] They assert that the IMF maximizes conditionality, and by extension its own power, when countries have fewer alternative sources of funding. This is because higher interest rates in capital markets mean that it is more expensive for countries to borrow outside the IMF. Secondly, in a separate study, Dreher argues that the IMF has a tendency to impose as many conditions as possible, in order to maximize its prestige and the odds of maintaining its budget. Using panel data for 43 countries between 1987 and 1999, he finds that the number of conditions imposed on borrower countries is positively associated with weak current accounts and heavy dependence on loans from the IMF and World Bank.[45] In contrast, however, Stone finds that the IMF frequently refrains from imposing maximum conditionality even when it is in a compelling position to do so.[46]

Here, it is not conclusive that principal-agent relationships play a key role in determining IMF program design. Dreher's interpretations of statistical links between conditionality and factors such as the number of World Bank loans or world interest rates are up for debate. For example, higher world interest rates are an indication of less liquidity in capital markets and a probable slowdown in the global economy, which

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[43] Axel Dreher and Roland Vaubel, "Do IMF and IBRD Cause Moral Hazard and Political Business Cycles? Evidence from Panel Data," *Open Economies Review* 15, no. 1 (2004): 5–22.

[44] Axel Dreher and Roland Vaubel, "The Causes and Consequences of IMF Conditionality," *Emerging Markets Finance and Trade* 40, no. 3 (May 1, 2004): 26–54, doi:10.1080/1540496X.2004.11052571.

[45] Dreher, "A Public Choice Perspective of IMF and World Bank Lending and Conditionality."

[46] Stone, "The Scope of IMF Conditionality."

would mean that the IMF has less funds to disburse to a larger number of countries in trouble. Therefore it could impose more conditions on borrowers to ensure that it has a higher likelihood of remaining solvent. In this case, however, the hypothesis underlying the theory of principal-agent relations could still hold—that is, that conditionality will increase at times when potential borrowers have less access to alternative sources of financing. I incorporate this factor into my framework as a global environment factor affecting the IMF's perspective instead of continuing to frame it in terms of bureaucratic impulses.

*Program Implementation*

During the implementation phase, the main principal-agent relationship in play is similar to the design phase; however, here it acts in favor of borrower countries once an agreement has been signed. There are two reasons for this. The first reason concerns the IMF's dual role as both the lender of funds and the monitor of economic reforms. Marchesi and Sabani argue that this twin function can diminish the IMF's incentives to punish a country's non-compliance due to the desire to protect its own reputation.[47] They highlight Fund policies in Argentina and Russia as qualitative evidence that the Fund continued to lend despite clear evidence of non-compliance. They also analyze a panel of 53 middle-income countries over the period 1982 to 2001 to provide empirical evidence that a longer relationship with the Fund significantly increases loan disbursements.[48]

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[47] Marchesi and Sabani, "IMF Concern for Reputation and Conditional Lending Failure," 4.

[48] Marchesi and Sabani, "IMF Concern for Reputation and Conditional Lending Failure."

Secondly, the IMF's incentives to penalize non-compliance are further reduced due to a practice known as "defensive lending."[49] In order to ensure that a borrower country can meet its outstanding obligations, a significant portion of which is owed to the IMF itself, the Fund disburses new loans which the borrower state uses to pay off the interest or principal on old ones.[50] Due to the reluctance of IMF staff to ruin relationships with a country's government or prematurely induce a crisis before it becomes obvious that there is no other option, this practice often continues until the situation becomes untenable. The IMF's Independent Evaluation Office has issued warnings against this practice in its report on fiscal adjustment on programs from 1993 to 2001.[51]

Although some might argue that the "defensive lending" factor has little explanatory value since it appears, at first glance, to affect all programs in the same way, I argue that analyzing the conditions under which this factor gets taken to the extreme greatly enhances our understanding of the implementation phase. In these critical cases, there occurs a complete breakdown of the IMF's mandate to promote international financial stability. The Fund effectively adds volatility to the global system by pandering to the short-term political interests of a borrower state and exacerbating its eventual economic collapse. Given the clear reference to the case of Argentina in the literature and the potentially broad explanatory power it could have in critical cases, I incorporate principal-agent relationships into my Critical Framework as the IMF's principal consideration when weighing its institutional priorities.

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[49] Axel Dreher, Silvia Marchesi, and James Raymond Vreeland, "The Political Economy of IMF Forecasts," *Public Choice* 137, no. 1–2 (June 5, 2008): 147, doi:10.1007/s11127-008-9318-6.

[50] Rodney Ramcharan, *Reputation, Debt, and Policy Conditionality* (Washington, D. C.: International Monetary Fund, 2003), 3–4.

[51] Independent Evaluation Office, *Fiscal Adjustment in IMF-Supported Programs*.

### (4) THE DOMESTIC POLITICAL ECONOMY APPROACH

Much of the older literature takes the IMF as the unit of analysis,[52] relegating the other main actor in the equation of IMF conditionality—the borrower government—to a place of secondary importance. When characteristics of borrower countries were brought in, they were almost always exclusively linked to program initiation. In his review of the empirical research until 1996, Graham Bird asserts that some economic variables appear to be significant according to most, if not all, studies. For instance, IMF arrangements were linked to countries with low levels of reserve holdings, overvalued exchange rates, a near-term record of past programs, and low levels of income and development.[53] In addition, there seems to be a positive relationship between program incidence and high levels of external debt as well as terms of trade shocks in a number of studies, while the empirical evidence concerning the relevance of fiscal deficits, monetary expansion, and inflation was more mixed.[54]

Yet these variables have little explanatory power in predicting whether or not a country has an arrangement with the IMF, let alone the specific program design in such cases. Even though these models accurately predict a country's participation in an IMF arrangement 80 to 90 percent of the time, a blind guess would be right about 80 percent of the time anyway, as that is the number corresponding to the percentage of countries

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[52] Keohane, *After Hegemony*; Krasner, *Structural Conflict*; Vaubel, "A Public Choice Approach to International Organization"; Spraos, "IMF Conditionality: Ineffectual, Inefficient, Mistargeted"; Polak, *The Changing Nature of IMF Conditionality*; Roland Vaubel, "Bureaucracy at the IMF and the World Bank: A Comparison of the Evidence," *World Economy* 19, no. 2 (1996): 195–210; James, *International Monetary Cooperation Since Bretton Woods*; Marchesi and Thomas, "IMF Conditionality as a Screening Device."

[53] Graham Bird, "Borrowing from the IMF: The Policy Implications of Recent Empirical Research," *World Development* 24, no. 11 (November 1996): 1755, doi:10.1016/0305-750X(96)00153-2.

[54] Ibid.

without arrangements.[55] Still, these early models are useful in identifying and specifying important variables that are used in later studies.

*Program Design*

Since the start of the millennium, scholars have begun to investigate the relationship between the aforementioned political economy variables and program design, measured by the number of conditions in a program. In terms of economic variables, Dreher and Vaubel argue in their analysis of 206 letters of intent between 1997 and 2003 that the number of conditions imposed was negatively related to the level of international reserves.[56] Other purely economic variables were found not to have statistically significant relationships with the breadth or depth of conditionality. Ivanova et al., using a data set with 170 IMF programs approved between 1992 and 1998, find no evidence that political variables affect program design,[57] a claim corroborated by Dreher in his study of 43 countries between 1987 and 1999.[58] Stone, however, asserts that countries with democratic institutions receive markedly fewer conditions, contradicting the previous two studies' findings.[59] Lastly, Dreher adds that low levels of economic freedom are correlated with more conditions.[60] From these studies, it is evident that a

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[55] Bird, "The IMF: A Bird's Eye View," 702.

[56] Dreher and Vaubel, "Do IMF and IBRD Cause Moral Hazard and Political Business Cycles? Evidence from Panel Data," 12.

[57] Anna Ivanova et al., *What Determines the Implementation of IMF-Supported Programs?*, Working Paper, IMF Working Papers (Washington, D. C.: International Monetary Fund, 2003).

[58] Dreher, "A Public Choice Perspective of IMF and World Bank Lending and Conditionality," 458.

[59] Stone, "The Scope of IMF Conditionality," 614.

[60] Dreher, "A Public Choice Perspective of IMF and World Bank Lending and Conditionality," 458.

consensus has yet to emerge regarding the effects of domestic political economy variables on program design.

Yet these quantitative studies do little to help us understand exactly how these variables affect the breadth and depth of conditionality through the negotiation process. I argue that a close and careful examination of the relationships between these variables and conditionality as well as with each other is crucial to pave the way for an understanding of how borrower governments bargain with the IMF.

*Program Implementation*

Deductively, it appears obvious that domestic political economy variables have a significant effect on program implementation. After signing an agreement with the IMF, the borrower government is required to implement a range of performance criteria to address chronic balance of payments deficits and low growth. These criteria include long-term, supply-side policies such as eliminating price controls and liberalizing trade. The measures aim to secure external sources of funding for the country, slow down domestic demand, and boost economic growth.[61] At the time of agreement, the borrower country has signaled to the IMF and financial markets its commitment to implementing these reforms, but still requires legislative or executive action to do so in reality. Therefore, political economy variables such as the strength of political opposition and special interest groups can hinder the actual implementation of these reforms.

A number of studies that analyze implementation do so using a game-theoretic approach in which IMF-mandated conditions are seen as constraints on “veto players”,

[61] Gould, *Money Talks*, 66.

powerful special interest groups, who pose the greatest threat to reform.[62] According to this approach, governments will find it harder to comply with Fund conditions when these "veto players" are against them.[63] Furthermore, the actual execution of Fund-mandated elements is dependent on the bureaucratic capacity of the borrower state, another political economy variable that can affect compliance.

It is extremely commendable that many recent studies use multiple measures of implementation in an attempt to address the measurement problems that earlier studies faced. For example, the comprehensive survey conducted by Ivanova et al. measures implementation in terms of reversible interruptions, irreversible interruptions, an overall index of implementation derived from the MONA database,[64] and the disbursement-commitment ratio. Similarly, Arpac, Bird, and Mandilaras analyze programs over the period 1992 to 2004 using the same measures of implementation: program interruption, the MONA index, and the disbursement ratio.[65]

Probably due to the fact that they are in a stage of nascent development and have a wide range of potential variables to test, these studies demonstrate an even greater divergence than those on program design. While there is an overwhelming consensus that

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[62] Allan Drazen, "Conditionality and Ownership in IMF Lending: A Political Economy Approach," *IMF Staff Papers*, IMF Staff Papers, 49 (2002): 36–67; Alex Mourmouras and Wolfgang Mayer, "IMF Conditionality: An Approach Based on the Theory of Special Interest Politics," *The Review of International Organizations* 3, no. 2 (2008): 105–21.

[63] Mourmouras and Mayer, "IMF Conditionality," 112.

[64] This stands for the IMF's Monitoring Fund Arrangements database, which covers the economic objectives and outcomes (i.e. program design and implementation) of Fund programs. See Bird, "The IMF: A Bird's Eye View," 721.

[65] Ozlem Arpac, Graham Bird, and Alex Mandilaras, *What Determines the Implementation of IMF Programs?*, School of Economics Discussion Paper (School of Economics, University of Surrey, 2006), https://ideas.repec.org/p/sur/surrec/1806.html.

implementation is strongly influenced by borrower states' political economy,[66] there is much disagreement in exactly how they do so. For example, Ivanova et al. assert that strong special interests, lack of political cohesion, inefficient bureaucracies, and ethno-linguistic divisions are strongly correlated to weak implementation.[67] Dreher, surveying 104 countries from 1975 to 1998, contradicts these findings and maintains that there are no "robustly significant coefficients" between implementation and political variables such as government fractionalization, the existence of autonomous regions, and the degree of political cohesion.[68] Arpac et al. find that the number of veto players is a significant determinant, which supports the first study's findings to a limited extent. Regarding initial economic conditions and the breadth and depth of loan conditions, Ivanova et al. do not find a statistically significant link, while Dreher and Arpac et al. do.[69]

In addition, there are a number of qualitative studies[70] and, even more recently, mixed-methods approaches[71] that have emerged to complement the quantitative work on

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[66] Ivanova et al., *What Determines the Implementation of IMF-Supported Programs?*; Axel Dreher, "The Influence of Elections on IMF Programme Interruptions," *The Journal of Development Studies*, The Journal of Development Studies, 39, no. 6 (2003): 101–20; Saleh M. Nsouli, Rouben Atoian, and Alex Mourmouras, *Institutions, Program Implementation, and Macroeconomic Performance* (Washington, D. C.: International Monetary Fund, 2004); Joseph P. Joyce, "Promises Made, Promises Broken: A Model of IMF Program Implementation," *Economics & Politics* 18, no. 3 (2006): 339–65; Arpac, Bird, and Mandilaras, *What Determines the Implementation of IMF Programs?*.

[67] Ivanova et al., *What Determines the Implementation of IMF-Supported Programs?*.

[68] Dreher, "The Influence of Elections on IMF Programme Interruptions."

[69] Ivanova et al., *What Determines the Implementation of IMF-Supported Programs?*; Dreher, "The Influence of Elections on IMF Programme Interruptions"; Arpac, Bird, and Mandilaras, *What Determines the Implementation of IMF Programs?*.

[70] International Monetary Fund, *Strengthening Country Ownership of Fund-Supported Programs*, Policy Development and Review Department (Washington, D. C.: International Monetary Fund, December 5, 2001); International Monetary Fund, *Conditionality in IMF-Supported Programs—Policy Issues*, Policy Development and Review Department (Washington, D. C.: International Monetary Fund, February 16, 2001); Stone, *Lending Credibility*; Independent Evaluation Office, *Fiscal Adjustment in IMF-Supported Programs*; Silva-Garbade, *Determinants of National IMF Policy: A Case Study of Brazil and Argentina*.

implementation. These studies call attention to a number of potentially significant variables including the gravity of initial economic conditions, the gap between the policy preferences of the borrower government and the IMF, the stage of the electoral cycle, and the occurrence of unanticipated external shocks.[72]

With an overwhelming consensus that political economy factors influence program implementation but no agreement on which ones are most significant, it would be premature for me to isolate one or two factors for inclusion in my proposed framework. Instead, I include the political economy approach as a broad factor—economic and political conditions in the borrower country—that enables me to analyze a wider range of variables within my case study.

### My Critical Framework for IMF Program Design and Implementation

In this section, I explain the need for my Critical Framework for IMF Program Design and Implementation and detail the factors that are incorporated in it. As Vreeland explains in his insightful review covering previous generations of studies on IMF conditionality, most details of IMF arrangements were kept secret until the late 1990s.[73] From 1996, the IMF released to the public an increasing number of its documents, publishing letters of intent and opening its archives, which sparked a wave of quantitative studies on conditionality which were impossible to conduct before.[74] It is little wonder,

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71 Vreeland, *The IMF and Economic Development*; Pop-Eleches, *From Economic Crisis to Reform*.

72 Bird, "The IMF: A Bird's Eye View," 726.

73 James R. Vreeland, "IMF Program Compliance: Aggregate Index versus Policy Specific Research Strategies," *The Review of International Organizations* 1, no. 4 (December 1, 2006): 359–78, doi:10.1007/s11558-006-0161-6.

74 Steinwand and Stone, "The International Monetary Fund: A Review of the Recent Evidence," 135.

then, that earlier work on IMF conditionality is limited to analyzing program initiation and program effects, without much consideration given to the relationship between the design and implementation of IMF programs, as well as their subsequent link to these programs' effects.

Secondly, in Chapter One and earlier in this chapter earlier, I took issue with the crucial aspect of measurement with regard to both program design and program implementation. There is no doubt that the most challenging aspect of research into IMF conditionality remains the problem of measurement. It is difficult to reach a consensus as to how to measure conditionality and, to an even greater extent, compliance. Debates continue over even the definition of compliance.[75] Thus, the broad differences in the findings of political economy studies on implementation and design can be attributed in part to these differences in measurement. Another possible reason for this divergence is that a neat, distinct pattern may not exist at all, whether in terms of program design or program implementation.

While the first three bodies of theory—the functionalist approach, structural relations, and principal-agent relations—lend themselves easily to deductive reasoning as to how they affect program design and implementation, the effects of political economy variables are much more complicated. As Arpac et al. contend, they may have idiosyncratic and country-specific elements that are missed by any basic model.[76] In this case, large-*n* quantitative studies need to supplemented with theoretically situated case studies to uncover such specific factors.

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[75] Vreeland, "IMF Program Compliance," 360.

[76] Arpac, Bird, and Mandilaras, *What Determines the Implementation of IMF Programs?*, 26.

As a result, my framework is critical because it provides a theoretically-grounded model with which to analyze the design and implementation of IMF programs. It draws on the four aforementioned bodies of theory and specifies the circumstances under which each factor becomes most significant in determining the IMF's decision-making process. Without a careful analysis of these two phases of IMF conditionality, it would be unfair to judge IMF program effects on borrower states. After all, how would one differentiate between detrimental effects due to poor design or non-compliance? It would even be possible that compliance itself had negative consequences, given the lack of consideration for degrees of implementation. Before we can properly determine the programmatic effects of IMF arrangements and propose policy reforms, we must first accurately determine and weigh the factors governing IMF program design and implementation, because it is against this criteria that we must judge the effects of the programs.

## EXPLAINING MY CRITICAL FRAMEWORK

At the most basic level, IMF conditional loan arrangements involve two main parties, the IMF and the government of the borrower state. The ensuing design of IMF programs is the result of negotiations between these two actors, while the eventual outcome of implementation is the result of the degree of compliance by the borrower government and the IMF's subsequent decision whether to grant a waiver, suspend or terminate a program depending on the situation.

*The Logic of Two-Level Games*

Here, I draw on Robert Putnam's theory of two-level games, which seeks to explain the complicated relationship between domestic politics and international relations.[77] According to this theory, at the national level, the government faces pressure from domestic political interests to implement policies favorable to them, while politicians gain power by garnering support from these groups. At the international level, national governments aim to maximize their ability to "satisfy domestic pressures," while minimizing "the adverse consequences of foreign developments."[78] In the case of conditionality, the national political leader appears at both levels, but it is the IMF, not fellow national leaders, that he faces at the international level. The political leader is constrained by a range of domestic variables at home while the IMF is motivated by its own institutional objectives and simultaneously buffeted by the interests of powerful shareholder governments, the international financial community, as well as its own bureaucrats. As a result, any framework of IMF program design and implementation needs to address the complex, multifaceted set of political factors at both these levels.

In addition, a comprehensive framework must capture endogenous and exogenous economic factors that have an impact on how both parties respond to their respective political circumstances as well as to each other. It also has to take into account the potentially cyclical and overlapping nature of the two phases. The outcome of the design phase—(1) the size of the loan and (2) the breadth and depth of conditions—is simultaneously the starting point of, a key variable in, and the criteria by which the

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[77] Putnam, "Diplomacy and Domestic Politics."

[78] Ibid., 434.

implementation phase is judged. My Critical Framework for IMF Program Design and Implementation, illustrated in Figure 2.1, captures all these complexities in a two-step model that is intuitive and easily replicable.

*Step 1: Program Design*

The first step is the program design phase, which happens after a country approaches the IMF and negotiations on an agreement commence. Negotiations occur until a deal regarding the size of the loan and the breadth and depth of conditions is struck, represented by the blue box titled "Arrangement." This is Step 1, the program design phase.

*Step 2: Program Implementation*

The starting point of Step 2, the implementation phase, is the agreement signed between the IMF and the borrower government, which comprises the size of the loan and the strictness of conditionality. The conditions outlined here are also the criteria against which compliance is judged.

This phase can be further divided into two mini-steps—(1) the degree of compliance of borrower governments and (2) the IMF's decision in the event of non-compliance. In this first mini-step, the onus is on the borrower government to comply with the performance criteria agreed upon either through legislative means or executive action. In the second mini-step, in case of borrower non-compliance, the IMF faces the decision whether to suspend the program or grant a waiver. In the event of suspension, the borrower country is given another chance to comply or the IMF may decide to terminate the program entirely. If the IMF grants a waiver, the country is able to draw on the next tranche of credit, whereupon it will repeat this process.

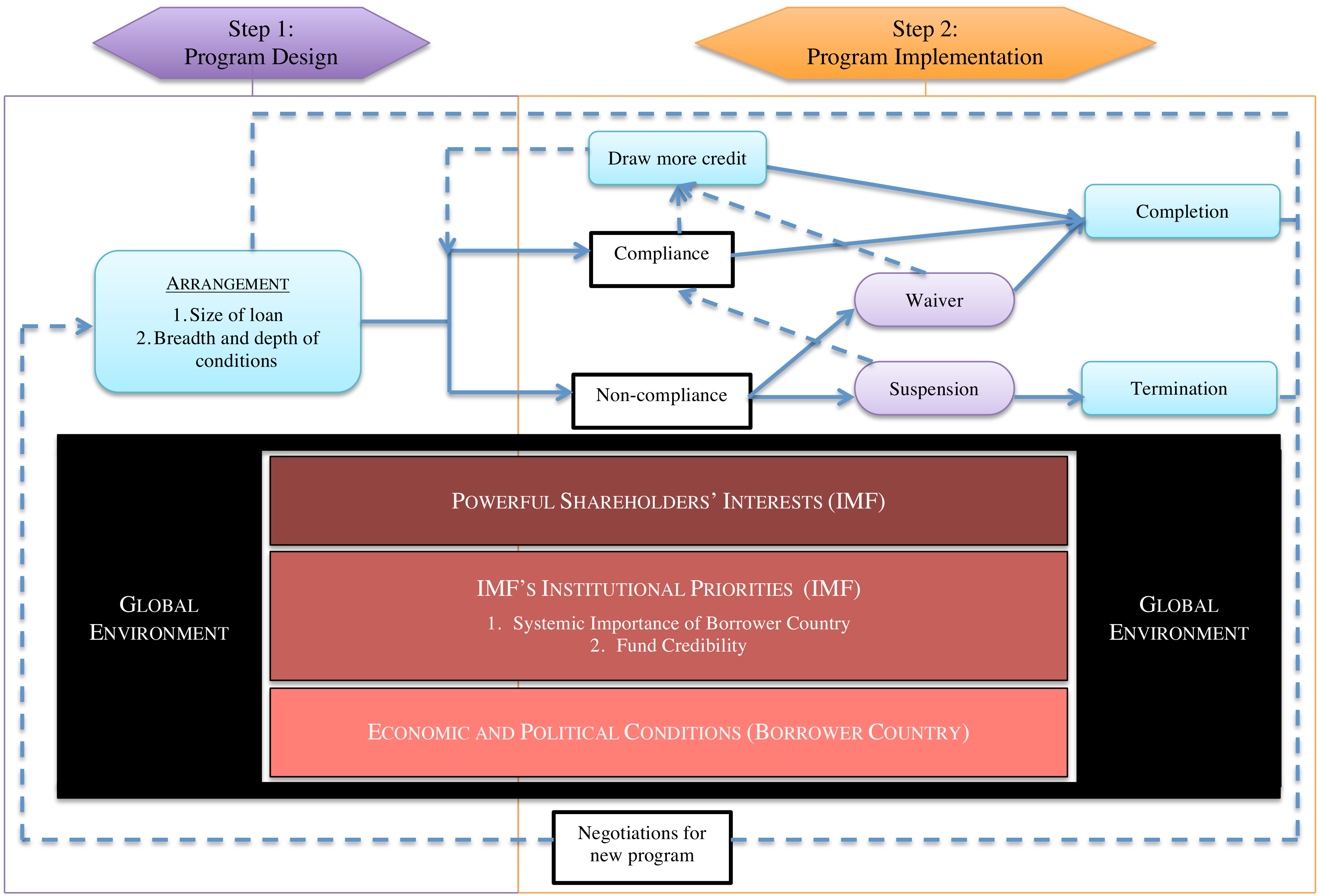
After an arrangement has been approved, at any time during the process of implementation, the country may enter into negotiations for a new program. When this happens, the IMF and the borrower government negotiate both the implementation of the current program and the design of the new program simultaneously, which results in the two steps overlapping. Because this overlap happens very often, it is more useful to simultaneously analyze the four independent variables—(1) powerful shareholders' interests, (2) the IMF's institutional priorities, (3) the borrower country's economic and political conditions, and (4) the global environment—in the context of both phases.

*Explanation and Hypothesis*

The four independent variables in my study are highlighted in red and black in Figure 2.1. They are arranged in descending order of importance, from top to bottom. I hypothesize that the most important factor determining IMF program design and implementation is the interests of powerful shareholders, followed by the IMF's institutional priorities, and then the economic and political conditions of the borrower country. The global environment does not directly impact the decision-making process; instead, it provides the underlying conditions in which the other three factors operate. It is therefore highlighted in black, with the other three factors situated within it.

I hypothesize that the interests of powerful shareholders, in particular, the U.S., are most significant in determining program design and implementation. If a borrower has a special relationship with powerful shareholders, the size of the loan the IMF is will-

**Figure 2.1**: My Critical Framework for IMF Program Design and Implementation



ing to offer increases and the breadth and depth of conditions it insists on decreases. During implementation, countries important to the powerful shareholders are more likely to be granted a waiver in the event of non-compliance. The U.S. and other powerful shareholders, however, do not necessarily have strong policy preferences regarding a particular country, and even if they do, these preferences are not likely to manifest themselves all the time.

In the event that powerful shareholders do not have substantial interests in a country, I hypothesize that the IMF's institutional priorities become the most significant factor. There are two priorities that interact with each other here, namely, (1) the systemic importance of the borrower country and (2) Fund credibility. Regarding the first priority, by its mandate as a global lender of last resort, the IMF would presumably seek to help countries resolve their fiscal, monetary and BoP problems. It can, however, decide on the breadth and depth of conditions to impose in return for a loan as well as the size of the loan itself. If the borrower is critical to the functioning of the global economy—i.e., a crisis in the country would have contagion effects around the world—, the IMF would be more likely to agree to a bigger loan and more lenient conditions. During implementation, a systemically important country will be given more leeway and is more likely to be granted a waiver. With regards to the second priority, the more the IMF's credibility is tied to a country's economic program, the more likely it is to disburse new and bigger loans in order to ensure that a borrower country can meet its outstanding obligations. It is also more likely to grant waivers in cases of non-compliance, because suspending an arrangement is likely to trigger a crisis in the country, which would undermine its credibility on the world stage. I hypothesize that these two priorities work in tandem in most cases because IMF programs in systemically important countries are far more likely to receive global attention. Financial markets and other international institutions are less likely to pay attention to a country that is economically or geopolitically insignificant, and the IMF is less likely to herald it as an example of success. Therefore, the Fund's credibility is tied to a country's systemic importance in most cases.

