The London School of Economics and Political Science

The Causes and Consequences of IMF Interventions in the Southern Cone

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A thesis submitted to the Department of International Development of the London School of Economics and Political Science for the degree of Doctor of Philosophy, London December 2012

Declaration

I certify that the thesis I have presented for examination for the MPhil/PhD degree of the London School of Economics and Political Science is solely my own work other than where I have clearly indicated that it is the work of others (in which case the extent of any work carried out jointly by me and any other person is clearly identified in it).

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Javier Díaz Cassou

December 20, 2012

Abstract

The International Monetary Fund has often been accused of adopting a one-size-fits-all approach to the resolution of financial crises. However, its programs present substantial differences in terms of their relative size and conditionality among other characteristics. This dissertation examines the causes and consequences of this variation through the lenses of two cases in which the contrast between the Fund´s interventions was particularly marked: Argentina and Uruguay during the period that surrounds the financial crash of 2001-02.

The first part of this study analyses the determinants of these multilateral interventions through an adaptation of Robert Puntam´s two level games, exploring the way in which national politics interacted with international priorities to produce distinct outcomes in Argentina and Uruguay. The two experiences confirm that domestic ratification processes impose significant constraints on the negotiation of IMF programs, potentially conferring localized bargaining advantages to borrowing governments. Beyond a certain point, however, an intensification of these ratification constraints can result in a suspension of the Fund´s support, after which borrowers´ bargaining position weakens dramatically. That this point of rupture was reached in Argentina but not in Uruguay was due primarily to the different propensity to cooperate exhibited by political actors in these two countries, itself the product of certain institutional conditions such as the strength of their systems of checks and balances or a varying distribution of veto power.

In turn, the second part of this thesis applies a hypothetical counterfactual approach to assess the consequences of the multilateral decisions adopted during the 2001-02 crisis in the Southern Cone. Although the contrast between the suspension of the Argentine program in December 2001 and the Uruguayan bailout of August 2002 had surprisingly modest macroeconomic consequences, its impact on politics and institutions was profound both in the short and in the medium-term. As a result of these findings, this dissertation argues that a better understanding of the implications of multilateral crisis resolution loans on the political economy of the countries concerned is still needed.

Acknowledgement and Gratitude

This project could not have been completed without the support and guidance of my supervisors, Dr. Ken Shadlen and Dr. Lauren Phillips. Both have been a great source of inspiration as well as challenging teachers. Their encouragement, dedication, candid criticism and openness gave me the confidence to turn my thoughts and findings into this thesis.

A special word goes to all the wonderful friends that I left in London. I will not forget the camaraderie, intellectual dynamism and, above all, the sense of humor of Chris, Giulia, Borge, Dominik, Laureen, Sheila, Ignacio, Gianlu and Arik among others. I really miss you all.

I am thankful to the LSE Research Studentship, Fundación Cajamadrid, the Santander travel fund and Universidad Torcuato di Tella for their generous funding and research support.

My gratitude also goes to all the interviewees that participated in this research project. In particular, I would like to thank Paulina Beato, Enrique Iglesias, Jorge Batlle and Miguel de las Casas, who opened many doors in Buenos Aires, Montevideo and Washington DC.

Last but not least, I am deeply indebted to my parents, Raymonde Cassou and Jose-Luis Díaz Fernández. Their support and inspiration have made me what I am.

This dissertation is dedicated to Monica Gozzi, my fiancée, for having helped me cope with the ups and downs of a PhD at the London School of Economics. I love you so much!

A Moni, por compartir la búsqueda

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CHAPTER 1

Introduction

1.1 Research topic and questions

After three years of recession and several months of negotiations, the International Monetary Fund (IMF) suspended its financial support to Argentina in late November 2001. A few weeks later the country had descended into chaos, triggering an almost immediate contagion effect on neighbouring Uruguay. But the international community responded very differently to that crisis, approving a financial rescue package which until recently was the largest IMF program in history if measured against the size of the recipient economy. This dissertation looks at these contrasting experiences in order to shed some light on the causes and consequences of the multilateral response to financial crises. More specifically, the main research questions that will be addressed are the following: what accounts for the longitudinal and cross-sectional variation in the Fund's interventions in Argentina and Uruguay? How and why did the multilateral response to the 2001-02 crisis impact the Argentine and Uruguayan economic, political and institutional trajectories in the medium-term?

This dissertation, therefore, will focus on multilateral crisis lending, which can be characterized by the three instruments with which the international community can help or induce borrowing countries to close their financing gap: (i) the financial assistance provided by the IMF alone or in conjunction with other international organizations or national governments; (ii) the domestic adjustment and/or structural reform commitments accepted by debtors as part of the Fund's conditionality; (iii) private sector involvement (PSI), i.e. the losses more or less voluntarily absorbed by private creditors in order to alleviate the borrower's financial distress. Given that the private sector does not take part in the negotiations with the IMF, considering that this third element is a constituent of multilateral loans may seem counterintuitive. However, when the international community decides on the terms of a program, on occasions it is also adopting an implicit or explicit stance about the losses that the borrowing country's private creditors will have to absorb in order to maintain or restore debt sustainability.[1] In fact, depending on the context, PSI could be the most relevant ingredient for the success of an IMF program.

The subject of this dissertation is relevant for various reasons. First of all, the 2001-02 financial crisis is one of the most traumatic events in the modern economic histories of Argentina and Uruguay and, therefore, these two case studies deserve attention in their own right. The Argentine crisis and, to a lesser extent, the case of Uruguay, have received a considerable amount of journalistic and scholarly attention. However, most existing contributions have tended to provide historical narratives without delving deep into the chain of causation that led to the crucial multilateral decisions that were taken in 2001 and 2002 (Mussa, 2001; IEO, 2004; Paolillo, 2004; Blustein, 2005). Furthermore, a comparative perspective has rarely been adopted to study the Argentine and Uruguayan experiences with the IMF. Therefore, cross-sectional variation in these two case studies has seldom been exploited to analyse the causes and consequences of the Fund's interventions and, hence, the risks and opportunities associated with the IMF-centred multilateral financial safety net.

Moreover, multilateral crisis lending has become more pertinent in the context of the global financial turbulences of the last few years. Prior to that crisis, the Fund's relevance as the linchpin of the international monetary system seemed to be on the decline. However, in successive G-20 summits the international community has restored the Fund's leading role in the management of the world economy. Studying the causes and consequences of past multilateral interventions can only help to gain a better understanding of the multiple financial programs in which the IMF is currently involved in Europe and elsewhere. In fact, it has been common to draw analogies between the cases covered in this dissertation and the Greek, Spanish, Portuguese or Italian crises, and some scholars have presented the Argentine and the Uruguayan debt restructuring models as alternative strategies to cope with sovereign debt problems in the Eurozone

[1] Ceteris paribus, the higher the volume of the financial package and/or the higher the level of domestic adjustment required by the program's conditionality, the lower the need to involve private creditors in the resolution of the crisis.

(Levy-Yeyati et al. 2011). The lessons yielded by these two case studies could therefore be of more immediate policy relevance than was foreseen when this research effort began in September 2008.

In addition, the Argentine and the Uruguayan experiences present various analytical puzzles. First of all, the contrast between the multilateral response to the two crises constitutes a puzzle for those who place powerful states' material interests at the centre of the study of international cooperation. Whereas by the turn of the century Argentina had attracted large volumes of capital inflows and, as suggested by its status as a founding member of the G-20, was perceived to have become a systemically important emerging economy, Uruguay was practically irrelevant on a global scale. Therefore, the G-7 and other creditor nations had reasons to be much more concerned about the potential spill-over effects of a full-blown financial crisis in Argentina than about the collapse of the Uruguayan banking system. Furthermore, while the Argentine embrace of the neo-liberal doctrine during the 1990s had been widely praised by international financial institutions and by the architects of the Washington Consensus, Uruguay's more modest market reform process had gone largely unnoticed. How to explain, then, that the international community eventually decided to suspend its support to Argentina while such extraordinary measures were taken to rescue the Uruguayan economy?

The comparison between the Argentine and the Uruguayan economic trajectories is also puzzling for those that believe that a strong multilateral safety net is crucial to help emerging markets cope with the risks associated with financial globalization. If such a collective insurance scheme was an effective tool to mitigate these risks, the Uruguayan rescue package should be expected to have significantly reduced the impact of the crisis in that country and to have facilitated the subsequent recovery. But the economic contractions experienced in Argentina and Uruguay during the worst years of the crisis were almost identical and Argentina exhibited a somewhat higher cumulative GDP growth in the aftermath of the 2001-02 events. If the rescue package did not enable the Uruguayan economy to perform better than that of Argentina, what was the impact of the contrasting multilateral response to the two crises?

On the methodological side, another reason to have selected Argentina and Uruguay for comparison is that these case studies fit the logic of the "most similar system design"

(Przeworski and Teune, 1970). Indeed, these countries have close social and cultural identities and share other characteristics such as their level of economic development, their economic structures as traditionally important exporters of meat, soy and other primary products and their exposure to comparable types of external shocks. Furthermore, at the onset of the crisis Argentina and Uruguay were at a similar historical juncture having recently completed a political transition from an authoritarian regime to a democratic system and an economic transition from an import substitution industrialization model with extensive state intervention to a more open and market-based political economy. The two episodes of financial instability themselves were also relatively similar, combining elements of a currency, banking and sovereign debt crisis. Moreover, the Argentine and the Uruguayan crises took place almost simultaneously implying that the rules and state of the art that guided the Fund's interventions were essentially the same in the two episodes. This case study selection, therefore, maximizes cross-sectional variation in the outcome of interest (the Uruguayan rescue package vs. the suspension of the Argentine program) while minimizing the number of potential explanatory dimensions, which is aimed at mitigating the problem of over-determination that inevitably characterizes small-N empirical exercises.

1.2 On the causes of IMF interventions

In the analysis of the causes of the Fund´s interventions in Argentina and Uruguay, this dissertation tries to go beyond the traditional separation between the domestic and the international levels of analysis that dominates the study of international relations, which has constituted a matter of growing concern for IPE theorists since the 1970s (Katzenstein, 1978; Gourevitch, 1978; Putnam, 1988; Cohen, 2008). The literature on the IMF is no exception in this respect, and most theoretical and empirical contributions have either focused on the domestic or on the international determinants of multilateral crisis lending, tending to produce rather partial interpretations of these interventions. However, some recent contributions such as Vreeland (2003a), Stone (2008) or Pop-Eleches (2009) have tried to integrate the two levels of analysis. Pulling in that direction, this dissertation applies an analytical framework based on Robert Putnam's two-level games, which is aimed at gaining a more holistic understanding of the dynamics that shape the negotiations of IMF-supported programs (Putnam, 1988).

The two-level game metaphor rests on the idea that the outcome of international negotiations is largely determined by the constraints facing negotiators as a result of the need to secure the domestic ratification of whatever they agree with their foreign peers. This idea is operationalized through the concept of win-sets, which refer to all the international agreements that are domestically ratifiable by each of the negotiators. The overall constraint of the two-level game is given by the intersection between all the individual negotiators' win-sets, generating the following two hypotheses: (i) international cooperation depends on the existence of a win-set overlap and will be easier to sustain when individual win-sets are large (i.e. when domestic ratification constraints are loose); (ii) a narrow win-set (i.e. tight domestic ratification constraints) on one side of the negotiations can be turned into a bargaining advantage at the international table.

The empirical analysis conducted in this dissertation is partly aimed at testing the validity of these hypotheses in the specific context of the Argentine and the Uruguayan negotiations with the IMF. However, win-sets are inherently unobservable and the two-level game analytical framework is for the most part agnostic about what might determine the intensity of domestic ratification constraints. As a result, these hypotheses cannot be examined unless a causal relationship is established between other observable variables pertaining to the ratification process and the design and implementation of IMF-supported programs. Subsequent chapters will cover the cases of Argentina and Uruguay in an attempt to unearth such causal relationships and, therefore, should be understood as a hypothesis generating exercise rather than as a hypothesis testing task. In order to identify the most relevant explanatory dimensions to be explored, the point of departure will be a review of the rich literature on the IMF and on the politics of macroeconomic adjustment and reform, which has already emphasized a number of factors that may have played a significant role in these two cases. Particular attention will be placed on the interests of powerful creditors, on bureaucratic politics, on the role of veto players and on the determinants of political actors' ability to cooperate in times of crisis.

Relying primarily on 41 interviews conducted in Buenos Aires, Montevideo, Washington DC, London and Madrid with direct participants in the negotiations and with other privileged observers (see Appendix A), this dissertation will use both process-tracing and comparative methods in order to exploit the longitudinal and cross-sectional variation observed in the Argentine and the Uruguayan case studies. A process-tracing approach will be applied to the longitudinal analysis of the Argentine and the Uruguayan negotiations with the IMF, which will initially be treated as independent cases in an attempt to identify the cause-effect relation between the dependent variable, i.e. the Fund's interventions, and a number of potential explanatory variables. Given that this first part of the analysis on the determinants of IMF interventions will focus on longitudinal variation, the emphasis will be placed on those factors that exhibited variation over time, such as the outcome of electoral processes, the evolving strength and cohesiveness of governing coalitions or changing rules in the issue area of international crisis lending.

In turn, the comparative method will be used to analyse cross-sectional variation. This empirical strategy relies on the idea that, as mentioned above, these two case studies fit the logic of a most similar system design reasonably well. Therefore, causation will be inferred from the co-variation between the outcome of interest and the explanatory dimensions that have not been controlled for as a result of the similarities between the Argentine and the Uruguayan cases. Given that this second part of the analysis will concentrate on cross-sectional variation, the emphasis will be placed on more static explanatory variables differentiating the Argentine and Uruguayan case studies, such as the size of the two economies, the location of veto-players within their political systems, or other structural institutional features.

The empirical analysis presented in subsequent chapters confirms that domestic ratification constraints at the level of debtor nations can have a significant impact on the design and implementation of IMF interventions. In certain contexts, these constraints are exploited by debtors in the negotiations with the Fund, which can have an effect on the financial and non-financial terms of multilateral programs. Beyond a certain point, however, the loss of domestic political room for manoeuvring can result in a collapse of the international negotiation's cooperative equilibrium, after which domestic ratification constraints become an obstacle to resume a program relationship rather than a bargaining tool to soften the conditionality associated with these loans. In other words, this dissertation will argue that there is a non-linear relationship between the intensity of domestic ratification constraints and borrowers´ bargaining power vis-à-vis the IMF.

Given the above, much of the focus will be placed on the determinants of domestic ratification constraints. In this sense, the longitudinal analysis of the Argentine and the Uruguayan case studies will explore the relationship that exists between the outcome of electoral processes and the ratification constraints facing debtor nations´ negotiators, which played an important role at various junctures of the two processes. However, other more subtle causal relationships will also be emphasized in the comparative analysis. More specifically, a crucial factor to explain the contrast between the Argentine and the Uruguayan negotiations with the IMF is the different propensity to cooperate exhibited by political actors in these two cases. In turn, I will argue that this propensity to cooperate was influenced by certain structural features of their polities, such as the different strength of their systems of checks and balances, which encouraged the Uruguayan government's stakeholders to engage in intertemporal bargaining processes to a much greater extent than in Argentina.

Another factor that contributed to shape the negotiations with the IMF through the constraints facing the Argentine and the Uruguayan negotiators was the location of veto players within these two countries' political systems. It will be argued that these actors tend to focus primarily on those conditions that are likely to affect their interests and not on the whole policy package negotiated with the Fund. As a result, the conditionality associated with IMF loans will tend to be weaker and more difficult to implement in the areas that are of direct concern to the veto actors empowered by specific configurations of political institutions. This is why in the decentralized Argentine state the veto-power of the provinces contributes to explain the failure of the fiscal adjustment programs negotiated with the Fund, while Uruguayan unions' prerogative to launch referenda weakened the structural conditionality associated with IMF loans. Mapping out the location of veto actors and anticipating how conditionality is likely to impact them, therefore, might be instrumental to anticipate where IMF interventions will tend to be more problematic.

Among the international variables considered in this dissertation, an emphasis will be placed on the cost of no agreement perceived by the Fund´s constituents and its relationship with the autonomy of IMF officials in their negotiations with borrowing countries. If the cost of no agreement is perceived to be high, powerful nations will be more likely to interfere in the negotiations. By contrast, if the cost of no agreement is perceived to be low, technical considerations and bureaucratic politics at the level of the IMF will tend to dominate the process. In this context, it is hardly surprising that at various points the very different size of the Argentine and the Uruguayan economies contributed to shape the negotiations. However, on the basis of the evidence provided by these two case studies I will argue that borrowers' economic might as such is not a consistent predictor of the multilateral response to financial crises because mobilizing the resources that are needed to bail-out small countries is easier and might pursue other equally relevant strategic objectives.

The role of rules will also be explored in subsequent chapters. Although multilaterally agreed rules are found to have imposed a generally soft constraint on the negotiations of the Argentine and the Uruguayan programs, the position of powerful constituents vis-à-vis these two interventions was influenced by a desire to influence the reform of the international financial architecture according to their policy preferences. This became particularly relevant during the discussions on the Sovereign Debt Restructuring Mechanism (SDRM), which contributed to shape the preferences of the US and other G7 countries on the Argentine and the Uruguayan programs through channels that will be examined in detail. As a result of this issue-linkage, it will be argued that the causal association between rules and the design of the IMF programs under analysis was more complex and bi-directional than might be expected at first.

1.3 On the Consequences of IMF interventions

Moving on to the consequences of the multilateral response to the Argentine and the Uruguayan crises, the empirical approach adopted here is based on the contention that these two case studies can be used as hypothetical counterfactual scenarios. More specifically, I will argue that what happened in Argentina after the suspension of the program provides an indication of what would have occurred in Uruguay had its program been suspended rather than augmented. Equivalently, what happened in Uruguay after the financial rescue was approved provides an indication of what may have occurred in Argentina had its IMF program been massively augmented rather than suspended. Therefore, comparing the Argentine and Uruguayan trajectories after these crucial multilateral decisions is instrumental to overcome a common shortcoming present in most of the case study contributions that have tried to assess the impact of specific IMF interventions: the failure to establish a valid yardstick against which to compare observed outcomes.

As already mentioned, the contrasting response to the Argentine and the Uruguayan crises had a modest impact on real economic variables such as GDP growth or unemployment. However, the medium-term evolution of capital flows towards these economies was heavily influenced by the multilateral decisions adopted in 2001 and 2002. Whereas Uruguay recovered access to international financial markets relatively fast, Argentina has received a negligible volume of foreign investment since the suspension of the IMF program forced it to default in late 2001. Together with the fact that from that point onwards the Fund lost its ability to influence the design of Argentina´s economic policies, Uruguay´s greater integration into international financial markets might contribute to explain why this country has maintained a much more orthodox and anti-inflationary monetary stance after the crisis. By contrast, few differences have been found in the orientation of the fiscal policies implemented by the Argentine and the Uruguayan governments, suggesting that variation in the Fund´s interventions had a reduced impact on this policy-making dimension.

Finally, I will show that the contrasting response to the Argentine and the Uruguayan crises influenced these two countries´ post-crisis political and institutional trajectories. In the short-term, whereas the suspension of the Argentine program preceded the collapse of the De la Rúa administration, the Uruguayan rescue enabled President Batlle to complete his term in office. But these multilateral decisions had other more subtle and longer-lasting effects both on the policy preferences and on the policy space of subsequent administrations, contributing to explain the moderation of the Uruguayan left while in government vs. the progressive radicalization of the Kirchners in Argentina. In addition, there is ground to argue that institutions were much more affected by the crisis in Argentina than in Uruguay, another outcome that may be partly attributable to the Fund´s interventions. All in all, therefore, these case studies indicate that in spite of the fact that most attention has focused on the economic consequences of IMF loans, the impact of crisis resolution programs on the political economy of the countries concerned may be particularly pronounced.

1.4 Chapter plan

The remainder of this dissertation is structured as follows. Chapter 2 will review the literature and present an adaptation of the two-level games´ analytical framework. Chapter 3 will provide a first approximation of the contours of the Fund's win-set, identifying the structural constraints facing IMF negotiators during the period under analysis. More specifically, it will describe the institutions and constituencies that shape the Fund's ratification process as well as the evolution of rules in this particular issue area. Afterwards, Chapters 4 and 5 will present the cases of Argentina and Uruguay in isolation, applying a process-tracing approach to identify the causal paths that determined the longitudinal variation observed in this study's dependent variable. In turn, Chapter 6 will compare the two experiences, identifying other sources of cross-sectional variation and completing the empirical analysis on the causes of the Fund's interventions in Argentina and Uruguay. Chapter 7 will concentrate on the consequences of these interventions. It will begin with a review of the literature on the effects of IMF programs. Then, applying a counterfactual approach, it will carry out a comparative analysis in order to determine whether variation in the Fund's interventions had an impact on the Argentine and Uruguayan economic, political and institutional post-crisis trajectories. Finally, Chapter 8 will conclude, summarizing this dissertation's main contributions and identifying directions for future research.

CHAPTER 2

Towards a two-level interpretation of IMF programs

This chapter provides an overview of the literature on the determinants of IMF interventions in financial crises and presents an analytical framework that will be applied to the analysis of the Argentine and Uruguayan case studies. Scholars in the field of international relations distinguish between three levels of analysis: the individual level, which focuses on the explanatory power of statesmen' personal characteristics; the domestic level, which concentrates on the impact of national political processes on international outcomes; the international level, which focuses on the position of states in the international system. The literature on the IMF and, more generally, on international organizations is no exception and most contributions fall either in the domestic or the international levels of analysis. The review of scholarship presented in this chapter is structured around that distinction, beginning in section 2.1 with international explanations of IMF interventions and continuing in section 2.2 with the contributions that have focused on the domestic level of analysis.

In line with some recent contributions, this dissertation argues that in order to gain a more holistic understanding of multilateral lending it is necessary to bridge the gap between these two levels of analysis, shedding some light on how domestic and international factors interact to shape the design and implementation of IMF programs. Among the most prominent attempts to integrate the domestic and the international levels of analysis, Putnam's two-level games stand out in particular, which is why the empirical exercise presented in subsequent chapters applies this analytical framework (Putnam, 1988). In order to set the stage for the case studies, section 2.3 presents the logic of two-level games, explores some of the implications of applying this framework to the issue-area of multilateral crisis lending and provides a stylized representation of the model from which a number of hypotheses will be derived. Finally, the chapter will briefly conclude.

2.1 The international level of analysis

This section reviews some of the most salient international-level theoretical and empirical contributions that have analysed the role of the IMF among other multilateral organizations. The various approaches presented here emphasize different explanatory variables as the key driver of multilateral interventions. Neo-liberal and public choice scholars share a focus on the role of material interests. However, whereas the former concentrate on states and their reasons to cooperate through international organizations, the latter are more interested in these institutions' bureaucracies and the ways in which they pursue their own self-interested objectives. Constructivists, instead, interpret multilateral organizations as social constructs that need to be explained in terms of knowledge, ideas, beliefs or identities. In turn, neo-realist scholars, where they are interested in international cooperation, focus on the distribution of power capabilities among states as the key determinant of the actions of multilateral institutions.

2.1.1 The neo-liberal and public choice approaches

Since the late 1970s neo-liberal scholars have been particularly interested in explaining the factors that sustain international economic cooperation. This research agenda was originally motivated by the observation that important shifts in the international distribution of economic power were not resulting in the debilitation of institutions such as the IMF, the World Bank or the General Agreement on Tariffs and Trade (Dunne et al., 2007). Why, against the prediction of Hegemonic Stability Theory, was this international economic infrastructure maintained in spite of the perceived decline of the United States (Kindleberger, 1973)? In order to address this puzzle, international regime theories provided a framework to explain the mutual adjustment of states' behavior or policies and their acceptance of certain obligations in the absence of a supra-national authority with the ability to hierarchically enforce the rules of the game.[2]

[2] International regimes are broadly defined as "implicit or explicit principles, norms, rules and decision-making procedures around which actors' expectations converge in a given area of international relations." (Krasner, 1982)

Neo-liberal theories of international cooperation are rooted in an individualist and rationalist ontology and often apply economic methodologies to analyze problems of collective action. Robert Keohane's contractualism, for instance, interpreted international regimes as mechanisms enabling participating states to overcome the type of prisoner dilemma situations that arise in international relations (Keohane, 1984). In the absence of a regime, these collective action problems can prevent groups of states from achieving pareto-efficient cooperative outcomes resulting from their common interest in specific issue-areas. Individual states' rational choices can be compatible with Pareto-inferior solutions because of the presence of immediate incentives to defect in the first place and because these incentives to cheat may lead states not to trust others' willingness to stick to cooperation in the second place. International regimes provide a framework for negotiation that reduces transaction costs, creates iteration in the game and lowers uncertainty about the actions of others, thereby altering incentives and catalyzing co-operation. As a result, the pareto-superior outcomes are more likely to be realized, which forms the backbone of Keohane's functionalist theory: because countries anticipate the potential welfare improvement generated by co-operation they create international regimes.[3]

Various scholars have analyzed the role of the IMF through the lenses of this international regime approach. Cohen (1982) described the Fund's provision of finance as an international regime "governing access to external credit for balance of payment purposes". The basic foundation of this regime was the premise that an appropriate balance between domestic adjustment and external financing should be sought in order for countries to correct their balance of payments disequilibria. Under the Bretton Woods system the IMF managed a pool of national reserve currencies and gold, providing external financing on a limited scale. This tranched financial support was conditioned on the implementation of a number of policies, which ensured that recipient countries would not overtly postpone domestic adjustment as would otherwise be their tendency. The central question addressed by Cohen was whether the rise of private lending as the most important source of funding to cover external imbalances during the 1970s had effectively marked the end of this regime. Indeed, as opposed to the IMF,

[3] Various contributions have refined or extended this argument. Robert Axelrod (1984), for instance, showed that iteration and reciprocity in the Prisonner's Dilemma game can induce cooperation without central enforcement. Other scholars have focused on the potential for regimes to address other types of collective action problems (Hasenclaver et al., 1997).

private creditors were unable (or unwilling) to impose policy conditions and the question arose as to whether the system had mechanisms in place to continue promoting an appropriate balance between domestic adjustment and external financing. However, because private banks did gradually come to the realization that countries need to adjust in order to remain creditworthy, they increasingly required the presence of an IMF program in order to continue lending. As a result, Cohen argued that the rise of private markets did not fundamentally challenge the IMF's role as an "arbiter for access to financing". In other words, although the regime had changed, he contended that this was a change in degree rather than a change in kind.[4]

According to Biersteker (1993), developing countries' loss of access to international financial markets during the 1980s proved that Cohen was right: "(…) the petrodollar recycling by the commercial banks during the 1970s was more of an interruption in the post-war balance of payments regime than an indication of its profound transformation". In his view, the management of the 1980s debt crisis can be best interpreted as an international regime broadly re-establishing the principles, norms, rules and decision-making procedures described earlier by Cohen. The 1980s debt regime, therefore, was another stage in the evolution of the regime established at Bretton Woods. The most substantial addition to that regime was the gradual consolidation of the principle that in exchange for debt relief countries would pursue market oriented reforms (Brady plan).

Gould's theory of supplementary financiers is also related with Cohen's idea of the IMF as an arbiter for access to financing (Gould, 2003). Her main insight was that the IMF has historically complemented its programs with resources provided by states, private creditors and other international organizations such as the World Bank. Without supplementary financing, its programs would have failed to cover countries' balance of payment needs and the IMF would have lost leverage over its members. However, Gould showed empirically that supplementary financiers have gradually acquired the power to demand the inclusion of certain conditions in IMF programs. In her view, this

[4] Using the terminology developed by Ruggie (1983), the rise of private lending is seen by Cohen as a "norm-governed change" affecting rules and decision-making procedures, but leaving principle and norms essentially intact.

mechanism explains why the scope of conditionality has expanded so markedly in spite of the Fund's staff and Executive Directors' repeated attempts at reversing this trend.

Mainstream neo-liberal scholars tend to be state-centric and view international organizations as structure rather than agents. However, some contributions have treated these institutions as semi-autonomous actors exerting their own influence over international outcomes. This is the case of the theories of delegation rooted in the principal-agent model. According to this approach, delegation to a multilateral institution is a specific variant of international cooperation. States may opt to delegate for different reasons: to exploit gains from specialization, especially for repetitive or technical tasks; to overcome collective action problems and capture policy externalities; to pursue legitimacy and not to bear the full blame for the potential consequences of specific courses of action; to enhance the credibility of their policy commitments and reduce the incidence of time inconsistency problems; to facilitate collective decision-making or dispute resolution in specific issue-areas (Hawkins et al., 2006). Along with these potential benefits, the act of delegating authority to an international institution generates agency problems because the preferences of principals (states) and agents (international organizations) are never exactly aligned. Furthermore, contracts delegating authority are imperfect and monitoring and control mechanisms costly meaning that, in the presence of information asymmetries, there is always room for the agent to act opportunistically. In other words, once authority has been delegated, international organizations can shift policy away from states' preferred outcomes, giving rise to agency "slack".

Principal-agent models have been used to study the relationship between the IMF and its member states from various angles. Killick (1997) applied it to argue that conditionality is an ineffective tool to improve the quality of policy-making in developing countries. In his framework, the Bretton Woods Institutions are principals and their member states agents with a clear incentive to depart from the policies agreed upon in specific loans. Alternatively, Martin (2006) treated states as principals and IMF staff as their agent. Analyzing the historical development of rules concerning the use of conditionality, she tested a number of hypotheses relating distributional and informational concerns with the autonomy of the IMF. She found that staff discretion tends to be greater when: there is a strong dissatisfaction with the status quo, as tends to be the case during a crisis; states' preferences diverge; the design of a successful program requires high quality information and the recipients of such programs are concerned with the leakage of confidential data. Similarly, Copelovitch (2008) treated the five largest IMF shareholders (the G5) as a collective principal and the Fund's staff as its agent. Consistent with Martin, his empirical analysis found that the size and conditionality of IMF programs tend to be closer to the Fund's preferred outcome when there is a higher degree of heterogeneity in the preferences of the G5.

Although agency models provide a powerful instrument to study the interactions between states and international organizations, they usually fail to explain why the preferences of both actors may come to diverge. Instead, public choice scholars focus on international bureaucrats' incentive structures as an explanation for this divergence and, more generally, for public policy failures. Roland Vaubel departed from the premise that "bureaucracies are interested in power, prestige and amenities" to explain certain patterns in the evolution of IMF lending and conditionality, the scale and scope of which are instrumental for bureaucrats to maximize their budget and autonomy (Vaubel, 1986, 1991, 1996). In a similar vein, Dreher (2004) argued that the Fund's Executive Board is used by countries to resist the staff's drive for more conditionality and, therefore, more power. In this context, countries' bargaining capacity at the Board should be negatively correlated with the scope of the conditions imposed on them. However, because until recently the largest IMF shareholders were no longer considered potential borrowers, the Board has gradually given in to the staff lobbying for more intrusive conditionality. Other scholars focusing on the bargaining process between the various stakeholders of multilateral organization have adopted more nuanced views on the motivations of international officials. Bruno Frey (1997) for instance, claimed that "international bureaucrats pursue those policies that give them more prestige and influence within the reference groups with which they are connected". Willett (2002), in turn, contends that international officials' main objective is to progress in their professional careers, which incentivizes them to adopt their managers' preferences.

In conclusion, mainstream neo-liberal theories are particularly useful to understand why the IMF was created in the first place and how the institution has evolved over time. But this strand of the literature is more limited when it comes to analyzing cross-sectional variation in IMF interventions, especially when these interventions take place simultaneously, as was the case in Argentina and Uruguay. Nevertheless, the contributions reviewed above identify some potential sources of variation. For Gould (2003) it is important to look at the interests of supplementary financiers, which may have been different in the cases of Argentina and Uruguay. Following the logic of principal-agent models, the multilateral response to these two crises could also have differed because the international community was keener to delegate authority to the IMF in one case or another, maybe as a result of more or less convergent creditors' preferences (Martin, 2006; Copelovitch, 2008). Public choice scholars, in turn, would emphasize the role of bureaucrats' incentives during the management of the Argentine and the Uruguayan crises, which may have varied as a result of these two countries' different systemic importance.

2.1.2 The constructivist approach

Constructivist scholars argue that international cooperation is a social construction rather than the product of purely rational calculations on the part of egoist states with static preferences and ideas. In other words, they view international relations as a "world of our making" in which agents and structure are mutually constituted and interact on the basis of widely shared intersubjective beliefs (Onuf, 1989; Finnemore and Sikkink, 2001). As a specific form of international cooperation, constructivist scholars view multilateral organizations themselves as social facts that cannot be studied in isolation from the environment, culture and ideas in which they are embedded. Furthermore, once they are created international organizations also originate a distinctive social knowledge that influences the beliefs of their creators. In this way these institutions gradually become autonomous and purposive actors in world politics.

Departing from a Weberian conception of bureaucracy as the embodiment of the technical rationality demanded by modern societies, Barnett and Finnemore (1999) concentrated on the reasons why international organizations exercise power autonomously. It is precisely this "rational-legal authority" together with their control over knowledge and expertise what turns these institutions into independent actors exercising their own power in a variety of ways: they "define shared international tasks (like 'development'), create and define new categories of actors (like 'refugees'), create new interests for actors (like 'promoting human rights') and transfer models of political organization around the world (like markets and democracy)". However, international organizations are prone to misusing this power because their distinctive cultural features tend to breed dysfunctional or even "pathological" behavior. Drawing from sociological institutionalism, Barnett and Finnemore identify five bureaucratic mechanisms that yield such undesirable outcomes: the "irrationality of rationalization" that occurs when norms become ends in themselves; the inattention to local contexts and concerns arising from international organizations' tendency to develop universal rules and categories; [5] the "normalization of deviance" that comes with the gradual acceptance of exceptions as rules; the insulation from other competing worldviews affecting bureaucrats belonging to specific organizations; the contestation between various sub-cultures within a multilateral institution.

Babb (2003) also adopted a sociological approach to study the process through which international organizations come to gradually diverge from the objectives and goals of their creators. In her view, this "organizational slippage" is partly the result of ambiguous charters arising from the complexities of the multilateral negotiations establishing these institutions. In the case of the IMF, the ambiguity of the Articles of Agreement materialized in conflicting interpretations and disagreements about the role of conditionality in financial programs. Eventually, however, the Fund has played a relatively stable role in international financial affairs shaped by three sources of structure: external pressure from the US Treasury; "mimetic isophormism" understood as the replication of pre-IMF arrangements to cover countries' balance of payment needs;[6] shifting dominant paradigms among economists, the dominant professional category at the IMF. According to Babb, these three factors combine to explain the IMF's gradual departure from its original Keynesian mandate to embrace the objective of promoting free markets and macroeconomic austerity as its main raison d'être.

In a similar vein, Jeffrey Chwieroth (2010) explored the dynamics that gradually modified the Fund's staff position on capital controls in spite of the absence of formal

[5] The example offered by Barnett and Finnemore to illustrate this "universalism" is the imposition of conditions of fiscal austerity in IMF programs to address the Asian financial crisis. The IMF exported a Latin American mode of action to an Asian context in spite of the fact that fiscal profligacy was not a cause of the Thai, Korean and Indonesian crises.

[6] The loans agreed between central banks during the Gold Standard, which also imposed policy conditionality.

rules about the institution's role in the promotion of financial liberalization.[7] Based on surveys, archival research and extensive interviews he tracked the formation of beliefs and the internal debates that led to this normative change, emphasizing the following dynamics. Professionalization refers to the process through which by the 1970s economists had gradually reconstructed their discipline's mainstream understandings about the desirability of capital mobility. As a result of the generational renovation of IMF economists that took place in the 1980s and 1990s, these new beliefs were inserted in the Fund's decision-making process. The emerging market crises of the 1990s triggered a process of adaptation that fed an internal debate about how to proceed (the sequencing vs. big bang approach) but failed to question the long-term objective of fostering capital freedom.[8] Chwieroth also emphasized the ways in which norm entrepreneurs within some of the Fund's subcultures strategically exploited agency slack to construct technical interpretations of events that called for policy initiatives compatible with their principles and beliefs.

As was the case with some of the mainstream neo-liberal contributions described in section 2.1.1, constructivist scholars have tended to concentrate on the forces behind the emergence and evolution of the IMF as an institution rather than on the determinants of specific multilateral interventions. In fact, given that the Argentine and the Uruguayan crises took place almost simultaneously and were relatively similar in nature, it would be difficult to argue that ideational variables were a significant determinant of the variation observed in the Fund's interventions in these two countries. Furthermore, because the same IMF department handled the negotiations (the Western Hemisphere Department) and because of the cultural proximity between Argentina and Uruguay there is no a priori reason to emphasize the explanatory potential of diverging inter-subjective beliefs.[9] The constructivist view of the world, therefore, appears ill-equipped to study the causes of the contrasting multilateral response to the Argentine and the Uruguayan crises.

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[7] During the 1990s there was an attempt to amend the Fund's Articles of Agreement in order to formalize the objective of liberalizing the capital account. However, this attempt was dropped after the Asian financial crisis.

[8] As opposed to adaptation, a learning process would have entailed a change in beliefs about the desirability of capital mobility as a policy objective.

[9] On the other hand, as will be argued in Chapter VII, the contrasting response to the Argentine and Uruguayan crises may have had a significant effect on the evolution of inter-subjective beliefs in Argentina and Uruguay.

2.1.3 The realist approach

As opposed to constructivists, realist scholars tend to consider that international organizations are epiphenomenal to states interests and, therefore, have a limited explanatory role of their own. In fact, realists consider that power is central to explain most international outcomes, yielding a rather pessimistic view about the resilience of cooperative arrangements between states. This skepticism is grounded in three presumptions about the nature of the international system: states care about relative rather than absolute gains (Grieco, 1988); international anarchy poses too binding a constraint on cooperation (Waltz, 1979); states always fear others cheating on their commitments (Grieco, 1993). This is not to say that international regimes and multilateral organizations cannot exist. However, it means that realists view such arrangements as "little more than ciphers for state power" (Koremenos et al., 2001). In other words, international organizations may constrain behavior, but only that of weaker states.

Both realist and institutionalist contributions adopt a state centric rationalist approach. This concord reflects the neoliberal objective of departing from realist assumptions to reach different conclusions about the feasibility of cooperation between states (Keohane, 1984). In 1991, however, Stephen Krasner articulated a powerful realist counter-critique to the neo-liberal research agenda which is illustrative of the debate between both schools of thought (Krasner, 1991). His basic point was that the prisoner's dilemma fails to depict many of the situations that arise in international affairs. Instead, a more realistic characterization of a usual challenge in the formation of international regimes is the Battle of the Sexes game, where there is agreement on the undesirable outcomes but not on the preferred one. In this setting there are various possible co-operative possibilities along a Pareto frontier, each of which has different distributional outcomes which are likely to generate conflict and discord. According to Krasner, these are dilemmas of common aversion rather than common interest, and give rise to institutional arrangements that are "better explained by the distribution of power capabilities than by efforts to solve problems of market failure" (Krasner, 1991). Power can be used to solve such distributional conflicts in various ways: to impose who sits at the negotiating table; to impose the rules of the game and thereby determine which particular point will be realized in the Pareto frontier; to alter other states' incentives (the 'payoff matrix'), for instance through threats or promises.

Several empirical contributions have tested realist hypotheses about IOs and, more specifically, about the IMF. In an influential paper Thacker (1999) tested econometrically whether political proximity to the US or the political realignment towards US positions at the United Nations General Assembly increase countries' probability of entering into an IMF program. He found robust evidence to support the political realignment hypothesis: "the US has been more concerned with attracting new allies and punishing defectors than rewarding loyal friends". Barro and Lee (2005) extended this analysis to show that political proximity to other major IMF shareholders also increases the probability of receiving a loan. Economic proximity with such countries (proxied by bilateral trade) is also found to be a significant determinant of IMF lending in their study. Similarly, Oatley and Yackee (2004) found that IMF lending tends to be directed towards countries to which American banks are more exposed. In turn, Reynaud and Vauday (2009) illustrated the importance of geopolitical factors in IMF lending decisions. Finally, Stone (2008) found that countries that are important recipient of US aid are more likely to have an IMF program approved and are subject to a less intrusive conditionality. However, the US is willing to exert its leverage on the design of IMF programs only for important allies, and borrowing governments only request the US support when they are in a highly vulnerable situation. According to Stone, in other circumstances IMF economists have much more leeway in the program negotiations with borrowing countries.

The neo-realist approach offers a more promising avenue to study variation in the Fund's response to specific financial crises. In fact, it yields a rather straightforward prediction: those countries in which the US and other important creditors have more material and political interests will receive a better treatment from the IMF. But as argued in Chapter 1, this prediction does not fit well with the Argentine and Uruguayan experiences. Indeed, there is little doubt that at the time of the 2001-02 crises the Argentine economy was systemically much more important than that of Uruguay. In this context, why did the G-7 end up suspending its support to Argentina fall while adopting extraordinary actions to rescue Uruguay a few months later? Powerful states' material interests and, more generally, international variables on their own seem to have a limited potential to explain that outcome. A close examination is therefore needed on the scholarly contributions that have concentrated on the domestic level of analysis.

2.2 The domestic level of analysis

The IMF lends only to countries that request participating in a program. Furthermore, once an agreement has been reached between the Fund and a borrowing government, the policies and measures on which disbursements are conditioned have to go through domestic political and bureaucratic institutions in order to be ratified and implemented. Therefore, domestic variables are likely to play a significant role in the allocation of IMF credit and in the design and implementation of its programs. This section presents the contributions that have focused on the domestic level of analysis.[10] Because the countries that sign an IMF program are usually going through a financial, fiscal and/or balance of payment crisis, it begins with a selective overview of the literature on the politics of economic adjustment and reform. Then, it will continue with the contributions that have concentrated more specifically on the role of domestic political variables in the negotiation and implementation of IMF arrangements.

2.2.1 The politics of domestic adjustment

The domestic political processes that shape states' response to an economic crisis have received much scholarly attention. This literature was kick-started by the 1980s debt crisis and by the realization that countries facing relatively similar shocks ended up taking different macroeconomic adjustment and structural reform paths.[11] More specifically, variation was identified in the timing of the measures adopted to address the debt crisis, the content of these measures and the extent to which countries persevered with adjustment and structural reform. Early contributions tended to emphasize the collective action problems stemming from the distributional consequences of macroeconomic adjustment. In the words of Alesina and Drazen (1991), such distributional effects tend to feed a "war of attrition" between the various groups affected by these measures, resulting in substantial delays in the decision-

[10] In this section the domestic level of analysis focuses on debtor rather than creditor nations.
[11] Good summaries of this early literature are provided in the volumes edited by Nelson in 1990 and by Haggard and Kaufman in 1992 (Nelson, 1990; Haggard and Kaufman, 1992).

making process which carry a cost for society as a whole. Furthermore, potential winners are not only more dispersed but also more uncertain about the potential benefits of the reforms than the groups that lose, which weakens the incentives of the former to mobilize against the status quo (Fernández and Rodrik, 1991). Supporting the contention that democratic governments are likely to be more exposed to such interest group pressures, various case study analyses argued that authoritarian regimes were more successful at initiating reforms (Kaufman, 1985; Kahler, 1986). However, the broader comparisons and statistical studies that looked at this issue failed to provide consistent evidence that democracy systematically impairs governments' economic adjustment efforts (Haggard and Webb, 1993)

Going beyond the democracy vs. authoritarianism debate, politicians and technocrats' autonomy from the pull of distributive politics has long been emphasized as a crucial requirement for the initiation of the reform process (Kaufman and Haggard, 1992). However, various contributions have also argued that once such processes of change are launched their consolidation will depend on whether the state elites that are behind the reforms are able to construct supportive and relatively stable coalitions of beneficiaries. In an attempt to reconcile these two apparently contradictory necessities, Peter Evans (1992, 1995) developed the notion of "embedded autonomy". This referred to the beneficial effects of bureaucracies that are insulated from the pressures of particularistic interests but sufficiently integrated in a network of social and institutional ties with non-governmental actors, enabling the state to fine-tune its policies and to generate the trust and support that is needed to sustain reform processes.[12] According to this argument, those governments that reach an appropriate balance between autonomy and embeddedness will be better placed both to foster economic development and to adequately respond to economic shocks.

More recently, some scholars have built upon Tsebelis' veto-player theory to identify the factors that determine governments' capacity to adapt when policy changes become necessary (Tsebelis, 1995, 2002). Part of the reason why this approach has received so much attention is that it provides a general framework applicable to all types of political systems, making it possible to go beyond the pairwise comparisons that had previously

[12] Evans argued that this embedded autonomy is behind the success of developmental states such as South Korea.

dominated the literature and opening the way to broader statistical analyses. Indeed, this analytical framework uses only two dimensions to characterize polities: the number of veto-players and their policy preferences. Veto-players are defined as "individual or collective actors whose agreement is required for a change of the status quo" (Tsebelis, 1995). Such actors can have different forms. Institutional veto players are individual or collective decision-making bodies such as presidents or the chambers of parliament, which derive their power from the constitution. In turn, partisan veto players are parties or factions within parties endogenously empowered by the political game. Other potential veto-players are the judiciary, the army, particularistic interest groups or actors with the prerogative of launching a referendum. Tsebelis' model predicts that departing from the status quo will be more difficult when the number of veto-players is high and when their preferences (their "ideal points") diverge. The internal cohesiveness of collective veto players will also tend to impair polities' responsiveness to economic shocks.

Having a small number of like-minded veto-players, therefore, should be expected to facilitate the process of policy adjustment. However, the presence of checks and balances underpinning the credibility of the executive's policy commitments has long been identified as an important determinant of economic development, providing the necessary stability and predictability for private investment to flourish (North and Thomas, 1973; North and Weingast, 1989; Henisz, 2000; Stasavage, 2002). This suggests that there is a trade-off between policy stability and policy adaptability. In the words of Haggard and Mc Cubbins (2001: 27): "as the effective number of veto-players increases, the polity becomes more resolute and less decisive". Building upon this idea, MacIntyre (2001) has argued that countries in an intermediate situation are better placed to address a crisis. The reason is that an excessive concentration of veto authority tends to generate policy volatility whereas institutional configurations with an excessive dispersion of veto authority tend to generate policy rigidity, both of which feed investors' panics in a situation of crisis. In order to substantiate this point, MacIntyre compared the response of international investors to the Asian financial crisis in four countries: Indonesia, Malaysia, the Philippines and Thailand. He attributes the fact that the Philippines suffered the least severe capital flows' reversal to its intermediate distribution of veto authority.[13] Angkinand and Willett's econometric analysis brought support to this hypothesis: out of a sample of 45 episodes in 27 emerging economies they found that banking crises were costlier in those countries with an absence of veto-players or with too many such actors (Angkinand and Willett, 2008).

However, building upon the theory of repeated games, some contributions have challenged the view that policy stability and policy adaptability are necessarily conflictive objectives. A recent example is Scartascini et al. (2010) who emphasize the inter-temporal nature of the policy-making process to argue that under certain conditions and depending on the needs of the moment, cooperation between political actors can produce both outcomes at different points in time. According to this line of thought, polities' responsiveness to an economic crisis does not depend on the number of veto-players but on their ability to engage in an inter-temporal bargaining process. In their set-up, adding veto-players to the game does not undermine the ability of governments to adjust their policies, but rather the opposite. The reason is that if veto players fear that they may lose that condition while knowing that the preferences of those that will succeed them differ from theirs, they will not only concentrate their political activity on the content of public policies but also on the adoption of decision-making technologies that constrain future choices.[14] The uncertainty that they face is more marked when checks and balances are weak, providing veto players an incentive to "write policy in stone today" in order to insure against the risk of opportunistic one-sided behaviour tomorrow. Instead, the presence of strong checks and balances increases the likelihood that current veto players will retain their sit at the table, weakening their incentives to introduce additional rigidities. Hence, a larger number of veto players may be associated with more flexible decision making procedures and, therefore, with greater policy adaptability.

The critical question for these authors is what conditions make cooperation among political actors more likely, yielding both policy stability and policy adaptability. In their repeated game model it is easier to sustain a cooperative equilibrium when there

[13] Instead, Indonesia and Malaysia had the most centralized veto authority, which generated problems of policy volatility, whereas Thailand had the most decentralized veto authority, yielding policy rigidity.
[14] For instance, policies can be constitutionalized, international agreements with high exit costs can be signed and heavy delegations structures can be set up. An obvious example is the currency board adopted in Argentina in the 1990s.

are more veto players but a lower number of political actors affected by policies' distributional impact, when players are more patient and when they have an element of common interest (Scartascini et al., 2010). Stein and Tommasi (2008) looked at this issue from an empirical perspective, adopting a case study approach to identify the institutional features that foster cooperation in the policy-making processes of eight Latin American countries. Their study found substantial longitudinal and cross-sectional variation in the dependent variable, with countries like Chile and Brazil much more capable of sustaining cooperation than others like Argentina and Ecuador. Among the various factors that influence that outcome, they emphasized the presence of policymaking institutions that provide an arena where political actors interact repeatedly during sufficiently long periods of time.[15] The degree of institutionalization of these policymaking arenas and the availability of enforcement technologies such as professional and politically neutral bureaucracies or independent judiciaries was also found to weaken actors' tendency to defect from cooperative arrangements. Finally, cooperation will be easier to sustain in policy areas in which the short-term payoff of deviating from inter-temporal agreements is low.

In sum, the literature reviewed in this section identifies various factors that may significantly influence the implementation of the macroeconomic adjustment and structural reforms associated with IMF conditionality. In particular, the number and preferences of veto players together with political actors' ability to cooperate may have constituted potentially important sources of variation in the Argentine and the Uruguayan case studies. But this literature is not concerned with the specific context of IMF programs and, therefore, leaves some important questions unanswered about the causal link between domestic politics and multilateral crisis lending. As described in the following section, however, this issue has received increasing scholarly attention in recent years.

2.2.2 Domestic politics and IMF programs

The contributions that have looked at the relationship between domestic political variables and the Fund's program engagement in emerging economies have

[15] This point is substantiated by the finding that more cooperation is found in countries where legislators are replaced less frequently.

concentrated primarily on the following three questions. The first one is related with the decision to participate in an IMF program. Why do countries request the Fund's financial support? Are IMF programs merely a response to an economic necessity or do political calculations come into play? The second is related with the design of these programs. To what extent do domestic political constraints influence the negotiation of the policy conditions attached to an IMF program? The third question is related with the implementation phase. What are the domestic political and institutional variables that determine countries' capacity to comply with conditionality and to successfully implement an IMF program?

Focusing on the first question, the dominant view has been that there is a stigma attached to participating in a program because IMF conditionality is painful, unpopular, and often perceived as an imposition from abroad. Therefore, requesting the Fund's financial support carries a political cost and national governments tend to resort to it as a last resort when they face a crisis situation. This is consistent with the fact that governments tend to request an IMF program right after they are elected, partly in order not to be held electorally accountable for that decision in the short term (Stone, 2008). Supporting the contention that requesting the Fund's support is a matter of necessity, a substantial body of evidence has identified various economic variables that are significantly associated with countries' propensity to participate in a program. As shown in table 2.1, most studies find that weak external accounts (proxied by the stock of foreign exchange reserves and the current account balance) and a stagnant economy (proxied by GDP growth) increase the probability that countries will turn to the IMF for assistance. In turn, countries' debt burden appears to have an ambiguous effect. On the one hand, various studies find a positive correlation between the probability of participating in an IMF program and the ratio of debt servicing to GDP. On the other hand, different contributions find opposite results about the impact of total debt to GDP and of the budget balance. Finally, a number of studies have found that trade openness and a lower per capita income make it more likely that a country will enter an IMF program.

Table 2.1

Macroeconomic determinants of participation in IMF programs[16]

	F/X Reserves	GDP growth	Current account balance over GDP	Debt service over GDP	Debt/GDP	Budget balance	Change in exchange rate	Trade openness	GDP per capita	Investment
Garuda, 2000	-	-			+					
Przeworski & Vreeland, 2000				+		-				
Bird & Rowlands, 2001	-		-		-					
Hutchinson, 2003	-					+				
Bird et. al., 2004							+			
Brune et al., 2004	-					+				+
Jensen, 2004	-	-			+					
Sturm et al., 2005	-	-								-
Barro and Lee, 2005	-	-								
Edwards, 2005	-	-			+					
Eichengreen et al., 2006		-	+	+			+	+		
Nooruddin & Simmons, 2006		-	-						-	
Dreher, 2006				+	-					
Broz & Hawes, 2006					-			+		
Atoian & Comway, 2006		-	-							
Stone, 2008	-				+	+			-	

Source: Steinward & Stone (2008)

However, some scholars have also argued that governments may request an IMF program not only because they need to but also because, under certain circumstances, they may have a political incentive to do so. Although this public choice argument was originally put forward by Roland Vaubel, it has been developed primarily by Allan Drazen and James Vreeland (Vaubel, 1986; Drazen, 2002; Vreeland, 2003a, 2003b,

[16] The table reports the signs of the statistically significant correlations between countries' propensity to enter an IMF program and macroeconomic variables found in the relevant literature.

2007).[17] Drazen developed a theoretical model in which he showed that even when the IMF and its borrowers agree on the policies to be attached to a program, conditionality can play an important role by reinforcing the government's bargaining position vis-à-vis the interest groups opposed to adjustment and reform. In turn, according to Vreeland there are three main reasons why governments can have a desire for IMF conditionality.[18] First, national policy-makers may use the IMF as a scapegoat to lessen the political cost associated with the adoption of unpopular adjustment measures or structural reforms. Second, some governments may want to become subject to conditionality in order to send a positive signal to private investors about the quality of their economic policies. Third, along the lines of Drazen's model, national politicians may desire conditionality in order to gain leverage in the domestic political process, tipping the balance in favour of the ratification of certain policies that, in the absence of an IMF program, would have been blocked by veto players opposed to a departure from the status quo. Vreeland emphasized this third mechanism, which creates an additional cost for veto-players to oppose the policies covered by the Fund's conditionality if the possibility of a disruptive program suspension is credible enough.[19]

Most of the studies that have tried to identify the determinants of conditionality have focused on international factors such as the interests of powerful countries and supplementary financiers or the bureaucratic incentives of IMF negotiators. However, the impact of domestic political constraints on the bargaining process between borrowing countries and the IMF has also been explored recently. Randall Stone (2008) interpreted conditionality as the result of a negotiation in which the IMF is given space to bargain autonomously when US strategic interests are not at stake. His econometric analysis found that domestic political conditions matter.[20] More specifically, the IMF appears to impose less policy conditions to democracies, presidential regimes and

[17] This is not to say that these scholars disregard the political cost of signing an IMF program. However, they argue that the political benefits of conditionality may sometimes surpass this cost, especially in countries that are "used" to being in an IMF program. According to Vreeland, this is why even after economic factors are controlled for, having been under an IMF program in the past (recidivism) is a significant predictor of participation in IMF programs (Vreeland, 2007).

[18] Drazen uses this model to illustrate why the ideas of program conditionality and country ownership are not necessarily contradictory.

[19] This is why Vreeland argues that domestic political calculations will matter less in countries that count on the support of the US or other large IMF shareholders, where the threat of a program suspension is not credible (Vreeland, 2004).

[20] This econometric analysis is conducted using the Fund's MONA (Monitoring of Fund Arrangements) database, which contains information about programs' conditionality and countries' performance with it.

coalition governments. According to Stone, the reason is that under these circumstances governments face stronger political constraints domestically, which they use as a bargaining tool in their negotiations with the IMF. Therefore, Stone interprets this result as evidence of a causality that runs in the opposite direction of Vreeland's contention that governments facing strong veto players domestically tend to exploit the Fund's conditionality as an instrument to gain leverage in the domestic political process.