I hypothesize that the economic and political conditions in a borrower country are not as significant as the two factors above in determining program design and implementation, except in exceptional circumstances. For the borrower government, more severe economic problems reduce its bargaining power and make it more willing to settle for stricter conditions in order to obtain a bigger loan. Depending on its systemic importance to the world economy and/or its importance to powerful shareholders, however, worse economic conditions may actually increase its bargaining power and reduce the breadth and depth of conditionality. Because it is the executive branch that negotiates with the IMF, more legislative opposition enables it to bargain for more lenient conditionality. The IMF would realize that overly stringent conditions would not be passed during the implementation phase.

While the IMF takes these economic and political conditions into account in its decisions, I hypothesize that powerful shareholders' interests and the IMF's institutional priorities take precedence because it is ultimately the IMF, not the borrower, that makes the final decision on the breadth and depth of conditionality as well as whether or not to tolerate non-compliance. Only under exceptional circumstances, when economic and political conditions become so untenable that no amount of IMF support will prevent a crisis, do these conditions become the most significant factor. Under these circumstances, the IMF is *unable* to act on its major shareholders' interests or its institutional priorities.

Lastly, the global environment factor does not determine IMF decisions directly, but underpins all of the three other factors and works through them. For example, an unanticipated external shock may hit a country at any time. Depending on the severity of the shock, the interests of powerful shareholders, the IMF's institutional priorities, and the borrower country's economic and political conditions may all change. It is therefore important to analyze how changes in the global environment may affect all three factors.

The Critical Framework is a model, grounded in theory, that I apply to the case of Argentina. It is a deductive and dynamic model that synthesizes factors from the four aforementioned bodies of theory and accounts for changes in circumstances over time.

## CONCLUSION

Debates on IMF conditionality have traditionally overlooked the interactive relationship between the IMF and borrower governments. As a result, many studies prove insufficient in providing a comprehensive understanding of how IMF program design is negotiated between these two parties and how it subsequently forms the criteria against which program implementation is analyzed. My Critical Framework for IMF Program Design and Implementation synthesizes key ideas and evaluates pertinent variables from traditional bodies of theory to lay the theoretical groundwork on which future analyses of case studies can be performed. In the following chapter, I outline the historical context behind the IMF's relationship with Argentina leading up to the period of convertibility in order to frame my analysis of IMF programs in Argentina in subsequent chapters.

## CHAPTER THREE

## THE POLITICAL ECONOMY OF ARGENTINA UNTIL 1991

> There are four types of countries in the world: developed countries, undeveloped countries, Japan, and Argentina.
>
> —Simon Kuznets, unconfirmed attribution

The Nobel laureate, Simon Kuznets, is said to have made the above remark in the 1950s in reference to Japan's spectacular recovery after the Second World War and Argentina's equally remarkable move in the opposite direction over the course of the twentieth century.[1] While other countries have since emulated Japan's rapid industrialization, Argentina is alone in its dramatic reversal of fortune. It relinquished its position as one of the richest, most advanced economies of the world in 1914 and is now relatively poor compared to an average OECD country.[2] Much research has been done to

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[1] "A Century of Decline," *The Economist*, February 15, 2014, http://www.economist.com/news/briefing/21596582-one-hundred-years-ago-argentina-was-future-what-went-wrong-century-decline.

[2] Gerardo Della Paolera and Alan M. Taylor, eds., *A New Economic History of Argentina* (New York: Cambridge University Press, 2003), 5. Members of the Organization for Economic Cooperation and Development (OECD) are high-income countries and are widely regarded as developed countries. In 1913, Argentina's income level was $3,797, measured in 1992 international dollars. This was higher than many middle-income European economies at the time, such as France ($3,452), Germany ($3,134), and the Netherlands ($3,533), and well above Southern European economies like Italy ($2,507) and Spain ($2,255). Argentina was surpassed by only five countries, including the United States ($5,307) and Australia ($5,505). Since then, its ratio of OECD income levels has dropped to 43 percent in 1987.

address this paradox.[3] Even though my thesis does not seek to answer this question, it is important to note this distinctive aspect of Argentina's history in order to more comprehensively understand its political and economic standing in 1991, the starting point of my empirical analysis in Chapters 4 and 5.

In this chapter, I delve into the evolution of Argentina's political economy from the 1800s to 1991, with a special focus on its relationship with the IMF after the organization was founded in 1946. Prior to 1991, Argentina undertook IMF stabilization programs on three separate occasions, in 1959, 1976, and 1985.[4] These programs are covered in the five different macro periods that I examine in this chapter: (1) from the 1800s to 1929, (2) 1929 to 1955, (3) 1955 to 1976, (4) 1976 to 1984, and (5) 1984 to the present. The first section covers Argentina's golden years, in which primary-export growth drove rapid development; the second covers the country's turn to an import-substitution industrialization (ISI) development model as well as the rise and fall of Perón; the third section covers the deep social and economic cleavages in Argentine society that manifested themselves in multiple military coups and ultimately allowed Perón to return to power; the fourth covers the violent Process of National Reorganization, in which a military junta forcefully took control of all aspects of society and the economy; and the last section covers the transition back to democracy and the

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[3] Della Paolera and Taylor, *A New Economic History of Argentina*; William C. Smith, *Authoritarianism and the Crisis of the Argentine Political Economy* (Stanford University Press, 1991); Alan M. Taylor, "External Dependence, Demographic Burdens, and Argentine Economic Decline After the Belle Époque," *The Journal of Economic History* 52, no. 04 (December 1992): 907–36, doi:10.1017/S0022050700011955; Carlos H. Waisman, "The Argentine Paradox," *Journal of Democracy* 1, no. 1 (1990): 91–101.

[4] Luigi Manzetti, *The International Monetary Fund and Economic Stabilization: The Argentine Case* (New York: Praeger, 1991), 6.

numerous heterodox stabilization plans[5] that tried but failed to steady the Argentine economy.

## 1800S – 1929: THE *BELLE ÉPOQUE*

Between 1864 and 1914 Argentina enjoyed one of the most remarkable periods of growth recorded in contemporary history, often referred to as its *Belle Époque* (French: Beautiful Era). Despite setbacks that occurred in 1875–76 and 1890-91,[6] it has been estimated that during this period, the rate of growth of per capita GDP averaged 5 percent a year.[7] This was driven primarily by the export of primary goods, as Argentina was one of the world's leading exporters of beef and grains. Through the sale of these exports, Argentina was able to amass vast amounts of foreign-exchange and gold reserves with which to purchase imported manufactured goods.[8]

### *The Primary-Export Development Model*

This primary-export development model had its origins in the 1870s, when a group of conservative politicians, backed by major landowners and the upper-middle class in the capital, tightly linked the Argentine economy to that of the United Kingdom.

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[5] Miguel A. Kiguel and Nissan Liviatan, "When Do Heterodox Stabilization Programs Work?: Lessons from Experience," *The World Bank Research Observer* 7, no. 1 (January 1, 1992): 35–57. Heterodox stabilization programs refer to economic plans that use orthodox policies such as a tight fiscal policy and a fixed exchange rate but with initial, temporary income policies such as price and wage controls. They were implemented in multiple Latin American countries and Israel in the 1970s and 1980s in response to high, chronic inflation and slow or negative growth.

[6] H. S. Ferns, "The Baring Crisis Revisited," *Journal of Latin American Studies* 24, no. 2 (May 1, 1992): 241–73.

[7] Carlos F. Díaz Alejandro, *Essays on the Economic History of the Argentine Republic*, Publication of the Economic Growth Center, Yale University. (New Haven: Yale University Press, 1970), 3.

[8] Manzetti, *The IMF and Economic Stabilization*, 25.

British investors were responsible for financing expansions in production, commerce and infrastructure in Argentina until World War One. Agricultural production was channeled from the fertile land of the *pampas* to Buenos Aires, where it was then shipped overseas.[9] Capital investment was concentrated in the rural sector (to improve land and cattle stock), in export infrastructure (to construct railroad networks and enlarge the port of Buenos Aires), and in housing and urban infrastructure (to accommodate the great foreign immigration required to sustain the boom).[10]

The abundance of land and relative scarcity of labor drove wages up, making the country a magnet for European immigrants. By 1914, approximately half the population living in Buenos Aires had been born outside the country.[11] As a result, the middle and working classes expanded and pushed the conservatives, who traditionally represented the interests of the upper classes and were backed by the military, out of power. They were replaced by the Unión Cívica Radical (UCR) in 1916. The new government was nationalistic and anti-conservative in tone, but continued to follow the primary-export model of the previous government.[12]

*The Impact of World War One*

The onset of the first world war in 1914 delivered a blow to Argentine exports as global demand slowed and British financing dried up. Even though per capita GDP growth remained considerable, averaging 3.5 percent between 1914 and 1930, cracks in

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[9] Ibid., 26.

[10] Díaz Alejandro, *Essays on the Economic History of the Argentine Republic*, 6.

[11] "A Century of Decline."

[12] Manzetti, *The IMF and Economic Stabilization*, 26.

the Argentine economic model were beginning to show.[13] The economy's severe dependence on foreign labor and capital made it extremely vulnerable to exogenous shocks. Just prior to WWI, for example, foreigners owned almost half the fixed capital stock in Argentina. In particular, 60 percent of foreign capital was British-owned.[14]

As economic and population growth in Europe and in particular the U.K. slowed, capital and migrant flows to Argentina fell. This retarded growth until the end of the war in 1918, when Argentina's economy began to grow again. From 1918 to 1920, the average annual growth rate for real GDP was 9.8 percent per annum; from 1921 to 1923, it was 7.2 percent per annum; even from 1924 to 1929, just before the Great Depression was setting in, it hovered around 5.1 percent per annum.[15]

In 1929, Argentina appeared on course to becoming a developed nation. It ranked eleventh among the major trading nations of the world and it had a high level of official gold reserves (standing at 490 million gold pesos, from less than 2 million in 1900).[16] Furthermore, it was widely regarded as a country with a prosperous future and one that would play a leading role in regional and international affairs.[17]

## 1929 – 1955: La Década Infame and The Rise of Perón

Between 1929 and 1945, the Great Depression and the protectionist, anti-liberal measures enacted throughout the world, commonly referred to as "beggar-thy-neighbor"

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[13] Díaz Alejandro, *Essays on the Economic History of the Argentine Republic*, 52–53.

[14] Díaz Alejandro, *Essays on the Economic History of the Argentine Republic*.

[15] Ibid., 52–53.

[16] Ibid., 57.

[17] Ibid., 59.

policies,[18] effectively forced Argentina to turn inward and focus on import-substitution activities. From 1929 to 1932 alone, aggregate output fell by nearly 14 percent.[19] Negative growth in real GDP was registered in eight of the 25 years in this period.[20]

*The Great Depression and the Start of Import-Substitution Industrialization (ISI)*

Lt. General José F. Uriburu and his conservative counterparts took advantage of an internal struggle within the Radical party and deteriorating economic conditions to stage a coup d'état and take control in September 1930.[21] This marked the beginning of what many historians have dubbed the Infamous Decade (in Spanish: *La Década Infame*), which lasted until 1943. This was due to the electoral fraud and persecution of political opponents that characterized the political scene as well as the widespread corruption that saturated all levels of government.[22] Economically, however, the government entrusted policy-making to a group of technocrats who were responsible for the creation of several new institutions, including a central bank and regulatory agencies, as well as the enactment of various distributive measures, such as the income tax.[23]

Throughout the 1930s, many of Argentina's export markets engaged in agricultural protectionism and established preferential trading blocs, such as the British

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[18] For more on these policies, see Barry Eichengreen, *Golden Fetters: The Gold Standard and the Great Depression, 1919-1939* (Oxford University Press, 1992).

[19] Díaz Alejandro, *Essays on the Economic History of the Argentine Republic*, 71.

[20] Ibid.

[21] Alberto Ciria, *Parties and Power in Modern Argentina 1930-1946* (SUNY Press, 1974), 7.

[22] Lee J. Alston and Andrés A. Gallo, "Electoral Fraud, the Rise of Peron and Demise of Checks and Balances in Argentina," *Explorations in Economic History* 47, no. 2 (April 2010): 179–97, doi:10.1016/j.eeh.2009.09.002.

[23] Díaz Alejandro, *Essays on the Economic History of the Argentine Republic*, 103; Della Paolera and Taylor, *A New Economic History of Argentina*, 27.

Commonwealth. Both dealt a huge blow to Argentine exports. In response, Argentina embarked on a program of import substitution.

The rationale behind import-substitution industrialization (ISI) was four-pronged: (1) International demand for primary goods could be highly volatile, which exposed Argentina to the risk of drastic foreign exchange shortages and consequent economic depression; (2) The rural sector alone could not provide full employment, thus the manufacturing sector had to be developed to absorb excess labor capacity; (3) ISI would reduce the country's dependence on foreign exchange, as previously imported goods could be produced domestically; and (4) ISI would modernize Argentina's institutions, infrastructure, and redistribute income from the land-owning elite to the working class.[24]

Raúl Prebisch, an economist who worked at the Central Bank of Argentina in the 1940s, built on this to formulate his theory of center-periphery relations, which challenged classical theory's assumptions of free trade based on comparative advantage. He divided the world into the "center," industrialized nations that produced manufactured goods, and the "periphery," nations that produced primary goods.[25] The protectionist measures of the 1930s hurt nations in the periphery that included Argentina disproportionately, as the prices of primary goods declined at a rate much faster than that of manufactured goods. As a result, imports became more and more expensive, and their economies suffered recessions, unemployment, and inflation. The solution for primary producers was to industrialize and put an end to the flow of resources from the periphery to the center. In this context, protectionist measures and government subsidies were

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[24] Manzetti, *The IMF and Economic Stabilization*, 27.

[25] Raúl Prebisch, "Towards a Dynamic Development Policy for Latin America," *Economic Commission for Latin America and the Caribbean*, 1963, 16, http://lacer.lacea.org/handle/11362/14892.

necessary at the initial stages of industrialization to shelter new industries from international competition.[26]

*The Rise of Perón and the Labor Movement*

The Great Depression brought to the fore social and economic tensions that had been simmering during the past decades of growth. Even as early as the 1890s, an atmosphere of resentment developed against foreign companies and investors, and the open, liberal system in general.[27] Projects financed with foreign capital, including railroads, meat-packing plants, and even public utilities, were attacked for abusing their oligopolistic positions to make extortionate profits.[28] The high proportion of foreigners living in the country, however, made it difficult for the working class to band together and consolidate political power, which remained largely in the hands of the land-owning elite.

Agricultural protectionism in other countries and the government's focus on ISI led to a stagnation of the rural sector, which stimulated internal migration from peripheral regions towards urban centers. For example, by 1947, 62.5 percent of the population lived in urban centers of at least 2,000 inhabitants, with about 30 percent of the total population in the Greater Buenos Aires region alone.[29] The expanding urban labor force was not politically organized, with less than 20 percent of workers belonging to a labor

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[26] Manzetti, *The IMF and Economic Stabilization*, 28.

[27] Díaz Alejandro, *Essays on the Economic History of the Argentine Republic*, 60.

[28] Ibid.

[29] Ibid., 108.

union.[30] As the social welfare system was extremely underdeveloped and wages continued to decline, a charismatic leader, Juan Domingo Perón, was able to establish a massive base of support among the working class for his program of higher wages and social reform.[31] Furthermore, he was able to stoke nationalistic fervor and tap on the underlying resentment against foreigners and the elites who associated with them.

A coup in 1943 removed the conservatives from power and saw the military install themselves directly as the government. Then a colonel, Perón deftly used his position as the head of the National Labor Department to establish the *Confederación General del Trabajo* (CGT [General Confederation of Labor]), an umbrella organization that incorporated all existing unions.[32] He also drastically expanded union membership by bringing previously neglected communities, such as recent migrants, into the CGT's fold. Enlarged and considerably strengthened, the labor movement would remain a central player in the political scene from then on.[33]

With the labor movement fully behind him, Perón was elected president in 1946 and fully committed the country to ISI. His economic policies can be generally divided into two periods: 1946 – 1951 and 1952 – 1955.

### *Perón's First 5-Year Economic Plan (1946 – 1951)*

During the first period, Perón concentrated on income redistribution and increasing wages. Between 1946 and 1948, real wages went up by 62 percent, spurring

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[30] Ibid.

[31] Ibid.

[32] Manzetti, *The IMF and Economic Stabilization*, 28.

[33] Ibid., 29.

domestic consumption.[34] Other policies at the time included an overvalued exchange rate, import controls, expansionary fiscal policies and government employment as well as the nationalization of banks, public utilities and transportation companies.[35] For example, government employment also grew by 6 percent a year and government services grew at a much higher rate than the manufacturing sector.[36]

To finance these policies, Perón exhausted the foreign reserves Argentina had accumulated during WWII and tapped on the revenues coming from a national institute he had established, the *Instituto Argentino de Promoción del Intercambio* (IAPI [Argentine Trade Promotion Institute]). It effectively operated a monopoly over the country's exports by purchasing commodities from producers at artificially low prices and selling them to foreign markets at much higher prices.[37]

Perón's regime prioritized certain aspects of import-substitution and focused its efforts on providing health services, education, and recreation to the masses. This approach was effective in two ways: (1) it satisfied nationalistic and reformist sentiments, and (2) it generated employment for the urban working class, Perón's core supporters.[38] This came at the expense of industrial efficiency, however, as the government arbitrarily concentrated resources on industries that had expanded during the war and neglected other potentially import-competing sectors. In particular, the agricultural sector suffered from depressed prices and government control over the sale of rural produce.

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[34] Díaz Alejandro, *Essays on the Economic History of the Argentine Republic*, 123.

[35] Manzetti, *The IMF and Economic Stabilization*, 30.

[36] Díaz Alejandro, *Essays on the Economic History of the Argentine Republic*.

[37] Manzetti, *The IMF and Economic Stabilization*, 30.

[38] Díaz Alejandro, *Essays on the Economic History of the Argentine Republic*, 125.

Productivity in the agricultural sector also stagnated due to the difficulty of importing various inputs, such as tractors and fertilizers, and the labor shortages arising from increasing urban migration.[39]

By the end of 1951, foreign reserves had vanished, agricultural exports were declining, and inflation was at record levels. Between 1948 and 1954, for example, the price level rose at an average rate of 20 percent a year, while in comparison, annual inflation in the United States was less than 1 percent.[40]

*Perón's Second 5-Year Plan (1952 – 1955)*[41]

In 1952, instead of trying to boost exports and increase exchange earnings, Perón imposed across-the-board cuts in imports and instituted more drastic exchange and interest-rate controls.[42] He did, however, attempt to stimulate rural production after severe droughts in 1951 and 1952. Perón even began to seek the cooperation of foreign capital to develop more technologically demanding industries, which included the steel, petroleum, and automotive sectors, which was seen as a major setback to his more nationalist supporters.

While the stabilization policies succeeded in reining in inflation, which was 3.1 percent in 1954, compared to 49 percent in 1951,[43] this was only possible due to

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[39] Ibid., 115.

[40] Ibid., 122.

[41] His second five-year plan was, as the name suggests, projected to last for five years, but was cut short in 1955 by the military coup that pushed him out of power.

[42] Manzetti, *The IMF and Economic Stabilization*, 31.

[43] Pablo Gerchunoff, "Peronist Economic Policies, 1946-55," in *The Political Economy of Argentina, 1946-83*, ed. Guido Di Tella (Pittsburgh: University of Pittsburgh Press, 1986).

voluntary wage cuts by the unions as well as further price controls and government subsidies. Fundamental problems, however, were not addressed. A bloated government bureaucracy, the inefficiency of nationalized firms, endless subsidies, and an overvalued exchange rate created an endemic fiscal deficit.[44]

Yet it was undeniable that the quality of life for the urban masses had improved tremendously. Higher wages, stronger job security, a comprehensive social security system as well as new health, education, and recreation facilities generated feelings of self-respect among the labor force. This in turn inspired a fierce loyalty to Perón, who soon enjoyed a cult-like following among the masses. Unfortunately, these social advancements had taken place at the expense of economic efficiency and long-term growth.

*Analysis of the Period 1930 – 1955*

Even though both Perón and his conservative predecessors were responsible for Argentina's shift to an ISI model, they had done so in very different global economic contexts. Uriburu faced a world where all of Argentina's export markets had implemented various types of protectionist measures and was arguably forced to look inward. In contrast, Perón enacted even more severe tariffs and quotas on tradable imports in the face of a general, booming expansion of world trade after the end of WWII. As a result, there was little incentive for domestic industries to become more competitive and Argentina's share of world markets fell dramatically.

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[44] Manzetti, *The IMF and Economic Stabilization*, 31.

Perón's policies also engendered a great deal of animosity among agricultural producers and the upper-middle classes, who were closely linked to the export sector. His policies manipulated the country's economic institutions for political needs and created a system in which resources were allocated to fundamentally inefficient sectors. Argentine society had become increasingly polarized, as each group sought to hijack policy-making to gain special privileges and sabotage others.[45] These tensions would plague Argentina's political economy for decades to come.

### 1955 – 1976: Frondizi's Fall and the Peronist Restoration

In September 1955, Perón was deposed in a military coup known as the *Revolución Libertadora* (Liberating Revolution). Although the country was suffering from some severe economic imbalances, the main reasons for the coup were political in nature.[46] Perón's personalistic style and growing authoritarianism had alienated many of the groups who had backed him in 1946. By 1955, he had lost the support of large parts of the military, the Church, as well as many opposition parties.[47]

After the coup, the military attempted to stamp out all vestiges of Peronism from the country. Perón was forced to go into exile in Paraguay, all public references to him and his wife, the beloved Evita, were outlawed, and the unions were put under government administration.[48] Despite this repression, Peronist labor leaders effectively

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[45] John Sheahan, *Patterns of Development in Latin America: Poverty, Repression, and Economic Strategy* (Princeton University Press, 1987).

[46] Richard D. Mallon and Juan V. Sourrouille, *Economic Policymaking in a Conflict Society* (Harvard University Press, 1975), http://agris.fao.org/agris-search/search.do?recordID=US201300534638.

[47] Gerchunoff, "Peronist Economic Policies, 1946-55."

[48] Manzetti, *The IMF and Economic Stabilization*, 33.

remained in charge of the unions and managed to continue their political activities in secret. Polarization in Argentine society had reached even greater heights.

*The Slight Reorientation of Argentina's Economy*

The period following Perón's overthrow was marked by an effort to overhaul the existing economic structure in order to reduce the occurrence of exchange crises and ensure steady growth. The government devalued the exchange rate several times and gradually eliminated price controls, allowing the price of goods to become more aligned with their costs of production.[49] More contentious measures, however, such as the privatization of state corporations and a reduction in government bureaucracy, failed to be implemented.[50] It was then that Argentina became a member of the IMF and the World Bank, institutions that Perón had decried as manifestations of American imperialism and refused to be a part of.

In 1958, elections for a civilian government were held, but under strict conditions. Peronist groups were prohibited from running.[51] Arturo Frondizi was elected president on a platform of a strong welfare state, wage increases, the reestablishment of Perón's labor laws, and other forms of industrial protectionism, themes that appealed to many Peronist voters.[52] Together with his chief economic advisor, Frondizi devised an aggressive ISI plan that aimed to (1) capitalize on Argentina's oil and mineral resources to reduce

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[49] Díaz Alejandro, *Essays on the Economic History of the Argentine Republic*, 127.

[50] Manzetti, *The IMF and Economic Stabilization*, 34.

[51] Ibid.

[52] Marcelo Cavarozzi, *Sindicatos Y Política En Argentina* (Buenos Aires: Centro de Estudios de Estado y Sociedad, 1984).

dependence on energy imports, (2) develop the petro-chemical, steel, and automotive industries, (3) improve transportation infrastructure between the capital and other regions, and (4) increase domestic savings to encourage both private and public capital formation.[53] He did not, however, have the foreign reserves Perón did to finance this plan and had to depend on foreign capital instead.[54]

Under pressure to fulfill his campaign promises, Frondizi authorized a 60 percent wage increase and expanded price controls.[55] As a result, the money supply grew by 46 percent in 1958 and the budget deficit increased by 5 percent of GDP.[56] Inflation hovered at around 50 percent and the country was in a deep balance-of-payments (BoP) crisis.[57] The deteriorating economic situation forced Frondizi to look to the IMF for assistance, as foreign governments and international banks were unwilling to lend without rapid stabilization measures.

### *The 1958 IMF Stabilization Plan*

In December 1958, an IMF-led stabilization plan was announced. This marked a turning point in Argentine economic policy, with even Frondizi himself recognizing "the end of an era and the beginning of what must be a new life for the nation."[58] The main objectives of the agreement were to bring about a BoP equilibrium, balance the fiscal

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[53] Manzetti, *The IMF and Economic Stabilization*, 39.

[54] Gary W. Wynia, *Argentina in the Postwar Era: Politics and Economic Policy Making in a Divided Society* (Albuquerque: University of New Mexico Press, 1978).

[55] Cavarozzi, *Sindicatos Y Política En Argentina*.

[56] Mallon and Sourrouille, *Economic Policymaking in a Conflict Society*.

[57] Manzetti, *The IMF and Economic Stabilization*, 40.

[58] Arturo Frondizi, *Política Económica Nacional* (Buenos Aires: Ediciones Alayu, 1963), 127–128.

budget, and eradicate inflation.[59] The IMF was to grant Argentina $75 million (of which only $42.5 million was drawn), but this was accompanied by loans from the United States and other international banks to the tune of $328.5 million, including the IMF loan.[60]

While the SBA contained many measures characteristic of an IMF stabilization plan, the Fund made several important concessions that included the retention of protectionist import surcharges, various price control measures, and an increase in import deposits on some goods subject to tariffs.[61]

The IMF-assisted plan was initially successful, achieving price stability at the end of 1959. Foreign capital also flowed in at an increasing rate, contributing to a much more rapid rate of capital accumulation and technological advancement; foreign-exchange reserves increased from $70 million to $293 million over the course of the year.[62] Direct investments also reached $332 million in 1960 alone.[63] Satisfied with the results, the IMF granted one-year renewals at the end of 1959, 1960 and 1961.

Unfortunately, the policies implemented had the effect of reducing the wage share of GDP, which declined by 5 percent from 38.8 percent in 1955 to 33.8 percent in 1961.[64] Real wages were stagnant and attempts to revise labor legislation were met with social and political opposition. It appeared to be a zero-sum game between economic efficiency

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[59] Manzetti, *The IMF and Economic Stabilization*, 41.

[60] Jorge Marshall, Jose Luis Mardones, and Isabel Marshall, "IMF Conditionality: The Experiences of Argentina, Brazil, and Chile," in *IMF Conditionality* (Washington, D. C.: Institute for International Economics, 1983), 275–321; Clarence Zuvekas, "Argentine Economic Policy, 1958-62: The Frondizi Government's Development Plan," *Inter-American Affairs* 22, no. 1 (1968): 45–73.

[61] Manzetti, *The IMF and Economic Stabilization*, 43.

[62] Ibid., 45.

[63] Zuvekas, "Argentine Economic Policy, 1958-62: The Frondizi Government's Development Plan."

[64] Díaz Alejandro, *Essays on the Economic History of the Argentine Republic*, 129.

and income redistribution, as the lowest 60 percent of all income-earners saw their share of total income decline.[65] The budget deficit remained high; to make up for it, the government increased public utility rates and began to trim overstaffed state corporations, most notably the railway networks.

With inflation creeping back and averaging 5 percent a quarter in 1961, the CGT and workers' unions called for strikes and forced the government to back down on its railway restructuring plans.[66] This was a huge blow to the government's credibility and foreign investors began to retreat from the country. Political turmoil also ensued after Frondizi defied the wishes of the military and allowed Peronists to stand for election in 1962, only to have the military declare their victory invalid. Despite GDP growth of 7.1 percent and the manufacturing sector expanding by 9.7 percent, the balance of payments was suffering a $134 million deficit.[67] The government deficit had also ballooned from 17 billion pesos in October 1961 to 29 billion by the end of March 1962.[68]

Citing the government's inability to rein in their borrowing from the central bank, the IMF suspended the payment of the $100 million loan agreed upon in December and terminated their SBA with Argentina in March 1962.[69]

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[65] Ibid., 130.

[66] Manzetti, *The IMF and Economic Stabilization*, 57.

[67] Ibid., 58.

[68] Eprime Eshag and Rosemary Thorp, "Economic and Social Consequences of Orthodox Economic Policies in Argentina in the Post-War Years," *Bulletin of the Oxford University Institute of Economics & Statistics* 27, no. 1 (1965): 1–44, doi:10.1111/j.1468-0084.1965.mp27001001.x.

[69] Manzetti, *The IMF and Economic Stabilization*, 59.

*Deepening Social Cleavages and the Return of Perón*

Divisions between the different classes in Argentine society grew deeper and more entrenched over this period, as the working class remained loyal to Perón while the middle and upper classes were split between those who championed a soft or hard approach toward Peronist groups.[70] The military deposed of Frondizi in March 1962 and held elections in 1963, again excluding the Peronist party. The Radical candidate who won the election did so with only a quarter of the total vote and lasted just three years before the military staged another coup.[71] This time, it handed leadership to a retired general, Juan Carlos Organía, who held onto power for three years until increasing unrest led the military to take direct control of the country from 1970 to 1973.

Frequent changes in the administration meant that economic policy was reversed often, all of which had a detrimental effect on price stability and growth expectations. From 1955 to 1964, for example, average annual inflation reached a stark 33 percent, even more than the average of 16 percent during 1943 to 1955.[72] Despite GDP growth averaging 5.2 percent between 1966 and 1970 and inflation falling from 30 percent in 1966 to 7.6 percent in 1969, large currency devaluations meant that imports were more expensive and real wages fell, leading to riots in various parts of the country.[73]

The tense economic situation was exacerbated by the appearance of left-wing guerrilla groups in the early 1970s, which included the Peronist-linked Montoneros and Guevarist ERP (*Ejercito Revolucionario del Pueblo* [People's Revolutionary Army]). In

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[70] Díaz Alejandro, *Essays on the Economic History of the Argentine Republic*, 132.

[71] Manzetti, *The IMF and Economic Stabilization*, 91.

[72] Díaz Alejandro, *Essays on the Economic History of the Argentine Republic*, 134.

[73] Smith, *Authoritarianism and the Crisis of the Argentine Political Economy*.

1973, the military found itself with little civilian support and allowed free elections for first time in two decades. The Peronist candidate who triumphed, Héctor Cámpora, resigned after a few months to facilitate Perón's return from Spanish exile. As an indication of his enduring popularity, millions of supporters greeted Perón upon his arrival at the Ezeiza airport; however, in a sign of the violence to come, camouflaged snipers opened fire on waiting crowd, killing 13 and injuring more than 300.[74]

Perón received 62 percent of the vote in the subsequent election and soon after initiated a social pact among businesses, labor unions, and the government in an attempt to rein inflation in. This was achieved by negotiating price and wage controls and was largely successful until Perón's death in 1974.[75] His second wife, Isabel, took over as president, but was unable to manage the competing interests of the different social classes. She was also ill-equipped to deal with the growing violence that was breaking out between the left-wing guerrilla groups and a new right-wing group, known as the AAA (*Alianza Anti-Comunista Argentina* [Argentine Anti-Communist Alliance]), that had alleged links to her closest advisor.[76] With hyperinflation setting in and a civil war threatening to break out, the military stepped in and deposed Isabel Perón in March 1976, assuming direct power once again.

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[74] Daniel James, "The Peronist Left, 1955–1975," *Journal of Latin American Studies* 8, no. 02 (May 1976): 273–96, doi:10.1017/S0022216X00022008.

[75] Manzetti, *The IMF and Economic Stabilization*, 92.

[76] Ibid.

## 1976 – 1983: THE PROCESS OF NATIONAL REORGANIZATION ("*EL PROCESO*")

Led by Lieutenant General Jorge Rafael Videla, the military took sweeping measures in an attempt to stabilize the situation. Congress was closed, strikes were declared illegal, the CGT's leadership was dismantled and placed until military control, the death penalty was reinstated, political parties were disbanded, and students were not allowed to participate in any political activity.[77] This time, the military did not intend to merely restore order and allow for a transition to civilian elections; instead, following the example of Brazil, Chile, and Uruguay—all of which had military dictatorships installed in the past decade—, it was determined to institute a "bureaucratic-authoritarian regime."[78] On March 24, 1976, the junta released a document known as the *Acta Para el Proceso de Reorganización Nacional* (Act for the National Reorganization Process), which detailed its rhetorical aims of creating a system "where the state maintains control over the vital areas of both security and development," and in which "all possibility of [private initiative's] interference in the political process" is "neutralized."[79]

### *The Bureaucratic-Authoritarian Regime*

Essentially, the junta had three main goals: (1) root out terrorism and reestablish order, (2) stabilize the economy by eliminating hyperinflation and BoP problems, and (3) redefine the country's institutional framework by establishing more stable political and

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[77] Ibid., 93.

[78] For more, see Guillermo A. O'Donnell, *Bureaucratic Authoritarianism: Argentina, 1966-1973, in Comparative Perspective* (University of California Press, 1988).

[79] Military Junta, "Acta Para el Proceso de Reorganización Nacional," trans. Luigi Manzetti (Congreso de la Nación, Oficina de Información Parlamentaria, 1976), 1.

social institutions.[80] The military oversaw the first and third objectives, leaving the economic one to a team led by José Alfredo Martínez de Hoz.

At the time, the country was experiencing a deep recession, inflation had reached 900 percent, the fiscal deficit was spiraling out of control, the trade balance was severely in the red, and reserves were at a historic low.[81] Argentina was also on the brink of default, with the interest on $3.7 billion of its $7.8 billion debt due within a year.[82]

In April, Martínez de Hoz released a stabilization plan that called for the country "to pass from a speculative economy to a productive one, to improve the position of the external sector, and to attain economic growth through increased investments."[83] This plan included measures to (1) liberalize prices, (2) incentivize agricultural producers to increase exports, (3) set a sustainable exchange rate, (4) open up to foreign competition in order to increase efficiency, (5) loosen interest rates and eliminate credit controls, (6) gradually eliminate protectionist tariffs, (7) reduce the bloated government bureaucracy, (8) eliminate wage indexation and collective bargaining agreements, and (9) phase out export subsidies.[84] This program was welcomed by the banking community, which extended $300 million in short-term loans and postponed the $350 million payment of public sector debt that was due.[85]

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[80] Manzetti, *The IMF and Economic Stabilization*, 93.

[81] Ibid., 94.

[82] Della Paolera and Taylor, *A New Economic History of Argentina*.

[83] José A. Martínez de Hoz, *Diez Años Despues: Principios y Ejecución del Programa Económico de la Argentina Anunciado el 2 Abril de 1976*, trans. Luigi Manzetti (Buenos Aires: Ministerio de Economía, n.d.).

[84] Manzetti, *The IMF and Economic Stabilization*, 97.

[85] Roberto Frenkel and Guillermo A. O'Donnell, "The Stabilization Programs of the International Monetary Fund and Their Internal Impacts," in *Capitalism and the State in US-Latin American Relations*, ed. R. Fagan (Stanford: Stanford University Press, 1979), 171–203.

*The 1976 IMF Stabilization Plan*

In May, the Argentine government requested IMF and World Bank assistance and signed a new stand-by agreement (SBA) with the IMF in August. The terms of the agreement were roughly the same as the plan agreed upon with the Frondizi administration, where emphasis was placed on improving the BoP equilibrium, balancing the fiscal budget, and eradicating inflation.[86] The stabilization plan presented by Martínez de Hoz conformed suitably to the IMF's prescriptions, which included reducing the money supply through imposing limits on the Central Bank, reducing the fiscal deficit by cutting public sector employment, selling state-owned enterprises, and increasing taxes, as well as eliminating wage and price controls.[87] The IMF gave Argentina access to $260 million, of which it drew on $195.5 million,[88] and spurred international banks to loan an additional $1 billion, which was used to repay foreign debt obligations.[89]

Initial results were encouraging, with inflation dropping from 37.6 percent in March to 2.7 percent in June, stock prices doubling over half a year, and agricultural exports increasing by 30 percent.[90] The fiscal deficit also showed a marked improvement. Inflation, however, reappeared quickly, even after the IMF renewed the agreement and approved the disbursement of up to $215 million in new funds. Even though wages had been cut significantly, producers continued to raise their prices, causing inflation to rise.

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[86] For more details on the letter of intent, see Roberto Frenkel and José María Fanelli, "La Argentina Y El Fondo En La Década Pasada," *El Trimestre Económico* 54, no. 213(1) (January 1, 1987): 75–131.

[87] Manzetti, *The IMF and Economic Stabilization*, 98–99.

[88] Marshall, Mardones, and Marshall, "IMF Conditionality: The Experiences of Argentina, Brazil, and Chile."

[89] Wynia, *Argentina in the Postwar Era: Politics and Economic Policy Making in a Divided Society*.

[90] Manzetti, *The IMF and Economic Stabilization*, 100; Frenkel and O'Donnell, "The Stabilization Programs of the International Monetary Fund and Their Internal Impacts."

By most other economic measures (e.g., fiscal deficit, export growth), though, the stabilization plan had delivered the desired results and the SBA was suspended in 1977 to the satisfaction of both the IMF and the Argentine government.[91]

### *The Dirty War*

Thanks to the political hard line the junta had taken, Martínez de Hoz enjoyed wide-ranging powers to implement his economic reforms, free from the infighting and special-interest lobbying that had plagued previous administrations. This authority, however, came at the expense of the people's basic constitutional rights. Besides outlawing most political activities and strikes, the junta went on a campaign of active repression, hunting down left-wing guerillas as well as any suspected political dissidents. It has been estimated that between 1974 and 1983, anywhere between 8,000 and 30,000 people were killed, with the official count numbering around 13,000.[92] Assisted by the right-wing AAA, secret security forces conducted a campaign of terror to eliminate opposition to the government, taking away anybody suspected of having left-wing connections. This period quickly became known as the *Guerra Sucia* (Dirty War), marked by the forced disappearances of thousands of young men and women (*los desaparecidos* [the disappeared]) who were often held in secret concentration camps around the country or simply killed.[93]

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[91] Manzetti, *The IMF and Economic Stabilization*, 112.

[92] Pablo Calvo, "Una Duda Histórica: No Se Sabe Cuántos Son Los Desaparecidos," *Clarín*, October 2003, http://edant.clarin.com/diario/2003/10/06/p-00801.htm.

[93] Antonius C. G. M. Robben, "How Traumatized Societies Remember: The Aftermath of Argentina's Dirty War," *Cultural Critique* 59, no. 1 (2005): 120–64, doi:10.1353/cul.2005.0010.

At the end of 1978, in an attempt to bring down inflation, Martínez de Hoz decided to devalue the peso at a rate slightly below the domestic rate of inflation, a plan called the "*tablita*".[94] Unfortunately, the program was unsuccessful in combating inflation and dealt a huge blow to domestic producers, who were unable to compete with foreign competition. Industrial production fell by 19% from 1979 to 1981[95] and the policy stoked great resentment from virtually all classes of society.

*The 1980 Economic Crisis and the Invasion of the Malvinas*

In March 1980, four banks that held 8 percent of the total financial resources of the country went under.[96] This set off a crisis both in the economy as well as within the military leadership. As Videla's term was set to end the following year, Martínez de Hoz found it increasingly difficult to convince the junta to follow through on his economic plans. He was forced to announce the abandonment of the *tablita* before he resigned in February 1981.

General Roberto Viola took over from Videla a month later, but lasted less than nine months, as he was ousted in a coup led by general Leopoldo Galtieri, the commander-in-chief of the army.[97] The military was weakened by internal strife and Galtieri's confused political and economic policies did not help matters. With his popularity waning, he chose to embark on an invasion of the Malvinas (known in the

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[94] David Pion-Berlin, "The Fall of Military Rule in Argentina: 1976-1983," *Journal of Interamerican Studies and World Affairs* 27, no. 2 (July 1, 1985): 59, doi:10.2307/165718.

[95] Fundación de Investigaciones para el Desarrollo (FIDE), *Coyuntura y Desarrollo, Anexa Estadística XIV* (Buenos Aires: FIDE, April 1983).

[96] Pion-Berlin, "The Fall of Military Rule in Argentina," 60.

[97] Ibid., 63.

U.K. as the Falkland Islands) in December 1981. In doing so, Galtieri was attempting to divert public attention away from Argentina's internal problems by unifying the nation against an external threat.[98]

Unfortunately, the military had made two fundamental miscalculations: (1) they did not expect the British to retaliate, and (2) they believed this show of strength would increase the junta's stature in the eyes of the public. With regard to the latter, approximately 250,000 people showed up in a rally to support the operation, but simultaneously voiced their disapproval of the regime itself; with regard to the former, the British responded with a full show of strength, sinking an Argentine battleship and mounting a land invasion of the islands.[99] Galtieri's plan had backfired spectacularly, and the subsequent military government was forced to call for civilian elections in 1983.

### 1983 – 1989: Alfonsín and the Austral Plans

In October 1983, Raúl Alfonsín, the Radical (UCR) candidate, secured a surprise victory over the Peronists by appealing to moderates, conservatives, and members of the working class who had become disenchanted with the authoritarian practices of their union leaders.[100] He inherited an economy in tatters, with inflation running at 433 percent.[101] The current account deficit was at $2.5 billion and, as a result of capital flight during the junta's term, the country's external debt stood at $45 billion, a staggering 80

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[98] Jack S. Levy and Lily I. Vakili, "Diversionary Action by Authoritarian Regimes: Argentina in the Falklands/Malvinas Case," in *The Internationalization of Communal Strife*, ed. Manus I. Midlarsky (London: Routledge, 2014).

[99] Pion-Berlin, "The Fall of Military Rule in Argentina," 70.

[100] Manzetti, *The IMF and Economic Stabilization*, 140.

[101] Ibid., 141.

percent of GDP.[102] The military's decision to take over large amounts of private debt in 1982 meant that the government had the responsibility of servicing 90 percent of this debt.[103] This came at the expense of its ability to maintain public services and stimulate any sort of investment. Alfonsín's initial plan to increase wages, reduce inflation, trim the deficit and increase growth was extremely ineffective; in fact, these contradictory measures exacerbated the situation, doubling the rate of inflation to 626 percent in 1984.[104]

*The 1984 IMF Stabilization Plan and the Austral Plan*

Argentina was forced to turn to the IMF for assistance and Alfonsín signed a SBA in December 1984. The Fund made available $1.39 billion in funds, which was accompanied by an additional $269 million from a separate IMF facility and $500 million from the U.S. Treasury.[105] In return, Alfonsín had to agree to a fifteen-month austerity plan, which aimed to drastically cut the inflation rate as well as the budget and current-account deficits; however, under pressure from unions and the Peronist-controlled senate, the government was forced to authorize increases in wages and government spending in March 1985. This was in open defiance of the terms negotiated with the IMF. As a result, all new loans were suspended.[106]

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[102] Ibid.

[103] William C. Smith, "Democracy, Distributional Conflicts and Macroeconomic Policymaking in Argentina, 1983 - 89," *Journal of Interamerican Studies and World Affairs* 32, no. 2 (July 1, 1990): 3, doi:10.2307/166007.

[104] Ibid.

[105] Manzetti, *The IMF and Economic Stabilization*, 142.

[106] Chris C. Carvounis, *The Foreign Debt/National Development Conflict: External Adjustment and Internal Disorder in the Developing Nations* (New York: Quorum Books, 1986).

Facing hyperinflation and in desperate need of foreign credit to service its debt, Alfonsín announced a new agreement with the IMF in June. This time, he decided to go for the shock treatment and introduced what became known as the Austral Plan. This ambitious plan combined orthodox monetary and fiscal policies with a sudden "heterodox shock" to combat hyperinflation.[107] Measures taken included a 14 percent currency devaluation, 12 percent increase in import and export tariffs, tax hikes, and a mandatory savings program.[108] It was hoped that by introducing a new currency (the Austral) and a fixed exchange rate, and de-indexing prices and wages (i.e., severing their links to the inflation rate), the Austral Plan would be able to break the link between wages, prices, and inflation expectations.

Initial results were encouraging, with inflation declining to 20.2 percent in the six months after the plan was introduced, compared to an average of 28.4 percent per month in the previous quarter.[109] People were saving more, tax revenue was up, and the budget deficit went down. Yet old social tensions refused to go away and organized labor threatened to conduct massive strikes if wages were not increased.

The second phase of the plan was implemented in April 1986 with the removal of wage and prize freezes in favor of more flexible controls. Inflation increased to 50.1 percent over the next year, although this worrying sign was mitigated by an 11 percent expansion in GDP and a 26 percent increase in industrial output.[110] Little had been done,

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[107] Smith, "Democracy, Distributional Conflicts and Macroeconomic Policymaking in Argentina, 1983 - 89," 9.

[108] Manzetti, *The IMF and Economic Stabilization*, 145.

[109] Ibid., 147.

[110] Frenkel and Fanelli, "La Argentina Y El Fondo En La Década Pasada."

however, to tackle the deep-seated structural problems in the economy (i.e., the exchange rate, the foreign debt, inefficient state corporations, powerful labor unions).[111] Under pressure from organized labor, the Alfonsín administration let the SBA expire in June 1986, hoping that the country would be able to stabilize the economy on its own.

*An Economic Crisis Deepens*

Over the next three years, the government introduced three short-lived plans in quick succession—the "Little Austral" (*Australito*) in January 1987, an unnamed one in October later that year, and the *Plan Primavera* (Spring Plan) in August 1988—, all of which were accompanied by equally short-lived agreements with the IMF.

The first, the *Australito*, reintroduced a wage-price freeze and raised interest rates drastically to combat capital flight; however, these measures only served to further distort prices and did nothing to improve the fiscal deficit, which remained well in excess of IMF targets.[112] These economic troubles caused the Radicals to lose the provincial elections in September 1987, indicating the lack of public support for their policies.

The second plan, announced in October, involved a $700 million bridge loan from the U.S. as part of the Treasury Secretary James Baker's plan to relieve Third World debt.[113] Another agreement was signed with the IMF and measures taken included the usual price and wage freezes, together with large tariff increases. Some state-owned enterprises, such as the national airlines, were privatized. This shock treatment was even

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[111] Smith, "Democracy, Distributional Conflicts and Macroeconomic Policymaking in Argentina, 1983 - 89," 14.

[112] Ibid., 15.

[113] Ibid., 21.

less successful than the Austral Plan or the *Australito*, with inflation reaching 174.8 percent in 1987, GDP growth slowing, the trade balance declining, and the fiscal deficit widening.[114] The IMF insisted on even more stringent terms (e.g., keeping monthly inflation to 4 percent), but the government was powerless to control wages or carve out an economic consensus among the competing interests of industrial, financial, agro-export, and labor groups. In 1988, the IMF terminated the agreement and Alfonsín was desperate to find a solution.

The *Plan Primavera* in August 1988 was Alfonsín's last chance to fix the economy and improve its chances in the upcoming presidential elections in 1989. The plan involved even more severe orthodox monetarist measures than the plans before. It also hinged on the government's ability to maintain a stable but overvalued exchange rate, in order to revive economic confidence and prevent inflation from creeping back in. The U.S. Treasury approved a $500 million loan, the IMF provided $1.2 billion, and other international creditors also issued $1.5 billion in new funds.[115]

The lack of confidence in the government's ability to maintain the exchange rate, however, prompted a massive sell-off of pesos by corporations and individuals alike. The Central Bank was forced to sell hundreds of millions of dollars in a matter of weeks in a futile attempt to prop up the currency, until it exhausted almost all of its reserves. The IMF, World Bank, and the U.S. Treasury cut off loans to Argentina soon after, and the currency collapsed.[116] Hyperinflation set in, with prices increasing by 114.5 percent in

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[114] Ibid., 23.

[115] Ibid., 26.

[116] Ibid., 28.

June and 196.6 percent in July alone. From August 1988 to July 1989, consumer prices had gone up by 3,610.2 percent and wholesale prices 5,061.9 percent.[117] Foreign debt stood at $63 billion and the country's GDP was shrinking by 6 percent.[118]

What was originally an economic crisis turned into a wider political and social crisis as riots broke out in the industrial suburbs of Buenos Aires and cities such as Córdoba, Rosario, and Mendoza. This forced Alfonsín to transfer power to Carlos Menem, the Peronist who had won the presidential election earlier in the year, seven months ahead of schedule, on July 8, 1989.

*The Early Menem Years*

Carlos Menem had campaigned for the presidency as a critic of the existing system and its ruling class, appealing to the masses by driving an old garbage truck through working-class suburbs and frequently wearing a poncho. He had, however, secretly begun an alliance with big local capitalists immediately after securing his party's presidential nomination. In exchange for their financial and electoral support, he promised to pick his Minister of Economy from their group and discuss the government's economic strategy with them.[119]

As a result, Menem appointed a high level executive with the vast Bunge y Born conglomerate, Nestor Rapanelli, as his Minister of Economy after an earlier appointee died of a heart attack. His first stabilization plan, announced the day after he took office,

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[117] Della Paolera and Taylor, *A New Economic History of Argentina*, 251.

[118] Paul H. Lewis, *The Agony of Argentine Capitalism: From Menem to the Kirchners* (New York: Praeger, 2009), 16.

[119] Ibid., 19.

built on the heterodox experiences of Alfonsín's government and was named after the corporation to which Rapanelli belonged. The B&B plan sought to reduce fiscal deficits by increasing export-tax revenue and raising public-enterprise prices in the gas, electricity, water, telephone, and transportation sectors. About 400 of the nation's largest companies also agreed to voluntarily freeze their output prices for as long as the government froze the exchange rate and public-sector prices.[120] The country received support from the IMF in the form of a US$1.5 billion loan in September, which enabled them to meet immediate financial payments.[121]

The fiscal deficit, however, did not yield as the government continued to fund inefficient state enterprises and pay the wages of an excessive number of state employees. The money supply grew by over 300 percent from July to mid-November, and the authorities devalued the austral in December in response to panic buying of dollars, effectively ending the B&B plan.[122] Congress failed to approve most revenue measures on time and most of the performance criteria under the IMF-supported program were missed by wide margins.[123]

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[120] Paul Ely Beckerman, *The Economics of High Inflation* (New York: St. Martin's Press, 1992).

[121] Paul Blustein and Adela Gooch, "IMF to Lend Argentina $1.5 Billion: Agreement Seen as Crucial Step Toward Economic Recovery," *The Washington Post (1974-Current File)*, September 28, 1989, 5.

[122] Paul Beckerman, "Central-Bank 'Distress' and Hyperinflation in Argentina, 1989–90," *Journal of Latin American Studies* 27, no. 03 (October 1995): 663–82, doi:10.1017/S0022216X00011640.

[123] Shinji Takagi and International Monetary Fund, eds., *The IMF and Argentina, 1991-2001*, Evaluation Report (International Monetary Fund. Independent Evaluation Office) (Washington, D.C.: International Monetary Fund, Independent Evaluation Office, 2004), 79.

*The Plan Bonex*

On January 1, 1990, the government instituted a new plan, dubbed the Plan Bonex, which involved the central bank arrogating all short-term time deposits in Argentina's private banks, which were held in australes, and converting them into ten-year dollar-denominated Treasury bonds (called Bonex). This capital was then used to settle the government's debts to commercial banks.[124] The plan temporarily eased inflationary pressures by radically reducing the money supply and recapitalizing the central bank; however, it also triggered a recession as the government had essentially appropriated around $3 billion from its citizens' bank accounts, money that was needed for wages, supplies and daily expenses.[125] Retail sales declined by almost 60 percent and a third of the shops in downtown Buenos Aires went out of business. In 1989 alone, GDP fell by 5.2 percent and industrial production dropped by 7.7 percent. The value of the austral, too, was plummeting rapidly, from 3,000 to the dollar in January to 6,200 by March.[126]

Between March 1989 and March 1990, inflation rose by more than 20,000 percent, resulting in the looting of supermarkets in the poorer neighborhoods of Buenos Aires, Córdoba, and Rosario.[127] The IMF also suspended a tranche of the US$240 million from the September SBA because Argentina had failed to comply with many of the conditions in the agreement. More pressingly, Menem's popular support was

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[124] Lewis, *The Agony of Argentine Capitalism*, 42.

[125] Pamela K. Starr, "Government Coalitions and the Viability of Currency Boards: Argentina under the Cavallo Plan," *Journal of Interamerican Studies and World Affairs* 39, no. 2 (1997): 83–133, doi:10.1111/j.1548-2456.1997.tb00030.x.

[126] Lewis, *The Agony of Argentine Capitalism*, 41.

[127] Ibid.

disintegrating swiftly. His approval rating dropped from 71 percent in October 1989 to 33 percent in February 1990, while negative reactions to his leadership rose from only 7.5 percent to 37 percent in the same period.[128] It was against this disastrous backdrop that Menem realized that he had to act decisively before the political capital he had built up dissipated.

## Conclusion

This chapter provides an overview of Argentina's economic and political history up to 1990 in order to give context to the economic programs implemented over the next decade. In the following chapters, I analyze IMF programs in Argentina from 1991 to 2002 using my Critical Framework for IMF Program Design and Implementation.

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[128] Ibid.

# CHAPTER FOUR

# THE MIRACLE OF CONVERTIBILITY

> In many respects the experience of Argentina in recent years has been exemplary … so clearly, Argentina has a story to tell the world: a story which is about the importance of fiscal discipline, of structural change, and of monetary policy rigorously maintained.
>
> —Michel Camdessus, Press Conference in 1998

Chapter 3 describes the various heterodox economic plans that Alfonsín and Menem had implemented in attempts to stimulate growth, reduce the fiscal deficit, and rein in the destructive bouts of hyperinflation that plagued the Argentine economy in the late 1980s. Some of them met with initial success, but they all proved ineffective within one or two years.