Focusing next on the third question, various studies have identified some domestic political and institutional variables that compromise borrowing governments' capacity to successfully implement an IMF program. Ivanova et al. constructed three measures of program performance: a binary variable that captures whether programs are temporarily or permanently interrupted, a quantitative indicator that reflects the extent to which borrowing countries comply with conditionality and the ratio of the resources committed by a program that are actually disbursed (Ivanova et al., 2003).[21] Their econometric analysis found that the presence of strong interest groups in parliament, political instability, ethnic fragmentation, a lack of political cohesion and poor quality bureaucracies significantly undermine the implementation of IMF programs. Furthermore, once they control for these political and institutional variables, economic conditions in borrowing countries have a statistically non-significant impact on the success prospects of IMF programs. Using a similar specification, Arpac et al. (2006) also emphasized the important role of political variables in the implementation of IMF programs. More specifically, they found that the presence of veto players is a particularly significant predictor of program interruptions. In line with Ivanova et al., borrowing countries' macroeconomic conditions are not found to affect the likelihood that a program will be successfully implemented.[22] Another contribution that builds upon Ivanova et al. is Nsouli et al. (2004), who found that government corruption is negatively associated with the likelihood of success in program implementation.

Summing up the literature on the domestic politics of IMF programs, there is some evidence to argue that borrowing governments do not only request the Fund's financial assistance because they need to but also because under certain conditions they may have

[21] They find that 44 percent of the programs they analysed were irreversibly interrupted while 70 percent experienced at least one minor or major disruption.
[22] Only trade openness positively affects program implementation in their study.

a domestic political incentive to do so. Indeed, conditionality can be an instrument used by politicians to reinforce their leverage against the interest groups that are opposed to their desired policies. On the other hand, the possibility that causality runs in the other direction has also been emphasized: borrowing countries may exploit domestic political constraints to strengthen their bargaining position vis-à-vis the IMF. There is broad evidence to argue that domestic political and institutional variables have a marked impact on the implementation of IMF programs. What is perhaps more surprising is that when these variables are controlled for, borrowing countries' ability to comply with the Fund's conditionality appears not to be influenced by economic conditions.

2.3 Bridging the gap: the two-level game analytical framework

Although most scholars with an interest in the IMF continue to concentrate either on the domestic or on the international level of analysis, a number of recent contributions have tried to integrate these two approaches. A case in point is the aforementioned exchange between James Vreeland (2003a) and Randall Stone (2008) about the direction of the casual relationship between domestic political constraints and the negotiation of the Fund's conditionality. Another attempt to integrate the domestic and international politics of IMF interventions is Pop-Eleches (2009), whose study provides a holistic account of the multilateral response to financial crises in Latin America and Eastern Europe during the 1980s and 1990s. This dissertation pulls in a similar direction, applying a two-level game approach to test and generate hypotheses about the ways in which domestic and international factors jointly interact to shape IMF interventions in emerging economies. This section begins with a summary of Putnam's 1988 seminal paper on two level games. It continues with some preliminary considerations about the application of this approach to the negotiations between the IMF and its borrowing members. Finally, in order to set the stage for the empirical analysis presented in subsequent chapters, a stylized representation of this analytical framework is provided.

2.3.1 Putnam's two-level games

The two-level game approach developed by Robert Putnam in 1988 constitutes one of the most prominent attempts to integrate the domestic and the international levels of analysis in the study of international relations (Putnam, 1988).[23] This analytical framework focuses on the figure of "chief negotiators", who participate in two negotiations that may be conceived as taking place either sequentially or simultaneously: a "level I game" in which they bargain with their foreign peers in order to coordinate policies in a specific issue-area and a "level II game" in which they bargain with their constituents in order for the level I agreement to be ratified domestically. The crucial link between the domestic and the international levels of analysis is provided by the need for consistency between the outcomes of the two games: whatever is agreed at the level I game needs to be ratified domestically by all the chief negotiators in order to be brought into fruition. As a result, a re-alignment in any of the two games can trigger re-alignments in the other, which provides fertile ground for analysing strategic interactions between the international negotiations' various stakeholders.

In order to operationalize the two-level game metaphor, Putnam introduced the concept of win-sets, which refer to all the possible level I agreements that negotiators can ratify domestically. The contours of their respective win-sets, therefore, determine the constraints that domestic ratification politics impose on each chief negotiator. Because the outcome of the level I game needs to be ratified by all the chief negotiators, the universe of feasible agreements is given by the intersection between all the individual win-sets, which is the overall constraint of the two-level game. Departing from a number of initial assumptions (each chief negotiator has perfect information about the contours of his own and on his peers' win-sets; the payoff structure of the various games is fixed; chief negotiators are "honest brokers" with no agendas of their own), this basic framework enabled Putnam to articulate two central hypotheses. The first one is that international cooperation (i.e. a level I agreement) is more likely to be achieved if win-sets are large, the corollary of which being that conflict is likelier when win-sets are small. In iterative two-level games this implies that transitions from cooperation to conflict can be explained in terms of shrinking win-sets and vice versa. The second hypothesis is that chief-negotiators with a smaller win-set have a bargaining advantage over chief-negotiators with

[23] Another important attempt is Gourevitch second-image reversed theory (Gourevitch, 1978). See Caporaso (1997) for an in-depth review of this literature.

larger win-sets. In other words, difficulties to ratify an international agreement domestically can be used as a bargaining tool in the level I negotiation.

A difficulty associated with these two hypotheses is that the size of win-sets is an abstract and rarely observable concept. Hence, in order to be testable, the two-level game framework requires a theory or the generation of additional hypotheses to link the size of win-sets with other observable variables. More specifically, Putnam considered three broad categories of possible determinants of win-sets. The first one refers to domestic ratification procedures and to the institutions that shape them, which may empower certain constituencies at the expense of others and give rise to specific veto-players with the capacity to derail an international negotiation. The second category of variables refers to the distribution of power between the various coalitions and interest groups that are affected by the international agreement and that may have an influence over the ratification process. This second category of determinants will be particularly relevant if the cost of agreement or of non-agreement in the level I negotiation is unevenly distributed among level II constituents. Domestic ratification politics will matter especially if obtaining "more" in the level I negotiation is not necessarily "better" for all the level II constituents. The third category of variables refers to the strategy adopted by chief negotiators, which may have tools at their disposal to alter the size both of their own and of their opponents' win-set. For instance, chief negotiators may use side payments or "generic good-will" in an attempt either to increase the likelihood of domestic ratification or to gain leverage in the international negotiation.

Putnam's article on two-level games also explored the implications of relaxing the framework's initial assumptions. Introducing uncertainty makes involuntary defection feasible, an idea that is more difficult to integrate in the theories of international cooperation that treat states as unitary and purposeful actors. Indeed, as opposed to the more traditional concept of opportunistic or voluntary defection, involuntary defection refers to situations in which well-intentioned chief negotiators overestimate the size of their win-set and fail to obtain the domestic ratification of an international agreement to which they have already committed. According to Putnam, involuntary defection could be as significant an obstacle to international cooperation as opportunistic defection because some chief-negotiators may decide not to take part in a level I agreement if they become sceptical about their peers' chances of obtaining domestic ratification. On the other hand, some chief-negotiators may exploit uncertainty about domestic ratification as a strategic tool to gain leverage in the level I game. If pushed too hard, however, this bargaining tactic can lead to the failure of the international negotiation.

Another relaxation of the framework's initial assumptions is that in which pay-off structures are considered an endogenous element of the two level game rather than fixed and externally determined. Indeed, level I negotiations may "reverberate" within domestic politics if they serve to legitimize or to de-legitimize a certain course of action, hence altering the pay-off structures of specific constituents and therefore the size of win-sets. Alternatively, chief-negotiators may try to "restructure" their peers' win-sets by strategically taking actions that resonate with foreign swing constituencies. Finally, dropping the "honest broker" assumption recognizes the possibility that chief-negotiators may have an agenda of their own, and that they may use international negotiations as an instrument to pursue some domestic political purpose such as enhancing their reputation or overcoming opposition to their preferred policies.

Some preliminary considerations

Although Putnam's 1988 article focused primarily on the application of the two-level game framework to the negotiation of a treaty between states (more specifically, the 1978 Bonn accord between the United States, Germany and Japan), it also considered other types of agreements in which one, some, or all of the chief negotiators represented other types of organizations. Putnam did not seem to consider that such alternative scenarios required any fundamental qualification of his arguments. In fact, throughout his paper he used the negotiation of the Italian 1977 SBA as an example to illustrate some of his main points. In spite of Putnam's apparent disregard for the specificities of such scenarios, it is worth exploring whether an application of his framework to the case of IMF interventions has relevant implications for the dynamics of the two-level game.

A first specificity of such cases is that, as opposed to most international treaties, IMF programs cannot be understood as single discrete agreements followed by implementation (Kahler, 1993). Because of their tranched structure, the implementation of an IMF program requires periodic (usually quarterly) re-negotiations: each disbursement has to be approved by the Executive Board following subsequent re-enactments of the level I bargaining process between finance ministers and IMF officials. Hence, this set-up is likely to display more variation in the dependent variable than other applications of the two-level framework focused on a single Level I agreement.

A second set of implications is derived from the asymmetries that are present in the case of the negotiations of an IMF program, which are likely to be more pronounced than in inter-state applications of the two level game framework. In fact, few parallelisms can be established between the institutions that shape the ratification politics of the IMF and of the borrowing country. As we shall see in Chapter 3, program-related decisions are always ratified by the Fund's Executive Board. Instead, no single institution monopolizes the power to ratify or to reject program-related decisions in borrowing countries. In most cases, borrowing from the IMF as such does not require approval from the legislative branch of government. In other words, borrowing country chief negotiators can enter into IMF arrangements unilaterally (Vreeland, 2004). But the various policy conditions that are attached to an IMF program do usually require some form of subsequent ratification. Some of these conditions, such as certain fiscal adjustment measures, the adoption of new laws or the modification of existing ones, may require congressional approval. In turn, depending on countries' degree of political and administrative de-centralization, some other conditions may have to be ratified and implemented at the sub-national level. Even when there is no formal constraint to implement the Fund's conditionality, there may be some informal mechanisms at play preventing the borrowing government from successfully implementing a program. As pointed out by Putnam, an example of such informal ratification processes is that in which labour unions or civil society at large mobilize against an austerity program negotiated with the IMF (Putnam, 1988). As a result of this multi-faceted ratification process, the outcome of the level II game is likely to be more uncertain in borrowing countries than at the IMF.

The asymmetric nature of this negotiation is reinforced by the different composition of level I constituencies. Whereas finance ministers are likely to be constrained primarily by those coalitions and interest groups that are affected by the program and that are capable of mobilizing for or against it, IMF negotiators' main constituents are the institution's "principals", i.e. its member states. Therefore, an interesting feature of the two-level game framework as applied to an IMF program is that borrowing countries' governments are present both in the level I game and in the Fund's level II game. Although for reasons that will be explored in Chapter 3 borrowing countries have a very limited influence in the IMF's Executive Board, this specificity may have important informational implications. Indeed, because they have representatives at the IMF with direct exposure to the institution's decision-making process, finance ministers do presumably have more information about the Fund's level II game than IMF officials do about the borrowing country's level II game. Hence, imperfect information should be expected to be more of a concern for IMF negotiators than for borrowing governments, which implies that finance ministers are more likely to use uncertainty as a bargaining tactic and that the IMF is more likely to refuse to agree on the basis of a program's uncertain ratification at the country level.

In fact, the Fund's concern about uncertainty contributes to explain the aforementioned tranched structure of its programs: periodic program reviews are largely aimed at determining whether the borrower is complying with conditionality. To some extent, therefore, reviews are conceived as a "disciplining" device providing a disincentive to voluntary defections. However, even in cases in which countries do not comply with conditionality (hence partially defecting on their agreement with the IMF) the Board has discretion to grant waivers in order to approve the program review. A relevant question is whether the distinction between voluntary and involuntary defection emphasized by Putnam plays a role in this process. It might be that the Board tends to be more tolerant with those governments that are able to prove their commitment to a program, in which case involuntary defection would be less of an obstacle to the approval of a review than voluntary defection.[24] This would create incentives for the government to signal that domestic ratification is being difficult. However, it may also be the case that the Board does not approve a review because it comes to perceive that the ratification of conditions that it considers crucial for the success of a program is highly unlikely even if the government supports them. In this case, the strategy of exaggerating domestic ratification difficulties would backfire, making the distinction between voluntary or involuntary defection less relevant.

Another implication of the asymmetries present in this game lies in the types of transnational alliances that can emerge between chief negotiators and their counterparts' constituents. The key transnational alliances for borrowing countries' finance ministers are built upon their governments' diplomatic ties with the countries that have more influence over the Fund's decision making process, i.e. the creditors. Consistent with the predictions of Thacker (1999), Barro and Lee (2005) or Reynaud and Vauday (2009), the potential for such transnational alliances to tip the balance in the Fund's ratification process is likely to depend on factors such as whether borrowers are geo-politically relevant, whether they are political allies of the US and other G7 countries and/or whether the G7 has strong material interests in these countries. In turn, the IMF's chief negotiators should be expected to develop transnational alliances with the domestic interest groups that are closer to their own positions, for instance business groups or central bankers. Given that the Fund's main interlocutors are borrowing country governments, these channels are likely to be less well developed than the diplomatic ties described above. However, since the IMF has increasingly tried to reach out to civil society and other stakeholders in recent decades, these transnational alliances could be meaningful.

2.3.3 A stylized representation

After having reviewed the logic of the two-level games approach and some of the implications of its application to the study of IMF lending, this sub-section provides a stylized representation of this analytical framework. Chapter 1 argued that multilateral

[24] Another type of non-compliance with the Fund's conditionality may not be attributed to defection as such but to some exogenous factor invalidating the projections on which these conditions were based. For instance, it might be that GDP growth is lower than expected, turning fiscal targets unattainable.

interventions in emerging economies have three components: official finance, policy conditionality and private sector involvement. In order to map the possible outcomes of the level I game in a two-dimensional space it is necessary to drop one of these three components. Given that, as opposed to official finance and policy conditionality, private sector involvement does not form part of all IMF programs, it makes sense to drop this component rather than the other two.[25] Hence, the horizontal axis in figures 2.1 to 2.4 represents the volume of official finance provided by the IMF and the vertical axis the conditionality associated with this financial support. Conditionality takes the form of macroeconomic adjustment and structural reform and is measured in terms of the impact that these actions have on the balance of payments. For simplicity, one unit of adjustment and reform is assumed to be equivalent to one unit of official finance.

The negotiation between the two sides' chief-negotiators begins when an exogenous shock hits the borrowing country, generating a balance of payment need of a magnitude determined exogenously. For each shock there are infinite combinations of official finance and adjustment/reform that can potentially cover the resulting balance of payments need, which are represented by the isolines IL in figures 2.1, to 2.4. By construction, the further away isolines are from the origin, the largest is the impact of their corresponding shock on the balance of payments. Both chief-negotiators are assumed to have the same information about the shock and to agree on the impact that the various combinations of adjustment/reform and official finance have on the balance of payment. Therefore, the isoline corresponding to the shock that the borrowing country is undergoing constitutes a first restriction in the level I game that is known to both players.

The level II games generate additional restrictions on the two sides of the negotiation. WS_{IMF} represents the frontier of the Fund's win-set in such a way that the institution's chief-negotiators can only secure the ratification of level I agreements located to the left of that curve. Whereas adjustment/reform provides a utility to the Fund's constituents, official finance generates a disutility given that it puts multilateral resources at risk. As a result, WS_{IMF} is upward sloping: at the frontier, an increase in official finance will

[25] Both in the Argentine and the Uruguayan cases, however, the involvement of private creditors was a crucial element of the multilateral intervention and the empirical chapters devote much attention to this component of the IMF programs.

only be approved in exchange for a more demanding conditionality. The convexity of WS_{IMF} results from the assumption that official finance has an increasing marginal disutility, which is rooted in the idea that the Fund's constituents are likely to be more reluctant to augment programs that are already large in order to avoid an excessive concentration of risk in their institution's balance sheet. Therefore, the additional units of adjustment and reform that they will demand in exchange for one more unit of official finance will tend to increase with the size of the program.

In turn, WS_{BC} represents the frontier of the borrowing country's win-set in such a way that all the possible level I agreements ratifiable domestically are located to the right of that curve. WS_{BC} is upward sloping because adjustment and reform constitutes a disutility for the borrowing country's constituents. In turn, the concavity of that curve results from the assumption that adjustment/reform has an increasing marginal disutility for these same constituents. The rationale behind that assumption is that the domestic political opposition to intensify adjustment tends to be stronger when substantial austerity measures have already been implemented. Therefore, the additional units of official finance needed to convince domestic constituents of the need to ratify one additional unit of adjustment will increase with the level of effort that borrowing countries have already undertaken.

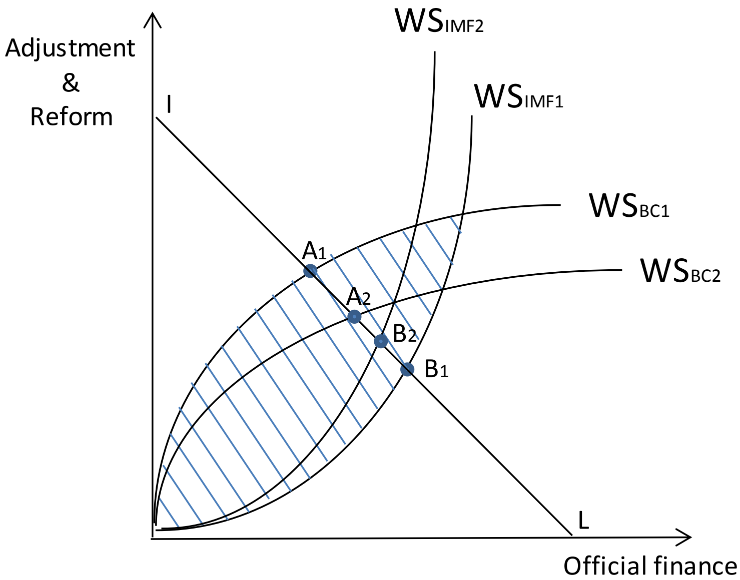
The set of feasible level I agreements is defined as the combinations of adjustment/reform and official finance that satisfy the three restrictions outlined above, which are superposed in Figure 2.1. The striped area in between WS_{IMF1} and WS_{BC1} captures the combinations of adjustment/reform and official finance that can be ratified in the level II games of both the IMF and a first borrowing country. If that country was hit by a shock depicted by isoline IL, the set of level I agreements that would simultaneously satisfy the three restrictions would be given by segment A_1B_1. In turn, WS_{IMF2} and WS_{BC2} correspond to the domestic constraints faced in the bargaining process between the Fund and a second borrowing country. For some exogenous reason, it is more difficult for the two sides' chief negotiators to obtain their respective constituencies' support in this second situation, which is why WS_{IMF2} is located to the left of WS_{IMF1} and WS_{BC2} to the right of WS_{BC2}.[26] If that country was hit by an

[26] For instance, it might be that the second borrowing country has more veto players and less geo-political importance than the first borrowing country.

exogenous shock of the same exact magnitude as that undergone by the first borrowing country (therefore represented by the same isoline IL), the set of level I agreements that would simultaneously satisfy the three restrictions would be given by A_2B_2. It is clear from Figure 2.1 that A_2B_2 covers a smaller portion of IL than A_1B_1. This illustrates the rather obvious first hypothesis outlined in Putnam's 1988 article: it will be easier to achieve a cooperative equilibrium in the level I game if win-sets are large and, therefore, when the political constraints faced domestically by chief-negotiators are loose.

Figure 2.1

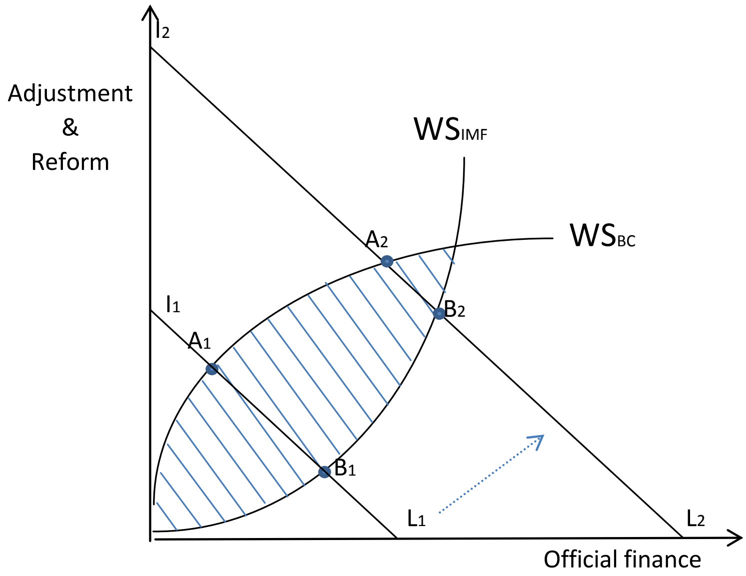
The cooperative outcome



Another factor that affects the likelihood of reaching a cooperative equilibrium in the two-level game is the magnitude of the macroeconomic shock undergone by the borrowing country. This is illustrated in figure 2.2, where isoline I_1L_1 represents a low magnitude shock and isoline I_2L_2 a high magnitude shock. If win-sets remain unchanged both on the side of the IMF and of the borrowing country, an amplification of the shock from I_1L_1 to I_2L_2 shifts the subset of level I agreements that can satisfy the three restrictions simultaneously from A_1B_1 to A_2B_2. It is clear from figure 2.2 that, as a result of the marginal disutility assumptions, A_2B_2 covers a smaller portion of I_2L_2 than A_1B_1 does of I_1L_1. This implies that the more intense is the impact of the exogenous shock on the balance of payments, the more unlikely will it be that a cooperative equilibrium is reached and sustained in the negotiations.

Figure 2.2

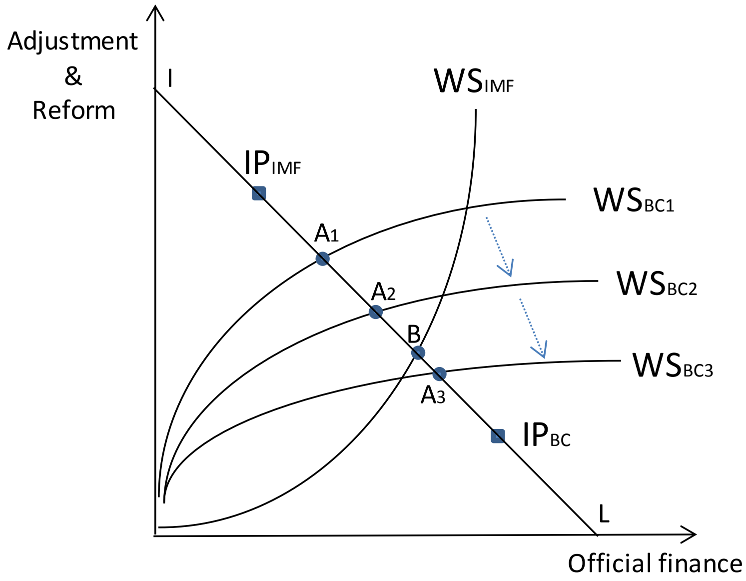
Amplification of the shock



So far, this representation of the two level game analytical framework has ignored the possibility that chief-negotiators have preferences of their own. Instead, Figures 2.3 and 2.4 introduce ideal points IP_{IMF} and IP_{BC} to capture these exogenously determined preferences. The game presented in figure 2.3 explores the consequences of a narrowing win-set on the side of the borrowing country combined with a constant win-set on the side of the IMF. This may be the result of an election that forces the executive to govern in coalition, thus adding a veto-player to the game. If this development shifted the country's win-set frontier from WS_{BC1} to WS_{BC2}, the sub-set of level I agreements that satisfy the three restrictions would contract from A_1B to A_2B. If the original equilibrium of the game was located in segment A_1A_2, the restoration of a cooperative equilibrium would require a move toward the borrowing country's ideal point. However, if the win-set continued to narrow, the likelihood of maintaining the cooperative equilibrium would gradually fall and, eventually, disappear. In figure 2.3, this happens when WS_{BC2} shifts to WS_{BC3}, making it impossible to find a level I agreement that simultaneously satisfies the three restrictions. Therefore, the two-level game framework predicts a non-linear relationship between domestic political constraints and chief-negotiators' bargaining power vis-à-vis the IMF. Ceteris paribus, and in line with the second hypothesis outlined by Putnam in 1988, the intensification of these constraints can be turned into a bargaining advantage. Beyond a certain point, however, an excessively constrained ratification process will result in the collapse of the cooperative equilibrium and, therefore, in a suspension of multilateral support to the country hit by the macroeconomic shock.

Figure 2.3

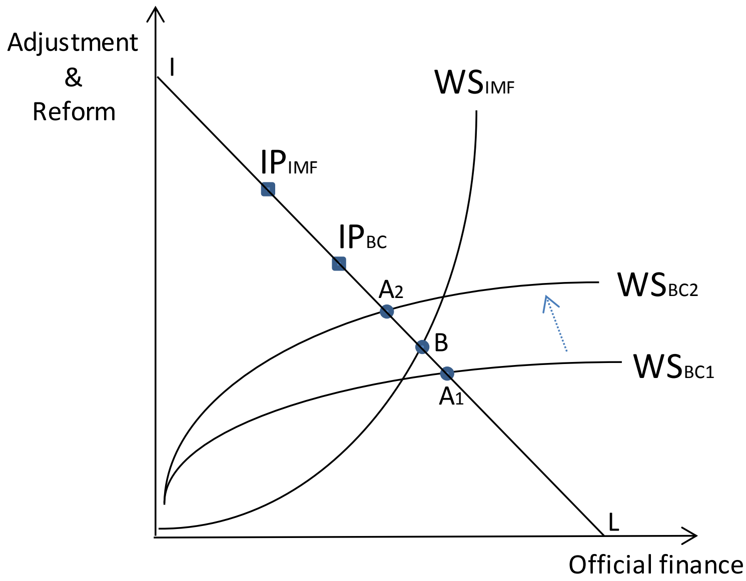
Narrowing win-set



The mechanism described above is consistent with Randall Stone's contention that borrowing countries can exploit domestic political constraints as a bargaining tool in their negotiations with the IMF. However, Vreeland's hypothesis that IMF arrangements are used to gain leverage in the domestic political game can also be captured with this analytical framework. In Figure 2.4, the borrowing country's chief negotiator's ideal point IP_{BC} is located out of its win-set area, which is delimitated by WS_{BC1}. This implies that the government cannot ratify its desired level of adjustment and reform. Furthermore, if that country was hit by a macroeconomic shock represented by isoline IL, it would be impossible to reach a cooperative equilibrium in the negotiations with the IMF given that there is no combination of adjustment/reform and official finance that simultaneously satisfies the three restrictions. However, the borrowing country's chief-negotiator could use its prerogative to enter an IMF program unilaterally in the hope of altering domestic constituencies' willingness to acquiesce to certain policies. If that strategy paid off, the borrowing country's win-set would expand as a result of the program. This may be due to domestic constituents' fear of the consequences of a suspension of multilateral financial support. In figure 2.4, this occurs with the shift from WS_{BC1} to WS_{BC2}, which has two related effects. The first one is that it makes a cooperative equilibrium possible given that segment A_2B simultaneously satisfies the three restrictions. The second is that reaching a cooperative equilibrium within that segment would entail a move towards the borrowing country's chief negotiators' ideal point. In other words, in this game entering an IMF program is strategically exploited to alter domestic pay-off structures in such a way as to make cooperation possible and to approximate policies to the government's ideal point.

Figure 2.4

Political instrumentation of IMF programs



2.4 Conclusion

This chapter has reviewed existing scholarly debates about IMF lending. Much of this literature has concentrated either on the domestic or on the international level of analysis, producing a rich body of theory and empirical evidence about the role played by specific explanatory variables in the provision of multilateral credit. However, in line with some recent contributions, this dissertation argues that in order to gain a more holistic understanding about the multilateral response to emerging markets' crises it is necessary to take simultaneous account of domestic and international factors and to shed some light on how these variables interact to shape the design and implementation of IMF programs. It is precisely in order to create a logical link between the two levels of analysis that Putnam's two level games analytical framework is applied in the upcoming empirical chapters on the causes of IMF interventions in Argentina and Uruguay.

A stylized representation has also been presented in order to illustrate the usefulness of this analytical framework, from which a number of hypotheses have been derived: (i) cooperation between the IMF and its members will be easier to achieve and sustain when win-sets are large; (ii) the larger the impact of the shock that gives rise to the Fund's intervention, the more difficult will it be to sustain the cooperative outcome of the negotiations; (iii) narrow win-sets can be turned into a bargaining advantage, but beyond a certain point the intensification of domestic political constraints will result in the collapse of the negotiations between the IMF and its borrowers; (iv) borrowing governments can strategically exploit their prerogative to enter an IMF program unilaterally in order to expand the size of their win-set and, hence, to overcome domestic opposition to some of their preferred policies.

Subsequent chapters will try to test these hypotheses. But the concept of win-sets around which two-level games are constructed is inherently unobservable. Therefore, other observable variables will have to be identified in order to proxy the size of win-sets, without which it would be impossible to isolate the causal relationship between ratification processes and the Fund's interventions in Argentina and Uruguay. In this way the testing of the above hypotheses becomes a hypothesis generating exercise: what are the specific factors that influenced chief-negotiators' win-sets and, hence, the design and implementation of IMF programs in Argentina and Uruguay? The review of the literature presented above has already highlighted a number of variables that may have played a significant role in this respect. Among the factors emphasized by the contributions that have concentrated on the international level of analysis, the interests of powerful states and of supplementary financiers, the extent to which creditors' preferences converged and the bureaucratic incentives of the Fund's staff and management stand out in particular. In turn, at the domestic level of analysis the number and preferences of veto players together with the factors that determine political actors' ability to cooperate in times of stress have been emphasized and will be taken into consideration in the upcoming case study analysis.

CHAPTER 3

Approximating the Contours of IMF Negotiators' Win-sets: Institutional Design and Rules in Multilateral Crisis Lending

What are the structural constraints that IMF officials faced in their negotiations with borrowing countries during the decade that followed the Mexican (Tequila) crisis of 1994? This chapter addresses this question in an attempt to provide a preliminary approximation to the contours of IMF negotiators' win-sets. This analysis is generic in the sense that it focuses on the constraints that should be expected to apply across the board, irrespective of the additional constraints that may be present in specific negotiations, which will be explored in subsequent chapters for the cases of Argentina and Uruguay.

Structural constraints can fall into two categories. First, IMF negotiators are structurally constrained by the arrangements that define their institution's decision-making process, through which their constituents interact to determine what level I agreements can be ratified. These arrangements constitute the structure within which the Fund's level II game unfolds. In this regard, the key issues that this chapter will try to clarify are which constituencies take part in the Fund's ratification process and what is the relative power that existing institutional arrangements provide to each of them. Second, IMF negotiators are structurally constrained by the rules present in this particular issue area. The decade under analysis witnessed significant changes in these rules given that after the Mexican and Asian crises the international community embarked on a coordinated effort to prevent future crises, and to deal with them as they occur (Rubin, 1998). The key aspects to be clarified are the content of the rules that emanated from this so-called reform of the International Financial Architecture (IFA), and whether these rules were clear and specific enough to have constituted a binding constraint on the discretion of IMF negotiators.

In order to address these issues, section 2.1 begins with a description of the decision-making process that governs multilateral crisis lending, introducing the constituencies that take part in this process as well as the distribution of power that is derived from the Fund's institutional design. Subsequent sections adopt a chronological approach to describe the gradual adoption of rules in the three areas that define multilateral interventions in emerging market crises: the provision of official finance (section 2.2), private sector involvement (section 2.3) and the design of policy conditionality (section 2.4). In order to do so, this chapter has relied primarily on IMF policy papers and on G7 and IMFC Communiqués.[27] Finally, the chapter concludes by offering an assessment of the significance of the Fund's institutional design and of the rules adopted in the context of the IFA initiative as determinants of IMF negotiators' win-sets.

3.1 Chief-negotiators, constituents and power at the IMF

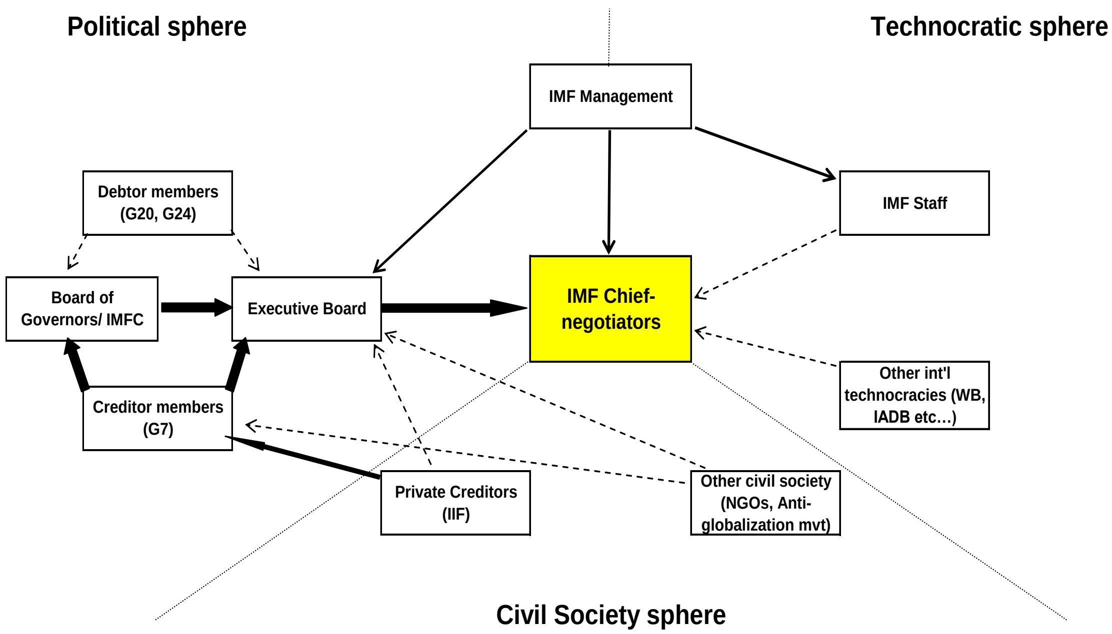
A first issue that needs to be clarified in order to analyse the power relationships that shape the framework within which the Fund's level II game takes place is who are the institution's chief-negotiators. Within the IMF's organizational chart, the five Regional or Area Departments (African Department, Asia and Pacific Department, European Department, Middle-East Department and Western Hemisphere Department) are responsible for the design of financial programs and, hence, conduct the negotiations with borrowing countries. Within these Departments, specific countries are covered by teams of economists headed by a mission chief who comes close to fulfilling the role of chief-negotiator contemplated in Putnam's two-level game framework. However, it is often the case that higher ranked officials do also take part in the negotiations, especially in more sensitive cases or in situations in which senior country officials such as finance ministers or heads of state are also involved. Under such circumstances the Regional Departments' Directors as well as the Fund's Managing Director and the Deputy Managing Director tend to participate in the negotiations with borrowing countries either directly or indirectly. To some extent and to varying degrees, therefore, the Fund's senior management shares the role of chief-negotiator with mission chiefs.

[27] Appendix B offers a more extensive description of the key measures that were adopted to reform the IFA during the decade under analysis.

There is a broad spectrum of actors that can have a more or less direct and influential part in the decision-making process through which the Fund's financial programmes are ratified. Chart 2.1 summarizes the actors that participate in this process as well as the relationships that link these actors. It distinguishes between three spheres of influence: a political sphere formed by national authorities; a technocratic sphere formed by IMF staff and by other specialized bureaucracies such as the World Bank or the regional development banks; a civil society sphere formed by private creditors' lobbies such as the Institute of International Finance (IIF) and by a loose group of activists and NGOs. Of these three spheres of influence, the political one is by far the most powerful, which reflects the fact that in the context of the limited accountability that tends to characterize international organizations, the Fund's architects assigned a great importance to the presence of a political counterweight constraining the discretion of international bureaucrats. Indeed, the remainder of this section as well as subsequent chapters treat member states' governments as the IMF's key constituents and, hence, as the actors determining which Level I agreements are ratified.

Figure 3.1

Actors and relationships in the IMF's decision-making process



Although the Fund's design is such that the political sphere of influence dominates the institution's Level II game, the role played by the actors belonging to the other two spheres of influence should also be acknowledged. The technocratic sphere of influence is particularly important because it constitutes a crucial source of legitimacy for the IMF. The Fund's central role in international monetary and financial affairs rests to a large extent on its staff's technical expertise, which is expected to underpin the decisions that are ultimately adopted by the formal decision making bodies described below.[28] In fact, all of the decisions adopted by the Executive Board are systematically supported by a technical document prepared by the Fund's staff.[29] This implies that even though some of the decisions that are ratified through the Fund's level II game may be political in nature, all of them need to be formally justified on technical grounds in one way or another. In this context, the Fund's management is often required to mediate between the political and the technocratic spheres of influence. In contrast, the actors that belong to the civil society sphere of influence do not have a formal role in the Fund's decision-making process neither at the negotiation nor at the ratification levels. However, private interests have occasionally managed to successfully mobilize for or against specific courses of action and the anti-globalization movement exerted a substantial pressure on the IMF in the aftermath of the Asian crisis, implying that this third sphere of influence should not be disregarded.

Focusing now on the formal decision making process, the Bretton Woods system relies on various forums to ensure national governments' control over the operations conducted by international civil servants at the IMF and the World Bank. The IMF's highest ranked body is the Board of Governors, where each of the Fund's 184 member states is represented individually either by a Finance Minister or by the head of the Central Bank. In principle, the role of the Board of Governors is to provide high level political endorsement, a sense of ownership and strategic guidance. In practice, however, due to its large size and to the fact that it only meets once a year, the Board of Governors' tends to focus on very general issues and is directly involved only in a few

[28] In addition, officials from other multilateral or national agencies have increasingly influenced the design of specific IMF interventions in recent decades, thus also taking part in this technocratic sphere of influence. The World Bank and the US Treasury have been particularly active in this respect, partly reflecting their role as "supplementary financiers", which has given them an implicit right to have a say on programs' conditionality (Gould, 2006).

[29] Although as mentioned above, the Fund's chief-negotiators belong to the regional departments, they may also rely on the expertise of functional departments such as the Research, Fiscal Affairs or Policy and Review Departments for the design of financial programmes. In fact, as we will see in Chapter IV on the Uruguayan financial crises, different departments may not always agree on the best strategy to address a specific financial crisis.

critical decisions such as the acceptance of new members, the revision of country quotas or the setting of income targets for the IMF (Santor, 2006). In this context, the Board of Governors has delegated most of its authority to other decision making bodies such as the International Monetary and Financial Committee (IMFC) and the Executive Board (EB).

The IMFC is an advisory forum with no statutory power of its own that functions as a bridge between the Board of Governors and the EB (Shakow, 2008). A first key feature that has enabled the IMFC to function as such a bridge is that it is formed by the most powerful Governors of the IMF and, therefore, has a sufficient leverage to make sure that the Board of Governors will almost systematically endorse its recommendations. A second key feature is that its constituency composition mirrors that of the EB. Therefore, the IMFC is small enough (24 members as opposed to 184 in the Board of Governors) to generate some meaningful discussions. Furthermore, each of the participants in the IMFC is hierarchically the superior of his constituency's corresponding Executive Director at the EB. In this context, it is not surprising that IMFC communiqués tend to be interpreted as guidelines on the strategic priorities to be followed by the EB and, consequently, by the IMF's management and staff (IEO, 2008a).

In its bi-annual meetings, the IMFC has usually acted either as an agenda setter or as the penultimate endorser of the final policy choices to be made by the IMF. In other words, the IMFC does usually become involved at the beginning and at the end of the process by which important decisions are made. This implies that the IMFC has tended to deal primarily with strategic issues such as the reform of the IFA rather than with the design of specific programs. However, the IMFC has occasionally also provided political endorsement to the Fund's interventions in some of the most prominent emerging market crises.

The day-to-day oversight of the Fund's operations is conducted by the Managing Director and by the Executive Board (EB). The Managing Director, which has traditionally been appointed by the European members of the EB, plays a crucial leadership role by interacting face to face with the heads of state and senior officials of the Fund's most influential members and by providing the institution with a sense of purpose and direction (Bossone, 2008).[30] In turn, the EB is a resident committee sitting in continuous session to "conduct the business of the Fund" (IMF Articles of Agreement, Article XII, Sections 3-4). It is formed by 24 Executive Directors (EDs), eight of which are appointed by a single country (the United States, Japan, Germany, France, the United Kingdom, China, Saudi Arabia and the Russian Federation), while the remaining 16 represent mixed constituencies of the other 176 members of the IMF.

An interesting feature of the Fund's institutional design is that, once appointed, Executive Directors become employees of the IMF and, at least de jure, should owe as much allegiance to the institution as to their governments. Such an institutional design was agreed upon at the Bretton Woods conference in order to foster the IMF's role as a genuine technocratic provider of international public goods (Gianviti, 1999). Indeed, during its first decades of existence, the EB enjoyed a fair amount of autonomy, at least from principals other than the US. However, in more recent decades, and partly as a result of the development of modern communication technologies, the Board has lost much of this independence (Martinez-Diaz, 2008). This means that, nowadays, most of the positions defended by Executive Directors have been coordinated with their corresponding national authorities. The extent to which capitals are eager to influence the positions of their Executive Directors depends on whether the issues discussed at the EB directly affect their national interest, which tends to be the case for large rescue packages or for important strategic decisions such as those concerning the IFA initiative.

Each of the EB chairs has a voting power which is determined on the basis of the country quotas of the members that are represented in it, plus the combined number of basic votes assigned to them (see Figure 3.2).[31] These quotas, therefore, allocate power among constituents within the political sphere of influence of the IMF. However, formal voting is rare at the EB and only used as a last resort if the Chairman (the Managing Director) cannot informally ascertain what in IMF jargon is referred to as 'the sense of

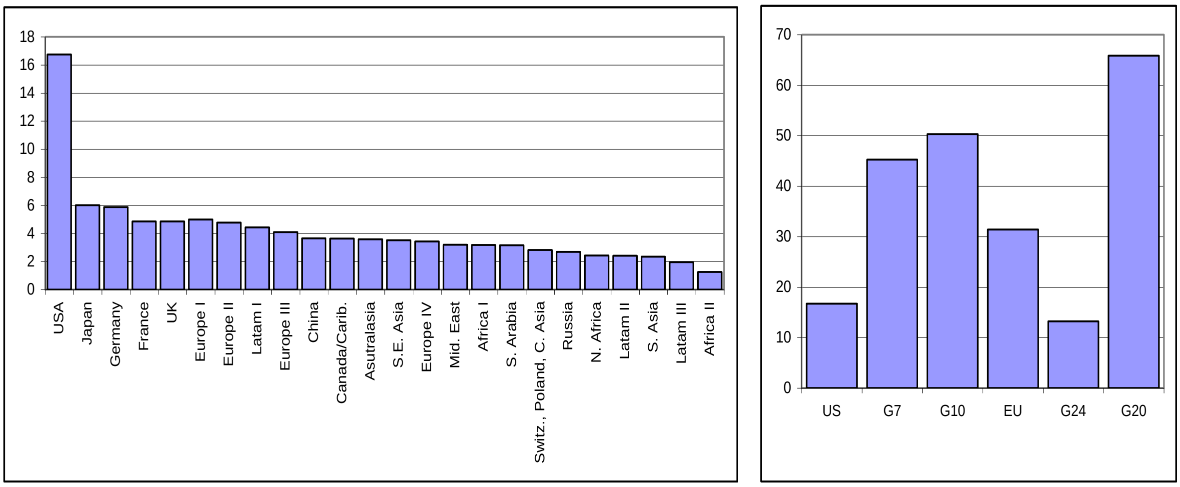
[30] The IMF has had three Managing Directors during the period under analysis: Michel Camdessus from 1995 to May 2000, Horst Kohler from May 2000 until June 2004, and Rodrigo Rato thereafter.

[31] Basic votes are assigned to individual countries irrespective of their country quota. This was the instrument used in the original design of the IMF to mitigate disparities in members' voting power. However, throughout the Fund's history, basic votes have remained constant, while country quotas have been regularly reviewed. As a result, the weight of basic votes has decreased over time, which has intensified disparities at the Board. In order to mitigate these disparities, the number of basic votes has been recently tripled.

the meeting'. Partly because of this consensus-based decision-making culture, and partly because as members of a resident committee Executive Directors are closely involved in the day-to-day operations of the IMF, what precedes EB meetings is at least as important as what happens during these meetings. Indeed, the Board's decisions are largely based on a continuous deliberation in which Executive Directors interact among themselves and with their corresponding country authorities, with the Fund's staff and with the Managing Director. Ultimately, most EB meetings do simply provide a seal of approval on decisions on which a sufficient support has been secured in advance (IEO, 2008a). As a result, informal practices are a central element of the Fund's governance, which is one of the reasons why the US government wields so much influence over the Fund (Stone, 2008).

Figure 3.2

Voting power of constituencies and of selected coalitions at the EB (% of total)



Source: IMF

In spite of this consensus decision making culture at the EB, quotas remain crucial to assess whether a sufficient support has been gathered to ratify specific courses of action. The Fund's Articles of Agreement establish that different types of decisions require different majorities. Those decisions that do structurally affect the IMF as an institution or the functions that it performs require special majorities of 70% or 85%. Instead, those decisions that are related with individual country programs require only simple majorities. As can be seen in Figure 3.2, the United States is the only country with a quota large enough to exert a veto power over decisions requiring an 85% majority. For all other decisions, cross-constituency coalitions need to be formed in order to ratify a specific course of action. Such coalitions can emerge on a case by case basis depending on the issues that are being debated.

However, a number of stable coalitions with a voting power equivalent to the combined quotas of the countries that take part in them have tended to dominate the Fund's decision making process. Of these, the most powerful one has unambiguously been the G-7, whose combined quota was close to 47% during the decade under analysis, enabling its members to form winning decision-making coalitions for almost all the issues that were debated at the EB.[32] This was facilitated by the fact that the G-7 is formed by a compact group of relatively homogenous creditor countries with aligned interests at the IMF. Therefore, and although as this and subsequent chapters will illustrate the world's richest countries have not always agreed, the G-7 constituted the key locus of power for issues such as the IFA initiative, the allocation of IMF credit and the design of specific financial interventions in important emerging markets.

There are various mechanisms through which the G-7 countries coordinate their positions. At the highest level, the periodic ministerial and leaders' meetings have played a crucial endorsement role for the more strategic decisions regarding the Bretton Woods institutions. In fact, it is certainly not a case that G-7 ministers have traditionally met prior to the joint IMF-World Bank spring and fall meetings.[33] For those decisions that affect specific financial interventions in crisis countries, the G-7 deputies conference calls have also played a prominent role (Woods and Lombardi, 2006). Finally, the G-7 Executive Directors meet on a regular basis to coordinate their positions in the most sensitive discussions held at the EB.

Another important creditor coalition at the EB is that formed by the members of the European Union, whose combined voting power exceeds 30% of total, thus enabling it to veto all the decisions of structural importance for the IMF. In order to reach a unified position and to exploit this collective voting power, the European governments have

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[32] As a result of recent reforms, the combined quota of the G-7 has fallen slightly, currently amounting to about 45% of total.

[33] To a large extent, these G-7 meetings have been aimed at coordinating positions prior to the IMFC meetings, which implies that IMFC communiqués can to some extent be interpreted as a reflection of the G-7 positions: "once the G-7 ministers have agreed on a position, they seek a broader endorsement for it through the IMFC" (Shakow, 2008).

relied on forums such as the Economic and Financial Affairs Council (ECOFIN) and its Sub-Committee for IMF issues (SCIMF) or the International Relations Committee (IRC) of the European Central Bank. In addition, the EURIMF gathers the European Executive Directors in Washington DC.

In spite of this complex coordination infrastructure and of its large combined voting power, the European coalition has not been able to match the influence exercised by the US government on the IMF (Woods and Lombardi, 2006; Bini Smaghi, 2006). To a large extent, this has been due to a lack of consensus among European countries on IMF issues neither with regard to fundamental reforms nor with regard to specific interventions in emerging markets. In addition, the French, German, British and Italian governments have tended to prioritize their participation in the G-7, which has somewhat undermined the broader European efforts to consolidate a unified position at the Fund. Nevertheless, as we will see below, on some occasions the European coalition has tried to overcome its differences in order counter US power at the IMF. This has tended to be the case in situations in which the US was perceived to be using the system to pursue narrow national interests or when the largest European governments did not share the US preferences regarding the reform of the IFA.

As opposed to the creditor coalitions described above, debtor nations lack a coalition with sufficient voting power to tip the balance in the Fund's decision-making process. A case in point is the Inter-Governmental Group of 24 or G-24, created in 1971 to coordinate the positions of the developing world in international monetary and financial issues.[34] The G24 has reached a very limited relevance in the overall multilateral decision making process for various reasons. First of all, its combined voting share at the EB does not surpass the 15% threshold that is required to block the most important decisions adopted by the IMF's governing bodies. Second, the members of the G-24 often have a small share of voting power within the multi-country constituencies in which they are represented at the EB. As a result, even if the G-24 reaches a consensus on a particular issue, its members struggle to have their positions voiced at the EB because that requires going through another difficult layer of policy coordination with

[34] The G-24 is formed by Algeria, Argentina, Brazil, Colombia, D.R. Congo, Cote d'Ivoire, Egypt, Ethiopia, Gabon, Ghana, Guatemala, India, Iran, Lebanon, Mexico, Nigeria, Peru, Pakistan, Philippines, South Africa, Sri Lanka, Syria, Trinidad and Tobago and Venezuela.

the countries with which they share their constituency. Third, these countries have often lacked cohesion, which is largely due their divergent interests in financial affairs (Shakow, 2008). Indeed, the G-24 includes both low income countries very mildly integrated in international financial markets and some of the middle income countries that have attracted the bulk of emerging market finance over the last two decades. Another coalition of developing countries is the G-11, which gathers Executive Directors from developing countries. As the G-24, the G-11 is hampered by its low combined voting power and by the heterogeneity of its members. A more fruitful attempt at mobilizing the capabilities of developing countries was the creation of the G-20 in 1999, which brought together the G-7 countries with systemically relevant emerging economies. However, the G20 has only recently begun to play a central role in international financial affairs, which is why this chapter takes little notice of it.

Summing up, with its reliance on the quota system, the Fund's design has consolidated a highly asymmetric distribution of power between the institution's constituents. It is somewhat paradoxical that this system of quotas was originally designed upon the 'principle of mutuality' (Giannini, 2002). Indeed, the basic idea that underpinned the concept of the IMF as a credit union was that members' right to borrow from their peers from time to time should constitute a corollary of their commitment to lend at other times, which would ensure the revolving nature of the Fund's resources (Kenen, 1986). In order to ensure that such a system would treat members uniformly, both this right to borrow and this commitment to lend were defined in terms of objective quotas reflecting member's weight in the world economy on the one hand and the potential scale of their balance of payment needs on the other hand. The adoption of such a lending framework, therefore, was based on the presumption that all members had broadly homogenous interests and expectations. This may have constituted a relatively realistic assumption during the first decades of operation of the IMF in the context of a smaller membership, limited convertibility and fixed-but-adjustable exchange rates.

However, as new members joined the Fund and as the Bretton Woods monetary system was dismantled, it became increasingly rare for advanced economies to borrow from their peers, which consolidated an increasingly large category of systematic debtors among emerging and developing economies.[35] This trend has marginalized debtors for two reasons. First, the principle of mutuality on which the quota system was originally designed has ceased to operate in practice, turning the framework governing the IMF into an ineffective mechanism to mediate between members' increasingly heterogeneous interests. Second, the combined voting power of systematic debtors has fallen drastically over the years: while the added quotas of the countries that borrowed at least once from the IMF during the 1950s was close to 50% of total, in between 2000 and 2006 it did not surpass 17% (Irwin et al., 2008). As a result, those borrowing countries that were more dependent on multilateral crisis lending during the decade under analysis were also the constituents that had a lesser capacity to influence the Fund's decision-making process.

Official finance

During the first years of the IFA initiative, international policy-makers focused primarily on upgrading the facilities and institutional mechanisms by which financial assistance could be made available to countries in distress. This process was heavily influenced by the Mexican financial crisis, which was interpreted early on as a turning point both in the way future crises were to unfold in emerging economies and in the way the international community was to deal with them (Calvo, 1998). Indeed, the rescue package provided jointly by the IMF and the US Treasury was much larger than any previous crisis resolution programme in history: US$48 billion, a substantial part of which was made available almost immediately in order to cover Mexico's short-term sovereign obligations.[36] Ultimately, this bailout can be considered a success in the sense that it prevented a disastrous sovereign default from happening, that macroeconomic stability, growth and access to international financial markets were restored relatively fast and that the loans provided by the IMF and the US Treasury were repaid ahead of schedule.[37] It is in this context that the so-called Rubin Doctrine of International

[35] Most developing countries joined the IMF in 1960s, with the bulk of transition economies joining in the 1990s. Until the recent Icelandic program, Italy and the United Kingdom were the last countries to have borrowed from the IMF in 1976.

[36] Of these, the United States provided about US$ 30 billion and the IMF the remaining US$18 billion.

[37] However, it is worth noting that the Mexican bailout was not free from criticism. Indeed, several conservative economists argued that this rescue package severely distorted incentives in the international financial system and enabled the Mexican authorities to postpone a necessary restructuring of the domestic financial system, thereby increasing the long-term cost of the crisis for the domestic economy (Calomaris, 1998; Vásquez, 2002).

Finance began to take shape: in a world of free capital mobility, the official sector should stand ready to provide exceptionally large volumes of financial assistance in the event of a sudden stop in capital flows so as to bridge emerging markets' liquidity needs and restore investors' confidence. In Rubin's words: "Money is no substitute for strong policy, but there are times when it is more costly to provide too little money than to provide too much" (Rubin and Weisberg, 2003: 251).

Nonetheless, the Mexican bailout did also leave many policy-makers on both sides of the Atlantic with a sour aftertaste which contributes to explain the dynamics of the debate that followed. In the US, the Congressional battle to mobilize the resources needed to rescue Mexico was fierce. Eventually, the Treasury took the controversial move of circumventing Congressional opposition by using the Exchange Stabilization Fund (ESF) to intervene in this crisis.[38] Given that the US Congress subsequently retaliated with the imposition of constrains on the Treasury's ability to tap the ESF (the so-called d'Amato restrictions), one of the Clinton administration's priorities in the aftermath of the Mexican crisis was to create mechanisms to multilateralize financial rescue packages (Roubini and Setser, 2004). This would serve the double purpose of implementing the Rubin doctrine while at the same time reducing the amount of resources to be provided bilaterally by the US.

In Europe, however, the Mexican bailout was interpreted as an abuse of power on the part of the US, providing further evidence of the American propensity to use International Financial Institutions to pursue its own narrow national interests. The European members of the G-7 were outraged to have been excluded from the decision to provide Mexico with an IMF program three times as large as any other one in the institution's history (Rubin and Weisberg, 2003).[39] This constitutes a central factor behind Europe's subsequent insistence on the importance of a rules-based IFA framework with which it often opposed the Clinton administration's emphasis on flexibility. In other words, experience with the Mexican bailout shaped the Fund's

[38] The ESF is an emergency fund created in the 1930s for foreign exchange intervention purposes. Following a reform in the 1970s, the US Treasury Secretary gained discretion over the use of the ESF resources.