In the following empirical chapters, I focus on three periods between 1991 and 2002 to demonstrate how the IMF's arrangements with Argentina evolved in response to changing economic conditions in the country, domestic political events, developments in the global economy, shareholders' interests, and the IMF's institutional priorities. The three periods under analysis each capture a major shift in the design and implementation of IMF policy in Argentina. I briefly outline events that happened between these periods at the beginning and end of each section; however, they do not warrant comprehensive analysis as there were no major shifts in either the design or implementation of IMF policy. Chapter 4 of my thesis covers the first two periods of analysis, between April 1991 and March 1992, and between December 1994 and December 1997, while Chapter 5 deals with the period between February 2000 and January 2002.

During the first period, between April 1991 and March 1992, Argentina implemented a radical economic program, the cornerstone of which was the Convertibility Law, that marked a drastic shift from its previous heterodox policies. The program worked well and there were no significant changes in Argentina's domestic policies or IMF arrangements until the end of 1994, when the Mexican crisis struck and compelled Argentina and the IMF to react to the resulting, large outflows of capital from emerging markets. The second period of analysis, from December 1994 to December 1997, marks Argentina and the IMF's responses to a series of destabilizing global events which threatened Argentina's success thus far. Between 1998 and 2000, the global economy remained weak and Argentina's economy was on a gradual decline, but there were no outstanding events that warrant close analysis.

During the final period of analysis, from February 2000 to January 2002, Argentina's problems intensified when domestic and external factors continued to deteriorate further. In response, the IMF made a series of decisions to provide unprecedented financial support to Argentina until December 2001. The IMF indicated that, for the first time in over ten years, it could not clear the scheduled disbursement. This decision precipitated Argentina's partial default on its international obligations. In early January 2002, Argentina formally abandoned the convertibility regime.

## FIRST PERIOD: APRIL 1991 – MARCH 1992

### BRIEF CHRONOLOGY

At the beginning of 1991, Menem's administration was faced with a rapidly deteriorating economy and the loss of IMF support. He appointed Domingo Cavallo, a former central bank president and foreign minister with orthodox free-market views, as Minister of Economy. In March, inspired by the rigid, gold-based monetary system Argentina had adopted from 1899 to 1929, Cavallo introduced the idea of establishing a currency board that would peg the Argentine peso to the value of another country's currency. Accordingly, a new piece of legislation, known as the Convertibility Law, guaranteed that the central bank would exchange pesos for dollars at the fixed rate of one peso per dollar. The legislation was approved by Congress on March 28 and took effect on April 1, 1991.[1] The exchange rate was initially set at 10,000 australes per dollar until the austral was replaced with the peso on January 1, 1992. The Convertibility Law further required the central bank to keep on hand currency reserves equal to 100 percent of the country's money supply, in order to limit the ability of the central bank to print pesos to fund government spending.[2] The law also abolished price indexation, allowed contracts to be denominated in foreign currencies and even allowed foreign currencies to be used as alternative means of payment.[3]

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[1] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 11.

[2] Blustein, *And the Money Kept Rolling in (and Out)*; Hector E. Schamis, "Argentina: Crisis and Democratic Consolidation," *Journal of Democracy* 13, no. 2 (2002): 81–94, doi:10.1353/jod.2002.0030. It should be noted, however, that the law permitted up to a third of the monetary base to be backed by the government's own dollar-denominated bonds rather than actual dollars.

[3] Domingo F. Cavallo and Joaquin A. Cottani, "Argentina's Convertibility Plan and the IMF," *The American Economic Review* 87, no. 2 (May 1, 1997): 17–22.

The IMF signaled its public endorsement of the new economic plan by approving a stand-by arrangement for SDR 780 million (US$1 billion) in July 1991,[4] which was followed by an extended fund facility (EFF) in March 1992 in the amount of SDR 2,483 million (US$ 3.4 billion), which amounted to 161 percent of Argentina's quota.[5]

The Convertibility Law was the central feature of an economic program that called for sweeping free-market reforms in other areas of the economy. This included the privatization of almost all state-owned enterprises in Argentina: oil-fields were sold in 1991; steel mills, power plants, water and sanitation companies, the national gas company, and the Buenos Aires subway system were privatized in 1992; and still others, including the highway system and the national oil company YPF, were put on the market in 1993.[6] The government also eliminated export taxes, simplified the income tax schedule, and cracked down on tax evasion.[7] In addition, the country put the 1980s debt crisis firmly behind it in April 1993 when it negotiated agreements with foreign banks to replace bank loans with long-term U.S. Treasury-backed bonds under the debt-reduction plan established by Treasury Secretary Nicholas Brady. The government's obligations were reduced by about US$10 billion, to 29 percent of GDP.[8] All these measures were

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[4] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 77. IMF loans are denominated in Special Drawing Rights (SDRs), the currency value of which is determined by summing the US dollar value of a basket of major currencies.

[5] Cavallo and Cottani, "Argentina's Convertibility Plan and the IMF." As mentioned in the introduction, a country's quota is a weighted average of its GDP, international reserves, and other economic factors. It determines the amount of financial resources a member is obliged to provide to the IMF, its voting power, and, most relevant to this thesis, its access to financing. From 1991 to 2002, the amount of financing a member could obtain from the IMF was normally held to an annual limit of 100 percent of their quota, with a total ceiling of 300 percent.

[6] Lewis, *The Agony of Argentine Capitalism*, 53.

[7] Ibid., 55.

[8] Blustein, *And the Money Kept Rolling in (and Out)*, 21.

welcomed by the international financial community and supported by the IMF; however, the IMF's role during this period was largely limited to providing technical assistance in areas such as tax administration, with most of the initiative for reform coming from the Argentine government itself.[9]

## Conditions of the July 29, 1991 Stand-By Arrangement

In a letter of intent dated June 28, 1991, Minister of Economy Domingo Cavallo requested an SBA in the amount of SDR 780 million (US$1 billion) to support his economic program and outlined a number of measures Argentina intended to implement over the course of the arrangement. The arrangement approved by the IMF on July 29, 1991, contained seven quantitative performance criteria.

*Letter of Intent*[10]

1. Tax reform and improvement of tax administration
    a. Elimination of export taxes
    b. Replacement of income tax with distributed earnings tax for 10 years
    c. Increase in value-added tax (VAT)
2. Reduction of government expenditure
    a. Reduction of state employment
    b. Transfer of program functions to provinces
3. Continuation of privatization program
4. Establishment of financial agencies
5. Social security system reform
6. Improvement of provincial finances
7. Restructuring of banking system
8. Opening of economy to foreign competition
    a. Restructuring of import tariffs
9. Labor market reform

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[9] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 4.

[10] International Monetary Fund, *Request for Stand-By Arrangement - Letter of Intent*, Letter of Intent (Washington, D. C.: International Monetary Fund, June 28, 1991).

*Quantitative Performance Criteria*[11]

1. Limit on combined deficit of the non-financial public sector and the Central Bank
2. Limit on the cash deficit of the non-financial public sector
3. Limit on treasury outlays
4. Targets for change in the net domestic assets of the Central Bank
5. Targets for change in net international reserves
6. Limit on external arrears of the public sector
7. Limit on the external debt of the public sector and on net disbursements of short-term public sector debt

## ANALYSIS OF FACTORS

### *DEVELOPMENTS IN ARGENTINA*

Economic Conditions. Towards the end of 1990, the government's fiscal performance deteriorated as pension benefits increased faster than expected and the social security system lost revenue. As a result, external interest payments could not be eliminated as planned. Provoked by a default of the largest provincial bank (in Buenos Aires), provincial banks experienced a substantial loss of deposits. International reserves declined from $3.2 billion to $2.5 billion from December 1990 to March 1991. The austral experienced severe fluctuations and depreciated from 5,000 per U.S. dollar in mid-December 1990 to 9,000 per U.S. dollar at end-January 1991. Inflation declined from 1,350 percent during 1990 to 7.7 percent in January 1991 and 27 percent in February.[12]

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[11] International Monetary Fund, *Argentina - Stand-By Arrangement*, Stand-By Arrangement (Washington, D. C.: International Monetary Fund, August 7, 1991), 2, http://adlib.imf.org/digital_assets/wwwopac.ashx?command=getcontent&server=webdocs&value=EB/1991/EBS/84558.PDF.

[12] International Monetary Fund, *Staff Report on Request for Stand-By Arrangement*, Country Report (Washington, D. C.: International Monetary Fund, July 16, 1991), 1–4.

After the implementation of the Convertibility Law, inflation declined significantly, averaging 3 percent in May and June. Interest rates also declined sharply. Aided by the sale of state-owned assets, the fiscal position improved tremendously, with the government running a surplus of $238 million in the second quarter. The improvement enabled Argentine to meet net debt service payments in the January-June period. International reserves also recovered to $3.2 billion by the end of June.[13]

*Political Developments.* The profound social dislocations caused by hyperinflation spurred both the Peronists and the opposition in Congress to give Menem unprecedented powers to implement his economic programs. The State Reform Law, passed in August 1989, gave him the power to intervene in any state enterprise and either dissolve or privatize it, while the Economic Emergency Law passed in September that same year allowed the president to downsize the government by removing any public employee's right to tenure and suspend all subsidies to private businesses.[14] He also used emergency decrees to pass contentious modifications to tax and labor laws he was worried Congress might obstruct. For example, from 1853 to 1989, such decrees had been issued only 35 times; however, Menem used them on 336 occasions from 1989 to 1994.[15]

Conventional wisdom dictated that the labor-based Peronist party would be opposed to the neoliberal reforms that accompanied the Convertibility Law, and this was partly true. Many local activists were critical of the reforms and openly defied Menem's

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[13] Ibid., 7–8.

[14] Steven Levitsky, *Transforming Labor-Based Parties in Latin America: Argentine Peronism in Comparative Perspective* (Cambridge University Press, 2003), 145–146.

[15] Lewis, *The Agony of Argentine Capitalism*, 35.

instructions to align with the right-wing Center Democratic Union in the 1991 provincial elections; in Buenos Aires, Governor Duhalde also rejected Menem's appeal to place his favored business leaders on the party's parliamentary list.[16]

Yet public opinion was in the administration's favor. A survey asking which countries Argentina should strengthen its ties with saw support for industrialized countries rise from 40 percent in 1985 to 70 percent in 1991 while public support for privatization increased from around 57 percent in 1985 to over 75 percent in 1990.[17] The national labor confederation also supported the economic program in general. It reduced the number of general strikes from thirteen against the Alfonsín administration to just one under Menem's first term.[18]

### *Developments in the IMF and the World Economy*

*Global Environment.* In the late 1970s and early 1980s, the growth rate of most developing countries, including Argentina, collapsed and most of them were beset with economic crises.[19] Similarly, in industrialized countries, the economic expansion of the 1950s and 1960s was followed by a general slowdown in the 1980s and inflationary surges in the early 1980s.[20] These developments established the background for the

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[16] Levitsky, *Transforming Labor-Based Parties in Latin America*, 80.

[17] Shannon O'Neil, "The Role of Ideas in Neoliberal Economic Reform: The Case of Argentina" (Latin American Studies Association, Washington, D. C., 2001), 11, http://lasa.international.pitt.edu/lasa2001/oneiltrowbridgeshannon.pdf.

[18] M. Victoria Murillo, "From Populism To Neoliberalism: Labor Unions and Market Reforms in Latin America," *World Politics* 52, no. 02 (January 2000): 139, doi:10.1017/S0043887100002586.

[19] Charles Gore, "The Rise and Fall of the Washington Consensus as a Paradigm for Developing Countries," *World Development* 28, no. 5 (May 2000): 792, doi:10.1016/S0305-750X(99)00160-6.

[20] Francisco Panizza, *Contemporary Latin America: Development and Democracy beyond the Washington Consensus* (London, UK: Zed Books, 2009), 18, http://zedbooks.co.uk/.

political ascendency of the free-market model of capitalism represented by the U.S. and Britain, made even more dominant with the collapse of the Soviet Union in December 1991.

In particular, around the region, a new paradigm[21] was taking hold. The Washington Consensus was the name given to the introduction and widespread adoption of a set of neoliberal policy prescriptions in Latin America in the late 1980s and early 1990s.[22] The main tenets were the pursuit of macroeconomic stability by controlling inflation and reducing fiscal deficits, the opening of economies through trade and capital account liberalization, and the liberalization of domestic markets through privatization and deregulation.[23] Under Pinochet and the Chicago Boys,[24] Chile was an early adopter of economic liberalization and privatization measures, starting from 1974. Bolivia under Víctor Paz Estenssoro, Mexico under Miguel de la Madrid, Brazil under Fernando Collor de Mello, Venezuela under Carlos Andrés Pérez, and Peru under Alberto Fujimori were among the other Latin American countries that implemented such reforms from the late 1980s.[25]

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[21] Defined as a constellation of beliefs, values, techniques, and group commitments shared by members of a given community, founded in particular on a set of shared axioms, models, and exemplars. For more, see Gore, "The Rise and Fall of the Washington Consensus as a Paradigm for Developing Countries," 801.

[22] Panizza, *Contemporary Latin America*, 11.

[23] Gore, "The Rise and Fall of the Washington Consensus as a Paradigm for Developing Countries," 789.

[24] This was a name given to a group of Chilean economists who, having studied at the University of Chicago, returned to the country and ushered in a wave of reforms beginning in 1975. For more, see Juan Gabriel Valdes, *Pinochet's Economists: The Chicago School of Economics in Chile* (Cambridge University Press, 1995).

[25] Kurt Weyland, "The Political Fate of Market Reform in Latin America, Africa, and Eastern Europe," *International Studies Quarterly* 42, no. 4 (December 1, 1998): 653, doi:10.1111/0020-8833.00101.

US Interests. As the name suggests, the U.S. government was the leading force behind the change from a developmentalist to neoliberal strategy in developing countries that was the Washington Consensus. The Treasury Secretary, James Baker, suggested in 1985 that the IMF and the World Bank should play a central role in promoting the adoption of market-oriented policies for growth by debtor countries;[26] however, his plan, which also included a $20 billion increase in commercial bank financing to developing countries, failed to restore growth.[27] In 1989, Nicholas Brady, the new Treasury Secretary, proposed a new plan to voluntarily reduce debt and replace existing bank loans with bond swaps, which would reduce countries' overall debt liability, but conditioned on the implementation of structural economic reforms that included price liberalization and privatization.[28] The World Bank promoted this new growth strategy in Latin America, using Structural Adjustment Loans (SALs) to fund infrastructure projects; U.S. Congress also called on the IMF to coordinate with domestic banking regulators on the debt reduction programs.[29]

Institutional Priorities. During a meeting of the Executive Board on July 29, 1991, Argentina's status as a "prolonged user of Fund resources" was brought up.[30] From 1983 to 1991, Argentina had four consecutive SBAs with the IMF, but did not have

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[26] Panizza, *Contemporary Latin America*, 34.

[27] Manuel Monteagudo, "The Debt Problem: The Baker Plan and the Brady Initiative: A Latin American Perspective," *The International Lawyer* 28, no. 1 (April 1, 1994): 59.

[28] Panizza, *Contemporary Latin America*, 35.

[29] Monteagudo, "The Debt Problem," 77.

[30] International Monetary Fund, *Minutes of Executive Board Meeting 91/102*, Meeting Minutes (Washington, D. C.: International Monetary Fund, July 29, 1991), 51.

outstanding debts to the Fund.[31] Still, three directors warned that the Board should take into account Argentina's prolonged use of Fund resources and its capacity to repay the Fund before approving the requested SBA and future arrangements.[32]

Further, despite concerns over Argentina's unimpressive record of economic policy implementation,[33] the Fund's Executive Board expressed support in their meeting for the broad measures taken by Menem's administration, which included the Convertibility Law, and the immediate positive effects that it had already engendered. Several directors also voiced their concerns about the possibility of fiscal slippages in terms of wage policy, the social security system, and provincial spending,[34] as well as the decreasing competitiveness of Argentine exports as a result of its fixed exchange rate.[35] They were impressed, however, by Cavallo's "drastic" approach, which offered "the best chance in many years" of solving Argentina's recurring problem of inflation.[36] As a result, the Executive Board unanimously supported and approved Argentina's request for a Stand-By Arrangement.

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[31] International Monetary Fund, "Argentina: History of Lending Arrangements as of May 31, 2005," *International Monetary Fund*, May 31, 2005, http://www.imf.org/external/np/fin/tad/extarr2.aspx?memberKey1=30&date1key=2005-05-31.

[32] International Monetary Fund, *Minutes of Executive Board Meeting 91/102*, 51, 57; International Monetary Fund, *Minutes of Executive Board Meeting 91/103*, Meeting Minutes (Washington, D. C.: International Monetary Fund, July 29, 1991), 4.

[33] International Monetary Fund, *Minutes of Executive Board Meeting 91/103*, 14.

[34] International Monetary Fund, *Minutes of Executive Board Meeting 91/102*, 44, 56.

[35] International Monetary Fund, *Minutes of Executive Board Meeting 91/103*, 35.

[36] International Monetary Fund, *Minutes of Executive Board Meeting 91/102*, 43, 53.

*Analysis*

Contrary to conventional wisdom that the IMF, the World Bank, and the industrialized nations were behind the wave of neoliberal reforms in Latin America,[37] it is clear from the data above that the Argentine government instituted the Convertibility Law and other free market reforms on their own accord. Cavallo implemented the main features of his economic program in April 1991, before requesting IMF support in June, demonstrating his prior commitment to the policies proposed in his letter of intent, without pressure from the Fund.

It might be argued that the IMF and the U.S. Treasury were influential in setting the agenda of economic reform in the region, providing technical assistance and incentives in the form of the Baker and Brady debt-reductions plans; however, a closer look at the economic and political developments leading up to the 1991 SBA makes it clear that the driving force behind its design was the Argentine government. The old ISI developmentalist model had crumbled, a string of heterodox programs had failed, and the Menem administration faced fast-deteriorating economic conditions and waning political support. Tired of the distortionary effects of hyperinflation, public opinion was also in favor of a drastic break with the past. In this context, structural reforms that would otherwise have been shunned by the labor-based Peronist party were viewed as the solution to the country's economic woes. They were part of a forward-looking program of modernization that embodied 'change', a key political signifier in times of crisis.[38]

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[37] Panizza, *Contemporary Latin America*, 33.

[38] Ibid., 27.

In this instance, the design of the IMF arrangement was determined almost exclusively by the borrower government, which singlehandedly proposed and implemented reforms even before signing an arrangement with the IMF. I argue here that Argentina's economic and political conditions were the most important factor during this period.

*Outcome*

From 1991 to 1994, Cavallo's economic program had incredible success. Hyperinflation ended immediately, with the inflation rate declining dramatically from 1344 percent in 1990 to 84 percent in 1991, 17.5 percent in 1992, and then to levels not seen in decades—7.4 percent in 1993, 4.2 percent in 1994, and close to zero for the rest of the 1990s.[39] These figures can be seen in Table 4.1. Net capital inflows increased from US$7 billion in 1992 to over US$12 billion in 1994, in large part due to the massive wave of privatization.[40] GDP growth took off, increasing at more than 10 percent per year in 1991 and 1992, followed by 6.3 percent growth in 1993 and 5.8 percent in 1994.[41] A comparison to GDP growth prior to 1991 can be found in Table 4.2.

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[39] Pedro Pou, "Argentina's Structural Reforms of the 1990s," *Finance & Development* 37, no. 1 (March 2000), http://www.imf.org/external/pubs/ft/fandd/2000/03/pou.htm; Blustein, *And the Money Kept Rolling in (and Out)*, 21.

[40] Roberto Pablo Saba and Luigi Manzetti, "Privatization in Argentina: The Implications for Corruption," *Crime, Law and Social Change* 25, no. 4 (December 1, 1996): 353–69, doi:10.1007/BF00572515.

[41] Blustein, *And the Money Kept Rolling in (and Out)*, 21.

Table 4.1: Rate of Inflation in Argentina, 1990-2000

| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Inflation rate (%) | 1344 | 84 | 17.5 | 7.4 | 3.9 | 1.6 | 0.1 | 0.3 | 0.7 | -1.8 | -0.7 |

Source: Data adapted from Shinji Takagi and International Monetary Fund, eds., *The IMF and Argentina, 1991-2001*, Evaluation Report (International Monetary Fund. Independent Evaluation Office) (Washington, D.C.: International Monetary Fund, Independent Evaluation Office, 2004), 10.

Table 4.2: Real GDP Growth in Argentina, 1988-1994

| | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 |
|---|---|---|---|---|---|---|---|
| GDP Growth (%) | -2.6 | -7.5 | -2.4 | 10.5 | 10.3 | 6.3 | 5.8 |

Source: Data adapted from World Bank; Shinji Takagi and International Monetary Fund, eds., *The IMF and Argentina, 1991-2001*, Evaluation Report (International Monetary Fund. Independent Evaluation Office) (Washington, D.C.: International Monetary Fund, Independent Evaluation Office, 2004), 10.

In 1992, Argentina cancelled the SBA upon its completion in March and immediately signed a new extended arrangement with the IMF. While I do not analyze the design of this arrangement, I outline its conditions below in order to evaluate its implementation during the second period of interest, from December 1994 to January 1998.

### Conditions of the March 31, 1992 Stand-By Arrangement

On March 4, 1992, Cavallo submitted a letter of intent requesting the cancellation of the existing 1991 SBA upon the completion of its review. The letter also requested an extended arrangement equivalent to SDR 2,003 million (US$2.76 billion). The extended arrangement would be in line with the Argentine authorities' three-year strategy to consolidate the progress made in stabilizing and expanding the economy as well as to achieve external viability through debt-service reductions with private creditors.[42]

*Letter of Intent*[43]

1. Generate primary fiscal surplus sufficient to provide for planned debt service payments and for a steady decline in public debt
2. Eliminate existing non-refinanceable arrears and avoid incurring new external arrears
3. Increase in net international reserves
4. Full normalization of relations with external bank creditors through voluntary market-based debt and debt service reduction operation
5. Continued deregulation and opening of economy
6. Privatization of remaining state enterprises
7. Major tax reform to simplify system and encourage investment
8. Major social security system reform
9. Improve financial discipline in the provinces
10. Reduction in state employment

*Quantitative Performance Criteria*[44]

1. Limit on the combined overall deficit of the nonfinancial public sector and the Central Bank and on the overall cash deficit of the nonfinancial public sector
2. Limit on the net domestic assets of the Central Bank
3. Floor for the net international reserves of the monetary authorities
4. Limit on the total external debt of the public sector and on the cumulative net disbursements of short-term external debt to public sector entities
5. Elimination of external payments arrears on public sector debt

*Structural Performance Criteria*[45]

1. Implementation by June 30, 1992 of tax reform aimed at replacing income tax by taxes on distributed profits and business primary surplus
2. Implementation by December 21, 1992, of social security reform to achieve financial balance on cost and accrual basis

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[42] International Monetary Fund, *Staff Report for the 1992 Article IV Consultation, Review Under Stand-By Arrangement, and Request for Extended Arrangement*, Country Report (Washington, D. C.: International Monetary Fund, March 11, 1992), 8.

[43] International Monetary Fund, *Request for Extended Arrangement - Letter of Intent and Memorandum on Economic Policy*, Letter of Intent (Washington, D. C.: International Monetary Fund, March 4, 1992).

[44] For specific numbers, see Table 4 in International Monetary Fund, *Staff Report for the 1992 Article IV Consultation, Review Under Stand-By Arrangement, and Request for Extended Arrangement*.

[45] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 83.

## SECOND PERIOD: DECEMBER 1994 – DECEMBER 1997

### BRIEF CHRONOLOGY

In December 1994, Mexico suffered a currency crisis, known informally as the "Tequila crisis", which was marked by the Mexican government's sudden devaluation of the peso.[46] To combat the spillover effects of the crisis, the Argentine government implemented swift fiscal and structural measures to raise revenues and preserve convertibility. It temporarily increased the value-added tax by 3 percent, reduced reserve requirements on both U.S. dollar and peso deposits, and established trust funds to facilitate the restructuring of provincial and private banks.[47] It also introduced further cuts in expenditure through a reduction of the salaries of public employees and increased tariffs on certain imports to ensure fiscal balance in light of the significant decline in capital inflows.[48]

On April 6, 1995, the IMF approved a fourth year extension for the existing extended arrangement and increased the funds available to Argentina to the equivalent of SDR 1.53 billion (US$2.4 billion), bringing the total amount under the arrangement to SDR 4.02 billion (US$5.86 billion).[49] After the expiration of the extended arrangement, the IMF continued to signal its support for Argentina and the convertibility system by

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[46] Frederic S. Mishkin, "Lessons from the Tequila Crisis," *Journal of Banking & Finance* 23, no. 10 (October 1999): 1521–33, doi:10.1016/S0378-4266(99)00029-1.

[47] Eduardo J. J. Ganapolsky and Sergio L. Schmukler, *Crisis Management in Argentina During the 1994-95 Mexican Crisis: How Did Markets React?* (World Bank Publications, 1998), 13; International Monetary Fund, *Staff Report for the 1995 Article IV Consultation and Request for Modification of the Extended Arrangement*, Country Report (Washington, D. C.: International Monetary Fund, September 8, 1995), 2.

[48] International Monetary Fund, *Request for Extended Arrangement - Letter of Intent*, Letter of Intent (Washington, D. C.: International Monetary Fund, March 23, 1995), 3.

[49] International Monetary Fund, "IMF Management and Argentina Agree on Program for 1995," Press Release (Washington, D. C., March 23, 1995), https://www.imf.org/external/np/sec/nb/1995/nb9510.htm.

approving a SBA on April 12, 1996 and completing three reviews of the arrangement, allowing Argentina to draw on SDR 720 million (US$1.05 billion) over 21 months.

In the following paragraphs, I outline the arrangements, augmentations, modifications, and waivers that the IMF approved throughout the period under analysis.

April 6, 1995:[50] The Executive Board approved the completion of the ninth review and augmented the arrangement to the equivalent of SDR 4,020.25 million (US$ 6.3 billion) from the SDR 2,483.15 million approved in 1992. The Board waived Argentina's failure to meet a number of fiscal performance criteria for end-September and end-December. Argentina also received support from the World Bank, the Inter-American Development Bank (IDB) and the Eximbank of Japan, as well as from private foreign banks, allowing it to meet its debt-service obligations and rebuild the central bank's reserves.[51]

September 27, 1995:[52] The Executive Board approved Argentina's requests for a waiver for a minor deviation from the June ceiling on the fiscal deficit and a modification of the September and December program performance criteria to allow for a deficit in the nonfinancial public sector.

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[50] International Monetary Fund, *Minutes of Executive Board Meeting 95/35*, Meeting Minutes (Washington, D. C.: International Monetary Fund, April 6, 1995), 13.

[51] International Monetary Fund, *Staff Report for the 1995 Article IV Consultation and Request for Modification of the Extended Arrangement*, 2.

[52] International Monetary Fund, *Minutes of Executive Board Meeting 95/94*, Meeting Minutes (Washington, D. C.: International Monetary Fund, September 27, 1995), 48.

*December 14, 1995:*[53] The Executive Board approved the completion of the tenth review of the 1992 extended arrangement, with Argentina meeting all of the modified quantitative performance criteria.

*March 29, 1996:*[54] The Executive Board approved the completion of the last review of the 1992 extended arrangement, waiving Argentina's non-observance of a number of performance criteria due to its weakening fiscal performance. This waiver enabled Argentina to make the last purchase under the extended arrangement.

*April 12, 1996:*[55] The Executive Board approved a SBA in an amount equivalent to SDR 720 million (US$1.05 billion) with the following *quantitative performance criteria*:

1. Limit on the cumulative deficit or surplus of the public sector
2. Limit on the cumulative ceiling on federal expenditure
3. Limit on the cumulative change in net domestic assets of the Central Bank
4. Target on the cumulative change in the free international reserves of the Central Bank
5. Limit on the cumulative net disbursements of external and domestic public sector debt
6. Limit on the cumulative net increase in short-term public sector debt

*October 30, 1996:*[56] The Executive Board approved Argentina's request for a waiver of the September performance criteria for the purchase subject to end-June performance and

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[53] International Monetary Fund, *Second Review of the Fourth Year of the Extended Arrangement and Request for Modification*, Country Report (Washington, D. C.: International Monetary Fund, December 7, 1995).

[54] International Monetary Fund, *Staff Report for Request for Stand-By Arrangement*, Country Report (Washington, D. C.: International Monetary Fund, March 14, 1996), 4.

[55] International Monetary Fund, *Staff Report for Request for Stand-By Arrangement*, March 14, 1996.

[56] International Monetary Fund, *Minutes of Executive Board Meeting 96/98*, Meeting Minutes (Washington, D. C.: International Monetary Fund, October 30, 1996).

a modification of performance criteria related to the public finances for September and December 1996. With that, it approved the completion of the first review of the 1996 SBA.

*February 24, 1997:*[57] The Executive Board approved on a lapse of time basis[58] the completion of the second review of the 1996 SBA, with Argentina meeting all of the modified quantitative performance criteria.

*July 30, 1997*:[59] The Executive Board approved on a lapse of time basis the completion of the third review of the 1996 SBA, with Argentina meeting all of the quantitative performance criteria for end-March 1997.

*February 4, 1998*:[60] The Executive Board approved a precautionary extended arrangement in the amount of SDR 2,080 million (US$2.8 billion). This arrangement was scheduled to last until 2001. It included the following *quantitative performance criteria*:

1. Limit on the cumulative federal deficit
2. Limit on the cumulative change in the net domestic assets of the Central Bank
3. Limit on the cumulative net disbursements of external and domestic public sector debt

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[57] International Monetary Fund, *Staff Report for the Second Review Under the Stand-By Arrangement*, EBS/97/17 (Washington, D. C.: International Monetary Fund, February 9, 1997).

[58] A lapse of time basis means that the Executive Board approved the draft decision crafted in the staff report without discussing it in a meeting. A decision made under such circumstances indicates that the directors were broadly satisfied with developments in Argentina during that period and no director considered formal discussion necessary.

[59] International Monetary Fund, *Third Review Under the Stand-By Arrangement*, Country Report (Washington, D. C.: International Monetary Fund, July 15, 1997), 5.

[60] International Monetary Fund, *Staff Report for the 1997 Article IV Consultation and Request for Extended Arrangement*, Country Report (Washington, D. C.: International Monetary Fund, January 14, 1998).

4. Limit on the cumulative net increase in short-term public sector debt

It also included the following *structural criteria*:

1. By the first review: Implement single presumptive tax, tax administration program, and labor market reform; present to Congress tax reform bill; and lease airport and telecommunications frequencies.
2. By the second review: Obtain congressional approval of tax reform and new anti-trust law; implement reforms of tax administration, budgetary operations, social security system, and financial system; and submit to Congress draft legislation on privatization of Banco de la Nación Argentina, the national bank.

### *Developments in Argentina*

*Economic Conditions.* The Mexican crisis had a severe contagion effect on Argentina, where the banking system was drained of over US$8 billion, equivalent to 18 percent of deposits, in three months at the beginning of 1995.[61] Bank liquidity tightened, central bank reserves declined by a third, the stock market fell by 50 percent between December 1994 and March 1995, and GDP contracted by 2.8 percent.[62] More than 85,000 employees had lost their jobs from 1990 to 1993 due to the privatization and downsizing of state-owned enterprises and, exacerbated by the recession, unemployment quickly grew to almost 17 percent in 1995.[63] Table 4.3 illustrates the unemployment and poverty indicators for Argentina from 1991 to 1995.

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[61] Cavallo and Cottani, "Argentina's Convertibility Plan and the IMF," 18.

[62] Ganapolsky and Schmukler, *Crisis Management in Argentina During the 1994-95 Mexican Crisis*, 2.

[63] Nancy R. Powers, "The Politics of Poverty in Argentina in the 1990s," *Journal of Interamerican Studies and World Affairs* 37, no. 4 (December 1, 1995): 99, doi:10.2307/166248.

Table 4.3: Unemployment and Poverty Indicators for Argentina, 1991-1995

| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|
| Unemployment rate (%) | 6.0 | 7.0 | 9.3 | 12.1 | 16.6 |
| Poverty rate (%) | 21.5 | 17.8 | 16.8 | 19.0 | 24.8 |

Source: Data adapted from Kurt Schuler, "Argentina's Economic Crisis: Causes and Cures," *Joint Economic Committee United States Congress,* Washington D.C. (June 2003), 5-6, http://www.hacer.org/pdf/Schuler.pdf.

The announcement and implementation of the measures in April-May 1995 successfully halted the run on the banks and stabilized the financial situation. There was a reflow of deposits, access to foreign borrowing was restored and interest rates declined.[64] Aided by a relatively weak U.S. dollar and tariff reductions achieved under the regional free-trade bloc, MERCOSUR, Argentina's exports grew by 32 percent.[65] Despite a 4.6 percent decline in GDP in 1995, the recession bottomed out at the end of the year, with GDP growth reaching 5.5 percent in 1996.[66] Private capital flows to Argentina also resumed after the announcement of the fourth-year extension and continued to remain strong until 1998. The country's recovery from the Tequila crisis was further underscored by the fact that, thanks to the growth in exports, the unemployment rate rapidly decreased from 18.4 percent in May 1995 to 12.4 percent in October 1998.[67]

On the surface, Argentina's fiscal account appeared to be disciplined throughout the decade. Its public debt-to-GDP ratio remained in the range of around 30 to 40 percent

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[64] International Monetary Fund, *Staff Report for Request for Stand-By Arrangement*, Country Report (Washington, D. C.: International Monetary Fund, March 14, 1996), 3.

[65] Ibid.

[66] International Monetary Fund, *Staff Report for the 1996 Article IV Consultation, First Review Under the Stand-By Arrangement, and Request for Waiver and Modification of Performance Criteria*, Country Report (Washington, D. C.: International Monetary Fund, October 9, 1996), 2.

[67] Fiorucci and Klein, *The Argentine Crisis at the Turn of the Millennium*, 42.

from 1991 to 1998.[68] The numbers from the 1997 budget year showed that the government was even running a small fiscal surplus, excluding interest payments; however, considering the economy's overall splendid health from 1993 to 1998, the increase in Argentina's debt from 29 to 41 percent of GDP should have been a cause for concern.[69] Furthermore, Argentina's debt was almost entirely denominated in foreign currencies, which meant that a depreciation of the peso would immediately translate into a huge jump in the debt ratio.[70] This possibility was unfortunately ignored because the pegged exchange rate regime was assumed to be sustainable in the long run.

There was also insufficient attention paid to the finances of provincial governments, whose expenses totaled about 10 percent of the country's GDP.[71] Some progress had been made to address the weaknesses caused by provincial finances, with structural adjustment measures such as the 1992 Co-participation Agreement that reduced the percentage of federal tax revenues distributed to the provinces and pacts to lower the provincial payrolls in exchange for debt forgiveness by the federal government.[72] It was difficult, however, for Menem's administration to fully control provincial spending and deficits. Provincial governments could float bond issues on international capital markets and the federal government was constitutionally limited to stop them. Buenos Aires

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[68] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 10.

[69] Blustein, *And the Money Kept Rolling in (and Out)*, 50.

[70] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 26.

[71] Blustein, *And the Money Kept Rolling in (and Out)*, 53.

[72] Kent Eaton, "Menem and the Governors: Intergovernmental Relations in the 1990s," in *Argentine Democracy: The Politics of Institutional Weakness*, ed. Steven Levitsky and María Victoria Murillo (University Park, Pa: Pennsylvania State University Press, 2005).

alone, for example, took advantage of the incoming capital flows and saw its spending soar from US$4.1 billion in 1991 to US$10.7 billion in 1998.[73]

Political Developments. One of the structural conditions of the 1992 arrangement was labor reform. The IMF considered laws that dated from the 1930s and 1940s, when Argentina embarked on the ISI model of national development, anachronistic. For example, labor laws mandated two months' notice before dismissal, at which point the worker laid off became entitled to a twelfth of his or her salary and bonuses from the last year multiplied by the total number of years worked.[74] These requirements made Argentina's labor markets inflexible and were ill-suited for a free-market economy. The reforms implemented eliminated job security and other benefits that workers had been entitled to. The government's privatization drive also resulted in large cutbacks in employment. In non-financial firms, employment decreased by approximately 36 percent after privatization.[75] As a result, dissatisfaction with the government increased and social tensions rose.

Under pressure from labor groups, who accused his policies of leading to record unemployment and increased poverty, and Menem, with whom he had often battled publicly over the pace of reforms, Cavallo, the architect of the Convertibility Law,

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[73] Blustein, *And the Money Kept Rolling in (and Out)*, 53.

[74] Christopher Sabatini and Eric Farnsworth, "The Urgent Need for Labor Law Reform," *Journal of Democracy* 17, no. 4 (2006): 52, doi:10.1353/jod.2006.0071.

[75] Sebastian Galiani, Paul Gertler, and Ernesto Schargrodsky, *The Benefits and Costs of Privatization in Argentina: A Microeconomics Analysis*, Working Paper (Universidad de San Andres, Departamento de Economia, 2002), 25, https://ideas.repec.org/p/sad/wpaper/53.html.

resigned as Minister of Economy on July 18, 1996.[76] He was replaced by Roque Fernández, the director of the central bank, who pledged to maintain the direction of his predecessor's policies.

### *Developments in the IMF and the World Economy*

The Mexican crisis of 1994. The external environment for Argentina deteriorated significantly in the wake of the Mexican crisis. Investors began to flee Argentina and other emerging markets in an attempt to avoid the risk of short-term capital losses.[77] As mentioned earlier, there was a drastic outflow of capital, reflected in the decline in bank deposits, and a sharp fall in the stock market as well as in bond prices. The outflow of deposits also led to an abrupt increase in interest rates, with prime rates increasing by 25 to 33 percentage points from December 1994 to March 1995, which severely reduced investment and industrial activity.[78]

Brazil, too, was affected, though to a smaller extent than Argentina. Capital outflows between December and February saw the country losing US$4 billion in currency reserves; in March alone, reserves fell by US$4.2 billion.[79] In response, the Central Bank removed restrictions on capital inflows that had been put in place over the

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[76] Calvin Sims, "President Ousts Finance Chief In Argentina," *The New York Times*, July 27, 1996, http://www.lexisnexis.com.revproxy.brown.edu/lnacui2api/api/version1/getDocCui?lni=3S89-45G0-0005-G2MY&csi=8399&hl=t&hv=t&hnsd=f&hns=t&hgn=t&oc=00240&perma=true.

[77] For a comprehensive analysis of different hypotheses on the aftermath of the Tequila crisis, see Jeffrey Sachs, Aaron Tornell, and Andres Velasco, *Financial Crises in Emerging Markets: The Lessons from 1995*, Working Paper (National Bureau of Economic Research, May 1996), 2, http://www.nber.org/papers/w5576.

[78] International Monetary Fund, *Request for Extended Arrangement - Letter of Intent*, 3.

[79] Nicolas Tingas and Paulo Pereira Miguel, "Capital Flows and Economic Policy in Brazil," in *Global Financial Crises and Reforms: Cases and Caveats*, ed. B. N. Ghosh (New York, N.Y.: Routledge, 2002), 253.

previous 18 months. The trade balance also deteriorated sharply, with the monthly trade deficit in February 1995 reaching US$1 billion. From July 1995, as a result of high domestic interest rates and lower perceived risk premiums, capital inflows returned and foreign reserves began to rise continually until mid-1996.[80]

*The Asian Financial Crisis of 1997.* Between June 1997 and January 1998, a financial crisis swept through Asia. States that had over the previous decade registered some of the most impressive economic growth rates in the world saw their stock markets and currency markets implode.[81] In July 1997, the Thai government allowed the baht to float freely against the dollar after running out of foreign reserves to defend its fixed exchange rate; the Philippines, Malaysia, Indonesia, and South Korea devalued in a similar fashion over the next six months.[82]

The single most dramatic element of the crisis was the rapid reversal of private capital inflows into Asia, which was the defining factor in the Mexican crisis as well. From 1996 to 1997, net private inflows in the five most affected Asian economies (South Korea, Indonesia, Thailand, Malaysia, and the Philippines) dropped precipitously from US$93 billion to negative US$12 billion, a swing of US$105 billion over what was effectively six months.[83] The resulting combination of real exchange rate depreciation and sharply higher interest rates wiped out a substantial portion of bank capital and

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[80] Ibid.

[81] Robert J. Barro, *Economic Growth in East Asia Before and After the Financial Crisis*, Working Paper (National Bureau of Economic Research, June 2001), 30–33, http://www.nber.org/papers/w8330.

[82] Ibid., 1.

[83] Steven Radelet and Jeffrey Sachs, *The Onset of the East Asian Financial Crisis*, NBER Chapters (National Bureau of Economic Research, Inc, 2000), 5, http://econpapers.repec.org/bookchap/nbrnberch/8691.htm.

brought lending and investment activity to a standstill. Furthermore, as a result of the creditor panics, bank runs, and consequent sovereign downgrades, Korea, Indonesia, and Thailand were thrown into partial debt defaults.[84]

Capital Flows to Emerging Markets. At the beginning of the decade, with a sustained decline in world interest rates and the wave of neoliberal reforms sweeping across Latin America, Asia, and what used to be the Soviet Union, there was a rush in the financial world to invest in these emerging markets. Between 1990 and 1994, about US$670 billion of foreign capital flowed to developing countries in Asia and Latin America, which was almost five times the $133 billion total of the previous five years.[85] After a brief reversal in the wake of the Mexican crisis, capital inflows quickly returned to pre-crisis levels and continued to rise over the next few years.

Investors believed that the fastest growth, quickest profits, and highest yields were to be found in these countries, and financial firms responded to this demand by establishing offices and dispatching analysts in Argentina and its neighboring countries.[86] Each bank would have a team of analysts whose job was to produce research reports that were purportedly to aid investors in making decisions on where and what to invest in.

There was, however, an inherent conflict of interest as banks earned fees from the sale of the very same bonds their analysts were recommending or not recommending.

[84] Ibid., 8.

[85] Guillermo A. Calvo, Leonardo Leiderman, and Carmen M. Reinhart, "Inflows of Capital to Developing Countries in the 1990s," *The Journal of Economic Perspectives (1986-1998)* 10, no. 2 (Spring 1996): 123, http://search.proquest.com.revproxy.brown.edu/docview/208938664/abstract/CD08D8E64C5D4037PQ/1?accountid=9758.

[86] Blustein, *And the Money Kept Rolling in (and Out)*, 30.

Furthermore, competition between banks was intense, with dozens of firms participating in the bidding processes for countries' bond offerings. This fierce competition meant that Wall Street firms were keen to have good relationships with their clients, which in turn meant not criticizing the country or pointing out their weaknesses in public. As the Argentine undersecretary of finance, Miguel Kiguel, remarked on the relationship between Argentina and Wall Street, "I think that with all the banks there was some censorship, to avoid offending us … They wanted to have good relations with us. My view is, these people are not fully independent or objective."[87]

In fact, by 1997, Argentina had emerged as the single largest emerging-market bond-issuer. In January of that year, J.P. Morgan and Merrill Lynch conducted a sale of US$2 billion in twenty-year Argentine government bonds, and as Kiguel, recalled later, "… people were desperate to buy Argentina."[88] In 1998, Argentina even won an award for "Issuer of the Year", bestowed by *LatinFinance* magazine, reflecting its capacity to sell large quantities of bonds even in difficult international markets. The magazine went on to say that "Argentina above all other issuers, both sovereign and corporate, was the bankers' saving grace in 1998."[89]

*Institutional Priorities.* During this period, Argentina was showcased as a success story of IMF policies. In a speech in Buenos Aires on May 27, 1996, Michel Camdessus, the Managing Director of the IMF, declared that "today, there is no longer any doctrinal

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[87] Ibid., 64.

[88] Ibid., 31.

[89] Ibid., 52.

divide" between the Fund and Argentina over the appropriate roles of the state and the private sector, the importance of fiscal discipline and the merits of liberalization and deregulation, alluding to Argentina's previous resistance to free-market reforms.[90] He added that Argentina's experience offered "what is in many respects a blueprint for success" and "lessons … that we can share with others."[91]

A year later, on May 21, 1997, Michel Camdessus returned to speak at Argentina's National Banks Convention. Citing the absence of inflation, increasing private capital inflows, and growth reaching 6 percent for the year, declared that "this may not be paradise, but the situation is far better than we would have dared imagine not so very long ago."[92]

This public veneration of Argentina by the IMF's top management, however, belied deeper reservations on the Fund's staff, who had distinct differences in opinion on policy toward Argentina.

A staff mission that visited Buenos Aires shortly after the May 1997 agreement "indicated to the authorities that, in its view, the proposed reforms fall well short of what is needed to ensure adequate flexibility in the labor market, and would not appear, in their present form, to deserve support" under the extended arrangement then being negotiated.[93] This view was shared by staff in several other departments, including the

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[90] Michel Camdessus, "Argentina and the Challenge of Globalization" (Speech, Academy of Economic Science, Buenos Aires, Argentina, May 27, 1996), 1.

[91] Ibid., 2.

[92] Michel Camdessus, "Toward a Second Generation of Structural Reform in Latin America" (Speech, 1997 National Banks Convention, Buenos Aires, Argentina, March 21, 1997), 2.

[93] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 32.

Strategy, Policy, and Review Department that was in charge of designing and implementing IMF policies on surveillance and use of financial resources.

From the middle of 1997, internal staff memorandums were almost unanimous in opposing the extended arrangement with Argentina based on the terms being finalized, with the Treasurer's Department questioning the Argentine authorities' ability to implement the required structural reforms, given their past performance and present political constraints. The Research Department also commented on the letter of intent, maintaining that "the program outlined … is not ambitious enough to warrant Fund support."[94] These concerns, however, were not included in the staff report on the 1998 extended arrangement presented to the Executive Board.

In September 1998, a senior advisor in the Research Department wrote a memo to Teresa Ter-Minassian, the Deputy Director of the Western Hemisphere Department who oversaw negotiations with Argentina,

> We realize that management opted for completing the review despite the staff's suggestion … that it be conditional on legislative approval of an amended draft of labor market reforms, which has not occurred. We see merit in the argument that the current turmoil in international markets justifies the continuation of Fund support, but, on the whole, we think that a weakening of conditionality in the area that has been widely perceived and publicized as the cornerstone of this Fund arrangement is a mistake. This decision will signal to the markets (and to the authorities) that there is only a remote possibility that the Fund will ever let this arrangement go off-track—even for a few months. The Fund's credibility will be further weakened as a result.[95]

Yet in public, the IMF continued to highlight Argentina as an outstanding example for other countries to follow. At the annual meeting of the IMF and World Bank in October 1998, Michel Camdessus invited President Menem to address the meeting's

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[94] Ibid., 37.

[95] Blustein, *And the Money Kept Rolling in (and Out)*, 57.

plenary session, the only world leader accorded the honor besides Bill Clinton, the head of the host government. In a press conference explaining the decision, he declared,

> In many respects the experience of Argentina in recent years has been exemplary, including in particular the adoption of the proper strategy at the beginning of the 1990s and the very courageous adaptation of it when the tequila crisis put the overall subcontinent at risk of major turmoil … Notable, too, are the efforts of Argentina since that time to continue its excellent compliance with the performance criteria under our arrangements and much progress in implementation of the structural reforms.
>
> So, clearly, Argentina has a story to tell the world: a story which is about the importance of fiscal discipline, of structural change, and of monetary policy rigorously maintained.[96]

The three examples from 1996 to 1998 demonstrate that Argentina was the poster child for the IMF during this period.

*Analysis*

Among the multiple factors determining IMF policy in Argentina from 1994 to 1998, I find that the IMF's institutional need for Argentina as a success story most heavily determined the manner of its engagement in the country over this period. The Fund's credibility was now inextricably tied to Argentina's economic success, which gave Argentina enormous leverage over the IMF from 1997 on.

Despite a brief reversal in capital inflows immediately after the Mexican crisis, Argentina enjoyed reasonably low-cost access to international capital markets throughout this period. From 1997 to 1999, the Argentine government did not draw any hard currency from the IMF, as private capital was flooding into the country at the time. This

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[96] International Monetary Fund, *Press Conference of Michel Camdessus, Managing Director International Monetary Fund*, Press Release (Washington, D. C.: International Monetary Fund, October 1, 1998), https://www.imf.org/external/np/tr/1998/tr981001.htm.

access arguably diminished the Fund's ability to put pressure on the Argentine government. Furthermore, the 1998 extended arrangement was precautionary, which meant that Argentina did not intend to draw on the funds available.[97] Coupled with Argentina's easy access to private credit, the IMF did not appear to have much leverage with the Argentine authorities; however, the fact remained that the availability of private sector finance was largely dependent on the IMF's seal of approval. The Argentine authorities were fully cognizant of this fact, as evidenced by Argentina's request for the arrangement with the Fund despite not needing to draw on the credit. This dependence meant that the IMF did in fact have considerable leverage with Menem's administration, as Menem knew that if the IMF withdrew its support and suspended the arrangements, investors would be frightened away as well.

Yet it was clear that after the Mexican crisis, the IMF shifted its stance from evaluating Argentina's policies in the context of the convertibility system to one directly defending and actively endorsing the regime.[98] During the Executive Board meeting of April 6, 1995, a director noted that neither the Argentine authorities or "the staff [felt] compelled to discuss or even mention possible pros and cons of an alternative policy approach" to the system of convertibility.[99] The Fund knew that, in the eyes of international opinion, its credibility had become closely linked to the survival of the exchange rate regime and Argentina's success and therefore did not consider any alternatives to convertibility despite signs that the regime might not be sustainable. Apart

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[97] Instead, the guaranteed access to these funds served to reassure investors that the country would not face liquidity problems even if other sources of financing dried up.

[98] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 37.

[99] International Monetary Fund, *Minutes of Executive Board Meeting 95/35*, 10.

from the review completed on July 30, 1997, Argentina had failed to observe all of the quantitative performance criteria spelled out in the arrangements or, in the event that it did observe them, had petitioned for modifications prior to the reviews over this period.

Furthermore, the IMF continued to approve arrangements and complete reviews even when it became clear that the Menem administration no longer had the political support to implement certain structural reforms, in particular, in the areas of labor and social security reform. This was done ostensibly for two reasons: (1) to maintain the credibility of the convertibility system, and (2) to support the Argentine authorities in good faith because the Executive Board recognized that they were doing as much as they could in the face of domestic political constraints. These reasons, however, are insufficient in explaining why the IMF failed to seriously consider any alternatives to the convertibility regime or apply any pressure to the Argentine authorities to improve their adherence to the performance criteria.

I find that during this period, IMF policy design and implementation were most significantly determined by the Fund's institutional need to appear credible to the world. The IMF had borne the brunt of the blame for the various crises that were unfolding in the world at the time. It had been heavily involved in shaping policy both in Mexico and in the Asian countries, and it was clear that the Fund was using Argentina as an example to uphold its own credibility. The multiple instances in which the Managing Director highlighted Argentina's success in public arenas despite internal staff apprehension over deep weaknesses in the country's debt position and reservations over the sustainability of the convertibility regime support my argument. Indeed, after leaving his position as the

IMF's chief economist, Michael Mussa explained the Fund's reluctance to be harsh on Argentina over this period,

> With the Fund under widespread criticism … for its involvement in Asia, it was particularly gratifying to be able to point to at least one important program country where the Fund appeared to be supporting successful economic policies. In this situation, there was probably even more than the usual reluctance for the Fund to be the skunk at the garden party, by stressing the accumulating failures of Argentine fiscal policy.[100]

This quote encapsulates the overwhelming desire among the top echelons of the IMF to use Argentina as a poster child to uphold the Fund's credibility. It is evident that this factor was the most important one in determining Fund policy over this period.

*Outcome*

Another series of external shocks exposed the underlying weaknesses of Argentina's economy, beginning with the Russian default in August 1998. The crisis in Russia sparked a reversal in capital flows to emerging markets and weakened demand in Argentina's major trading partners, in particular, Brazil. The strengthening of the U.S. dollar against the euro meant that Argentine exports, pegged to the dollar, were less competitive. As a result, the external current account deficit widened from 3.7 percent of GDP in 1997 to an estimated 4.4 percent in 1998, but Argentina financed this deficit with increasing net capital inflows, which rose during 1998 to about US$19 billion.[101] The capital inflows were spurred in part by Argentina's three-year extended arrangement with

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[100] Blustein, *And the Money Kept Rolling in (and Out)*, 50.

[101] International Monetary Fund, *IMF Concludes Article IV Consultation with Argentina*, Public Information Notice (PIN) (Washington, D. C.: International Monetary Fund, March 11, 1999), https://www.imf.org/external/np/sec/pn/1999/pn9921.htm.

the IMF that had been approved on February 4, 1998, for a total of SDR 2,080 million (US$2.8 billion).[102] Yet real GDP fell by over 3 percent in the second half of 1998.[103]

In early 1999, Brazil devalued its currency by 70 percent, abandoning its semi-fixed exchange rate after it lost more than half its foreign reserves (amounting to about US$35 billion) in 1998 alone and with capital outflows reaching US$350 million a day in December.[104] Brazil was a major export market for Argentina, accounting for almost a third of Argentina exports in 1998; the depreciation of the real meant that Argentine exports were much less competitive and Argentine exports to Brazil fell by 28 percent in 1999.[105] Argentina's fiscal situation, too, deteriorated as jockeying by the candidates in the 1999 presidential elections led to large increases in government spending. A simultaneous deceleration of growth meant that the debt-to-GDP ratio grew from 41 percent in 1998 to more than 47 percent at the end of 1999.[106]

## CONCLUSION

In the first period under analysis, from April 1991 to March 1992, it is evident that, faced with extreme economic conditions, the Menem administration took the unique step of implementing drastic structural reforms with little to no IMF involvement. In this instance, the borrower country's exceptional economic and political circumstances most heavily determined IMF policy in the country. Over the second period, the IMF's

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[102] Ibid.