[39] As a result to the discontent with the American interventionism during this episode, 6 European Executive Directors abstained from voting at the EB meeting in which the Mexican program was approved (Rubin and Weisberg, 2003).

major constituents positions in the debate on whether rules or discretion should determine crisis countries' access to official credit.

Given the importance that it attached to the policy implications of the Mexican crisis, the Halifax G-7 Summit of June 1995 can be considered to have officially launched the IFA initiative. As regards the role to be played by multilateral financial assistance in the international architecture, two were the immediate priorities identified by the G-7 leaders at that time: accelerating the speed at which the IMF could intervene to address an emerging market crisis and increasing the Fund's overall lending capacity (Group of 7, 1995). In order to address the first of these objectives, the so-called Emergency Financing Procedure was introduced by the EB in September 1995. This procedure was aimed at fast-tracking negotiations with countries facing an exceptionally urgent need for IMF assistance. Essentially, it contemplated a series of measures to bring about an early dialogue between governments, the EB and staff and ensure that a quick agreement could be reached on some critical aspects of financial programs such as the appropriate level of access to the Fund's resources or the conditionality to be attached to these loans (Kenen, 2001). During the decade under analysis, the Emergency Financing Procedure was activated five times: for the Philippines, Indonesia, South Korea and Thailand in 1997 and for Turkey in 2001. In turn, the pool of resources available for crisis lending was to be expanded in two ways: doubling the size of the General Agreements to Borrow (GAB) and completing a new quota review to increase member states' contributions to the IMF.[40] However, the implementation of these two measures eventually lagged behind as the international community and/or national legislatures (i.e., the US Congress) could not agree on their concrete terms once the pressures exerted by the Mexican crisis gradually waned (Roubini and Setser, 2004).

In fact, the G7 Lyon and Halifax Summits' Communiqués made little mention to measures related with the reinforcement of the multilateral financial safety net, reflecting the period of relative calm that preceded the devaluation of the Thai Baht in July 1997 (Group of 7, 1996; Group of 7, 1997). However, the Asian financial crisis

[40] The GAB constitutes a network of bilateral borrowing agreements between the IMF and a number of industrial economies which can be used in case of an emergency in the international financial and monetary system. This financing scheme dates back from 1962, committing 11 participating countries to lend an amount of hard currency specified in advance. The key goal of the GAB was to complement the IMF's lendable resources in case of need.

provided the stimulus that was needed to reignite the multilateral effort to reform the IFA. First of all, the two aforementioned measures to increase the Fund's lending capacity were implemented. The New Agreements to Borrow (NAB) entered into force in November 1998 to complement the GAB, jointly constituting a US$48 billion backup credit line to the IMF.[41] In addition, the US Congress finally approved a pending increase of the US subscription at the IMF, which was instrumental to bring the 11th review of IMF quotas into effect. As a result, the IMF's lending capacity was expanded by more than 50%. On top of these two measures, the Asian financial crisis brought about the adoption of other significant innovations in the IMF's financial intervention toolkit. Of these, the introduction of the Supplementary Reserve Facility (SRF) in December 1997 and the creation of the Contingent Credit Line (CCL) on April 1999 were of particular relevance.

The SRF was aimed at providing the IMF with an instrument to address "exceptional balance of payments difficulties due to a large short-term financing need resulting from a sudden and disruptive loss of market confidence reflected in pressure on the capital account and the member's reserves" (IMF, 2000a). In other words, the SRF was targeted at crises rooted in a sudden stop in capital flows, fully bringing the Rubin doctrine of international finance into implementation. This normalized the exceptionally large interventions that were approved on an ad hoc basis to address the Mexican, Thai or South Korean crises (Kenen, 2001).

As such, the SRF did not really constitute a new independent facility in itself, but a mechanism to complement the reserves provided under the traditional Stand-By Arrangements (SBAs), allowing the overall amount of resources made available to the crisis country to surpass the "normal" access limits contemplated by the Fund's lending rules.[42] This higher level of access, however, was to carry demanding financial conditions. Indeed, countries borrowing under the SRF would be expected to repay faster than under other more traditional facilities. Furthermore, the SRF was to carry a surcharge of 300 basis points over the Fund's normal lending rate, which would

[41] The NAB was signed with 25 countries and, therefore, is much broader than the GAB. The reason why the NAB was created instead of enlarging the GAB is that the countries participating in the GAB were unwilling to dilute their control over this line of credit (Kenen, 2001).
[42] Up until the 2009 review, normal limits to the IMF resources were of 100% of quota annually or 300% of quota cumulatively.

gradually increase up to a maximum of 500 basis points. This emphasis on the provision of incentives for early repayment reflects the underlying belief that briefly covering up for a temporary loss of access to international financial markets would be sufficient to catalyze rapid turnarounds in investors' confidence (Roubini and Setser, 2004).[43]

In turn, the CCL pursued the goal of preventing the sort of contagion episodes that had swept through the emerging world in the aftermath of the August 1998 Russian default. As opposed to the Fund's traditional facilities, the CCL would be negotiated prior to a balance of payment need actually taking place, explicitly insuring members against the risk posed by international spill-overs and other shocks to the international financial system beyond their control. In order to articulate such an insurance scheme, the new facility was made subject to a new type of ex ante conditionality instrumented through a number of pre-qualification criteria. In this way, access to the new facility was restricted to countries having received a positive assessment in the Fund's yearly bilateral surveillance exercise (Article IV Consultation). Potential signatories, therefore, were required to be implementing policies unlikely to give rise to a balance of payment problem, to be making progress with the standards and codes initiative and to maintain a constructive relationship with their private creditors. [44] In other words, the CCL was designed for countries in a rather solid situation, but facing vulnerabilities stemming from their growing integration in international financial markets. As regards the new facility's financial conditions, the signing of the CCL was subject to a 'commitment fee' charged before the member made actual use of the Fund's resources. Once activated, the financial terms of the CCL were similar to those of the SRF both in terms of maturity and in terms of cost.

The CCL, however, was never requested by any country, turning this facility into one of the most resounding failures of the IFA initiative. On top of its demanding financial terms and qualification criteria, there are various factors that explain the failure of the CCL. First of all, it did not provide automatic access to the IMF resources given that the

[43] However, in recognition of the fact that overcoming a capital account crisis might take longer than envisaged in the design of the SRF, the new facility allowed for semi-automatic roll-overs enabling countries to post-pone repayments if their balance of payments position remained weak at the time of the expiration of the SRF.

[44] The Standards and Codes initiative was jointly launched by the World Bank and the IMF in the context of the IFA initiative. It was aimed at assisting countries in the reinforcement of their economic institutions and to produce better and more readily available financial data.

first disbursement under a CCL required the EB to agree on an ‘activation review’. As a result, it was argued that the difference between this and other more traditional ‘ex post’ IMF facilities was more apparent than real. In addition, several emerging markets voiced concerns about the so-called entry and exit problems associated with the CCL. The entry problem referred to the fear that investors may interpret the request of a CCL as a sign of weakness rather than a sign of strength, thereby pressing sovereign spreads upwards. In spite of the intense diplomatic efforts undertaken to convince potential signatories to request the CCL, no country was ever willing to be the first to take that risk. The exit problem, in turn, referred to the fear that losing eligibility to the CCL may have a devastating impact on market access, precipitating the very financial crisis that it was aimed at preventing (Díaz-Cassou et al., 2006). In spite of the various attempts to reform the CCL, it was eventually allowed to expire in 2003.[45]

In any case, as the financial turmoil that characterized the late 1990s did gradually subside there was a tendency to re-assess the merits of international rescue packages. During these years a growing awareness developed among academics and policy-makers about the potential distortions that bailout expectation could induce on sovereign debtors’ and private creditors’ incentives (Calomaris, 1998). In fact, some observers went as far as arguing that the Mexican bailout had induced such a disregard to the risks associated with emerging market finance that it was a crucial factor to explain the Asian financial crisis (Friedman, 1998).

In order to mitigate this moral hazard problem, the G-7 Cologne and Okinawa Summits emphasized the need to involve the private sector in the resolution of financial crises (see below) and to clarify the rules governing access to IMF resources (Group of 7, 1999; Group of 7, 2000). However, the real turning point of the IFA initiative took place in January 2001 with the change of administration in the US. After all, Republicans had opposed large scale IMF interventions ever since the Mexican rescue package and soon after taking office the Bush administration made it clear that the US was about to profoundly reorient its IMF policy. Illustrating the ideological stance of the Bush administration, John Taylor, the new Undersecretary of the Treasury for

[45] Efforts to introduce a genuine insurance facility have continued after the failure of the CCL. However, it is not until the most recent global financial crisis erupted that the IMF has been able to successfully launch such an instrument: the so-called Flexible Credit Line.

International Affairs, had gone as far as calling for the abolition of the IMF in the 1990s. In his memoirs, the first Treasury Secretary of the Bush administration, Paul O'Neill, summarizes the Republican critique to Clinton's policies: "Many conservative economists (…) felt the international lending of the Clinton era had placed too much of taxpayer's money at risk and done more risk than good (…) The Rubin and Summers gravy train, they felt, created a moral hazard problem."(Suskind, 2006: 173).

Two were the main measures subsequently promoted by the US in order to limit international crisis lending. First of all, a policy of not topping up IMF programs was adopted early on by the Bush administration (Roubini and Setser, 2004).[46] Ultimately, the other G7 countries also embraced this principle during the G8 Finance Ministers meeting held in Rome in 2001 (Group of 7, 2001). At least de jure, this measure completed the multilateralization of rescue packages while consolidating the Fund's lending capacity as an overall cap on international crisis lending. Second, the US began to advocate for tightening the criteria determining the circumstances in which countries in distress should be allowed to borrow above normal access limits. This move was expected to reduce the uncertainty surrounding multilateral rescue packages which, in the view of some senior officials in the US administration, had aggravated previous crises by rendering investors' expectations even more volatile (Taylor, 2007a). In addition, it was aimed at limiting the size of these loans, restricting the use of high access programs to very specific circumstances and mitigating potential moral hazard distortions. Eventually, this resulted in the adoption of the so-called exceptional access framework by the EB in September 2002 and October 2003 (IMF, 2002b).

The exceptional access framework defined four criteria for the IMF to lend above normal access limits. First, members should be experiencing exceptional pressures in their capital account. Second, their debt should be sustainable and expected to remain so in the future. Third, they should have a high probability of regaining access to international financial markets quickly after the IMF's interventions. Fourth, the policy roadmap backing these IMF program should have a strong prospect of success. In order to assess whether each of these criteria were met, additional safeguards were established on the IMF's decision-making procedure in order to foster accountability and a higher

[46] However, as we will see in Chapter IV, the US government breached this policy during the Uruguayan crisis.

burden of proof. In this way, the exceptional access framework was trying to restrict large access programmes to quite a specific setting: for crises of liquidity and not of solvency, and for countries with strong policies in place and, thereby, a high likelihood of being able to catalyze private capital inflows through a large IMF intervention. Because this framework was aimed at dealing with such a specific type of crises, it was presented as part of a broader effort to adapt the IMF's policies, the other side of the coin being the development of new mechanisms to involve the private sector in the resolution of emerging market crises.

Private Sector Involvement

Private sector involvement (PSI) refers to the efforts undertaken by private creditors in order to help prevent, mitigate or overcome a financial crisis. PSI actions are instrumented through an agreement between private creditors and their debtors to partially write off outstanding credits, to reduce interest payments, or to lengthen repayment schedules (International Relations Committee Task Force, 2005).[47] Even though these actions are likely to influence the secondary market value of specific debt instruments, the losses (or gains) stemming from such fluctuations are not considered PSI because they don't affect the country's debt burden or its repayment profile.

There is a wide array of actions through which private creditors can be involved in the resolution of an emerging market crisis. On the mildest end of the spectrum in terms of coerciveness, certain specific categories of creditors may agree to rollover their loans, to maintain their exposure to a given country or to take part in a pre-emptive voluntary debt exchange aimed at re-establishing the sovereign's creditworthiness and avoid future losses. On the most coercive end of the spectrum, the sovereign may simply opt to declare a moratorium on the servicing of its obligations, forcing private creditors to absorb losses and in so doing restore debt sustainability (Cline, 2002).

[47] Although the term PSI is relatively recent, the IMF had already tried to share the crisis resolution burden with the private sector before. During the 1980s, for instance, the IMF did often require private banks to "involuntarily" lend to crises countries in order to provide multilateral financial support. The Brady Plan which ultimately solved the debt crisis was another coordinated PSI exercise promoted by the IFIs and the US Treasury.

PSI is to be distinguished from catalytic official finance (COF), which refers to the idea that "the announcement of an economic programme backed up by a limited amount of IMF resources (as compared to the size of potential capital outflows) may increase the propensity of investors to lend to the country concerned" (Cottarelli and Giannini, 2002: 6). PSI and COF are closely related concepts because both refer to international investors' actions that contribute to close a country's financing gap. However, these actions are different in nature in the sense that whereas COF is a spontaneous reaction to an IMF program, PSI entails altering debt contracts in a way that is possible only if creditors are collectively convinced or constrained to relieve the pressures undergone by their debtor.

In the immediate aftermath of the Mexican crisis, relatively little attention was paid to PSI as a crisis resolution instrument. To a large extent, this reflects the prevailing optimism about COF embodied in the aforementioned Rubin doctrine of international finance: private creditors would not need to be bailed-in because they were expected to spontaneously respond to an IMF program by maintaining their exposure to the crisis country. However, even at this early stage in the IFA initiative, some academics were already exploring the potential for PSI to substitute large Mexican style rescue packages. As early as 1995, Jeffrey Sachs argued that IMF practices should be reorganized in order for the institution to "play a role far more like an international bankruptcy court and far less like the lender of last resort to member governments" (Sachs, 1995: 14). This triggered a short-lived debate on the possibility of replicating a Chapter 11 procedure for sovereigns at the international level.

However, this proposal was considered impractical early on by the G-10 when the so-called Rey Report on the Resolution of Sovereign Liquidity Crises was endorsed in 1996 (G-10, 1996). Among this report's various recommendations, it is worth noting that the possibility of promoting the inclusion of Collective Action Clauses (CACs) in bond contracts was contemplated for the first time. As is described below in more detail, this is an option that was to capture policy-makers' attention years later. At that time it fell into oblivion relatively soon given that the international community was focused on the provision of emergency financial assistance as the main instrument to address emerging market crises.

As mentioned above, the Asian financial crisis raised awareness about the potential for PSI to mitigate the moral hazard problem potentially associated with large rescue packages, the idea being that only if private creditors were forced to absorb part of the cost of a crisis would they devote sufficient resources to evaluate and monitor their investments' risk. Another reason behind the international community's emphasis on PSI at that juncture is that, as opposed to the Mexican crisis, a distinctive element of various Asian countries' crisis resolution strategies was precisely their successful attempts to bail-in external private creditors. In particular, this was the case of South Korea, where an agreement reached with a group of international commercial banks to maintain their exposure to that country, and not so much the Fund's rescue package in itself, constituted the turning point of the crisis (Blunstein, 2003). Such an agreement was made possible by an unprecedented concerted effort on the part of the G-10 monetary authorities, which exerted moral suasion on the banks under their jurisdiction to roll-over the cross-border short-term inter-bank loans that were at the origin of the Korean crisis (International Relations Committee Task Force, 2005). This experience convinced the G-7 to initiate discussions on how to incorporate PSI into crisis resolution policies. In fact, the May 1998 G-7 Birmingham Communiqué was the first to insist on the need to achieve an appropriate burden sharing between the public and the private sectors' contributions to the resolution of financial crises. (Group of 7, 1998).

A first consequence of this change in tone was the reform of the Policy of Lending Into Arrears (LIA) ratified by the EB on October 1998. This policy was originally introduced in 1989 to abolish the non-toleration of sovereign arrears that had traditionally characterized IMF programs. It basically legalized the Fund's loans to countries in arrears with commercial banks as long as a negotiation process could be discerned between sovereigns and their creditors (IMF, 1999). The 1998 reform, in turn, broadened the scope of the LIA policy, encompassing arrears on bonded debt and thereby acknowledging the changing composition of capital flows toward emerging markets that had taken place during the 1990s. The basic criterion conditioning these LIA programs was also modified in order to soften what came to be perceived as a private creditors' pseudo 'veto power' over the Fund's lending decisions: the requirement of an on-going negotiation process to have started for the IMF to lend into arrears. Instead, under the reformed policy, countries would only be required to be making a 'good faith effort' to reach a collaborative agreement with their creditors. This reform paved the way for a much more active IMF involvement in the new generation of sovereign debt restructurings that were expected to take place in a world of securitized debt. However, the 1998 reform was partial in the sense that it did not systematize the role that LIA programs were to play during a debt restructuring or to specify the channels through which the IMF could influence the outcome of solvency crises (Díaz-Cassou et al., 2008).

It was not until the Cologne Summit of 1999 that the G-7 began to outline the principles and tools required to articulate a comprehensive strategy for PSI. In this exercise, the G-7 tried to reconcile two apparently contradictory principles: that in order to promote market discipline, prudent lending and thorough risk assessment, the conditions should exist for creditors to absorb occasional losses, and that governments incentives to meet their obligations in full and on time should not be undermined by PSI (Group of 7, 1999). In order to do so, the Summit's Communiqué established that the appropriate role to be played by the private sector would depend on the gravity of each crisis and on the nature of outstanding debt instruments. Where possible, an emphasis would be placed on "market-based, voluntary solutions". However, the Communiqué did also envision situations in which "more comprehensive approaches may be appropriate to provide a more sustainable future payments path".

One of the tools originally contemplated by the G-7 to promote PSI was the imposition of an international reserves floor in IMF programs. Such a floor would function as a pseudo trigger forcing debtors and their private creditors to negotiate in order to avoid the suspension of the Fund's financial support should the intensity of liquidity pressures reach a certain critical point. In addition, the G-7 proposed the establishment of more explicit conditions linking the provision of official financial assistance with countries' efforts to seek voluntary commitments of support from private markets or to restructure and refinance outstanding obligations. One of the first practical implications of the mandate set out by the G-7 in Cologne was the adoption of the so-called 80/20 rule. Under this rule, countries under an IMF program would have to restructure 80% of the obligations coming due during the duration of the program (Roubini and Setser, 2004)[48].

[48] This contributes to explain why Ukraine was asked to carry out a partial debt-restructuring in 1999 and why Ecuador did not receive the Fund's financial support until it defaulted in October of that same year.

In addition, the G-7 entrusted the IMF with the task of working out the technical and legal details associated with the various PSI options contemplated in the Cologne Communiqué. The months that followed this Summit, therefore, witnessed an intense effort on the part of IMF officials to come up with a coherent multilateral framework for the inclusion of private creditors in the resolution of financial crises. On November 1998 the US Congress did also establish its own advisory commission named after its chair, Allan Meltzer, which was to come up with recommendations about the future role to be played by the IMF, the World Bank and the other regional development banks. In the realm of the official finance vs. PSI debate, one of the Meltzer Report's most important recommendations was that the IMF should limit its crisis resolution financial role to that of a quasi-lender of last resort, lending at short maturities and a penalty rate only to solvent members having temporarily lost access to international financial markets (International Financial Institution Advisory Commission, 2000). What matters to this analysis is that suspending or restricting the provision of official financial support to countries with an unsustainable debt burden did implicitly assign PSI a central role in the resolution of solvency crises.

These various arguments were wrapped by the G7 in the fall of 2000, when the so-called Prague Framework for Crisis Resolution was disclosed at the annual IMF-World Bank meetings. This framework did essentially distinguish between three possible scenarios: (i) A pure liquidity crisis in which "the combination of catalytic official financing and policy adjustment should allow the country to regain full market access quickly"; (ii) Intermediate cases in which the "emphasis should be placed on encouraging voluntary approaches, as needed, to overcome credit coordination problems". (iii) Pure solvency crises in which "the early restoration of full market access (…) may be judged unrealistic, and a broader spectrum of actions, including comprehensive debt restructuring, may be warranted. (…) in certain extreme cases, a temporary payments suspension or standstill may be unavoidable" (International Monetary and Financial Committee, 2000).

The 80/20 rule, however, was dropped relatively soon as the focus was shifted to medium-term debt sustainability.

Therefore, the Prague framework interpreted financial crises as a continuum from the pure illiquidity scenario to the pure insolvency one. The closer to an illiquidity crisis, the more the IMF was to resort to catalytic official finance. Conversely, the closer to a pure insolvency scenario, the more the IMF was to resort to PSI measures such as standstills and comprehensive debt restructurings. In turn, in intermediate scenarios a combination of the two would have to be applied, the IMF providing official finance to be complemented by less coercive PSI measures (inter-bank concerted roll-overs, pre-emptive market-friendly restructurings, etc…). This finally provided a complete albeit broad roadmap to guide IMF's intervention in emerging market crises and to shape agents' expectations. However, the framework did not specify how the international community was to judge the degree of solvency of a country, which generated an important element of ambiguity.[49]

As mentioned above, after the Bush administration took office in January 2001, the debate on PSI further intensified because a corollary to the new policy of limiting the availability of international rescue packages was that other mechanisms would have to be sought in order to address debt overhangs. It is in this context that Paul O'Neill publicly argued in favour of a new 'international bankruptcy law' in September 2001 and that the new First Deputy Managing Director of the IMF Anne Krueguer proposed the creation of a Sovereign Debt Restructuring Mechanism (SDRM) in November of that same year (Suskind, 2004). The rationale behind that proposal was that the securitization of sovereign debt had made it more difficult to coordinate private creditors in the event of an insolvency crisis and, therefore, more difficult to carry out an orderly debt restructuring. As a result, it was argued that debtors in distress tend to 'gamble for redemption', postponing the inevitable as much as possible, and increasing the ultimate cost of the crisis both for domestic economies and for international investors. An SDRM, instead, would be instrumental to bring about prompt collective action to deal with unsustainable debt burdens, "helping preserve asset values and protect creditors' rights, while paving the way toward an agreement that helps the debtor return to viability and growth" (Krueguer, 2002: 2). Essentially, the SDRM

[49] Partly in order to address this ambiguity, the IMF has developed various debt sustainability analysis templates and methodologies after the Prague framework was agreed upon. However, because the scale of the financial assistance provided by the IMF can be such a relevant element to determine the ex post solvency of a country, basing the design of financial programs on countries' ex ante solvency introduces an element of circularity which is difficult to solve.

proposal revisited Sachs' idea of an international bankruptcy court, incorporating features that would entitle the IMF or another international body to sanction a standstill on debt payments, deter creditors from litigating during a 'legitimate' restructuring and bind all creditors to the restructuring terms agreed with a qualified majority of them.

The SDRM proposal was extensively debated in 2002 and 2003. However, in spite of Paul O'Neill's initial enthusiasm, the SDRM did eventually fail to gather the support that would have been necessary for it to be adopted. For a start, there was a lack of consensus about its desirability even within the US administration. Indeed, ever since it was proposed, the influential Under Secretary of the Treasury for International Affairs, John Taylor, advocated for other contractual market-based decentralized alternatives to the creation of an SDRM (Taylor, 2002a). Partly as a result of the pressure exerted on them by private financial institutions, the other members of the G-7 were also rather tepid in their support to the SDRM initiative. The main concern was that such a scheme could have been tantamount to making it easier for emerging economies to breach their contractual obligations. In the absence of other enforcement mechanisms applicable to international debt contracts, it was argued that the lack of a formalized debt restructuring framework was necessary to increase the expected cost of defaulting, thereby reinforcing emerging economies' incentives to service their obligations in full.

On their part, the emerging markets that were expected to become the beneficiaries of a sovereign bankruptcy regime also opposed its creation, fearing that such an innovation would structurally increase the cost of their access to international financial markets (Roubini and Setser, 2004). In this context, it is not surprising that at the IMF-World Bank 2003 spring meetings, the international community eventually abandoned this project: "the truth was, with the emerging market countries, the bankers, and the investors so adamant in their objections to the SDRM, there was no way it was going to be implemented" (Taylor, 2007b).[50]

However, the SDRM discussions gave way to a very significant landmark in the international financial architecture: the almost systematic inclusion of collective action

[50] For a more in depth discussion about the factors that have recurrently prevented the international community from creating an international sovereign bankruptcy mechanism, see Helleiner (2008).

clauses (CACs) in bonds issued under New York law.[51] CACs are contractual provisions establishing that in case of a debt restructuring the terms agreed between the sovereign and a supermajority of bondholders (usually 75 or 85%) will be applicable to all the holders of a given bond. Their main purpose, therefore, is to address the collective action problem posed by holdout creditors, and to avoid situations in which a minority of bondholders can block a debt restructuring process (IMF, 2002b). However, a crucial difference between the SDRM and CACs is that the latter do not permit to aggregate across bond issues, as a result of which it constitutes a much more partial instrument to overcome creditor coordination problems. To a large extent, CACs were embraced by private creditors and emerging markets' governments in order to derail the SDRM proposal. In fact, it has been argued that this was the main reason why the Mexican government strategically decided to become the first large emerging market to launch a bond issue including CACs in New York on February 2003 (Helleiner, 2009). Eventually, the market did not penalize Mexico for taking such a step and CACs became a common feature of most emerging markets' bonds within a matter of years: 90% of all sovereign issues in terms of value issued in 2005 already included CACs (IMFa, 2005). The practical effectiveness of CACs, however, has not yet been tested given that this instrument has never been used in a major sovereign debt restructuring.[52]

Conditionality

The IMF defines conditionality as "the various policies that require, as a condition for the use of Fund's resources, a member to implement measures that enable it both to resolve its balance of payment difficulties and to repay the Fund." (IMF, 2009). Central to enforce these policies is the tranche structure of financial programs, which allows the IMF to condition successive periodic disbursements on the adoption of observable measures proving that members are making a sufficient effort to generate the international reserves required to honour their multilateral obligations in due time. Conditionality pursues the complementary objectives of preventing members under a program from using the Fund's financial support to unduly postpone a necessary adjustment, safeguarding the IMF's resources and preserving their revolving character.

[51] CACs were already a common feature in bonds governed under English and Japanese law.
[52] The only case in which CACs were used to facilitate a sovereign debt restructuring was that of Belize in 2006-2007 (Díaz-Cassou and Erce, 2008).

Conditionality has traditionally focused on macroeconomic policies. Indeed, ever since the monetary approach to the balance of payments was developed by IMF economists in the 1950s and 60s, the adoption of a contractionary fiscal and monetary stance has remained a central element of the institution's strategy to induce a reduction in countries' absorption and, in this way, restore their external sustainability (Polak, 1998).

However, starting in the early 1980s the scope of conditionality has gradually expanded as the Fund's financial programs have increasingly tried to influence members' structural and institutional policies (IEO, 2008b). To some extent, this reflects some of the concrete circumstances that the IMF has confronted over the last three decades such as the protracted balance of payment needs facing some of its poorer members, the need to assist formerly planned economies' transition to a market economy or the financial instability associated with the liberalization of international capital flows. It can also be considered the product of an evolving paradigm as supply-side models have gained prominence and economists have sharpened their focus on the microeconomic foundations of external disequilibria.