[103] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 12.

[104] William C. Gruben and Sherry Kiser, "Brazil: The First Financial Crisis of 1999," *Southwest Economy*, no. Mar (1999): 14.

[105] Blustein, *And the Money Kept Rolling in (and Out)*, 59.

[106] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 13.

institutional need to preserve its credibility was the strongest factor determining its policy design and implementation. In the next chapter, I analyze the events over the period from February 2000 to January 2002.

# CHAPTER FIVE

# THE SPOILED CHILD OF THE WASHINGTON CONSENSUS

You've always lived with globalization. I've always lived with crises.
—Domingo Cavallo, Minister of Economy of Argentina (1991–1996, 2001)

In this chapter, I analyze the series of decisions the IMF made over the period from February 2000 to January 2002 when it provided unprecedented financial support to Argentina. In December 2001, however, the Fund did not complete the review of an arrangement with Argentina for the first time in over ten years, which precipitated Argentina's partial default on its international obligations and the subsequent collapse of the convertibility regime. Why did the IMF finally decide, after more than a decade, to finally stop providing Argentina access to its funds?

Unlike the previous chapter, I analyze the approval of the SBA and its subsequent reviews individually in order to demonstrate how the weight of different factors shifted throughout this period, leading to the non-completion of the fifth review in December 5, 2001.

## THIRD PERIOD: FEBRUARY 2000 – JANUARY 2002

### BRIEF CHRONOLOGY

On December 10, 1999, Fernando de la Rúa was elected to the presidency, riding public discontent over the deteriorating economy to victory over the Peronist party; however, he had no plans to change the economic policies of his predecessor. De la Rúa was fully committed to convertibility and launched a determined effort to reduce the country's US$6.9 billion deficit upon taking office.[1] In January 2000, he dramatically raised taxes and cut spending, but the contractionary measures only served to slow the economy down further, spurring unrest across parts of the country.

In March 10, 2000, the IMF signaled its support for the new government by approving an SBA in the amount of approximately SDR 5.4 billion (US$7.2 billion). In September, the Fund completed its first review of this arrangement, waiving Argentina's non-observance of a number of performance criteria. In January 12, 2001, the IMF approved Argentina's request for an augmentation of the arrangement, almost doubling its access to SDR 10.585 million.

As economic conditions continued to deteriorate in Argentina, the IMF continued to support the authorities by completing a third review in May 21, 2001, and augmenting the arrangement further in September to an unprecedented 800 percent of Argentina's quota at the Fund, amounting to almost SDR 17 billion. Finally, as the economic situation in Argentina showed no sign of improving, the IMF withdrew its support in December 2001, which caused Argentina to partially default on its debt and replace the fixed exchange rate regime with a floating one in January 2002.

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[1] Blustein, *And the Money Kept Rolling in (and Out)*, 80.

## CONDITIONS OF THE MARCH 10, 2000 STAND-BY ARRANGEMENT[2]

In a letter of intent dated February 14, 2000, Minister of Economy Jose Luis Machinea requested a three-year SBA in the amount of SDR 5,398.61 million (US$7.2 billion) to support his economic program for the period 2000-2002 and outlined a number of measures Argentina intended to implement over the course of the arrangement. The arrangement approved by the IMF on March 10, 2000 contained seven quantitative performance criteria, one of which was indicative, and three structural benchmarks. It aimed to improve investor confidence and help Argentina obtain access to financing at better interest rates, as the Argentine government borrowed more than US$10 billion by selling dollar- and euro-denominated bonds from January to September in 2000 in order to fund its budget deficit, pay interest on existing bonds, and pay off maturing ones.[3]

### *Letter of Intent*

1. Fiscal consolidation and structural improvement in the public sector finances
    a. Increases in the income, excises, fuels, and personal wealth taxes
    b. Broaden base of the value-added and income taxes
    c. Halt new tax incentives for industry and agriculture
    d. Limit planned reduction of employer contributions to social security system
    e. Federal commitment (*compromiso federal*) between the government and the provinces to set federal transfers to the provinces at levels lower than previously agreed
2. Substantial improvement in tax compliance by reducing tax arrears, avoidance, and evasion
3. Streamline the civil service and improve cost-effectiveness of public services
    a. Significant cuts in temporary state personnel
4. Reform of the social security system

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[2] For more information on the policies outlined in the letter of intent, the quantitative performance criteria, and the structural benchmarks, see International Monetary Fund, *Request for Stand-By Arrangement—Letter of Intent and Memorandum of Economic Policies*, Letter of Intent (Washington, D. C.: International Monetary Fund, February 14, 2000).

[3] Blustein, *And the Money Kept Rolling in (and Out)*, 81.

a. Raise retirement age for women
b. Align contributive base of the self-employed to their actual incomes
c. Strengthen regulatory framework and oversight of private pension plans

5. Consolidation of existing union-run health organizations
6. Seek sustained improvement in the provincial finances
7. Seek lasting reform of the revenue sharing system with the provinces after the expiration of the *compromiso federal* at the end of 2001
8. Smooth and lengthen the maturity profile of public debt
9. Continue sale of state assets in financial institutions and energy sector
10. Strengthen powers of the Central Bank and review the bank regulatory framework
11. Reform labor legislation
12. Promote competition in domestic markets, especially in the services sector
13. Continue open-trade policy both on a multilateral basis and within Mercosur

*Quantitative Performance Criteria*

1. Cumulative balance of the Federal Government
2. Cumulative ceiling on primary federal expenditures
3. Limit on the cumulative change in federal debt
4. Cumulative change in short-term government debt
5. Limit on the cumulative change in consolidated public sector debt
6. Limit on the net domestic assets of the Central Bank
7. (**Indicative**) Limit on the cumulative balance of the provinces

*Structural Benchmarks*

1. By the first review (July 2000)
    a. Entry into effect of laws to strengthen tax administration
    b. Entry into effect of labor market reform
    c. Submission to Congress of social security system reform
    d. Implementation of arrangements to monitor provincial finances
    e. Submission to Congress of reform of revenue sharing regime with the provinces
    f. Submission to Congress of reform of the Banco de la Nación
2. By the second review (2001)
    a. Entry into effect of social security system reform
    b. Enactment of planned modifications to the Central Bank charter and the banking law
    c. Completion of restructuring of *Programa de Atención Médica Integral* (PAMI), the public health insurance agency for retirees
    d. Conversion of Banco de la Nación into a public corporation
3. In 2001
    a. Enactment of reform of revenue sharing regime with the provinces

*DEVELOPMENTS IN ARGENTINA*

Initial Economic Conditions. Real GDP in 1999 declined by 3 percent due to a combination of adverse external factors, including a recession in some of its major trading partners, the devaluation of the Brazilian *real*, and a sharp terms of trade loss. The recession appeared to have bottomed out in July 1999, however, with industrial production and construction activity growing since then.[4] Inflation was not a concern as consumer prices declined by 1.8 percent. Public sector finances deteriorated substantially in 1999, with the overall deficit almost doubling from the year before, to almost 4 percent of GDP; the federal government deficit, too, almost doubled the level of 1998; and the provinces' consolidated deficit widened significantly.[5] As a result, the public debt rose to 47.6 percent of GDP by end-1999. Total external debt rose by US$7.2 billion to US$147 billion in 2000, about 51 percent of GDP. The growth Argentina's public sector debt from 1991 to 2000 is illustrated in Table 5.1. Even though the volume of exports remained the same, the continued decline in their prices led to an 11.7 percent drop in their value.

Table 5.1: Argentina's Public Sector Debt, 1991-2000

| | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|---|---|---|---|
| Debt (% of GDP) | 34.8 | 28.4 | 30.6 | 33.7 | 36.7 | 39.1 | 37.7 | 40.9 | 47.6 | 50.9 |

Source: Data adapted from Shinji Takagi and International Monetary Fund, eds., *The IMF and Argentina, 1991-2001*, Evaluation Report (International Monetary Fund. Independent Evaluation Office) (Washington, D.C.: International Monetary Fund, Independent Evaluation Office, 2004), 10.

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[4] International Monetary Fund, *Request for Stand-By Arrangement*, Country Report (Washington, D. C.: International Monetary Fund, February 24, 2000), 3.

[5] Ibid., 5.

The banking system remained generally sound, with private sector deposits increasing by 3.7 percent and foreign lines of credit expanding. Foreign exchange reserves also rose by US$1.4 billion in 1999 for a total of US$33.1 billion.[6]

*Political Developments.* As a result of the elections in 1999, the structural reform agenda came to a virtual standstill, which caused the prior precautionary arrangement to end.[7] Progress was made after Congress approved the Fiscal Responsibility law in September 1999, , which aimed to strengthen the solvency of the government and limit the size of the public sector. It set a timetable for the gradual elimination of the overall federal deficit, limited the growth of primary expenditures to the rate of GDP growth, and established a counter-cyclical fund to build up surpluses in good times and which was to be drawn down during recessions.

The new de la Rúa administration also initially appeared to have broad political support, managing to secure congressional approval of the budget, the fiscal package, and an agreement with the provinces within its first three weeks of office.[8] The social climate in Argentina was fast deteriorating, however, as citizens grew increasingly frustrated with the slow recovery from the recession, growing unemployment and poverty, and the introduction of two successive austere fiscal packages in less than six months. Table 5.2 highlights the growing unemployment and poverty rates in 1999 and 2000 compared to the years before.

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[6] Ibid., 6.

[7] Ibid., 29.

[8] Ibid., 12.

Table 5.2: Unemployment and Poverty Indicators for Argentina, 1996-2000

| | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Unemployment rate (%) | 17.3 | 13.7 | 12.4 | 13.8 | 14.7 |
| Poverty rate (%) | 27.9 | 26.0 | 25.9 | 26.7 | 28.9 |

Source: Data adapted from Kurt Schuler, "Argentina's Economic Crisis: Causes and Cures," *Joint Economic Committee United States Congress,* Washington D.C. (June 2003), 5-6, http://www.hacer.org/pdf/Schuler.pdf.

### *DEVELOPMENTS IN THE IMF AND THE WORLD ECONOMY*

*Global Conditions.* The external environment remained unfavorable, with most of Argentina's major trading partners experiencing recessions and Brazil, its largest trading partner, still recovering from its currency crisis a year before. The U.S. was gradually tightening its monetary policy, which meant that Argentina would have to offer higher interest rates to continue attracting capital inflows.

*Institutional Priorities.* Even though the IMF had not disbursed any funds to Argentina from 1997 to 2000, the World Bank was heavily involved in Argentina at the time. At the end of 1999, loans from the bank totaled US$16.2 billion, with fifty loans totaling more than US$8 billion under execution. Even though its focus was on social development, including poverty alleviation and education, a US$3 billion package approved in November 1998 in the form of a Special Structural Adjustment Loan (SSAL) supported regulatory reforms, in the financial sector and between government agencies. A portion of the SSAL was also converted into a policy-based guarantee, which allowed the

Argentine government to raise nearly US$1.2 billion in international capital markets at significantly lower spreads.[9]

The IMF continued to believe that its program in Argentina was a success. In its view, the country was facing a temporary liquidity problem and that the recession had bottomed out. It projected that GDP growth would rebound to 3.4 percent in 2000 if the Argentine authorities implemented the structural reforms as part of the SBA's conditions.[10] Even though some directors expressed concern at the Board meeting on March 10 that the exchange rate regime could be contributing to the prolonged recession, there were no serious attempts to propose any alternatives or consider an exit strategy.[11]

*Analysis*

With external conditions remaining unfavorable, the IMF approved the February 2000 SBA with the aim of improving investor confidence and helping Argentina obtain access to financing at better interest rates. Argentina had not drawn on IMF funds since 1997, which meant that the Fund's exposure to Argentine debt had not changed for more than three years. Here, it is evident that the design of IMF policy continued to be determined largely by the IMF's institutional need for Argentina as a success story and its desire to signal its support for the new government. It failed to seriously take into account the possibility that the slowdown in economic activity was due to what was arguably an

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[9] Ibid., 50.

[10] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 39.

[11] International Monetary Fund, *Minutes of Executive Board Meeting 00/24*, Meeting Minutes (Washington, D. C.: International Monetary Fund, March 10, 2000).

overvalued exchange rate brought about by the appreciation of the U.S. dollar and the crises in Argentina's trading partners.

### FIRST REVIEW: SEPTEMBER 15, 2000

The fiscal targets for end-March 2000 were observed with margins, except for the cumulative change in federal debt, which was exceeded by some US$0.5 billion, and the deficit and expenditure targets for end-June were observed. Preliminary data also indicated that the provincial deficit was Arg$200 million higher than the indicative ceiling.[12]

The Argentine government requested a modest increase of about 0.2 percent of GDP in the federal deficit and debt ceilings for September and December 2000. To underscore their commitment to fiscal consolidation, the authorities agreed to a reduction of the ceiling on primary federal expenditures equivalent to 0.1 percent of GDP. They recognized that, based on current developments, year-end targets for the ceiling on the provincial deficit and the change in the consolidated public sector debt would likely both be exceeded.[13] The Executive Board approved the completion of the first review on September 15 and agreed to the modifications proposed by the Argentine authorities.

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[12] International Monetary Fund, *Staff Report for the 2000 Article IV Consultation, First Review Under the Stand-By Arrangement, and Request for Modification of Performance Criteria*, Country Report (Washington, D. C.: International Monetary Fund, September 5, 2000), 8–9.

[13] Ibid., 16–17.

*Developments in Argentina*

*Economic Conditions.* Despite GDP growing a purported 1.2 percent in the first half of 2000, after correcting for seasonal adjustment it was estimated to be virtually zero. The rate of unemployment also increased to 15.4 percent. There was some good news, as the external trade balance improved, with the price and volume of exports boosted by strong demand in the U.S. and recovery in the rest of Latin America; however, the domestic economy remained weak as cost and price deflation began to set in. Declines in provincial tax revenues continued to increase the deficit of the provinces and further tightening of interest rates in the U.S. caused the spread on Argentine bonds to jump 150 basis points between April and May 2000.[14]

*Domestic Political Developments.* There was mixed support for the program's structural reforms in the legislature. Congress gave its final approval of labor market reform in May 2000 and the federal government implemented by decree the opening to competition of the healthcare system. It also began restructuring the health system for retirees (PAMI). A comprehensive tax administration law was approved in the lower house of Congress but was still awaiting consideration by the Senate, even though government decrees had already ensured that a number of its key provisions had gone into effect.

Lacking congressional support, however, de la Rúa used presidential decrees to force some changes to the pension system and health insurance system.[15] Congress also rejected legislation to transform the Banco de la Nación from a government-directed bank

[14] Ibid., 5–9.

[15] International Monetary Fund, *Second Review Under the Stand-By Arrangement and Request for Augmentation*, Country Report (Washington, D. C.: International Monetary Fund, January 4, 2001), 22–23.

into a state-owned corporation, but approved a bill giving the bank administrative autonomy as a public enterprise.[16] Therefore, while the rejection precluded meeting the structural benchmark for the second review, the alternative action taken was considered to have met the intent of the decision.

More worryingly, the social climate continued to deteriorate as the government's fiscal austerity package included a 12-15 percent cut in civil service wages and increases in various taxes.

### *Developments in the IMF and the World Economy*

*Institutional Priorities.* In response to the series of crises that rocked the developing world, the IMF publicly emphasized a change in Fund policy regarding how a country viewed conditionality policies. In August 2000, the new managing director of the IMF, Horst Köhler, advocated for more country ownership of IMF-backed programs, reasoning that "adjustment and reform programs are more likely to be successful on a lasting basis the more that countries identify themselves with these programs."[17] He also declared in the same speech that "creditors and borrowers must know that the Fund's resources are, and should remain, limited. So that there can be no doubt that they must assume responsibility for the risks they take and that taxpayers' money will not be easily available to protect them against the consequences of misjudgment."[18]

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[16] Ibid., 12.

[17] Horst Köhler, "Remarks by Horst Köhler, Managing Director, International Monetary Fund" (Speech, National Press Club, Washington, D. C., August 7, 2000), https://www.imf.org/external/np/speeches/2000/080700.htm.

[18] Ibid.

*Analysis*

The Fund's staff also noted that the proposed modifications by the Argentine government to the deficit and debt ceilings were relatively small and justifiable in the light of the cyclical developments and the major external shocks that affected the Argentine economy in the previous years.[19] In the country report dated September 5, 2000, the staff appraised that "the Argentine economy is now in a better underlying position than in recent years to achieve moderate growth, with price stability, and sustainable external deficits over the short and the medium term"; however, they believed that it remained "essential that confidence is strengthened, both domestically and abroad," through "the continued support of the international community."[20]

The Argentine authorities continued to treat the SBA as precautionary. They emphasized their full commitment to the convertibility regime in response to inquiries by the Fund's staff as to its costs and benefits.

Here, I find that the completion of this review was determined most significantly by the economic and political conditions in Argentina. With a minor improvement in Argentina's economy and the authorities' continued commitment to structural reforms, the IMF maintained its support for Argentina and approved the proposed modifications to the performance criteria which enabled the country to meet all of them. The IMF's concern that Argentina might not be able to fulfill its obligations to the Fund was not a factor at this point, as the authorities were still treating the arrangement as precautionary and had not withdrawn any funds.

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[19] International Monetary Fund, *Staff Report for the 2000 Article IV Consultation, First Review Under the Stand-By Arrangement, and Request for Modification of Performance Criteria*, 26.

[20] Ibid., 26–27.

## SECOND REVIEW: JANUARY 12, 2001[21]

On January 12, 2001, the Executive Board formally approved Argentina's request for an augmentation of the arrangement to SDR 10.6 billion (US$13.7 billion). In combination with commitments from other international financial institutions, like the World Bank and the IDB, and the Government of Spain, the total headline figure of what was named the "*blindaje*" (in English: shield) was advertised to be almost US$40 billion.[22] The package included US$20 billion of financing from the private sector.

With the augmentation, the total amount of the SBA was equivalent to 500 percent of quota, of which only one-fifth was to be provided under the Supplemental Resource Facility (SRF),[23] even though access under an SBA is normally capped at 300 percent of quota. This controversial aspect was justified in the staff report as reflecting "the more protracted nature of Argentina's financing problem" and to avoid increasing the heavy repayments scheduled for 2002-2003.[24] They recognized that the higher rate of charge and the shorter repayment period under the SRF would, coupled with Argentina's large concentration of debt maturities over the next few years, make it difficult for the country to manage its payments.

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[21] Unless otherwise indicated, all of the information in this section is based on International Monetary Fund, *Second Review Under the Stand-By Arrangement and Request for Augmentation*.

[22] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 40.

[23] The Supplemental Resource Facility (SRF) was a facility put in place in 1997 to provide financial assistance to countries experiencing exceptional balance of payments difficulties due to a large short-term financing need. Financing under the SRF is committed for up to one year and borrower countries are expected to repay within one to one and a half years of the date of each disbursement. Under the SRF, borrowers pay a surcharge of 300 basis points above the rate of charge on IMF loans. In essence, access under the SRF involves a higher rate of charge and a shorter repayment period than under an SBA.

[24] International Monetary Fund, *Second Review Under the Stand-By Arrangement and Request for Augmentation*, 26.

With a change in the calendar of purchases due to the augmentation of the arrangement, all end-December targets were made indicative. This modification meant that even though Argentina's federal deficit was expected to end the year at Arg$6.9 billion, some 0.7 percent of GDP higher than in the original program, the Fund did not have to explicitly grant a waiver. It then disbursed the undrawn amount of US$2 billion accumulated during the first nine months of the arrangement, which meant that the arrangement was no longer a precautionary one.

There were modifications to the quantitative performance criteria that included relaxing the federal deficit target for 2001 to US$6.5 billion from $4.1 billion as well as the debt target. The rationale behind this change was to prevent "a substantial fiscal contraction" to the economy while attempting to stabilize public debt in the near term.[25]

New structural benchmarks agreed upon included: (1) By the third review, issue presidential decree strengthening and consolidating tax payments facilities; design national tax audit plan; begin to set up Tax Frauds Tribunal; issue regulations for proposed pension reform and Protection of Competition Law; and prepare plans to restructure social security family allowances; as well as (2) By the fourth review, implement plans to restructure family allowances; issue regulatory proposal for ports system; and announce timetable for elimination of common external tariff (CET) surcharge.[26]

In addition, there were two prior actions that were not explicitly spelled out in the program documents, although there were clear understandings between the IMF staff and

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[25] Ibid., 14.

[26] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 84.

the Argentine authorities. They required the government to rescind by decree congressional action that had (1) added unwanted items to the 2001 budget and (2) deadlocked the passage of legislation to reform the pension and healthcare systems.[27]

### *Developments in Argentina*

Initial Economic Conditions. Concerns over the sustainability of the country's debt, which now amounted to over US$130 billion, drove Argentina's borrowing rates even higher, with a sharp increase (over 300 basis points) in spreads on Argentine bonds from September to November 2000.[28] Coupled with a decline in deposits, the tightening of external financing conditions resulted in a loss of international reserves of some US$4 billion by end November.[29] GDP proved to be stagnant throughout 2000, but, buoyed by an increase in exports, the current account deficit was projected to decline significantly. As mentioned earlier, the federal deficit was expected to end 0.7 percent higher than in the original program, reflecting continued weak revenue collection due to the prolonged recession.

Political Developments. The coalition government was considerably weakened when Vice President Carlos Álvarez resigned in early October 2000.[30] His resignation reflected a deep divide within the coalition government following a bribery scandal in Congress.

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[27] Ibid., 42.

[28] International Monetary Fund, *Second Review Under the Stand-By Arrangement and Request for Augmentation*, 43.

[29] Ibid., 10.

[30] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 39.

De la Rúa decided to keep two ministers whose names were implicated in the corruption scandal in his cabinet, prompting Álvarez to resign in protest and dealing a blow to the coalition in power.[31]

### *Developments in the IMF and the World Economy*

*Global Conditions.* The external environment remained precarious, with Russia, Brazil, and Turkey still recovering from the wave of emerging market crises that had swept through the world in the previous years.

*Shareholders' Interests.* On 10 November, 2000, the British Treasury wrote a private letter to the U.S. Treasury and other G-7 finance ministries, cautioning that the probability of program failure was extremely high. It stated that "If growth doesn't return, there is a real risk that a payments interruption will become inevitable, and [convertibility] will become untenable."[32]

*Institutional Priorities.* Members of the IMF staff continued to sound warnings about the Argentine economy. On November 20, Ter-Minassian, the director of the Western Hemisphere Department, sent an internal memo citing the danger of "a collapse of confidence, a drying up of financing to the government, [and] a massive flight of deposits from the banking system" which, while unlikely over the next two weeks, could begin to happen in the middle of December if "no clear prospect of an international support

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[31] Juan Labaqui, "¿Atrapado Sin Salida? El 'Frepaso' En El Gobierno de La Alianza," *Colección*, no. 16 (2005): 131.

[32] Blustein, *And the Money Kept Rolling in (and Out)*, 101.

package [materialized] soon."[33] It was clear to her that Argentina had large amounts of debt payments due and the country's cash on hand was fast running out.

From the Policy Development and Review Department, a staff member wrote that the proposed fiscal consolidation plan "risks stretching the credulity of market participants, coming as it does with only the promise of consolidation at a future date" and warned that "Argentina will remain entrapped in its current vicious cycle of low growth, low revenues, low confidence, high interest rates, and low growth."[34]

*Analysis*

Both Argentina and the IMF saw the convertibility regime as the anchor for financial stability, given Argentina's long history of high inflation and fiscal indiscipline. Furthermore, the high degree of de-facto dollarization in the economy, with 99 percent of public debt, over two-thirds of private debt, 60 percent of bank deposits, and the majority of contracts denominated in foreign exchange, meant that shifting to a floating exchange rate regime would be extremely disruptive and risk undoing all the progress made over the past decade.[35]

At the Board meeting on January 12, several directors raised concerns about the fixed exchange rate regime;[36] however, it was concluded that the risks and costs of exiting it were far higher. Even though the majority of the directors present were not fully

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[33] Ibid., 91.

[34] Ibid., 97.

[35] International Monetary Fund, *Staff Report for the 2000 Article IV Consultation, First Review Under the Stand-By Arrangement, and Request for Modification of Performance Criteria*, 21.

[36] International Monetary Fund, *Minutes of Executive Board Meeting 01/5*, Meeting Minutes (Washington, D. C.: International Monetary Fund, January 12, 2001), 30, 38, 88.

convinced that augmenting the arrangement would work, the consensus was that it was the best solution at the time even with its low probability of success, considering the certain negative impact that any other strategy would have.

In this instance, I argue that the IMF's desire to avoid contagion from an all-out crisis in Argentina was the main determinant of its policy. The global outlook remained extremely precarious and the Fund knew that if it did not complete this review, it would mean almost certain ruination for Argentina and possibly for other developing countries whose recoveries remained weak as well. These potential consequences weighed heavily on the directors' minds during the Board meeting and led them to go with the program despite its low chances of success and the deteriorating economic and political conditions in Argentina.

### THIRD REVIEW: MAY 21, 2001[37]

The Executive Board approved the completion of the third review under the SBA by granting waivers for substantial slippages in compliance with the end-March performance criteria, allowing the disbursement of a $1.2 billion tranche.

The federal deficit registered an overrun of US$1 billion over the US$2.1 billion program ceiling from January to March. The government also requested the relaxation of several other fiscal targets, including the cumulative change in the federal stock of debt and the cumulative change in consolidated government debt, for end-June and end-September because of the slippages recorded in the first quarter.

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[37] Unless otherwise indicated, all the information in this section is from International Monetary Fund, *Third Review Under the Stand-By Arrangement, Request for Waivers and Modification of the Program*, Country Report (Washington, D. C.: International Monetary Fund, May 14, 2001).

Seven out of the ten structural benchmarks set in January were observed, but critical measures in the areas of provincial finances, pension and healthcare reforms, and tax amnesties had not been implemented.[38]

New structural benchmarks agreed upon included: (1) by the fourth review, implement plans to streamline tax payments facilities arrangements and to restructure family allowances; submit to Congress draft law on pension reform; issue regulatory proposal for ports system; and announce timetable for elimination of CET surcharge; as well as (2) by the fifth review, complete 80,000 desk audits; present legislation to facilitate banking resolution; and implement new regulatory framework for telecom sector.

*DEVELOPMENTS IN ARGENTINA*

*Economic Conditions.* The January augmentation initially worked to reduce Argentina's financing rates for a short period of time, but by April the spread on Argentine bonds had gone up to over 1,000 basis points, from around 700 in January. GDP remained stagnant in 2001 and, as noted earlier, the federal deficit exceeded program targets.[39] The three major international rating agencies downgraded Argentina's sovereign debt in March, which reflected deteriorating market confidence in its future prospects.

*Political Developments.* The announcement of the augmentation had a favorable effect which was short-lived, as it became apparent that members of Congress were fiercely

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[38] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 47.

[39] International Monetary Fund, *Third Review Under the Stand-By Arrangement, Request for Waivers and Modification of the Program*, 5.

opposed to IMF conditions involving spending cuts in the pension and healthcare system and by the provinces. De la Rúa's earlier decrees were also challenged in court and suspended.[40]

The political crisis deepened as José Luis Machinea resigned on March 2, 2001, after Congress rejected the long-term pension and healthcare reforms. His replacement, Ricardo López Murphy, lasted less than three weeks.[41] López Murphy had proposed a package of deficit-reduction measures worth US$2 billion, which included one to end free university education, but it was fiercely rejected by the public and the backlash included the resignation of six top government officials who were protesting his proposed spending cuts.

On March 20, Domingo Cavallo was once again named Minister of Economy and was given broad authority to revive the economy. His appointment temporarily rallied the markets, as investors were aware of his domestic popularity and international credibility. Furthermore, recognizing the gravity of the economic situation, Congress granted special quasi-legislative powers to the executive through the Economic Emergency law and gave the administration the authority to set the tax rate.[42]

Cavallo announced a plan on March 28 consisting of a tax on financial transactions, and modifications to other taxes and tariffs, which aimed to demonstrate the sustainability of the convertibility regime.[43] While his fiscal target of a zero-deficit was the same his predecessors, he differed from them in his eschewing of further spending

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[40] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 46.

[41] Blustein, *And the Money Kept Rolling in (and Out)*, 110.

[42] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 46.

[43] Ibid., 61.

cuts in favor of increasing growth and tax revenue. Cavallo was confident of his plan, declaring a few days before the announcement that "in a couple of months, years at most, the whole topic of debt will be in Argentina like what it is in Australia or Canada, or in any European country where nobody even talks about it; it will be a technical and routine question, not a political one."[44]

In April, Argentina was fast losing access to international capital markets and Cavallo used his influence to pressure domestic banks into buying US$3.8 billion in government bonds below market interest rates in order to honor the country's financial obligations. To do so, he modified banking regulations to allow banks to count these bonds as part of their cash reserve requirements.[45] Pedro Pou, the central bank president, opposed this move as it undermined the Convertibility Law, because one-fifth of the deposits were not backed by U.S. dollars in the central bank, and was forced out by Cavallo.[46]

On May 2, 2001, Cavallo proposed a "mega-swap" (the *mega canje*), under which investors would voluntarily exchange old bonds that were maturing from 2001 to 2005 for new ones with higher interests and longer maturities, due between 2006 and 2030.[47] The idea behind this exchange was to postpone Argentine's debt obligations over the next four years, amounting to more than US$80 billion in principal and interest, that the government was hard-pressed to fulfill. It was hoped that the swap would help Argentina

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[44] Translated by the author of this thesis from the original Spanish article by Luis Cortina, "Con la Nueva Ley, el Gobierno Espera Generar un 'Vigoroso Crecimiento,'" *La Nación*, March 25, 2001, http://www.lanacion.com.ar/57316-con-la-nueva-ley-el-gobierno-espera-generar-un-vigoroso-crecimiento.

[45] International Monetary Fund, *Third Review Under the Stand-By Arrangement, Request for Waivers and Modification of the Program*, 5.

[46] Gelpern and Setser, "Pathways Through Financial Crisis," 469.

[47] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 61.

avoid a default or involuntary haircut[48] and give its economy time to recover. On June 3, Cavallo declared the mega-swap a success, with investors owning US$29.5 billion worth of securities agreeing to the terms of the deal;[49] however, the swap was heavily criticized by many analysts who argued that although no interest payments were due until 2006, the effective annual interest rate thereafter, equivalent to 15.24 percent, was far too high to be sustainable. The IMF's chief economist also calculated that the transaction would save US$12 billion in debt payments from 2001 to 2005 while adding US$66 billion in payments from 2006 to 2030, at an effective interest cost of 16 percent and well above the Argentine economy's potential growth rate even in the best of circumstances.[50]

### *Developments in the IMF and the World Economy*

<u>*Institutional Priorities.*</u> During Cavallo's tenure as Minister of Economy, Argentina's relationship with the IMF changed considerably. The previous two Argentine ministers had generally cooperated closely with the Fund; in contrast, Cavallo often unveiled major initiatives on Fridays or during weekends, with little or no consultation with the IMF.[51] For example, on April 16, after informing the IMF just two days earlier, Cavallo announced a modification to the convertibility system that would link the peso to a blended average of the euro and the dollar if and when the two reached one-to-one parity. His reasoning was that it would make the current peg less artificial, given that only about

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[48] Blustein, *And the Money Kept Rolling in (and Out)*, 127. A haircut refers to a situation in which bondholders are forced to accept less on the principal and interest of their bonds than the full amount due. This usually happens when investors recognize that a country or company is at risk of defaulting and, rather than lose all their money, accept lower interest rates or a reduction of principal of their bonds.

[49] Gelpern and Setser, "Pathways Through Financial Crisis," 469.

[50] Blustein, *And the Money Kept Rolling in (and Out)*, 129.

[51] Ibid., 121.

15 percent of Argentina's trade was with the U.S., while nearly 25 percent was with the European Union.[52] This was done despite concerns that any modification to the Convertibility Law would threaten the credibility of the regime.

In late April, the Argentina Task Force, an interdepartmental team assembled in 1999 within the IMF to conduct analytical work on Argentina, wrote a note to management stating that "the probability of a full-blown crisis in Argentina has increased. Avoidance of such an outcome seems unlikely, though not impossible."[53] In public, however, the Fund's managing director was optimistic. In a press conference on April 27, Horst Köhler pointed out that "no doubt, there is some concern about the situation in Argentina, but, indeed, I do think that everything is in place to find a good solution to overcome the problems."[54]

*Analysis*

According to the minutes of the Board meeting on May 21, directors continued to cite the Fund's mandate to preserve stability in Argentina, Latin America, and emerging markets in general as a reason to continue supporting the program in Argentina despite market signals indicating a loss of confidence and economic conditions that continued to deteriorate.[55] Indeed, the staff report and meeting minutes indicated that both the staff and management had serious reservations about the viability of the program, and were not

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[52] Ibid., 120.

[53] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 49.

[54] International Monetary Fund, *Press Conference By IMF Managing Director Horst Köhler Prior To The IMFC Meeting*, Press Release (Washington, D. C.: International Monetary Fund, April 27, 2001), https://www.imf.org/external/np/tr/2001/tr010427.htm.

[55] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 49.

convinced that the debt exchange engineered by Cavallo had helped the country at all; in fact, Cavallo's lack of consultation with the IMF on a number of his other measures should have been more of a cause for concern as well. Furthermore, Argentina had not met all the performance criteria of the program in any review since its approval.

Here, I find that the IMF continued to support this strategy because it did not have any viable alternative plans to offer and believed that the continually decreasing chances of success the current program had was still preferable to the certain failure of exiting convertibility. Its institutional desire to avoid failure was the main determinant of its policy in this instance. As Tomás Reichmann, a member of the Western Hemisphere Department who held overall responsibility for Argentina, recalled years later, "As an institution, we cannot be seen as the ones who pulled the plug on a country where the legislators and executive branches are making such efforts, so long as there is a chance the situation will work out—especially given the horrendous costs of the alternative."[56] It is clear that Argentina enjoyed an incredible amount of leverage over the IMF due to its systemic importance and the fact that the Fund's reputation was tightly linked to Argentina's success.

### FOURTH REVIEW: SEPTEMBER 7, 2001[57]

The Executive Board approved the completion of the fourth review under the SBA and an augmentation of SDR 6.3 billion (US$ 8 billion) to the arrangement, of

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[56] Blustein, *And the Money Kept Rolling in (and Out)*, 140.

[57] Unless otherwise indicated, all the information in this section is from International Monetary Fund, *Fourth Review Under the Stand-By Arrangement and Request for Augmentation*, Country Report (Washington, D. C.: International Monetary Fund, August 31, 2001).

which $5 billion was to be disbursed immediately and $3 billion set aside to be made available in support of a possible debt restructuring operation. This augmentation brought the total amount available under the arrangement to SDR 16,937 million (US$22 billion), which amounted to 800 percent of Argentina's quota, and cleared the way for an immediate disbursement of $6.3 billion to Argentina, the second-largest disbursement in Fund history.[58] Two directors abstained, in a move that is extremely rare in the IMF's consensus-based decision-making process.

Argentina met all of the modified quantitative performance criteria for end-June; however, the government failed to implement plans to streamline tax payments facilities arrangements, strengthen tax collections and restructure family allowances, shifting the benchmark for implementation to the fifth review. Legal challenges also delayed the proposed pension reform and regulatory changes to the ports system.

Additional structural benchmarks agreed upon included: (1) By the fifth review, submit to Congress reform legislation on revenue sharing with the provinces; and strengthen compliance with prudential and reporting requirements for public banks; as well as (2) By the sixth review, complete 100,000 desk audits; and fully implement the Tax Frauds Tribunal.

### *Developments in Argentina*

Economic Conditions. Cavallo's policies and the *mega canje* failed to restore confidence in the Argentine economy. Real GDP declined by 2.1 percent in the first quarter of 2001 alone, while indicators of industrial production, retail and construction activity, and

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[58] Blustein, *And the Money Kept Rolling in (and Out)*, 154.

consumer confidence registered declines. Unemployment also rose.[59] In a domestic debt auction in early July, the government was forced to offer yields of 14 percent on three-month bills, an unsustainably high rate for such short-term bonds.[60]

On July 11, 2001, accepting that Argentina could no longer raise money from bond issues, Cavallo announced a "zero-deficit plan" that consisted of draconian cuts to government spending.[61] The plan introduced across-the-board reductions to wages, pensions, and public expenditure, and aimed to completely eliminate any need for government borrowing. The markets viewed the policy as an act of desperation and saw it as confirmation of the dire liquidity situation of the Argentine government. Deposit runs intensified—from March to August, dollar deposits dropped by almost 9 percent and peso deposits by 27 percent, in a reflection of the public's fears of the confiscation of deposits, forced lending, or devaluation.[62] International reserves fell from US$28.8 billion in July to US$20.4 billion in early August, and spreads on Argentine bonds continued to climb, reaching 1,600 basis points by the end of July.[63]

Facing the prospect of a banking crisis, the Argentine authorities requested a rapid disbursement of a large amount of support from the IMF. Of the US$14 billion that Argentina was to borrow under the January 2001 SBA, the Fund had disbursed US$6 billion, with the rest scheduled for release later in 2001 and in 2002.[64]

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[59] International Monetary Fund, *Fourth Review Under the Stand-By Arrangement and Request for Augmentation*, 5.

[60] Ibid.

[61] Ibid., 16.

[62] Ibid., 11.

[63] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 51.

[64] Blustein, *And the Money Kept Rolling in (and Out)*, 135.

In public, despite not having secured a formal agreement with the IMF, the Argentine authorities made statements in the beginning of August announcing that they had received concrete commitments for an additional US$9 billion in financing.[65] These premature announcements put additional pressure on the IMF as markets were now expecting an announcement from them confirming the news.

*Political Developments.* Political discord between the federal and provincial governments was increasing as provincial governors claimed the federal government owed them money to cover their bills in June.[66] The zero-deficit plan announced in July provoked a sharp social and political backlash as citizens, already struggling from previous cutbacks, were outraged at being asked to accept even more onerous ones.[67]

### DEVELOPMENTS IN THE IMF AND THE WORLD ECONOMY

*Shareholders' Interests.* Despite considerable internal dissent and the program's small chance of success, the IMF's Managing Director, Horst Köhler, announced on August 21 that he would recommend this augmentation to the board.[68] The press release stated that while $5 billion would bolster Argentina's reserves, the other $3 billion would go towards a possible "voluntary and market-based" debt restructuring operation.[69] This lack

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[65] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 53.

[66] Blustein, *And the Money Kept Rolling in (and Out)*, 132.

[67] Ibid., 133.

[68] Ibid., 141–144.

[69] International Monetary Fund, *IMF Managing Director Prepared to Recommend Addition of US$8 Billion to Argentina's Stand-By Credit*, Press Release (Washington, D. C.: International Monetary Fund, August 21, 2001), 1.

of specificity in a program allocation was unprecedented, and many IMF staff members expressed confusion over what exactly the $3 billion would be used for if a debt restructuring operation did not occur.[70] John Taylor, the undersecretary of the U.S. Treasury, had proposed this "creative element" in direct talks with the Managing Director and the Argentine authorities in the days before, which suggested the large degree of influence the U.S. had on IMF policy-making in this instance.[71]

Over the past year, the U.S. had swayed several IMF decisions in favor of the borrower country. In May 2001, the U.S. administration had backed an augmentation of Turkey's SBA by SDR 6.4 billion (US$8 billion), concerned about its strategic importance as a base for U.S. forces in the Middle East.[72] It had also supported Brazil's request for an SBA of SDR 12.14 billion (US$15.6 billion) in September to aid recovery from its 1998 crisis.[73] In Argentina's case, the U.S. had received a series of phone calls from Latin American leaders pleading Argentina's case personally to President Bush. It was also afraid that the IMF's credibility, and by extension that of the neoliberal reforms Washington had promoted over the past decade, would suffer if Argentina failed.[74]

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[70] Blustein, *And the Money Kept Rolling in (and Out)*, 153.

[71] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 51.

[72] International Monetary Fund, *IMF Approves Augmentation of Turkey's Stand-By Credit to US$19 Billion*, Press Release (Washington, D. C.: International Monetary Fund, May 15, 2001), https://www.imf.org/external/np/sec/pr/2001/pr0123.htm; Blustein, *And the Money Kept Rolling in (and Out)*, 146.

[73] International Monetary Fund, *IMF Approves US$15.58 Billion Stand-By Credit for Brazil*, Press Release (Washington, D. C.: International Monetary Fund, September 14, 2001), https://www.imf.org/external/np/sec/pr/2001/pr0138.htm.

[74] Blustein, *And the Money Kept Rolling in (and Out)*, 146.

Institutional Priorities. The IMF had less of a reason to believe that the risk of contagion continued to be as high as was thought before. In a confidential memo dated August 15, members of the Research Department wrote that "a 'credit event' in Argentina is widely anticipated and has been (partly) discounted by the markets for some time. The possibility that a default by Argentina triggers a sharp reversal of capital flows to other countries in South America is therefore relatively small."[75]

*Analysis*

The unexpected, premature announcement by the Argentine authorities raised the stakes for the IMF in the review. Even though the stakes of withholding support were still enormous, the program's chances of success were proving slimmer and slimmer. This apprehension was reflected in the abstention of two directors in the consensus-based Board, which marked a significant departure from previous decisions, where the decisions had been unanimous. During the Board meeting, a number of directors remarked that the risk of blame was no longer as big of an issue.[76]

In this instance, I argue that pressure from the U.S., the IMF's biggest stakeholder, was the main determinant in the decision to approve the augmentation. All signs pointed to the fact that Argentina's chances of pulling through were only getting slimmer, and the risk of contagion was no longer large as markets had long begun to expect the eventual failure of the Argentine economy. American insistence on the augmentation, however, coupled with their inclusion of the unprecedented "creative

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[75] Ibid., 142.

[76] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 53.

element" of the program, demonstrated that it was the main determining factor in this review.

## NON-COMPLETION OF FIFTH REVIEW: DECEMBER 5, 2001

The IMF issued a press release indicating that the staff mission returning from Buenos Aires had concluded that the fifth review under the SBA could not be completed and that Argentina would not be able to access the US$1.3 billion tranche. The IMF suspended the program due to the likelihood of Argentina breaching the $6.5 billion fiscal deficit target for 2001 by more than $2.6 billion. Projections for 2002 also showed a large financing gap, which meant that Argentina stood little chance of receiving loans from any international institution or foreign bank.[77]

### *DEVELOPMENTS IN ARGENTINA*

*Economic Conditions.* By late October, it was clear that the zero-deficit policy and the augmentation had failed to turn Argentina's economy around and Argentina's economic performance continued to worsen in almost every respect. Spreads on Argentine bonds had widened to 2,000 basis points at end-October, GDP was expected to drop by 4.5 percent in 2001, and worst of all, tax revenue was falling rapidly, with a 14 percent drop in September.[78] In accordance with the zero-deficit rule, the government announced

[77] Ibid., 57.

[78] Ibid., 56.

additional spending cuts amounting to US$900 million to compensate, which exacerbated market conditions even more as investors anticipated further recessionary effects.[79]

On November 1, 2001, Cavallo recognized the unsustainability of the country's debt and announced, again without prior consultation with the IMF, a new package of measures to boost competitiveness through tax incentives and plans for an "orderly" debt exchange (as opposed to the "voluntary" one earlier).[80] The debt exchange would be conducted in two phases, with the first stage involving the conversion of $55 billion worth of international bonds held by Argentine banks into loans at lower interest rates and longer maturities, supported by revenues from a financial transactions tax. The second was directed at international creditors.[81] Foreign bondholders, afraid that they would not be treated fairly in the second stage, threatened litigation. The price of Argentine government bonds continued to fall and the country's risk spread climbed to 2,300 basis points.[82] On November 16, central bank reserves had dropped to $19.44 billion, which meant that $5 billion of the $6.3 billion disbursement in September had already evaporated, and in late November, a new bank run saw the loss of more than $3.6 billion in deposits over three days.[83]

On December 1, growing pressures on the banks led the Argentine government to restrict savers' access to their deposits (dubbed the *corralito*) as part of wide-ranging controls on banking and foreign exchange transactions. Cash withdrawals were limited to

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[79] Blustein, *And the Money Kept Rolling in (and Out)*, 160.

[80] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 56.

[81] Gelpern and Setser, "Pathways Through Financial Crisis," 469.

[82] Blustein, *And the Money Kept Rolling in (and Out)*, 170.

[83] Ibid., 171; Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 57.

1200 pesos a month and any transactions above 1000 pesos had to receive formal approval from the authorities.[84] The deposit freeze brought private-sector activity to a virtual stand-still, as businesses and individuals could not withdraw any deposits to pay for goods or services.

Political Developments. The *corralito* sparked mass street demonstrations, known as *cacerolazos* for the pots and pans that people banged to make noise and draw attention to their dissatisfaction. Middle-class citizens, many dressed in suits, took to the streets and chanted, "they must all go—not a single one should stay," as they marched to the Plaza de Mayo, the open space in front of the Casa Rosada where the political leaders they were referring to worked.[85] Most of the protestors had no prior involvement in political action, but felt compelled to respond to the gradual erosion of their standard of living and what they felt was inadequate political leadership.

*DEVELOPMENTS IN THE IMF AND THE WORLD ECONOMY*

Global Environment. The September 11 attacks in the U.S. just four days after the announcement of the augmentation were a further blow to the deteriorating global economic outlook. Argentina's external conditions looked bleaker than ever.

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[84] Banco Central de la República Argentina, *Decreto Nacional 1570/2001*, National Decree (Buenos Aires: Banco Central de la República Argentina, December 1, 2001), http://www.biblioteca.jus.gov.ar/DEC1570-01.html.

[85] Victoria Goddard, "'This Is History': Nation and Experience in Times of Crisis—Argentina 2001," *History & Anthropology* 17, no. 3 (September 2006): 271, doi:10.1080/02757200600900697.

*Institutional Priorities.* At this point, the IMF no longer felt that it could be blamed for giving Argentina insufficient support. As Claudio Loser, the director of the Western Hemisphere Department, put it, "We already gave them a large amount of aid … if that is not major support, I frankly don't know what is."[86]

*Analysis*

At the point of the fifth review, the outlook for Argentina was dire. It was clear to all parties except the Argentine authorities that a devaluation of the peso and a comprehensive, forced debt restructuring was unavoidable. Blame was no longer an issue, as the Fund realized that no program was sustainable unless Argentina exited the convertibility regime. The wide-ranging controls placed on deposits and foreign-exchange transactions by the Argentine authorities were also in flagrant violation of the conditions of the arrangement.

At this point, there was no question that completing the review would mean increasing Argentina's debt liability to the IMF without any prospects of success. In this instance, I find that the IMF was clearly compelled to withdraw its support by economic conditions in Argentina that were impossible to overcome, especially given the Argentine authorities' unwillingness to contemplate an exit from the convertibility regime and a forced restructuring of debt.

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[86] Marcela Valente, "ECONOMY: Argentina, the IMF's Biggest Headache," *Inter Press Service News Agency*, November 20, 2001, http://www.ipsnews.net/2001/11/economy-argentina-the-imfs-biggest-headache/.

*Outcome*

After the IMF's announcement, the country quickly descended into political and social chaos. On December 13, a nationwide general strike was called by unions. The next day, looting of supermarkets and other stores began. A week later, on December 19, riots took place in Buenos Aires and other major cities, which eventually led to the deaths of about thirty people and hundreds of injuries.[87] Minister Cavallo resigned on the same day, and President de la Rúa, a day later.

The interim president, Adolfo Rodríguez Saá, was appointed by Congress on December 23, and soon after declared a suspension of payment on the government's debt. He also introduced measures aimed at job creation and the creation of a new currency (the *Argentino*), to begin circulating in January 2002;[88] however, these measures were insufficient to quell social unrest over the continued imposition of the *corralito* as protestors broke into the Congress building and rioting continued through the end of the year. After just a week, on December 30, President Rodríguez Saá resigned and was replaced by Senator Eduardo Duhalde.

Finally, on January 6, 2002, the long-expected but nonetheless profound announcement came. Congress approved legislation formally ending the system of convertibility and replaced it with a dual exchange rate regime consisting of a fixed rate of 1.4 pesos to the dollar for foreign trade and a floating market exchange rate.[89] It was

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[87] Antonio Camou, "Argentina. La Rebelión de las Cacerolas," *Nueva Sociedad*, January 10, 2002, http://nuso.org/upload/articulos/3013_1.pdf.

[88] J. F. Hornbeck, *The Argentine Financial Crisis: A Chronology of Events*, Congressional Research Service Report (Washington, D. C.: Foreign Affairs, Defense, and Trade Division (CRS), January 31, 2002), 4, http://fpc.state.gov/documents/organization/8040.pdf.

[89] Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 57.

the end of the era of convertibility. As the new head of the Economy Ministry, Jorge Remes Lenicov, solemnly declared the "official death of convertibility" during the press conference, he added, "We are in a collapse. We are broke."[90]

## CONCLUSION

The developments from February 2000 to January 2002 demonstrate the rapidly changing economic and political circumstances within Argentina, the Fund and its shareholders, as well as the world economy. From the approval of the program in March 2000 to the third review in Mar 2001, I find that IMF policy design and implementation were determined mainly by the Fund's institutional desires to see Argentina succeed, prevent contagion in emerging markets, and preserve its credibility. If it withdrew its support and precipitated Argentina's failure, its image would be ruined, given how much it had heralded Argentina as a successful example of Fund policies before. This period is clear evidence of the incredible amount of leverage Argentina had over the IMF.

As economic and political conditions within the country deteriorated, however, it became clear that the chances of the program's success was close to zero and a crisis was inevitable. Markets recognized that and the Fund knew it would no longer be blamed. The fourth review demonstrates that even when consensus among the majority of shareholders and staff pointed to withdrawing support, the IMF's largest shareholder, the United States, was able to give Argentina one last boost in the unconventional form of a

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[90] Martín Kanenguiser, "El Fin de La Convertibilidad," *La Nación*, January 7, 2002, http://www.fmmeducacion.com.ar/Historia/Cacerolazos/220finconvertibilidad.htm; Blustein, *And the Money Kept Rolling in (and Out)*, 187.

mixed augmentation plan. Only when the situation proved completely untenable did the Fund withdraw its support entirely.

Using my Critical Framework for IMF Program Design and Implementation, these empirical findings demonstrate how the determinants of Fund policy change under different circumstances. In the next chapter, I discuss the implications of my findings for theory and practice as well as possible areas of further study.

# CHAPTER SIX

# THE FUTURE OF IMF CONDITIONALITY

Take your bailout and get out of here!

— Demonstrators in Greece, November 2013

It is a gross oversimplification to characterize the IMF as a benign, beneficent international institution or solely as a vehicle for industrialized countries' interests. It would appear that borrower countries are overwhelmingly dependent on the IMF to approve and disburse loans in times of trouble and would therefore be the unwitting subjects of harsh conditionality. Yet the process of negotiating and implementing an IMF arrangement is conducted by both parties, with the borrower country playing an active role in proposing and complying with loan conditionality. With the Critical Framework on IMF Program Design and Implementation, we are now better able to analyze the factors that determine the design and implementation of Fund conditionality and weigh their relative importance under different circumstances.

This thesis began with the following research question: What determines IMF program design and implementation in borrower countries? This research question is important because the IMF is an incredibly powerful international institution, with its membership encompassing all but six sovereign states in the world. Its loans are meant to smooth borrower countries' adjustments to external shocks by acting as a catalyst for other loans, and in so doing prevent crises and maintain global financial stability. Its perceived interference in domestic policy through conditionality, however, has sparked endless debate and fierce protests the world over. Despite internal reforms undertaken from 2009 to overhaul the IMF's lending framework, recent arrangements with countries hit by the global financial crisis have demonstrated that conditionality is here to stay. Therefore, it remains essential to understand how the Fund reaches decisions regarding its loan arrangements. Understanding this would allow nations to better prepare for negotiations with the IMF and enable the Fund to more comprehensively justify its actions to its staff, members, and the public alike.

To answer this research question, I analyzed the case of Argentina—with its characteristics of a critical case—from 1991 to 2002. I drew from four bodies of theory—(1) the functionalist approach to international institutions, (2) structural relations in international institutions, (3) principal-agent relationships, and (4) the domestic political economy approach—to isolate the critical factors behind both the IMF's and borrower governments' motivations. I used the process-tracing method to investigate causal links behind the major shifts in IMF policy over the decade and focused on three specific periods during which these shifts manifested themselves. I then analyzed the factors behind each Fund arrangement in the context of my Critical Framework for IMF Program Design and Implementation.