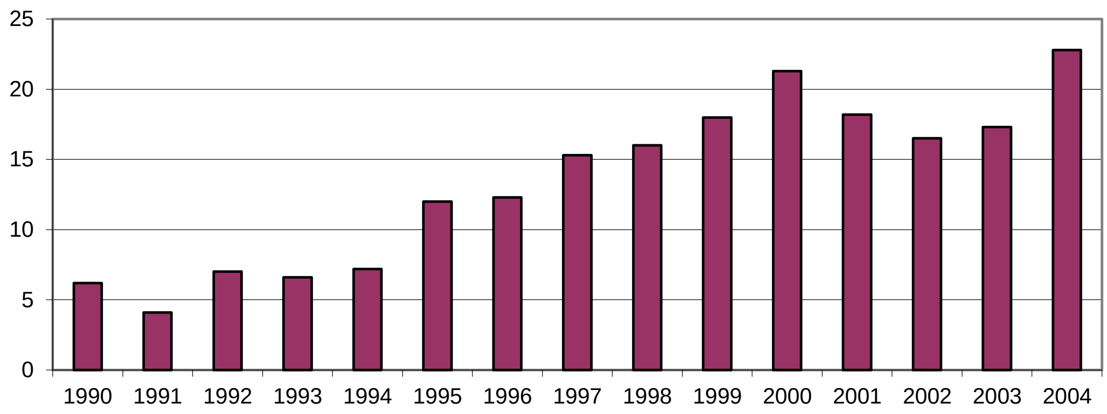
Another reason behind the expanding scope of conditionality has been the IMF's need to complement its programs with the resources provided by supplementary private and public financiers, who have gradually acquired a more or less explicit 'right' to demand the inclusion of additional conditions in IMF programs (Gould, 2006). As already mentioned, this trend has been particularly apparent during the decade under analysis given that the rescue packages that addressed some of the major emerging markets crises included a large amount of resources provided by other official creditors like the World Bank or the US Treasury.[53] Furthermore, because the resumption of access to international financial markets was crucial to the resolution of these crises, the inclusion of policy conditions aimed at restoring investors' confidence was increasingly seen as a key factor for the success of rescue packages.

[53] Rubin and Weisberg (2003) offer an account of the US Treasury's role in the negotiations of the conditionality attached to the Mexican rescue package. In this case, the US went as far as requiring Mexico to pledge future oil exports proceeds as collateral.

In fact, the initial years of the IFA initiative were characterized by the large number and invasive nature of the strings attached to the Fund's financing. This trend is illustrated in Figure 2.3, which shows that the average number of structural conditions per program more than tripled during the 1990s. This process reached its peak during the Asian financial crisis as the South Korean, Thai and Indonesian programs included as many as 94, 73 and 140 structural conditions respectively (Buira, 2003). Given that neither the G-7 nor the Fund's governing bodies did initially discuss conditionality as an element to be considered under the IFA initiative, this can be considered a spontaneous process. It would seem, therefore, that the international community quite simply contemplated the expanding scope of conditionality as a quid pro quo of larger rescue packages.

Figure 3.3

Average number of structural conditions per program



Source: IEO (2008b)

However, by the late 1990s, the IMF was being heavily criticized for its handling of the Asian crisis and, more specifically, for an excessively stringent conditionality. In 1998, for instance, Martin Feldstein argued that "a nation's desperate need for short-term financial help does not give the IMF the moral right to substitute its technical judgements for the outcomes of the nation's political process" (Feldstein, 1998: 27). Two years later, the Meltzer report also made the point that IMF conditionality had made programs "unwieldy, highly conflictual, time consuming to negotiate, and often ineffectual" (International Financial Institution Advisory Commission, 2000: 7).[54]

[54] The Meltzer commission report also advocated for a transition toward a model of ex ante conditionality, imposing four pre-conditions for members' access to the Fund's resources: that members liberalize the entry and operations of foreign financial institutions, that members disclose the maturity

In response to this torrent of criticism, the G-7 Okinawa Summit of July 2000 squarely incorporated the reform of conditionality in the on-going IFA Initiative. In fact, this summit's Communiqué was the first to emphasize the importance of 'country ownership' for the successful implementation of IMF programs (Group of 7, 2000). Later that year, at the Prague 2000 World Bank-IMF annual meetings, the IMFC went further, urging the EB to review all aspects of policy conditionality in order for it to be refocused on macroeconomic policies and only on those structural reforms that may have an unambiguous macroeconomic impact (International Monetary and Financial Committee, 2000).

The IMF's Managing Director responded to this mandate issuing in September 2000 an Interim Guidance Note aimed at streamlining conditionality (IMF, 2000a). This note did essentially orient staff on the criteria to be applied in the design of programs' structural conditionality. It established that, as a general rule, only those structural reforms that are macro-relevant and considered critical to meet a program's objectives should be included as part of the Fund's conditionality. On occasions, the note argued that the IMF was entitled to condition its financial support on the completion of reforms in areas that fall outside of the Fund's core responsibilities. However, in such circumstances the note commended staff to cooperate with the World Bank or other organizations with the sufficient know-how to design and monitor these conditions.

In any case, in this facet of the IFA Initiative the main reform was the EB's approval of new conditionality guidelines in September 2002. These new guidelines updated the framework governing conditionality, which had remained unchanged since 1979. The two key principles emphasized by the new guidelines were country ownership and parsimony. According to the former, national governments should have the "primary responsibility for the selection, design and implementation of its economic policy" and the IMF should pay "due regard to the domestic social and political objectives, economic priorities, and the circumstances of members, including the causes of their balance of payment problems and their administrative capacity to implement reforms"

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structure of all outstanding, guaranteed and off-balance sheet debt, that commercial banks are adequately capitalized and that the sufficient guarantees exist to make sure that the Fund's financial support will not be used to sustain irresponsible market policies.

(IMF, 2002c). In turn, the principle of parsimony established that the Fund's conditionality should only include policies and measures under the member's control considered crucial to achieve the program's objectives or to monitor progress in its implementation. The guidelines did also establish certain restrictions on conditions outside of the Fund's core responsibilities, whose inclusion in a program would require staff to prove their criticality for the program's success. This new framework tried to refocus conditionality toward the Fund's traditional areas of expertise, namely macroeconomic and financial stabilization and only those structural measures deemed strictly necessary to correct external disequilibria.

3.5 Conclusion

This chapter has offered a descriptive account of the two key structural constraints facing IMF officials in their negotiations with borrowing countries during the decade under analysis: the arrangements that define the Fund's decision making process and the rules governing multilateral crisis lending. The Fund's institutional design has been described as one which enabled the institution's most powerful members to tightly oversee chief-negotiators. In this context, the intense efforts undertaken by these same constituents to develop a rules-based crisis resolution framework become somewhat paradoxical. Indeed, if the Fund's institutional design enabled principals/constituents to control the day to day operations of their agents/chief-negotiators, the less prevalent should agency problems have been, which should have been expected to result in a lesser demand for rules. Why was this not the case in this particular issue area?

To some extent, this chapter has argued that a rules-based multilateral crisis lending regime was demanded on technical grounds, a common concern being that an absence of rules could turn IMF interventions into an additional source of uncertainty during financial crises, thereby exacerbating their effects and maybe even increasing their likelihood (Rajan, 2005). The development of a rules-based framework, therefore, was advocated as a signalling device to shape investors' expectations, which was expected to improve the functioning of the international financial system (Taylor, 2007a). Partly related to this point, strict rules governing access to IMF credit were also emphasized as an instrument that could potentially limit the moral hazard distortion that a discretionary multilateral financial safety net was suspected to have generated on creditors and debtors' incentives (Calomaris, 1998).

However, there were other political and ideological motivations behind the demand for rules in this particular issue area. As this chapter has described, the Fund's governance structure is characterized by the asymmetric influence that different constituents can exert on chief-negotiators. This does not only apply to creditor vs. debtor countries, the latter having a very limited say over the Fund's decisions, but also to the US vs. Europe. It has been argued that for a variety of reasons European countries have not managed to build a stable coalition capable of matching the power held by the US in the Fund's decision making process. Especially after the experience of the Mexican bailout, this explains why the European members of the G7 advocated for rules as a means to constrain the US government's ability to shape multilateral interventions according to its own political agenda (Porzcecanski, 2002; Giannini, 2002).

Eventually, this demand for rules would also resonate among conservatives in the US, which in the late 1990s became increasingly vocal about the idea that in the absence of a rules-based framework, the IMF would always tend to succumb to political pressures, intervening irrespective of the economic rationality of these interventions, and in so doing unnecessarily putting tax-payers' money at risk (Calomaris, 1998; Suskind, 2006). In this ideological context, the 2001 change of administration in the US constituted a turning point in the reform of the IFA which had an impact on the structural determinants of IMF negotiators' win-sets.

In fact, two clearly distinct phases can be discerned in the IFA initiative regarding both the relative importance of rules versus discretion and the specific content of rules. The first one corresponds to the Clinton administration and the Rubin-Summers team at the US Treasury. During this period the US government tended to favour flexibility, reflecting not only its views about how emerging market crises and cross border contagion should be addressed, but also a willingness to act as decisively as possible whenever American interests were put at stake (Rubin and Weisberg, 2003). The IFA initiative, therefore, focused on the reinforcement of a multilateral financial safety net through the introduction of new facilities and through the upgrading of existing institutional mechanisms, which made larger volumes of financial assistance more readily available to countries in distress.

The second phase corresponds to the George W. Bush administration and the O'Neill-Snow-Taylor team at the US Treasury. During these years, and more in line with the preferences of the European members of the G7, the US government leaned in favour of rules. Reflecting a growing criticism about the distortions caused by the international rescue packages of the Clinton era, stricter limits on the provision of emergency financial support were adopted and an emphasis was placed on the need to involve private creditors in the resolution of financial crises. In addition, new conditionality rules were adopted in order to promote country ownership and parsimony in the policy strings attached to IMF programs.

What does all this imply for the contours of IMF negotiators' win-sets? Ceteris paribus, the policy stance adopted by the Clinton administration could be expected to have increased IMF negotiators' win-sets given that new instruments were added to their crisis resolution toolkit and that the rules governing access to multilateral credit were made more flexible. Instead, a greater reliance on rules during the Bush administration could be expected to have reduced the IMF negotiators' win-sets.

This conclusion, however, should be qualified for a number of reasons. First, the greater flexibility promoted by the Clinton administration was aimed at increasing its own discretion rather than that of IMF negotiators. Hence, it is not necessarily the case that flexible rules resulted in an expanded IMF win-set, at least in those cases in which the US administration had an incentive to intervene. Second, most of the rules adopted by the international community during the decade under consideration failed to provide a clear guideline for IMF chief-negotiators. A case in point is the Prague Framework for the resolution of financial crises. Although this framework envisaged the adoption of different strategies for different types of crises, the criteria to distinguish between solvency and liquidity crises were never entirely clarified. As a result, whether this framework created an unambiguous association between specific circumstances and specific courses of action is open to discussion. Third, in the absence of a supra-national authority with the ability to hierarchically enforce the IFA rules, the largest IMF constituents retained discretion to break or to amend these rules after they were adopted.

In other words, rules in this issue area were only binding to the extent that IMF constituents wanted them to be.

Summing up, whereas the fact that the Fund’s institutional design imposed a hard constraint on IMF negotiators is unambiguous, whether rules in this issue area were really binding is an empirical question. The subsequent case studies, therefore, take the institutional design described in this chapter as the structure within which the IMF’s Level I game unfolded while considering the IFA rules as one among other possible determinants of the multilateral response to the Argentine and the Uruguayan financial crises.

CHAPTER 4

Argentina and the IMF

Argentina has been one of the most recurrent users of the Fund's financial support, being under a program for about 38 years since it joined the IMF in 1956 (Amadeo, 2003). From a historical perspective, the number of IMF interventions in Argentina during the decade that followed the Tequila crisis does not stand out in particular: five new programs were signed between 1996 and 2005 against four during the previous decade or five in between 1982 and 1991. Various factors, however, render this an exceptional decade in Argentina's relationship with the IMF. Most of all, the scale of the Fund's financial involvement was unprecedented: whereas the support that Argentina obtained from the IMF during the entire 1980s debt crisis totalled SDR 5 billion, had it not been suspended, the 2000 SBA alone would have provided access to more than SDR 16 billion. In fact, the Fund´s loans became the government's last remaining lifeline, and the suspension of the program in late November 2001 was the final trigger of the subsequent economic meltdown. Fairly or not, this placed the IMF in the difficult position of being often referred to as the cause rather than the solution to the worst crisis in Argentina's modern economic history. This has left deep scars in the relationship between Argentina and the IMF which are best exemplified in the Kirchners administrations' anti-IMF rhetoric.

The case of Argentina provides fertile ground for studying the patterns of IMF involvement in emerging markets. Indeed, the decade under analysis (from the approval of the 1996 SBA until the early cancellation of the last active financial program in January 2006) exhibits a wide variation in the nature, scope and cooperativeness of the relationship between the Argentine government and the IMF, which this chapter analyses using a two-level game framework. Given this chapter's longitudinal approach, it will focus primarily on those explanatory factors that varied more clearly over time, such as the outcome of electoral processes, the strength and cohesion of governing coalitions, bureaucratic interests or multilateral rules. Instead, other more static explanatory factors, such as some structural features of Argentina’s polity and institutions, will be the focus of the cross-sectional analysis presented in Chapter 6.

The evidence provided in this chapter brings support to the hypothesis that there is a non-linear relationship between domestic political constraints and borrower’s bargaining power in the negotiations with the IMF. Indeed, instances are found in which Argentine negotiators exploited the presence of domestic political divisions in order to obtain a better deal with the IMF. Eventually, however, growing difficulties to secure the domestic ratification of a coherent crisis resolution policy package eliminated the overlap between the Argentine and the Fund’s win-sets, resulting in the collapse of the cooperative equilibrium. In addition, the Argentine experience evidences that, depending on the government’s preferences and on public perceptions about the IMF, a program relationship can serve different domestic political purposes. If the preferences of both sides’ negotiators converge and the Fund is not too stigmatized in the domestic political debate, the conditionality associated with IMF programs can be exploited by borrowing governments as an instrument to legitimize certain unpopular courses of action. But if negotiators’ preferences diverge and the IMF is stigmatized in the domestic political debate, a conflictive program relationship can be exploited to garner public support for courses of action that depart from the Fund’s prescriptions.

The Argentine case study also suggests that the perceived cost of no agreement is negatively associated with the autonomy of IMF officials in the negotiations with borrowing governments. In other words, the higher the cost of no-agreement, the more significant will the Fund’s constituents’ strategic priorities become. Instead, when the cost of no-agreement is perceived to be low, technical considerations and the Fund’s internal bureaucratic politics tend to play a more prominent role in the program’s negotiations. Similarly, the Argentine experience indicates that the cost of no agreement perceived by the Fund’s constituents is associated with the explanatory significance of rules. Indeed, powerful nations seem to be more willing to consider breaching existing rules when the potential de-stabilizing consequences of the issues at stake are clearer. Instead, when the negative spillovers plausibly associated with a particular multilateral decision are perceived to be milder, rules tend to be more binding, thus imposing a harder constraint on the program negotiations.

The remainder of this chapter is organized as follows. Section 4.1 starts by offering a descriptive account of the evolution observed in this case study's dependent variable: the outcome of the "level I" international negotiation. This chapter distinguishes between three phases during each of which IMF programs pursued different objectives: crisis prevention; crisis management; restoration of debt sustainability. Subsequently, sections 4.2, 4.3 and 4.4 introduce the level II game, analysing these three phases in terms of the evolving preferences and win-sets of both sides' chief negotiators. Finally, the chapter concludes summarizing the hypotheses that this case study helps unveil about the relationship between domestic ratification politics and the bargaining interaction between the IMF and its borrowing members.

4.1 A decade of financial programs

During the first phase of the decade under analysis, which lasted until late 2000, the relationship between Argentine and IMF officials was one of close cooperation aimed at preventing future financial crises and at consolidating a process of market-oriented reforms that had been initiated in the early 1990s. As shown in Figure 4.1, the 'precautionary' nature of the 1996 and 1998 programs implies that net IMF disbursements were small or even negative during this period. The second phase of crisis management starts when adverse market developments forced the government to begin making extensive use of the Fund's financial support late in 2000. In spite of two sizeable augmentations of that program, the Fund's crisis resolution intervention in Argentina failed and was eventually suspended in December 2001. Notwithstanding the economic collapse that took place subsequently, the government was forced to make net repayments to the IMF and to the other IFIs throughout 2002. After very contentious negotiations a new program was approved in January 2003 giving way to the third phase analysed in this chapter, during which policy discussions were centred on the unsustainable stock of sovereign debt that the Argentine government had accumulated previously with private and public creditors. This continued to be a tense period in Argentina's relationship with the IMF, with recurrent threats on the part of the IMF to suspend the program and on the part of the Argentine government to default on its multilateral obligations.

Table 4.1

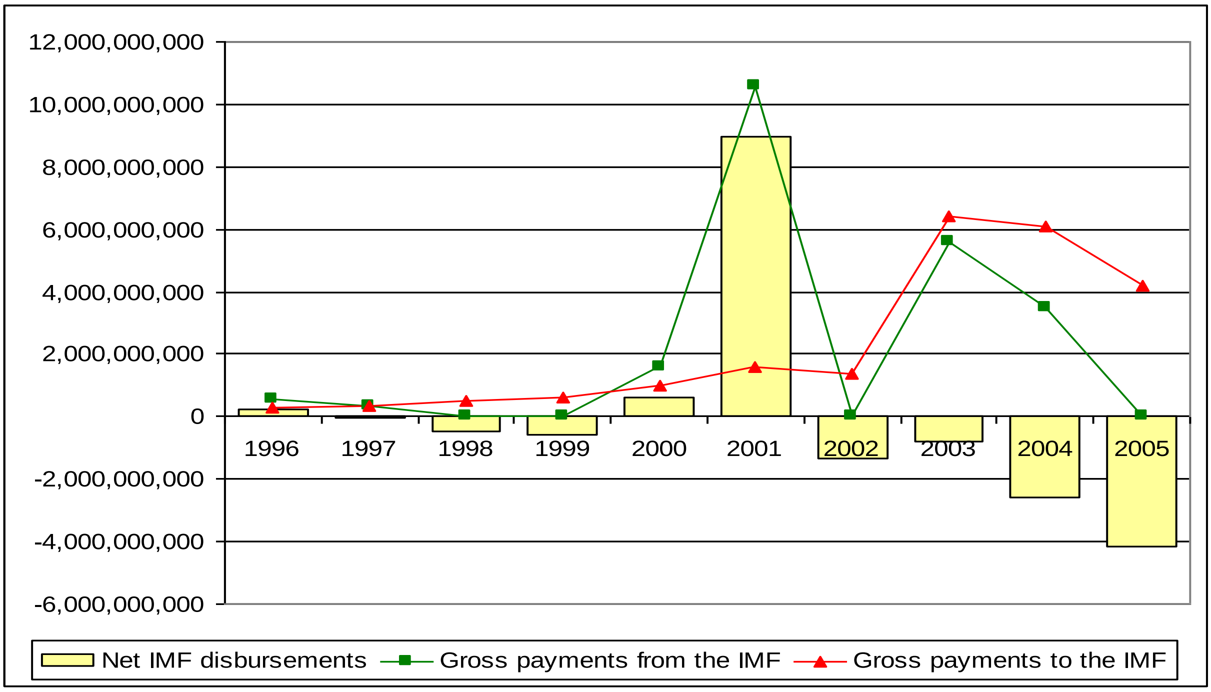
IMF programs in Argentina (1996-2005)

Program Type	Date of Approval	Duration	Amount committed in SDR and in % of quota	Amount disbursed in SDR and in % of total	Macroeconomic conditionality	Structural conditionality	C ompliance with conditionality
SBA	Apr-96	21 months	SDR 720mn 48% of quota	SDR 613mn 85%	Focus on fiscal consolidation.	No formal structural conditionality. However, the IMF pressed the authorities to reform the labour. market in the first and second reviews of the program.	Weak compliance with macroeconomic conditionality in spite of strong economic performance
EFF	Feb-98	3 years	SDR 2,080mn 135% of quota	0 0%	Focus on fiscal consolidation	Tax reform; Labor market reform; new anti-trust law; privatization of Banco Nacion; lease of airports to private operator	Weak compliance with both macroeconomic and structural conditionality in spite of strong economic performance
SBA	Mar-00	3 years	SDR 5.4bn 255% of quota	SDR 1.567bn 29%	Focus on fiscal consolidation. Growth projections overtly optimistic: real GDP was projected to grow by 3.8% in 2000. Instead, it contracted by 0.8%. The program's fiscal targets had to be accomodated in Sept. 2000	Labor market reform; Tax reform; new revenue sharing agreement with provinces; social security reform; new central bank charter and banking law	Very weak compliance with macroeconomic conditionality due to a worsening economic performance. Relatively good compliance with structural conditionality
1st augmentation (with SRF)	Jan-01	-	SDR 5.2bn 246% of quota Of which SDR 2.3bn under the SRF	SDR 4.219bn 81%	Relaxation of fiscal conditionality. Budget deficit allowed to increase in the short term. Stabilization of long term debt dynamics targeted.	Strengthening of tax payments facilities; Creation of a tax fraud tribunal; protection of competition law; new regulatory framework for the telecom sector; pension reform; restructuring of social security allowances	Fiscal slippage in spite of the relaxation of macroeconomic conditionality. Various measures included in the program's structural conditionality were not met due to opposition from Congress
2d augmentation (with SRF)	Aug-01	-	SDR 6.3bn 300% of quota Of which SDR 3.8 bn under the SRF	SDR 3.97bn 63%	Focus on fiscal consolidation: support to the zero deficit rule. The program envisaged a restructuring of sovereign debt and earmarked US$ 3 billion for that purpose	New legislation for revenue sharing with the provinces	Dismal compliance as a result of rapidly worsening economic conditions
Transitory SBA	Jan-03	8 months	SDR 2,174.5mn 103% of quota	SDR 2,174.5mn 100%	Primary surplus of 2.5% of GDP.	Draft legislation for fiscal reform; new banking regulations; appointment of an external advisor for the debt restructuring; revision of utilities tariffs	Good compliance with macroeconomic conditionality. Weak compliance with structural conditionality
SBA	Sep-03	3 years	SDR 8.9bn 424% of quota	SDR 4.171bn 47%	Minimum primary surplus of 3% of GDP in 2003. No fiscal targets defined for 2004 and 2005.	Fiscal reform; establishment of a new revenue sharing system with the provinces; compensation to banks for asymmetric pesoization	Good compliance with macroeconomic conditionality. Weak compliance with structural conditionality

Source: IMF

Figure 4.1

Financial transactions between Argentina and the IMF (US$)



Source: IMF

4.1.1 Crisis prevention

The first phase begins with the approval of a 21 months SBA in April 1996 for an amount of approximately US$ 1,000 million (see table 4.1). This program was signed after the effects of the Tequila crisis had subsided, and was primarily aimed at bringing confidence to international investors on the resilience of the convertibility regime and at supporting the continuation of the government's market-oriented reform strategy.[55] Yet, this SBA did not include any structural condition, although the IMF claims to have encouraged the Argentine authorities to embark on a labour market reform at the time of the program's second review (IMF, 2003a). In spite of a strong economic performance during the period of implementation of this SBA (GDP growth was 5.5% in 1996 and 8.1% in 1997) Argentina did not meet the program's fiscal targets in spite of which the

[55] Largely as a result of its rigid macroeconomic framework, the Mexican crisis hit Argentina particularly hard. Indeed, investors' concerns about fixed exchange rates and the government's ability to sustain Argentina's currency board fed an attack on the peso, a sudden stop in capital flows and ultimately a real GDP contraction of 2.2% in 1995. This did initially raise awareness about the need for further reforms. A rapid recovery in 1996, however, created a renewed sense of optimism about the resilience of the convertibility regime which was to substantially slow down the pace of reforms during the last years of the Menem administration.

Executive Board systematically approved subsequent reviews (Allen, 2003). This failure to press Argentina to tighten fiscal policy in good times has been criticized as one of the main failings of the IMF during the period that preceded the 2001 crisis (José-Luis Machinea. Personal interview. July 13, 2010; Mussa, 2002; Blunstein, 2003; IMF, 2003a; IEO, 2004).

The three-year US$ 2.8 billion Extended Fund Facility approved on February 1998 was similar in spirit to the 1996 SBA. It was declared as precautionary, making it clear that its main purpose was to signal the Fund's support to Argentina's policies and macroeconomic framework without disbursing financial resources. Its conditionality focused on fiscal adjustment and on a number of targeted structural reforms. Argentina's compliance with these conditions was generally weak in spite of which the Board continued to approve subsequent reviews with minor delays. As will be seen later in more detail, various factors contribute to explain this weak compliance. First of all, the combined effect of the Russian default in August 1998 and of the collapse of the Brazilian real in January 1999 abruptly pushed the Argentine economy into recession (real GDP contracted by 3.8 per cent in 1999) making the program's fiscal targets difficult to attain. In addition, the 1999 general elections fed a fiscal expansion and a growing reluctance to engage in unpopular reforms (Mussa, 2002). A case in point is the labour market reform included in the program's conditionality. Although a new labour law was approved by the Chamber of Deputies on September 1998, the Fund's staff made it clear that it fell short of expectations, which did not prevent the Board from approving the program's first review a few weeks later (IEO, 2003).

The administration of Fernando de la Rúa began negotiating a new program with the IMF soon after taking office in December 1999. It is precisely in order to secure the Fund's support and to signal the new administration's views on fiscal adjustment that a very significant tax increase was announced in January 2000: the so-called *Impuestazo*. A new US$ 7.2 billion SBA was signed in March. Like its predecessor, this program was intended to be precautionary, with a focus on fiscal consolidation and labour market reform. Eventually, however, the economy performed much worse than anticipated: instead of growing by 3.8% as projected in the program, real GDP contracted by 0.8% in 2000. The prolonged recession made it increasingly difficult to meet the program's fiscal targets in spite of some drastic actions such as a 13%

reduction in civil servants' salaries decreed in May 2000. Partly because of their pro-cyclical effect, not even with these measures did the government manage to regain control over public finances, and the IMF regularly accommodated higher than expected deficits. Compliance was better with structural conditionality: a new employment law was passed on April 2000. However, this reform had the unintended consequence of severely weakening the governing coalition: on October 2000 Vice-President Álvarez resigned after allegations that various senators had accepted bribes to vote in favour of the new law. As a result, country risk peaked, further deteriorating the government's fiscal position and making it almost impossible to tap international financial markets in order to roll-over debt obligations as they came due. This would eventually lead to a fundamental reappraisal of the program, giving way to a new phase in the Fund's involvement in Argentina.

4.1.2 Crisis management

A crucial landmark in Argentina's relationship with the IMF was the quasi-doubling of the SBA in December 2000. As opposed to past program-related announcements, this operation emphasized an urgent need for external financial assistance to cover the loss of access to international financial markets. Together with other multilateral, bilateral and private commitments, it was claimed that this augmentation would provide a total amount of US$ 40 billion: a so-called 'armour-plate' (*Blindaje*) expected to bolster market confidence.[56] The new strategy agreed between IMF and Argentine officials was to temporarily relax fiscal policy in order to avoid the contractionary impact that past adjustment measures had had. In addition, the Argentine authorities committed to an ambitious agenda of structural reforms which were expected to spark an economic recovery in the medium term (José-Luis Machinea. Personal interview. July 13, 2010). Although the new program brought about a few weeks of relative stability, the situation began to deteriorate again in February 2001. This was primarily due to contagion from the Turkish crisis and to the growing realization that the government would not be able

[56] The IMF program was augmented to almost US$ 14 billion; the World Bank and the IADB provided US$ 5 billion; the government of Spain provided US $1 billion. The US $20 billion corresponding to private financiers was constituted by pledges on the part of a number of market-makers to place Argentine sovereign Bonds in 2001 and thereafter.

to fulfil its commitments even under the relaxed terms of the augmented program.[57] The resignation of Minister Machinea and the failed fiscal adjustment attempted by Minister López Murphy during his brief tenure further aggravated the situation, and when Domingo Cavallo took over the Economy Ministry in March 2001 it was clear that, once again, the IMF program was severely off-track.