## MAIN FINDINGS

In Chapter Three, I analyzed the evolution of Argentina's political economy from the 1800s to 1991, with a focus on its arrangements with the IMF. Applying my Critical

Framework to events in Argentina from 1991 to 2002, I made the following empirical findings in Chapters Four and Five of this thesis:

1. *When a country is systemically important and the IMF's credibility is tied to its success, it holds enormous leverage over the Fund.* The IMF's sustained involvement in a country through successive arrangements ties its credibility to the country's success, especially when the Fund has publicly heralded this involvement to counter criticism of its programs in other countries. The Fund also has a mandate to preserve international financial stability, which often means delaying or alleviating a crisis to reduce the risk of contagion. When these two factors come together in a single country, the country becomes very significant. This gives the country incredible leverage over the IMF and means that the Fund will not withdraw its support from a country like this until there is an overwhelming consensus that its economy is doomed to failure.
2. *Direct pressure from the U.S. is the most significant factor determining Fund decisions when it is applied.* When there are differing opinions, the voice of the IMF's largest shareholder overrides the concerns of staff and other directors. This situation, however, does not occur often. In the case of Argentina, the U.S. applied direct pressure just once, in September 2001. This finding could mean that the U.S. does not interfere with decision-making as often as it is thought to be or, more disquietingly, that other decisions were simply in line with its interests, enabling it to take a back-seat until it saw fit to intervene.
3. *Limited options for punishing non-compliance encourages the IMF to sustain arrangements longer than they should, especially for significant countries in*

*precarious economic conditions*. The IMF faces two categorical options of either completing or not completing a review when a borrower country fails to comply with conditionality. It is difficult for the IMF to punish a borrower for non-compliance besides suspending an arrangement entirely. Just as the Fund's loans have a positive catalytic effect—i.e., spurring additional financing and increasing investor confidence—, withdrawing support would likely have the opposite negative effect. Because the Executive Board is aware of these effects, they are likely to sustain an arrangement as long as there is a possibility that the borrower country might recover. The alternative, suspension, would almost certainly trigger a crisis that the Fund is afraid it would be blamed for.

4. *The IMF is willing to overlook non-compliance when the authorities of a borrower country demonstrate commitment to reforms or when a program is extremely successful in some areas*. The IMF grants waivers and approves modifications when the executive branch shows clear evidence that they have been attempting to push reforms through despite legislative or judicial challenges. It also takes into account the impact of adverse global conditions on the ability of a borrower country to meet its performance criteria and frequently gives the government the benefit of the doubt. Furthermore, reviews are completed with little or no objections when a program achieves dramatic initial success in important areas such as reining in hyperinflation, even when other targets might not be fully met.

These findings, however, come with some caveats. Argentina has a number of unique characteristics. In its case, the IMF had staked its credibility heavily on

Argentina's success. Furthermore, weak global conditions after 1995 increased fears of contagion, giving the Fund another reason to be invested in avoiding Argentine failure. Therefore, there were strong reasons for the IMF to support Argentina despite non-compliance and deteriorating economic conditions. In other cases, where there are less reasons for the IMF to be invested in a country's success, it is less likely for the Fund to grant as many waivers in the event of non-compliance and much more likely to withdraw its support and suspend an arrangement earlier.

### IMPLICATIONS FOR THE CASE OF ARGENTINA

As mentioned earlier, much has been written on the causes and consequences of Argentina's crisis at the end of 2001. Conventional wisdom attributes much of the blame for prolonging and deepening the eventual collapse to the IMF and international capital flows.[1] Analyzing the factors behind the decisions of the Fund over the period leading up to 2001, however, adds nuances to our understanding of this case. These are the implications of my thesis for the case of Argentina:

1. *Until September 2001, the IMF was moderately justified in supporting Argentina.* Faced with a number of consecutive decisions between maintaining support for Argentina and suspending its arrangement between January 2000 and December 2001, the IMF augmented the existing SBA twice and completed four reviews despite growing evidence that Argentina's economic program was unlikely to succeed. Yet until the fourth review in September 2001, recovery remained a possibility, albeit a small one. Therefore, it is difficult to blame the IMF for taking

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[1] Blustein, *And the Money Kept Rolling in (and Out)*; Gould, *Money Talks*.

its chances, given the stark alternative of withdrawing support and triggering a crisis for which it would be blamed. It is only with the benefit of detached hindsight that we are able to see exactly how unsustainable Argentina's situation had been from 1999.

2. *U.S. sway over Fund decisions is confirmed by the September 2001 review*. In September 2001, the markets, IMF staff, and most of the Executive Board knew that Argentina's economy could not be saved. The U.S., however, pressured the Board to complete the review over the concerns of all other parties, which resulted in two directors abstaining from the decision. Conventional wisdom about the IMF regarding the clout of the U.S. is confirmed in this instance.
3. *The IMF prolonged and deepened the crisis by ignoring Argentina's debt problem and not planning for an exit strategy from convertibility*. The Argentine authorities were active participants throughout the decade, almost single-handedly ushering in reforms in the early years and continuing to request for new arrangements, waivers, modifications, and augmentations after the Mexican crisis in 1995. Conditionality was not forced upon them, as some would claim. Their biggest mistakes were their refusal to consider any alternatives to the convertibility regime and their inability to tackle the problem of endemic debt, especially when the conditions were ripe for doing so from 1992 to 1994 and again from 1997 to 1999. Yet this reluctance was understandable, given societal pressure to keep the fixed exchange rate regime going, and legislative and provincial constraints with regards to the debt.

Here, the IMF should have taken a more proactive role to plan for an exit strategy once the Mexican crisis struck and taken a harder line before 2000 to compel Argentina to tackle its debt, especially when its arrangements were precautionary. Instead, it heralded Argentina as a shining example of Fund policy success, ignored fundamental debt problems, and continued disbursing loans even when it was clear the country was headed for collapse. In this way, the IMF exacerbated the crisis and saddled Argentina with even more debt.

As active participants throughout the period leading up to the crisis, both the IMF and Argentina have to share the blame for how things turned out. Given the IMF's superior technical knowledge and the fact that Argentina had to shoulder the political, economic, and social fallout from the crisis, however, the IMF had the larger imperative to shape events differently. This is not a conclusion that is new to the debate on Argentina's crisis, but the critical analysis undertaken in this thesis arrives at this conclusion in a more nuanced way.

## CONDITIONALITY AT THE NATIONAL AND INTERNATIONAL LEVEL

### Implications for Theory on IMF Conditionality

Current scholarship tends to focus on factors pertaining to the IMF and its shareholders. We must pay closer attention to the domestic side, because the IMF makes decisions in response to conditions and government actions in the borrower country. By not considering the borrower, we fail to account for the specific circumstances behind each program and what they were designed to achieve. As a result, we may come to mistaken conclusions regarding the effectiveness of conditionality and the soundness of programs. My Critical Framework is built from theory and can be used to evaluate factors affecting both the IMF and the borrower country in other case studies. My findings have the following implications for the scholarly debate over IMF conditionality:

1. *Supplementing large quantitative studies with individual case studies is necessary*. Program effects have to be judged against the conditions they were designed to address and the extent to which the borrower country implemented the program. Furthermore, waivers, modifications, and augmentations approved during the implementation phase cannot be ignored in measurements of these effects, because they are a more accurate reflection of changing circumstances than the original program. Therefore it is imperative that we supplement large sample regressions studies with individual case studies, which are useful in analyzing the changing political economy variables that occur in individual countries. In the case of Argentina, for example, a purely quantitative study would fail to take into account the numerous modifications and augmentations that the IMF approved from 1995 to 2001. Ideally, there should be more cross-country and cross-regional studies that employ mixed methods to complement case-specific empirical knowledge as well as to add nuance to broad theoretical claims from large quantitative studies.
2. *Compared to other countries, prolonged users of Fund resources may engage with the IMF differently*. Some see countries that negotiate consecutive arrangements as evidence that conditionality has failed to achieve its key objective of generating deep and sustained reforms, while others see it as the natural consequence of the IMF's changing mandate towards long-term engagement in borrower countries. Scholars must articulate how political and

institutional pressures from major shareholders and the Executive Board affect the IMF's decision-making process with regards to these prolonged users of Fund resources and if moral hazard becomes a consideration in these cases.

3. *Measurements of compliance need to take into account government intentions and legislative constraints*. Measuring compliance remains a challenging task and the debate continues over whether program interruption, the disbursement-loan ratio, or the MONA index of implementation is a more accurate reflection of program implementation. In the context of the IMF's decision-making process, however, compliance is measured not just by actions taken by the borrower government, but is also recognized in the intentions of the executive branch and the legislative constraints it faces. Therefore future studies need to add these facets to current understandings of compliance.

## SIGNIFICANCE OF THIS STUDY FOR POLICY-MAKING

This thesis has implications for policy at both the national and international levels. At the national level, the Critical Framework can be applied to decipher the ways in which the IMF makes decisions on program design and implementation. Politicians would be better equipped to negotiate with the IMF when they know what factors determine the approval of arrangements and waivers; they would also be more aware of the way in which pressures from major shareholders and the institution itself can distort the decision-making process. Furthermore, my thesis has implications for countries with deep-seated economic problems. When the policy changes required to resolve a crisis come with large immediate costs, in the case of a sovereign default or involuntary debt restructuring, for example, delaying the necessary painful actions can significantly increase the costs. All parties involved would be naturally reluctant to undertake preemptive action for fear of being blamed. With the borrower country and its citizens bearing almost all of the costs of any eventual crisis, however, the onus is on policy-makers to take action early and minimize these costs.

There are two implications for policy at the international level:

1. *The IMF should increase incentives for policy implementation.* Currently, the IMF faces two options in the event of non-compliance—suspending an arrangement or granting a waiver—, and suspension is viewed as extremely costly. Instead of merely punishing non-compliance, the Fund should create new incentives to reward compliance so that borrower countries are more motivated to push through structural reforms in good times. Expanding these options would also prevent the IMF from having to choose between imposing strong conditions that a borrower country would likely reject and retaining limited influence with weaker conditions. It could also consider relying more heavily on prior actions and other forms of *ex ante* conditionality to ensure higher levels of compliance before an arrangement is approved. Focusing on *ex ante* actions, however, needs to be balanced against the Fund's role in providing relief during periods of difficult adjustment when it might not be possible to undertake these actions before an arrangement takes effect.
2. *Interference from the U.S. undermines the IMF's efforts to achieve its mandate and can sometimes lead to sub-optimal lending decisions.* Widespread perceptions of this interference would also diminish the credibility of the Fund, a particularly

salient risk with the rise of new institutions such as the NDB. Therefore, it is essential for the IMF to be aware of how political and institutional pressures can unfairly influence its decision-making process. It should take steps to ensure the accuracy and impartiality of staff reports and consider politically unpalatable contingency strategies in the event that an arrangement goes off-track. These strategies are especially pertinent when dealing with emerging economies under fixed exchange rate regimes because they are heavily dependent on short-term capital flows and vulnerable to external shocks.

## THE FUTURE OF CONDITIONALITY

This thesis points future research in the field of conditionality in three directions. First, while the findings of this thesis allow us to recognize the difficulties in measuring compliance with IMF arrangements, what remains unresolved is the impact that different levels of compliance have on program success and exactly what to measure this success against. Knowing that a borrower country has implemented all the reforms called for in the conditions of an arrangement, what happens when economic conditions do not improve? Would this program still be considered a success? Future research should distinguish between program compliance and its effects, in order to properly assess whether or not the IMF has been successful in designing and implementing programs.

Secondly, new questions that arise from this research involve prolonged users of IMF resources and how they might be different from other borrowers. Is recurring lending a reflection of poorly designed programs, unsuccessful implementation of previous arrangements, systemic external shocks, or some other factor? Finding out why some countries consistently turn to the IMF when previous arrangements never seem to succeed fully can shed light on the weaknesses of current program design and implementation. Additional research on these prolonged users can also help to address criticism that the IMF is overly concerned with curtailing consumption and deficits in the short term, and doing too little to promote sustainable growth in the long term.

Lastly, this thesis largely focused on the ways in which major shareholders and the IMF's institutional priorities bias its decision-making process. Future research should take into account the function of private capital flows and how market sentiment affects the IMF's decisions on whether or not to punish non-compliance. Do private capital flows act as a substitute or complement to IMF resources? Do private lenders differentiate between countries that comply fully with conditionality and those that do not, and if so, how? Answering these questions would enable politicians to make better decisions on how to attract sustainable private capital as well as the extent to which they should regulate these flows. For the IMF, clarifying the catalytic effects of its lending would enable it to make better decisions on when to grant waivers and when to strictly enforce conditionality.

As recent developments in Greece and other troubled Eurozone countries demonstrate,[2] IMF conditionality is here to stay. Therefore, there is a pressing need to better understand how it is designed and implemented, so as to enhance the effectiveness of IMF programs and improve the millions of lives that are in its orbit.

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[2] Landon Thomas Jr., "Greece and I.M.F. Hold Talks on a Crucial Debt Payment," *The New York Times*, April 5, 2015, http://www.nytimes.com/2015/04/06/business/international/greece-and-imf-hold-talks-on-crucial-debt-payment.html.

## APPENDIX A

## ARGENTINA'S ARRANGEMENTS WITH THE IMF, 1991 – 2002

| Facility | Type | Date | Amount *requested* / agreed (in SDRs) | Amount drawn (in SDRs) | Waivers given? |
|---|---|---|---|---|---|
| Standby Arrangement | Letter of intent | October 12, 1989 | *1,104 million* | | |
| | Approval | November 10, 1989 | 1,104 million | 184 million | |
| | First review | May 25, 1990 | 920 million | 368 million | Yes |
| | Second review | November 28, 1990 | 736 million | 506 million | Yes |
| | Expiration | March 31, 1991 | | 506 million | |
| Standby Arrangement | Letter of intent | June 28, 1991 | *780 million* | | |
| | Approval | July 29, 1991 | 780 million | 146.2 million | |
| | First review | December 20, 1991 | Completed | 292.5 million | Yes |
| | Second review | March 31, 1992 | Completed | 438.75 million | |
| | Cancellation | March 31, 1992 | | 438.75 million | |
| Extended Arrangement | Letter of intent | March 4, 1992 | *2,003 million* | | |
| | Approval | March 31, 1992 | 2,149.25 million | 15 million | |
| | First review | July 20, 1992 | Completed | 146 million | Yes |
| | Second review | September 1, 1992 | Completed | 292 million | |
| | Third review | December 30, 1992 | 2,483.15 million | 1,155 million | Yes |
| | Fourth review | March 29, 1993 | Completed | 1,301 million | |
| | Fifth review | July 14, 1993 | Completed | 1,426 million | Yes |
| | Sixth review | October 29, 1993 | Completed | 1,593 million | Yes |
| | Seventh review | February 14, 1994 | Completed | 1,927 million | Yes |
| | Eighth review | July 18, 1994 | Completed | 2,205 million | Yes |
| | Ninth review | April 6, 1995 | 4,020.25 million | 3,508 million | Yes |
| | Tenth review | December 14, 1995 | Completed | 3,764 million | Yes |
| | Last review | March 29, 1996 | Completed | 4,020 million | Yes |
| | Expiration | Mar 30, 1996 | | 4,020 million | |
| Standby Arrangement | Letter of intent | March 14, 1996 | *720 million* | | |
| | Approval | April 12, 1996 | 720 million | 78 million | |
| | First review | October 30, 1996 | Completed | 292 million | Yes |
| | Second review | February 24, 1997 | Completed | 399 million | Yes |
| | Third review | July 30, 1997 | Completed | 613 million | |
| | Expiration | January 11, 1998 | | 613 million | |
| Extended Arrangement | Letter of intent | December 3, 1997 | *2,080 million* | | |
| | Approval | February 4, 1998 | 2,080 million | 0 | |
| | First review | September 23, 1998 | Completed | 0 | |
| | Second review | March 3, 1999 | Completed | 0 | Yes |
| | Third review | May 26, 1999 | Completed | 0 | Yes |
| | Cancellation | March 10, 2000 | | 0 | |
| Standby Arrangement | Letter of intent | February 14, 2000 | *5,398.61 million* | | |
| | Approval | March 10, 2000 | 5,398.61 million | 0 | |
| | First review | September 15, 2000 | Completed | 0 | Yes |
| | Second review | January 12, 2001 | 10.585.4 million | 3,834 million | Yes |
| | Third review | May 21, 2001 | Completed | 4,810.5 million | Yes |
| | Fourth review | September 7, 2001 | 16,936.8 million | 9,756 million | |
| | Fifth review | December 5, 2001 | Not completed | | |

*Sources*: IMF database; various IMF staff reports.

# APPENDIX B

## TIMELINE OF EVENTS, 1991 – 2002[1]

| DATE | EVENTS |
|---|---|
| **1991** | |
| Jan 30 | Domingo Cavallo takes office as Minister of Economy. An exchange rate band is established, with a lower band of 10,000 australes and an upper band of 8,000 australes to the dollar. |
| Mar 27 | Argentina, Brazil, Paraguay, and Uruguay sign a treaty establishing the Mercado Común del Sur (MERCOSUR), a Free Trade Area. |
| Mar 28 | Congress approves the Convertibility Law. |
| Apr 1 | The Convertibility Law takes effect, with the parity of 10,000 australes per dollar. |
| Jul 29 | IMF Executive Board approves Stand-By Arrangement with Argentina |
| Nov 1 | President Menem announces a broad program of economic deregulation and trade liberalization. |
| Nov 14 | Congress approves the Employment Law, authorizing temporary contracts and capping indemnity. |
| **1992** | |
| Jan 1 | The peso replaces the austral at the conversion rate of 10,000 australes per peso. |
| Mar 31 | IMF Board approves extended arrangement with Argentina. |
| May 27 | Port services are privatized by executive decree. |
| Sep 23 | Congress approves the new Central Bank Law, establishing independence and mandating price stability as its primary objective. |
| Sep 24 | Sale of state oil company (YPF) is authorized by law. |
| Nov 9 | First general strike is organized by labor unions against President Menem. |
| Nov 11 | An agreement is reached with creditor banks. |
| Dec 6 | Argentina enters the Brady Plan. The IMF Managing Director congratulates Argentina on the agreement. |
| **1993** | |
| Jan 4 | Use of dollars for current and checking accounts is authorized. |
| Jan 20 | Last day to exchange australes for new pesos. |
| Mar 10 | The Radical party, labor unions, and retirees demonstrate in protest of the pension reform. |
| Mar 16 | Peronist governors approve the constitutional reform, allowing a second presidential term. |
| Sep 23 | Senate approves the pension reform law. |
| Oct 3 | Lower House elections. Peronist increase seats in Congress. |
| Nov 14 | Olivos Pact: Menem of the Peronist party and Alfonsín of the UCR reach agreement on the framework for constitutional reform, allowing a second presidential term of four years. |
| **1994** | |
| Aug 1 | Constitutional Convention approves the new Constitution. |
| Dec 16 | The MERCOSUR treaty is amended, transforming it from a Free Trade Area to a Customs Union. |
| Nov 22 | Senate approves the privatization of Encotesa (Federal Post and Telegraph Company). |
| Dec 23 | Mexico devalues its currency. |

[1] Adapted from Takagi and International Monetary Fund, *The IMF and Argentina, 1991-2001*, 98–100.

## 1995

| | |
|---|---|
| Mar 11 | Value-Added Tax (VAT) rate is raised to 21 percent from 18 percent. |
| Mar 27 | IMF Board approves extension of Argentina's extended arrangement. |
| Apr 14 | Government suspends five banks with liquidity problems. |
| May 14 | Presidential elections. Carlos Menem is reelected for a second term. |
| Nov 29 | Congress grants Minister Cavallo special powers for a year to balance the federal budget. |

## 1996

| | |
|---|---|
| Apr 12 | IMF Board approves Stand-By Arrangement with Argentina. |
| Jul 18 | Minister Cavallo threatens to resign if his fiscal adjustment program is not approved. |
| Jul 26 | Cavallo is replaced by Roque Fernández as Minister of Economy. |

## 1997

| | |
|---|---|
| Jan 2 | A judge declares the labor reform decree unconstitutional. |
| Mar 24 | Postal system is privatized by executive decree. |
| Apr 9 | Press reports of increasing tension between President Menem and Eduardo Duhalde, governor of Buenos Aires. |
| Apr 24 | National and provincial airports are privatized by executive decree. |
| May 9 | A labor reform plan is agreed upon with unions, introducing flexibility in labor contracts, but protecting union medical systems from competition. |
| Aug 2 | The Radical and FREPASO parties make an alliance, subsequently to be known as the *Alianza*. |
| Aug 14 | National strike is called. |
| Sep 15 | President Menem promises an increase in pension benefits. |
| Sep 21 | President Menem promises an increase in teachers' pay. |
| Nov 19 | The *Alianza* expresses public support for the convertibility regime. |

## 1998

| | |
|---|---|
| Feb 4 | IMF Board approves extended arrangement with Argentina. |
| Feb 20 | Press reports of accord between Governor Duhalde and President Menem. |
| Mar 28 | The *Alianza* launches a campaign against a second presidential reelection. |
| Apr 3 | Fernando de la Rúa is proclaimed presidential candidate for 1999 elections in Radical party convention. |
| Jul 8 | The *Alianza* rejects the labor reform plan. |
| Jul 12 | President Menem seeks Peronist support for a popular referendum regarding a second reelection. The idea is rejected by both the Peronist party and the *Alianza*. |
| Jul 17 | Press reports of a split in the Peronist party after President Menem seeks support for a second reelection from the party. |
| Sep 2 | Congress approves labor reform and it becomes law. |
| Oct 1 | The IMF Managing Director praises the Argentine economy at a press conference. |
| Oct 5-7 | President Menem attends and speaks at the IMF-World Bank Annual Meeting. |
| Oct 9 | President Menem reaffirms his desire for a second reelection and a third term. |
| Nov 29 | Fernando de la Rúa wins the nomination of the *Alianza* as presidential candidate. |
| Dec 2 | Carlos Álvarez is chosen as the *Alianza*'s vice presidential candidate. |
| Dec 5 | Press reports that President Menem seeks a constitutional reform but faces stiff opposition. |

## 1999

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| Jan 11 | The courts deny President Menem constitutional permission for a second reelection. |
| Jan 13 | Brazil devalues its currency. |
| Jan 15 | Press reports of President Menem reaffirming commitment to maintain the peso-dollar parity. |
| Feb 8 | Press reports of President Menem proposing dollarization. |
| Apr 16 | Domingo Cavallo is reported to suggest a need to modify the convertibility regime. |
| May 12 | Minister Fernández demands agreement with Congress to guarantee fiscal solvency. |
| Jul 14 | Governor Duhalde is reported to consider debt restructuring. |
| Oct 24 | Presidential and Lower House elections. Fernando de la Rúa and Carlos Álvarez of the *Alianza* win, with 48.5 percent of the votes. The *Alianza* increases its seats in Congress to 125 (from 105), while the Peronist party retains 101 seats (from 120). |
| Dec 10 | De la Rúa takes office as president, with José Luis Machinea as Minister of Economy. |

## 2000

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| Feb 24 | A strike is called against the labor market reform proposal stipulating decentralization of collective labor contracts. |
| Mar 10 | IMF Board approves Stand-By Arrangement with Argentina |
| Apr 26 | Senate approves labor reform with some modifications. Labor unions call for a national strike. |
| May 5 | National strike is called against the labor reform. |
| May 11 | Congress approves labor reform and it becomes law. |
| Jun 6 | National strike is called. |
| Aug 8 | Responding to public denunciations, President de la Rúa creates a special commission, chaired by Vice President Álvarez, to investigate bribery charges associated with the Senate approval of the labor reform law. |
| Sep 4 | President de la Rúa affirms that the government has not paid bribes to get the labor reform law approved. |
| Oct 6 | Vice President Álvarez resigns. |

## 2001

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| Jan 12 | IMF Board approves augmentation of Stand-By Arrangement and completes second review. |
| Mar 2 | Minister Machinea resigns. |
| Mar 4 | Ricardo López Murphy is appointed Minister of Economy. |
| Mar 16 | FREPASO members of the cabinet resign in protest over a proposed fiscal austerity program. The *Alianza* is broken. Labor unions call for a strike. |
| Mar 19 | Minister López Murphy resigns. |
| Mar 20 | Domingo Cavallo is appointed the new Minister of Economy. |
| Mar 26-28 | International rating agencies lower Argentina's long-term sovereign rating. |
| Mar 29 | Minister Cavallo secures emergency powers from Congress. |
| Apr 14 | Minister Cavallo announces a modification of the convertibility law, with the replacement of the dollar by an equally weighted basket of the dollar and the euro. |
| Apr 16 | Minister Cavallo requests major businesses to purchase "patriotic bonds" for $1 billion. |
| Apr 26 | The Central Bank Governor is replaced over alleged money laundering charges. |
| May 8 | Standard & Poor's lowers Argentina's long-term sovereign rating further from B+ to B. |
| May 21 | IMF Board completes third review of Argentina's Stand-By Arrangement. |
| Jun 3 | Authorities announce the completion of the "mega-swap," the voluntary bond exchange. |
| Jun 15 | Minister Cavallo announces package of tax and trade measures, including a trade compensation mechanism for exporters and importers of non-energy goods. |
| Jun 20 | Senate approves the revised convertibility law. |

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| Jul 11 | A zero deficit plan is announced, with mandatory reductions in expenditures to balance the budget. |
| Jun 30 | The zero deficit plan becomes law. |
| Aug 10 | Press quotes market sources to report that an IMF package will only delay the default. |
| Aug 21 | IMF announces planned augmentation of Stand-By Arrangement by $8 billion. |
| Sep 5 | Press reports that FREPASO is proposing an end to the convertibility regime. |
| Sep 7 | IMF Board approves augmentation of the Stand-By Arrangement and completes fourth review. |
| Oct 14 | Upper and Lower House elections. The Peronist party wins control over both Houses. |
| Nov 6 | Standard & Poor's lowers Argentina's long-term sovereign rating from CC to SD (selective default). |
| Dec 1 | The government introduces a partial deposit freeze (*corralito*) and capital controls. |
| Dec 6 | Minister Cavallo travels to the U.S. to meet with IMF management. |
| Dec 8 | Private pension funds are forced to buy national bonds. |
| Dec 12 | National strike is called, setting off a series of demonstrations against the government's economic policies. |
| Dec 19 | Minister Cavallo resigns. |
| Dec 20 | President de la Rúa resigns over death of demonstrators. Ramón Puerta, President of the Senate, becomes interim President. |
| Dec 23 | Adolfo Rodriguez Saá is elected president by the Legislative Assembly. He announces partial default on external debt. |
| Dec 30 | Rodriguez Saá resigns as president and Ramón Puerta resigns as Senate president. Eduardo Camaño, head of the Lower House, becomes interim president. |

## 2002

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| Jan 1 | Eduardo Duhalde is elected President by the Legislative Assembly to serve until Dec 2003. |
| Jan 3 | President Duhalde announces the end of convertibility and the introduction of a dual foreign exchange regime. |
| Jan 6 | The convertibility law ceases to be in effect. A dual exchange rate regime is introduced, one fixed at 1.40 pesos to a dollar for foreign trade, and the other determined by the free market. |
| Feb 11 | The foreign exchange market opens under a unified regime for the first time; the peso depreciates to Arg$1.8 to the dollar. |
| Mar 25 | The peso reaches a peak of Arg$4 per dollar. |

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