Cavallo's tenure at the Ministry was rich in policy innovations such as the introduction of a financial transactions tax, the modification of the convertibility regime that pegged the peso both to the euro and the dollar, the 'mega-swap', the zero deficit law or the introduction of a system of taxes and subsidies that was intended to mimic the effect of a devaluation (see Appendix C). Most of these measures were adopted with little or no consultation with the IMF as a result of which Argentina's relationship with the institution became increasingly strained during these months (Daniel Marx. Personal interview. June 28 2010; Mussa, 2002; Blustein, 2003). Yet, and although Cavallo's measures did little to reconcile Argentina's macroeconomic performance with the program's targets, the Executive Board approved two further reviews. The last important operation undertaken during this cooperative stage of Argentina's relationship with the Fund was the second augmentation of the program approved in August 2001. Although this augmentation was expected to provide an additional US$ 8 billion bringing the total size of the Fund's support to US$ 22 billion, it was approved in the context of severe disagreements with the measures that were being implemented by Minister Cavallo (IEO, 2004). A novel feature of the augmentation was that it earmarked US$ 3 billion for the specific purpose of supporting a sovereign debt restructuring.

After the IMF's disbursement to Argentina in September 2001, the situation continued to deteriorate with no respite in sovereign spreads, a dismal fiscal performance in spite of the zero-deficit law, and an intensifying depositors' run on the banking system. It is in this context that the IMF decided not to approve the SBA's fifth review, thus suspending scheduled disbursements and severing access to the last remaining source of hard currency available for the Argentine government. The weeks that followed

[57] The Turkish lira was devalued in mid-September. The fiscal deficit was projected to reach US$ 10 billion as opposed to the targeted US$ 6.5 billion. The Argentine judiciary suspended two decrees that had been issued to comply with structural conditions in the areas of pension and health care system reform.

witnessed a wave of social unrest that culminated in the resignations of Minister Cavallo and President de la Rúa. A chaotic succession of short-lived governments ensued, during which some extraordinary measures were adopted such as the declaration of a comprehensive moratorium on sovereign debt repayments or the abandonment of the convertibility regime. Given that the prevailing institutional instability temporarily impaired communication with the IMF, there is little doubt that these decisions were taken unilaterally by the Argentine government. Once the Argentine Congress elected Eduardo Duhalde as 'caretaker' president on January 1st 2002, however, it took only a few days for senior government officials to resume talks about a new program (Jorge Todesca. Personal interview. July 19, 2010).

The negotiations of a new program to succeed the 2000 SBA proved to be frustratingly lengthy: it was not until August 2002 that a proper Letter of Intent began to be officially drafted, and it would take five more months to reach a final agreement. As a result, the only financial support that the Duhalde government obtained during the worst months of the crisis was the roll-over (extension of repurchase expectations) of the SRF, but not of its entire outstanding stock of IMF credit.[58] This implies that in 2002 Argentina was forced to make net repayments to the IMF for a total amount of over US$ 1,300 million. Because other agencies tend to require the presence of an IMF program in order to lend to crisis-stricken countries, the failure to agree on a successor arrangement curtailed Argentina's access to other sources of official finance: in 2002 net debt service to the World Bank and to the Inter-American Development Bank amounted to US$ 672 million and US$ 938 million respectively (IMFb, 2005). In this context, it is hardly surprising that 2002 proved to be such a tense year in the relationship between Argentina and the IMF, with each side of the negotiations blaming the other for the delays in reaching a final settlement.

Although the policy discussions between Argentine and IMF officials addressed a very vast array of issues, a number of stumbling blocks stand out in particular. First of all was the monetary and exchange rate regime with which to substitute convertibility. On

[58] As seen in Chapter III, the SRF is a facility that was introduced to address sudden reversals in capital flows. Because of its short term profile and because it has more demanding financial terms than other facilities, its design contemplates the possibility to roll-over obligations as they come due for up to one year. Although the Executive Board has to agree to such extensions, these roll-overs have always constituted a quasi-automatic feature of SRFs since they were first used during the Asian financial crisis.

January 6, 2002, the Duhalde administration adopted a floating rate for financial transactions and a fixed rate for current account transactions. Given that dual exchange rate regimes are explicitly banned in the Fund's Articles of Agreement, this became a first obvious obstacle to resuming a program relationship. Although the exchange rate was unified a few weeks later, the decision of whether to fix or to float continued to be controversial throughout 2002. Because the risk of triggering a hyperinflation process loomed large after the demise of convertibility, the Argentine authorities supported the central bank's interventions in foreign exchange markets in order to moderate the depreciation of the peso. Instead, the IMF advocated for freely floating exchange rates on the grounds that defending the peso would merely deplete the remaining stock of international reserves, which were by and large constituted by the remnants of the 2000 program's disbursements. The government eventually complied with the IMF demands in late February. In May, however, the central bank's interventions were resumed in order to burst what the Finance Ministry referred to as a "dollar-bubble" (Ministerio de Economía y Producción, 2004).

A second area of contention was related with the management of the banking system, which was essentially paralyzed after the introduction of the *Corralito* (playpen) and the *Corralón* in December 2001 and January 2002.[59] The IMF was very critical about the asymmetric 'pesoization' of banks' assets and liabilities decreed in February 2002, which was interpreted as a measure that arbitrarily redistributed the burden of the crisis away from debtors and onto creditors, severely compromising the future solvency of the banking system. [60] During the months that followed, senior government officials claim that the IMF pressed for the adoption of a shock therapy *à la* Indonesia: removing banking restrictions as fast as possible, compensating banks for the asymmetric 'pesoization', letting insolvent institutions fall and compulsorily exchanging time deposits for bonds (Jorge Todesca. Personal interview. July 19, 2010; Lisandro Barry. Personal interview. September 13, 2010). Although Minister Remes Lenicov tried to comply with some of the Fund's demands, the Argentine Chamber of Deputies rejected his plan to exchange time deposits for bonds in April 2002, a few days after which he presented his resignation. Instead, under Minister Lavagna the Argentine government

[59] The 'Corralito' introduced by Minister Cavallo capped weekly withdrawals from sight deposits at US$ 250. The 'Corralón' introduced in January reprogrammed time deposits.
[60] The asymmetric 'pesoization' refers to the conversion of banks' liabilities at a rate of 1.4 pesos to the dollar and the conversion of banks' assets at a rate of 1 peso to the dollar.

insisted on the adoption of a piecemeal approach based on the gradual removal of banking restrictions, which was expected to give time for financial institutions to adjust and for depositors to regain confidence in the system (Nielsen, 2006). In December 2002, the government could finally suspend the *Corralito*, which was a very significant breakthrough for the millions of Argentine depositors that regained access to their savings.

Another difficult issue was the overhaul of the fiscal relationship between the federal government and the provinces (the so-called 'coparticipación'), which the IMF made clear early on would constitute a prior action for a new program. In February, the government and the provinces' governors agreed on a general framework to create harder budget constraints and stop the issuance of provincial quasi-currencies. In addition, bilateral agreements were negotiated with each of the provinces in order to deal with their specific circumstances. However, the IMF considered that such agreements failed to consolidate a rules-based system strong enough to sufficiently constrain sub-national spending and indebtedness. Other disagreements between Argentina and the IMF were centred on two laws which, according to the IMF, constituted a fundamental threat to judiciary security. The first one was the bankruptcy law adopted by the Duhalde administration in order to weaken creditors' rights and, in so doing, avoid the widespread bankruptcy and fire sale of Argentine businesses. The second one was the removal of the economic subversion law, which some judges were threatening to use against the "speculators" that were being blamed for having caused the crisis.[61] The government eventually managed to repeal both laws in May. In contrast with all the difficult issues described above, macroeconomic adjustment proved to be less of a problem. This was due to the contractionary fiscal and monetary stance adopted by the Duhalde administration, as a result of which and in spite of the recession a consolidated surplus would eventually be obtained in 2002 while inflationary pressures were gradually brought under control.

As will be explored later in more detail, the stalemate in the negotiations could only be overcome in the final months of 2002 when the Argentine government threatened to

[61] The economic subversion law was introduced in 1974 in order to criminalize business decisions detrimental to the "common good". Although never applied since the restoration of democratic rule in Argentina, in 2002 there was a popular demand to use it in order to take legal actions against those bankers responsible for the capital flight that was perceived to have caused the crisis.

default on its multilateral obligations. It is in this context that a US$ 805 million payment due to the World Bank was delayed in November 2002, signalling the government's willingness to risk international financial ostracism if needed in order to force the hand of the Bretton Woods institutions. In January 2003 the authorities went further, communicating that a payment of US$ 681 million due to the Inter-American Development Bank and another payment of US$ 998 million due to the IMF would also be missed until the approval of an IMF program (Amadeo, 2003: 332-337). Eventually, the program was approved in January 2003, giving way to the reluctant cohabitation that was to characterize the relationship between Argentina and the IMF during the years to come.

4.1.3 Restoring debt sustainability

The third phase analysed in this chapter broadly coincides with the onset of an economic recovery and with the approval of a new program in January 2003. During this period negotiations were centred on the resolution of the government's debt overhang, which required agreeing on a strategy to soften the amortization of multilateral credits and to restructure the bonds in default. The SBA approved in January 2003 had a duration of only 8 months, which was aimed at providing some breathing space to the Duhalde administration until the April general elections and to give time for the newly elected government to negotiate a longer-term more standard arrangement.

This transitory program rolled-over Argentina's obligations to the IMF falling due until September 2003 (a total of about US$ 2,980 million). Its conditionality set a primary surplus target of 2.5% of GDP and included a number of structural measures such as the adoption of new banking regulations, the preparation of a fiscal reform, and the revision of the utility prices frozen since January 2002. Given that Argentina's sovereign debt was in default since December 2001, this program was subject to the policy of lending into arrears (see Chapter 3), implying that the Fund's disbursements were formally conditioned on the government's 'good faith' in its negotiations with private creditors.[62]

[62] This is why the new program included the obligation to appoint an external advisor to deal with the debt restructuring. On February 2003 the government appointed the firm Lazard Frères as its external advisor. The fact that such a small institutions was selected to handle the largest sovereign debt

In stark contrast with its predecessors, this program's fiscal and monetary targets were outperformed, which was made possible by a stronger than expected economic recovery and by the government's commitment to a prudent macroeconomic management. Instead, compliance with the program's structural conditionality was weak, especially with regard to the revision of utilities' tariffs (IMF, 2003b).

A key development in the transition from the Duhalde to the Kirchner administration was that Roberto Lavagna retained the post of Economy Minister. This sent a clear signal about the new administration's intentions of continuity, at least with regard to economic policy. In this context, it is not surprising that the change of government did little to improve the relationship between Argentina and the IMF which, if anything, became tenser during the Kirchner presidency. Indeed, the negotiation of a new program after the April elections was extremely difficult, especially when it came to agreeing on the terms of a medium-term macroeconomic framework (Leonardo Madcur. Personal interview. 29 July, 2010; Ministerio de Economía y Producción 2004). Eventually, the government resorted to old tactics when it missed a US$ 2,900 million payment in September 9 (Bonelli, 2003: 304-308). One day after this temporary default the IMF's Managing Director Horst Köhler announced that an agreement had been reached with the government and that, upon the clearance of Argentina's arrears to the Fund, he would recommend the approval of a new program (IMF, 2003c).

On September 20, a new three years SBA was approved by the Board. As had been the case with the transitory SBA, this program rolled over Argentina's obligations with the IMF until 2006 (US$ 12.55 billion) without providing new net lending. One of the most peculiar characteristics of the new program was that, as opposed to traditional IMF arrangements, it did not establish a deterministic adjustment path: it only set a primary surplus target of 3% of GDP for 2004 but no targets for 2005 and 2006. The program included some structural conditions focused on fiscal reform (including the revision of the revenue-sharing mechanisms with the provinces) and on the compensation for the asymmetric 'pesoization' of banks' assets and liabilities decreed in February 2002. Once again, Argentina outperformed the program's fiscal and monetary targets but

restructuring in history was interpreted as a clear sign of the government's lack of rush to deal with its private creditors (Andrés Borenstein. Personal Interview. July 16, 2010). In March 2004 the government appointed Barclays Bank, Merryl Lynch and UBS to organize the debt exchange.

lagged behind with structural conditionality, especially with regard to the adoption of a new revenue-sharing law, which could never be agreed with the provinces.

Two days after the approval of this SBA, the Argentine government unveiled its first debt restructuring offer in the context of the IMF-World Bank annual meetings: the so-called 'Dubai terms'. Private creditors received this offer with dismay given that, at market discount rates, it implied a 90% net present value (NPV) loss on their bonds.[63] From this point onward, the assessment of the government's good faith in the negotiations with its creditors became a key point of contention between Argentina and the IMF. The first review of the program, which was scheduled for late November 2003, was delayed until January on the grounds that the Argentine government was not doing enough to settle with its creditors and to comply with the program's structural conditions. On March 2004, the Argentine authorities announced that a US$ 3,100 million payment would be missed unless the Fund's management expressed its support to the approval of the second review. Eventually, the Board agreed to approve this second review after the Argentine government committed to revise its restructuring offer and to recognise the Global Committee of Argentine Bondholders (GCAB) as its main counterpart in the negotiations (IMF, 2004a). Although the government unveiled a new restructuring offer in May, negotiations for the third review continued to be extremely difficult due to a growing dissatisfaction with the government bargaining tactics and to significant slippages with the program's structural conditionality. [64]

A new turn of events took place in August when Argentina and the IMF agreed to postpone the third review of the program until the completion of the debt restructuring. In practical terms, and although it was not officially referred to as such, this was equivalent to a suspension of the program given that it implied that Argentina would continue honouring its obligations as they fell due but that it would lose the right to draw from the IMF. It also meant that the Fund's periodical assessments on the Argentine government's good faith would no longer take place. No third review of the program would ever be approved. A few months later, and following the example set by Brazil, the government decided to anticipate the cancellation of the SBA. To that effect,

[63] Although the Argentine government offered 25 cents to the dollar, the Dubai terms did not recognize past due interests.
[64] The new offer (the 'Dubai Plus' terms) included past due interests and was valued by investors at close to 25 cents to the dollar.

on January 2006 it repurchased obligations for an amount of almost US$ 10 billion which terminated the Fund's financial involvement in Argentina.

4.2 Crisis prevention

Applying Putnam's two level game framework, the cooperative outcome of the negotiations during the first phase of crisis prevention should be understood as the result of an overlap between the Argentine and the IMF win-sets. Such an overlap can be explained by converging preferences and/or by a sufficiently large win-set either on the Argentine side, on the IMF side, or on both. In the presence of diverging preferences, the specific outcome of the level I negotiation observed at each point in time is determined by negotiators' relative bargaining power and hence by the relative size of their respective win-sets. This section applies this general framework to identify the specific factors that influenced the negotiations of the preventive IMF programs that were in place since the approval of the 1996 SBA until the Argentine government began to make use of the resources of the 2000 SBA. It initially focuses on the Fund's negotiations with Menem's second administration, during which the Argentine economy gradually lost steam but was not yet undergoing a full-blown financial crisis. It will then concentrate on the first few months of the De la Rúa government, after which the Fund's intervention had to switch to crisis resolution mode.

The defining features of the Fund's pre-crisis negotiations with the Menem administration can be summarized as follows. First, both the 1996 SBA and the 1998 EFF were precautionary, meaning that the government pre-announced its intention not to make use of the resources committed by the IMF. This implies that, as opposed to more traditional interventions, these programs were not designed to address an actual need for financial assistance. Second, their structural conditionality was generally weak. Indeed, the 1996 SBA did not include structural benchmarks, and although the 1998 EFF contemplated some meaningful reforms in the tax system and the labour market, overall compliance with these conditions was incomplete (Allen, 2003). Third, in spite of the strong performance of the Argentine economy until mid-1998, compliance with fiscal conditionality was persistently weak, to which the Executive Board responded by modifying fiscal targets and by granting waivers in about half of the programs' reviews (Mussa, 2002).

What do these features tell us about chief negotiators' preferences and win-sets? Since the Fund's interventions did not respond to a financial need, a first relevant issue is related with the objectives that these programs were aimed at achieving. According to the Vice-Minister of Economy and to the Undersecretary of Finance during the second Menem administration, the main objective pursued by the government was to enhance Argentina's access to international financial markets (Carlos Rodriguez. Personal Interview. September 20 2010; Miguel Kiguel. Personal Interview. July 29, 2010). This was expected to be achieved through two complementary mechanisms. First, the precautionary programs would be perceived by markets as a pseudo-insurance scheme against the risk posed by exogenous shocks such as the Tequila crisis.[65] Second, the programs would function as a device to signal the government's commitment to implement a set of market-oriented policies periodically sanctioned by the IMF.

There are reasons to argue that the preferences of IMF negotiators and of their constituents were closely aligned with the objective of deepening the integration of the Argentine economy in international financial markets. Indeed, during those years the G7 and the IMF were actively promoting financial globalization while exploring mechanisms to help emerging markets cope with the risks posed by capital account liberalization (Abelal, 2006). Furthermore, by 1996 Argentina had consolidated its reputation as a successful stabilizer and market reformer. In the words of the then Managing Director of the IMF: "(…) the fact that Argentina was able to withstand the Mexican crisis and restore growth and market confidence so quickly thereafter is a great tribute to these policies" (Cambdessus, 1997: 3). In this context, it is not surprising that the IMF and its main constituents were keen to associate themselves with Argentina's apparent successful implementation of policies so closely aligned with the Washington Consensus.

The lack of structural benchmarks in the 1996 SBA and the weak enforcement of this program's fiscal conditionality can be interpreted as further evidence of an initial convergence in the preferences of both sides' negotiators. At this stage the Fund's

[65] This is not only because precautionary arrangements provide access to the resources committed by the program at the discretion of the borrowing country should the need arise, but also because it is usually easier to augment an existing program than to negotiate a new one from scratch.

willingness to provide insurance without extracting relevant policy concessions from the Argentine authorities is consistent with the idea that the institution and its main constituents were in broad agreement with the general policy stance adopted by the Menem administration. Following this line of thinking, the more demanding conditionality attached to the 1998 EFF could be interpreted as a sign of emerging divergences between the preferences of Argentine and IMF negotiators. In fact, although in early 1998 the Argentine economy was still in a relatively good shape, there were growing concerns among IMF officials about a weakening fiscal discipline and about the government's increasing sluggishness in the structural arena, especially with regard to labour market reform (Teresa Ter Minassian. Personal interview. 28 April 2011; Allen, 2003; IEO, 2004).

If the IMF managed to extract stronger concessions from the Argentine authorities in the initial negotiation of the 1998 EFF, why was it so tolerant with an increasingly apparent weak compliance with this program's conditionality in subsequent reviews? A first explanation is that the IMF's leverage over the Argentine authorities was constrained by the fact that Argentina was not making use of the resources committed by the program (Blustein, 2003: 52; IEO, 2004; Domingo Cavallo. Personal interview. 21 July 2010; Teresa Ter Minassian. Personal interview. 28 April 2011). Another explanation for the aforementioned leniency with Argentina is rooted in other strategic considerations on the part of the G7, which sustained a wide IMF win-set during this period. Since the collapse of the Thai baht in July 1997, the institution had been the subject of intense criticism for its handling of the Asian crisis. In this context, the general perception of an Argentine success story was used as a vindication not only of the Fund's involvement in emerging markets but also of the liberalization policies that were associated with this success and that were under attack in Asia.[66] In the words of the then chief economist of the IMF: "With the Fund under widespread criticism (rightly or wrongly) 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 skunk at the garden party, by stressing the accumulating failures of Argentine fiscal policy" (Mussa, 2002: 20). Further reinforcing

[66] This was epitomized in the unusual invitation to President Menem to address the international community alongside President Clinton during the IMF-World Bank annual meetings in October 1998.

these dynamics, in the aftermath of the 1998 Russian default, IMF constituents came to fear that pointing the finger at Argentina could intensify an on-going financial contagion and trigger another crisis in one of the few remaining bright spots of the emerging world (IEO, 2004).[67]

Focusing next on Argentina's domestic ratification politics during the implementation of the two precautionary programs, there are reasons to argue that Menem's second administration departed from a large win-set, which gradually contracted as the 1999 general election approached. Indeed, President Menem was re-elected in 1995 by a landslide and his Justicialist Party (PJ) obtained absolute majorities both in Congress and the Senate while retaining control of most of the provinces. Given that these elections took place in the midst of the Tequila crisis, such an electoral success indicated a strong support for the orientation of the government's economic policies which resulted from the successful macroeconomic stabilization of the early 1990s. This should be expected to have facilitated the ratification of the (few) conditions associated with the 1996 SBA. The mid-term legislative elections in October 1997, instead, yielded very different results as the PJ lost its absolute majority in the Chamber of Deputies and the newly formed Alianza coalition obtained more than 45% of the popular vote, substantially reducing the size of Argentine negotiators' win-set and making it more difficult to ratify the conditions agreed with the IMF.

On top of reducing the size of its win-set, the political weakening of the Menem administration pushed Argentine negotiators' preferences away from those of the IMF. Many in the Justicialist Party interpreted the 1997 electoral set-back as clear evidence of the growing unpopularity of the IMF-supported neo-liberal agenda with which the Menem administration was so closely associated, a trend that became more pronounced with the onset of economic recession in late 1998 and with unemployment rates reaching 15% (Carlos Rodríguez. Personal Interview. 20 September 2010; Bonelli, 2003). Furthermore, in the run-up to the 1999 elections and given the declining popular support to the Menem administration, the PJ became increasingly focused on the

[67] The Fund's negotiators seem to have been less permeable to this type of political calculations. Indeed, various sources argue that some of the senior IMF officials working on Argentina were keen to adopt a tougher stance with regard to conditionality (Blustein, 2003: 50,51; IEO, 2004; Teresa Ter Minassian. Personal interview. 28 April 2011). However, the Fund's management and some key Executive Directors opposed this strategy, favouring instead the maintenance of a more tolerant approach in order not to put relationships with Argentina at risk.

mobilization of its Peronist grassroots organizations and patronage networks, which weakened the government's incentives to comply with the program's conditionality (Eaton, 2005). On the macroeconomic side, this resulted in a marked deterioration of provincial finances, especially after restrictions were softened for provinces to issue debt during Menem's second administration, a move that was partly aimed at securing the political support of the Peronist governors (Jiménez and Devoto, 2000). In the words of Domingo Cavallo, this turned provincial bonds into the 'toxic assets' of the Argentine crisis (Domingo Cavallo. Personal interview. 21 July 2010). On the structural side, the need to mobilize the traditional Peronist power bases led to inaction. This point was emphasized by the then IMF mission chief, according to whom the main reason why the government failed to liberalize the labour market, as had been contemplated in the program, was that when the PJ's electoral prospects got grimmer the support of the Peronist labour Union (*Confederación General del Trabajo* or CGT) became increasingly important (Teresa Ter Minassian. Personal interview. 28 April 2011).

Summing up the two-level game interpretation of the Fund's involvement in Argentina during Menem's second administration, both sides of the negotiations departed from converging preferences and relatively large win-sets, which sustained the cooperative outcome of the level I game. After the 1997 mid-term elections, however, the government was faced with a much stronger opposition and with uncertain prospects in the 1999 general election, resulting both in a departure from the Fund's preferences and in a narrowing win-set. Instead, IMF negotiators' win-sets remained large due to their constituents' political and strategic calculations in the context of the criticism that their institution was facing in the aftermath of the Asian crisis. These parallel trends reinforced Argentine negotiators' bargaining power, explaining why an increasingly weak compliance with the program's conditionality was systematically waived by the IMF's Executive Board in 1998 and 1999. This would eventually contribute to the build-up of the fiscal vulnerabilities that were to explode subsequently under the De la Rúa administration.

What was the impact of the political transition from the Menem to the de la Rúa administrations on the negotiations with the IMF? The Alianza government was quick to negotiate a new precautionary program, signalling its willingness to preserve the nature of the Fund's previous engagement in Argentina. The SBA approved in March

2000, however, was somewhat different from its predecessors. First of all, it was significantly larger (see Table 4.1), reflecting a growing awareness about the risks facing the Argentine economy. Second, it contemplated a stronger macroeconomic conditionality, an early manifestation of which was the contentious *Impuestazo* introduced in January 2000. However, the new government continued to miss the program's targets with the consent of the Executive Board, which systematically approved waivers for the non-observance of these targets. These slippages were primarily the consequence of a rapidly deteriorating economic situation, of the systematically over-optimistic projections on which the program was based and of the rigid fiscal relationship with the provinces inherited from the Menem years.[68] Third, structural conditionality was also reinforced, particularly with regard to labour market reform. The domestic ratification of these conditions proved to be difficult and generated intense frictions in the governing coalition and in the Argentine political system as a whole.

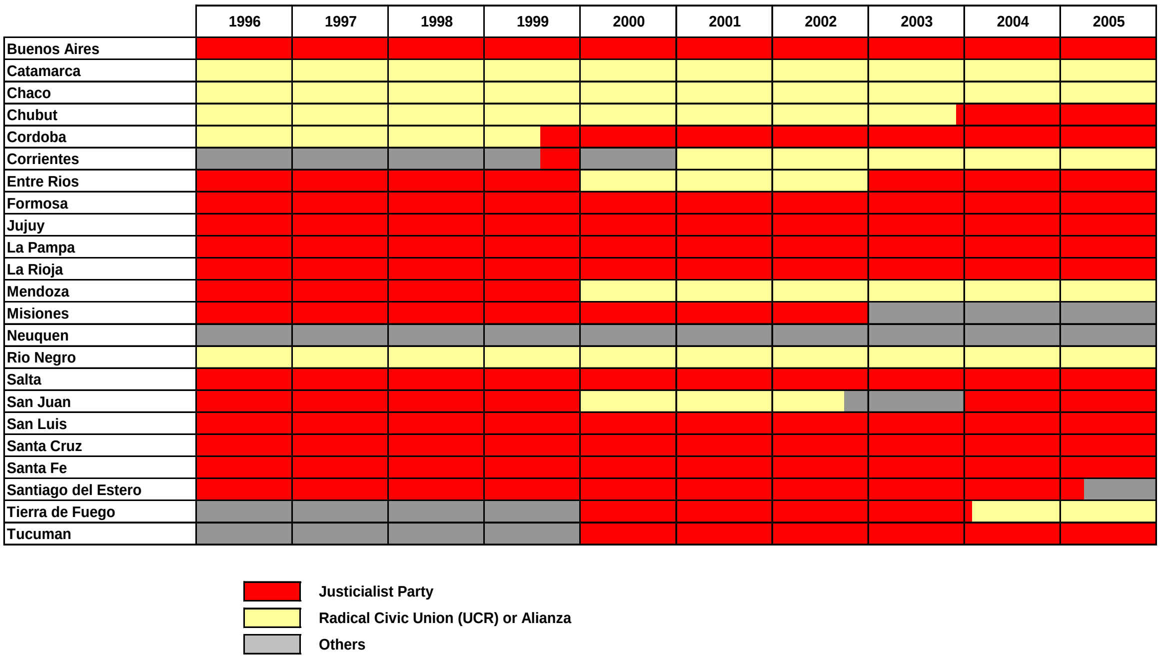
There is ground to argue that the change of government re-aligned Argentine negotiators' preferences with those of the IMF. Indeed, De la Rúa's Radical Civic Union (UCR) was initially determined to address the fiscal problem and to reignite a structural reform process that had stalled during the last years of the Menemist era. This facilitated the preservation of a cooperative outcome in the negotiations of a new and larger precautionary SBA (José-Luis Machinea. Personal interview. July 13, 2010; Teresa Ter Minassian. Personal interview. 28 April 2011). However, it soon became clear that the new government was politically weak and that progressing with its policy agenda would be difficult. Indeed, as opposed to the outgoing Justicialist Party, the incumbent Alliance for Work, Justice and Education (aka 'Alianza') was a coalition formed by UCR and the Frepaso (Frente País Solidario), a confederation of left of centre smaller parties generally opposed to the neo-liberal policies of the Menem years. Although UCR's preferences on macroeconomic policy and structural reform were aligned with the Fund's recommendations, the leaders of the FREPASO had traditionally held critical views about the prescriptions of the Bretton Woods institutions. On top of having to reconcile these internal differences, the Alianza

[68] The difficult inter-governmental relationship that characterized these years were partly the consequence of the rigid fiscal pact that Menem had reached with the provinces, which established a minimum revenue (*piso mínimo*) to be transferred to the provinces (Eaton, 2005).

coalition faced other significant domestic ratification constraints: it lacked an absolute majority in the Chamber of Deputies and, as shown in Figure 4.2, it controlled only 7 of the 23 Argentine provinces.[69] In this context, the frictions between the Federal government and the provinces became an obstacle to the fiscal consolidation attempts launched in 2000 and 2001.

Figure 4.2

Provincial governments in Argentina (1996-2005)



Source: Ministerio del Interior, Argentina

De la Rúa's administration, therefore, had a narrow win-set, which in the logic of the two-level game framework could only have reinforced Argentina's bargaining position. However, it has also been argued that preferences converged at this stage, reducing the relevance of this bargaining advantage. Illustrating this point, the then mission chief to Argentina argues that not only did the De la Rúa administration not resist the Fund's prescriptions, but it also bargained for a tougher conditionality on some issues (Teresa Ter Minassian. Personal interview. 28 April 2011). In this context, how did the two level games interact with each other? First of all, although Argentina's narrow win-set may not have been exploited in the negotiations of the program's conditionality it might have contributed to explain the bargaining process that resulted in the systematic

[69] Furthermore, as reported by Eaton (2005), even the provinces that were governed by the UCR often sided with Peronist governors during the De la Rúa administration.

approval of subsequent reviews in spite of increasingly apparent departures from the program's targets. Even more importantly, there is ground to argue that rather than using its domestic political weakness to get a better deal with the IMF, the De la Rúa administration initially viewed the Fund's conditionality as an instrument to generate a sense of urgency about the reorientation of Argentina's macroeconomic and structural policies (Domingo Cavallo. Personal interview. 21 July 2010). In other words, at this stage the Argentine government might have exploited the Level I game in order to facilitate the domestic ratification of the policies that it considered necessary to address the economic situation, and not the other way around.[70] As suggested by the congressional approval of two ambitious fiscal adjustments in 2000 and of the labour market reform passed later that year, this strategy paid off initially. However, it would eventually backfire when tensions within the coalition were laid bare by Vice-President Alvarez's resignation. Indeed, this event triggered the adverse market dynamics that forced the complete reappraisal of the program that is analysed in the next section.

4.3 Crisis management

The second phase focuses on the period of the Argentine financial crisis and can be divided into two sub-phases during which the negotiations with the IMF had a very different outcome. The first sub-period was characterized by the negotiations' cooperative outcome, which resulted in a large increase in the Fund's exposure to Argentina. Instead, the second sub-period was marked by the conflict that followed the suspension of the program in late 2001 and by the delays in the approval of a successor arrangement. This section does initially focus on the factors that preserved a win-set overlap during the first sub-phase. It will then concentrate on the reasons that were behind the collapse of that cooperative equilibrium in the two-level game and on the factors that prevented the resumption of a program relationship until January 2003.

Focusing on the first sub-period, the main trends observed in the Fund's involvement in Argentina after the resignation of Vice-President Alvarez in October 2000 can be summarized as follows. First, the intensification of the financial pressures that the Argentine economy was undergoing forced the government to draw from the

[70] This is consistent with Vreeland's conjecture about the domestic political use of IMF conditionality (Vreeland, 2003).

precautionary SBA that had been approved in March 2000. Furthermore, with the December 2000 and August 2001 augmentations the resources committed by the IMF under that program more than tripled, making the Argentine government increasingly dependent on the Fund's financial support in its struggle to save the Convertibility regime and to remain current on its sovereign obligations. Second, private sector involvement (PSI) constituted an important component of the two augmentations, first with the voluntary contributions agreed with private creditors in December 2000 and then with the launching of a domestic debt restructuring in September 2001. Third, the structural conditionality agreed with the IMF continued to be demanding and difficult to ratify domestically. After Minister Cavallo took office in March 2000 significant disagreements began to emerge about the direction of the reforms that the government was adopting, and no agreement could be reached on the structural conditions to be attached to the second augmentation. Fourth, although the first augmentation contemplated a temporary relaxation of the program's targets, fiscal conditionality was stringent during this period. Given that the recession continued to get worse during 2001, complying with this conditionality proved to be impossible. However, until the suspension of the program the Executive Board continued to systematically approve subsequent reviews in spite of significant departures from the program's targets.

Of the patterns described above, the most salient one was the increase in the scale of the Fund's financial support, which turned the SBA into one of the largest programs in history, fundamentally altering the nature of the relationship between Argentina and the IMF. To what extent can the first augmentation of December 2000 be explained in terms of converging preferences? The previous section has argued that following the election of President De la Rúa there was a re-alignment in the preference of both sides' negotiators about the orientation of Argentina's economic policies. As emphasized by former Minister Machinea, this convergence in preferences facilitated the negotiation of the conditionality that made the approval of the first augmentation possible (José-Luis Machinea. Personal interview. July 13, 2010). However, Chapter 3 has described the growing scepticism that was taking hold at the time about large multilateral bail-outs in the debate about the reform of the international financial architecture. This ideological trend could only have introduced a wedge between the Argentine and IMF negotiators' preferred outcome, at least with regard to the program's size. Therefore, a discussion on win-sets has to be brought into the picture.

There is little doubt that the resignation of Vice-President Alvarez constituted a devastating blow to the Alianza coalition, substantially narrowing Argentine negotiators' win-set. Instead, there are various factors that sustained a relatively large IMF win-set during this period. First, the Fund's constituents were conscious that a full-blown crisis in Argentina was bound to be partly blamed on the IMF, a trend that was to become more relevant subsequently (Mussa, 2002). Second, in spite of the aforementioned growing scepticism about IMF bailouts, during the negotiations of the December 2000 augmentation the Clinton administration was still in power in the US. Its ideological inclination to use multilateral financial packages of an exceptional magnitude to prop up emerging markets undergoing a sudden stop in capital inflows could only have expanded the Fund's win-set in the direction of Argentine negotiators' preferred outcome (José-Luis Machinea. Personal interview. July 13, 2010). [71] Third, the opposition of other more sceptical IMF constituents could be overcome with the unprecedented inclusion of private commitments for an amount of US$ 20 billion in the program, which was presented as an important breakthrough in the implementation of the new PSI doctrine adopted with the Prague Framework described in Chapter 3 (IEO, 2004; Daniel Marx. Personal interview. June 28, 2010).[72]

It will be argued later that the narrowing of the Argentine win-set played a crucial role in the collapse of the cooperative equilibrium in the negotiations. Because the Fund's win-set was still large, however, by the time of the first augmentation this trend did not yet eliminate the overlap between the Argentine and the IMF win-sets and, therefore, the negotiation's cooperative outcome was preserved. Furthermore, in the logic of the two-level game, the evolution of win-sets described above could only have provided Argentine negotiators with a bargaining advantage over their IMF counterparts, which might contribute to explain some of the outcomes of the negotiations such as the size of

[71] Machinea did also point out concerns in the US administration about the political consequences that the Argentine crisis could have domestically and regionally (José-Luis Machinea. Personal interview. July 13, 2010).

[72] Whether these private commitments did actually constitute an addition to the package, however, is open to discussion. According to former Minister Cavallo, such private contributions were only 'cosmetic' since the financial institutions that took part in the deal did not guarantee the interest rate at which they would place Argentine bonds in 2001 and thereafter (Domingo Cavallo. Personal interview. July 21 2010). The 2004 IEO report is also critical about the vagueness of the Prague Framework with regard to PSI. It argues that because involuntary PSI remained ill-defined, it was difficult for IMF officials to meaningfully apply the new doctrine to address the Argentine crisis (IEO, 2004).

the augmentation or the terms in which it was approved. Indeed, only one fifth of the augmented program was provided under the more demanding financial terms of the Supplemental Reserve Facility (SRF) in spite of the fact that this facility had been introduced in 1997 as the instrument to counter the sort of sudden reversals in the capital account that Argentina was undergoing. The 2004 IEO on the Argentine crisis report mentions that some Executive Directors objected to the composition of the augmented program, arguing that Argentina was being treated exceptionally and that the Fund was failing to deploy its crisis resolution instruments according to existing rules (IEO, 2004).

Of all the program-related decisions adopted during this crisis, IMF insiders have been particularly critical of the maintenance and expansion of the Fund's financial support in 2001 in spite of the growing realization that the Argentine macroeconomic framework had become unsustainable (Mussa, 2002; Allen, 2003; IEO, 2004; Roubini and Setser, 2004). These decisions constitute a puzzle for the following reasons. First of all, the victory of the Republican Party in the 2000 US elections marked a turning point in the reform of the international financial architecture. Indeed, senior officials in the Bush administration, and in particular the new Treasury Secretary Paul O'Neill, had repeatedly expressed their intention to bring multilateral bailouts to an end while adopting an uncompromising rhetoric in their public assessments of the Argentine crisis.[73] Second, as described in section 4.1.2, after the appointment of Domingo Cavallo as Economy Minister, the Argentine government began to implement a set of increasingly heterodox policies that departed from the preferences of the Fund's negotiators and of their constituents. Furthermore, in spite of the fact that some of these measures breached the program's conditionality, Cavallo did systematically fail to consult the IMF prior to launching them (Daniel Marx. Personal interview. June 28 2010; IEO, 2004).[74] In the context of a narrowing IMF win-set and of the government's departure from the Fund's preferences, how could the Argentine authorities successfully bargain for the completion of the May 2001 program review and for the August augmentation?

[73] Paul O'Neill famously stated in July 2010 that "Argentines have been off and on in trouble for 70 years or more. They don't have any export industry to speak of at all. And they like it that way. Nobody forced them to be what they are." (The Economist, 2010)
[74] For instance, upon taking office, Cavallo adopted a brief fiscal stimulus which breached the government's macroeconomic commitments with the IMF.

According to the 2004 IEO report, the May review was approved in spite of blatant departures from the program's conditionality because both the Fund's staff and Executive Directors understood that a suspension of the program would result in a financial collapse of uncertain consequences (IEO, 2004). Furthermore, it was considered at the time that Minister Cavallo still deserved the benefit of the doubt given his international reputation as the architect of the Convertibility Regime. Although most of his early measures had gone against the spirit of the augmented program, in May 2001 the Fund's constituents were still willing to assume that these were exceptional and transitory actions, and that in the longer-term Minister Cavallo's preferences still converged towards those of the IMF: fiscal discipline and an orthodox economic management.[75] More importantly, the Fund's constituents might have interpreted that the 'exceptional powers' that the Argentine Chamber of Deputies had granted Cavallo upon taking office provided the government with a minimum room for manoeuvre to overcome the domestic ratification obstacles that had stood on the way of the implementation of the program augmented in December.[76] In other words, the Chamber of Deputies' show of support to Minister Cavallo could only be perceived as having increased the size of Argentine negotiators' win-set, reinforcing its overlap with that of the IMF and thereby improving the prospects for the maintenance of a cooperative outcome in the level I game.

The credibility that the Argentine government had hoped to regain with the appointment of Minister Cavallo, however, evaporated within a matter of weeks as his economic policies became increasingly erratic and ineffective. The cooperativeness that had hitherto characterized Argentina's relationship with the IMF was also undermined by Minister Cavallo's tendency to conceal relevant information and to present his decisions as a *fait accompli*. According to the then Finance Secretary Daniel Marx, by the time of the August augmentation, the relationship between Argentina and the IMF had turned

[75] This was explicitly recognized by the Fund's Managing Director, Hörst Kohler, in his assessment of the Executive Board's discussion about the May review: "The IMF recognizes that some policy measures, while essential in the circumstances, would be distortionary if maintained for a long period. Therefore, the IMF welcomes that the financial transaction tax and the trade tariff increases will be temporary" (IMFa, 2001).

[76] During its last few weeks in office, Minister Machinea failed to ratify some of the augmentation's prior actions as the Supreme Court rejected the pension and health reform that had been decreed by the government, which contributes to explain his resignation. In turn, Minister López Murphy's fiscal adjustment attempt failed in less than two weeks as a result of widespread political opposition.

into "a system of mutual pressures with little or no dialogue" (Daniel Marx. Personal interview. June 28 2010). He argues that the August augmentation was not backed by a real program in the sense that no agreement could be reached on concrete measures to revert the dynamics of the crisis.[77] One of the few meaningful compromises contemplated by the augmentation was the launching of a broad-based sovereign debt restructuring, which was a direct request from the US Treasury aimed at signalling that the PSI doctrine had not been abandoned (Blustein, 2003: 145-153; Domingo Cavallo. Personal interview. July 21 2010). What the Executive Board decided in August was to allow Argentina to make use of an additional US$ 6 billion of immediate multilateral support and to postpone negotiations on a new medium-term strategy until September. In other words, the August augmentation was agreed before the program itself, which constitutes a glaring departure from the Fund's practice. Unsurprisingly, this decision was contentious, as suggested by the six informal Board meetings held in August to discuss this topic and by the fact that the Dutch and the Swiss Executive Directors took the decision of abstaining in the vote in which the augmentation was finally approved (Blustein, 2003: 154).

A central factor behind this decision was the reluctance on the part of the Fund's negotiators and constituents to take the blame for the disorderly unravelling of the crisis that was expected to be triggered by a program suspension (IEO, 2004; Claudio Loser. Personal interview. April 26 2011). Former IMF chief economist Michael Mussa accuses Minister Cavallo of having strategically exploited these fears by leaking to the press in July that the IMF was about to increase the size of the program even though this decision was not even being debated yet (Mussa, 2004: 41-43). In this way, Mussa argues that Cavallo manipulated expectations in such a way that a failure to approve the augmentation would have unleashed devastating market dynamics, which was bound to be identified as the proximate cause of an Argentine collapse. Although former Minister Cavallo downplays the importance of such bargaining tactics, he acknowledges that at the time of the August augmentation, and even afterwards, he believed that the G7 would not be willing to assume the political liability of letting Argentina fall (Domingo Cavallo. Personal interview. July 21 2010). The perceived cost of non-agreement,

[77] When the augmentation was announced, the Fund's Managing Director did simply support the zero-deficit law that had been approved in July, and announced undertakings to negotiate a new revenue sharing agreement with the provinces (IMFb, 2001).

therefore, played a crucial role in maintaining a sufficiently large IMF win-set to accommodate another increase in multilateral support to Argentina. As subsequent events were to prove, however, this last cooperative equilibrium in the two level game was extremely fragile.

What were the factors that eliminated the win-set overlap, resulting in the suspension of the program in November 2001? To some extent, the collapse of the cooperative equilibrium was rooted in diverging preferences as IMF negotiators and their constituents found it increasingly difficult to support the heterodox measures adopted unilaterally by Minister Cavallo. Claudio Loser, the former head the Fund's Western Hemisphere Department (WHD), points out that these divergences became increasingly difficult to ignore after new data on the evolution of the stock of foreign exchange reserves was issued in September and October, revealing that it would be practically impossible to meet the program's targets unless the Argentine government accepted a fundamental overhaul of its economic strategy (Claudio Loser. Personal interview. April 26 2011).

On top of these diverging preferences, towards the end of 2001 the Argentine and the IMF level II games became increasingly constrained. On the Argentine side, the legislative elections held in October constituted another blow to the De la Rúa administration given that the Justicialist Party obtained majorities both in the Chamber of Deputies and the Senate.[78] This was interpreted as a rebuke to Minister Cavallo's management of the financial crisis. In addition, some of the desperate measures adopted subsequently, such as the so-called *Corralito*, were met with popular uproar, all of which signalled that Argentine negotiators had lost all room for manoeuvre and that their win-set was too constrained to stand any chance of successfully implementing an IMF program. On the side of the IMF, a crucial factor was the September 11th attacks. Daniel Marx recalls how the attacks resulted in the cancellation of crucial meetings with the Fund's management and with the US Treasury Under Secretary for International Affairs scheduled to take place in Washington in order to discuss the terms of a medium term strategy (Daniel Marx. Personal interview. June 28 2010). Apart from diverting the attention of IMF constituents, the feared impact of the attacks on international financial

[78] Reflecting the public disaffection with political parties, the percentage of blank votes reached an unprecedented 22% (Levitsky and Murillo, 2005).

stability turned the Argentine crisis into a secondary problem, which was explicitly recognized by Paul O'Neill in an address to the US Senate for Banking Affairs shortly after the attacks: "One week ago, Argentina was top of our agenda, it is no longer in that position, or at least not to the same extent" (Russell, 2010: 102). This reduced the perceived cost of letting Argentina fall, weakening the last remaining mainstay of the cooperative equilibrium that had lasted throughout most of 2001.

The suspension of the SBA turned out to have the devastating impact that, by and large, had been anticipated, at least in the short-term. What is perhaps the most puzzling aspect of the Fund's involvement in Argentina during the period under analysis is that it took one year to re-establish a program relationship, forcing the government to make net repayments to multilateral institutions during the most acute phase of the crisis. In terms of the two-level game, how can the evolution of preferences and win-sets explain this outcome? With regard to preferences, a relevant factor is related with the emergency measures adopted by the Duhalde administration in January, which clearly departed from the Fund's rules and prescriptions. This was particularly clear with regard to the adoption of a dual exchange rate regime and to the asymmetric pesoization of banks' assets and liabilities. However, the Argentine former Secretary of Economic Policy and the former Finance Secretary argue that, at that time, the resumption of the Fund's financial support was considered crucial to address the crisis and that the Duhalde government was willing to compromise for that purpose (Jorge Todesca. Personal interview. July 19, 2010; Lisandro Barry. Personal interview. September 13, 2010). In fact, early on in 2002, some of the initial measures adopted by the new administration were reverted, and other steps were taken as a sign of goodwill vis-à-vis the IMF (Amadeo, 2003; Bonelli, 2003; Ministerio de Economía y Producción, 2004). For instance, the exchange rate regime was unified in early February, the peso was floated a few weeks later, and the federal government reached a preliminary agreement with the provinces in order to reform the co-participation system.[79]

Why did the Fund's negotiators fail to respond to the Argentine administration's overtures? The internal bureaucratic politics of the IMF might have played an important role in this respect. According to Claudio Loser, Horst Kohler and Anne Krueguer were

[79] As part of this agreement, Governors relinquished the minimum revenue guarantee (*piso mínimo*) that had caused so many fiscal problems to the De la Rúa administration (Eaton, 2005).

determined to maintain an uncompromising negotiating stance “in order to make Argentina pay for its sins” (Claudio Loser. Personal interview. April 26 2011).[80] In fact, the months that followed the Argentine collapse witnessed a complete restructuring of the Western Hemisphere Department and most of the chief negotiators of past programs were either forced to resign or to change department within the IMF, the general perception being that they had been too soft on Argentina (Tenembaum, 2005: 39-43).[81] The restructuring of the WHD substituted Latin American senior officials for non-Latin American economists, considered less likely to be co-opted by the Argentine authorities, which illustrates the suspicions nurtured by the Fund’s management in the aftermath of the 2001 events. When the Indian national Anoop Singh became the Fund’s chief-negotiator in March 2003, therefore, his mandate was to avoid the mistakes of the past and to adopt a tougher negotiating stance (Amadeo, 2003: 101-103). In addition, after President Duhalde ratified the comprehensive default on private debt declared by his predecessor Rodríguez Saá, the IMF had reasons to be concerned about its own financial exposure to Argentina. This provided another reason to be particularly vigilant about the safeguards offered by the Argentine government. In the absence of credible safeguards, IMF officials might have perceived that delaying an agreement was a sensible strategy to gradually clean up the Fund’s balance sheet (Ernesto Ramírez. Personal Interview. 28 April 2011).

However, the Duhalde administration was hardly in a position to make credible commitments as a result of the following factors. First, Duhalde was not popularly elected and, therefore, lacked a clear mandate, which reduced the legitimacy of many of the radical measures that he was forced to adopt during his administration. Second, in spite of the majorities obtained by the Justicialist party in the 2001 elections, both houses of Congress were opposed to many of the measures that the government tried to ratify in order to comply with the Fund’s demands. A case in point was the rejection of Remes Lenicov’s plan to restructure the banking sector. The modification of the bankruptcy law and the derogation of the economic subversion law also forced the

[80] This is consistent with the view expressed by the then permanent representative of the IMF in Argentina from 2002 until 2004: after the suspension of the SBA there was a willingness to signal that countries systematically breaching the Fund’s conditionality were bound to suffer the consequences of their unsustainable policies (Luis Cubeddu, Personal interview, April 22, 2011).

[81] Tenembaum’s book offers an extensive interview with the former head of the Western Hemisphere Department, the Argentine Claudio Loser. Loser resigned from the IMF a few months after the December events.

government to embark on a bitter political battle not only with the opposition but also with many Justicialist Deputies and Senators.[82] Indeed, this was a period of great factionalism and confrontation within the PJ, as the party's failure to agree on a single Peronist candidate for the 2003 elections would later demonstrate (Levitsky, 2005). Third, although the Justicialist Party controlled most of the provinces, Governors became another crucial veto-player given that the reform of the co-participation system was considered by the IMF a crucial step to restore the solvency of the Argentine public sector. Fourth, year 2002 was marked by the conflict between the Executive and the Judiciary branches of government after the Supreme Court ruled the unconstitutionality of the *Corralito* in February, giving way to the thousands of court-ordered injunctions (aka *amparos*) that enabled Argentine families to re-access their savings (Helmke, 2005). As a result, the run on deposits was allowed to resume, leaving the banking system teetering on the brink of collapse one more time. Fifth, the Duhalde administration was subject to the un-abating pressure of the *Piquetero* movement, which organized daily blockades and mobilizations in Buenos Aires and the provinces to oppose many of the measures adopted by the government.[83] Summing up, a highly adversarial political environment resulted in a narrow Argentine win-set throughout 2002, which stood in the way of the negotiations with the IMF.

Regarding the Fund's win-set, with the US attention focused on the geo-political and financial priorities that emerged in the aftermath of the September 11th attacks and with other countries such as Germany, Italy and Japan aggrieved by the December default, the largest constituents of the IMF expressed little support for a new program in the first months of 2002.[84] In fact, after the December events, the G7 adopted a hands-off approach to the Argentine crisis, which made sense given the uncertainty that still surrounded the orientation of the policies that the Duhalde administration was adopting. In addition, given that the handling of the Argentine crisis had proved to be such a

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[82] In fact, the Fund's pressure on these two laws was deeply resented by the Duhalde administration for having further eroded the government's political capital for an issue that it considered far from central (Eduardo Amadeo. Personal interview. 26 July, 2010; Ministerio de Economía y Producción, 2004). Gilbert Terrier, the then Fund's representative in Argentina corroborates that the institution was focusing on these items because at the time it did not want to lend to Argentina (Gilbert Terrier. Personal Interview. April 26, 2011).

[83] In June 26th 2002, one of such mobilizations resulted in a brutal police repression and the assassination of two leaders of the Piquetero movement in the city of Avellaneda. President Duhalde argues in his memoirs that this event convinced him to bring forward the presidential elections scheduled to take place in late 2003 (Duhalde, 2007).

[84] There was a large stock of defaulted bonds in the hands of German, Italian and Japanese bondholders.

fiasco, there might have been an incentive to divert responsibility away from the G7 and onto the IMF as an institution. Furthermore, having already internalized the cost of no agreement associated with the suspension of the program in November, the cost of continuing not to agree was relatively small. As a result of the wait-and-see attitude adopted by the G7, the Fund's management and staff gained autonomy in the negotiations, which gave more prominence to the internal bureaucratic incentives described above. In mid-2002, therefore, the prospects for resuming cooperation were dire as a result of diverging preferences and narrow win-sets on both sides of the negotiations. Nevertheless, various relatively unexpected developments would contribute to reshape this bargaining process in late 2002, giving way to a new phase of Argentina's relationship with the IMF.

4.4 Restoring debt sustainability

The third phase analysed in this chapter was marked by the resumption of a program relationship between Argentina and the IMF. During this period, the negotiations were centred primarily on the restoration of Argentina's debt sustainability. Initially, the main priority for the Argentine government was to roll-over and re-profile its obligations to the IMF and to the other IFIs. Once that objective was achieved with the approval of two SBAs in 2003, restructuring the debt instruments in default since December 2001 became the most controversial issue in the negotiations. Disagreements about the government's bargaining tactics with private creditors would eventually result in the unilateral suspension of the program in August 2004.

Of the various factors that contributed to unblock the stalemate in the negotiations, the unanticipated recovery of the Argentine economy stands out in particular. After several quarters of negative growth GDP stabilized in the third quarter of 2002 and began to experience a robust expansion thereafter. The hyperinflation that had been so feared by the authorities also failed to materialize and the stock of bank deposits stabilized after July (Levy-Yeyati and Valenzuela, 2007: 189-212). [85] Furthermore, as a result of the depreciation of the peso, of the collapse of domestic absorption and of rising commodity prices, the current account balance jumped from a deficit of 1.4% of GDP in

[85] Monthly inflation rates fell from 50% in March to less than 1% in the last three months of 2002.

2001 to a surplus of 8.5% of GDP in 2002. In addition, together with the adjustment measures undertaken by the Duhalde administration, the introduction of an export tax in March 2002 resulted in a substantial improvement in public finances, which registered a consolidated surplus of 1.8% of GDP in 2002.

This turnaround in macroeconomic performance had the effect of gradually alleviating the external financing needs of the economy as a whole and of the Federal Government in particular, which enabled Argentine negotiators to revise their aspirations and bargaining tactics vis-à-vis the IMF. Indeed, Minister Lavagna describes how he gradually came to the realization that the economy could recover without a massive injection of official support (Roberto Lavagna. Personal interview. July 20, 2010). Instead of bargaining for a new program in the range of US$ 20-25 billion, Argentine negotiators' focus was redirected to rolling-over existing multilateral obligations. This realignment in Argentina's preferences proved to be an option that the US and the international community as a whole were more willing to contemplate.

Another consequence of the economic recovery was that, together with the elimination of banking restrictions in December 2002, a renewed sense of stability provided a boost to the Duhalde administration, thus increasing the size of Argentine negotiators' win-set. This trend was reinforced after the April 2003 elections, which put an end to the caretaker administration of President Duhalde. In fact, the electoral victory of Néstor Kirchner, a relatively unknown politician and the governor of the sparsely populated province of Santa Cruz, was largely attributed to his pledge to maintain the economic policies implemented during the Duhalde administration. Indeed, President Duhalde explicitly backed his candidacy, and Roberto Lavagna announced that he would accept retaining the post of economy minister only with Néstor Kirchner as President. The outcome of the elections, therefore, substantially reinforced the political position of Argentine negotiators, which could only have facilitated the domestic ratification of the conditions that were to be attached to the IMF program.

However, the Argentine government didn't use this expanded room for manoeuvre to compromise with the IMF. In fact, the rhetoric adopted by Minister Lavagna and his team during this period as well as the default threats described in section 4.1 suggest otherwise. This raises the question of why the Argentine authorities did adopt a tougher negotiating stance precisely when the domestic ratification obstacles that they had hitherto faced were beginning to subside. To some extent, the bargaining tactics adopted by Minister Lavagna might be explained by the fact that Argentine negotiators felt entitled to the temporary roll-over they were bargaining for (Leonardo Madcur. Personal interview. 29 July, 2010). However, other strategic calculations might have also played a role in this respect, initiating a pattern that gained importance subsequently: because the idea that Argentina was being treated unfairly took hold in broad sectors of the electorate, cultivating the image of tough negotiators with the IMF turned into an asset for politicians. In Putnam's terms, the international negotiations with the IMF reverberated negatively within domestic politics, thus hindering cooperation (Putnam, 1988). This became particularly relevant in the run-up to the 2003 elections because the main opposition candidate was former president Carlos Menem, broadly perceived to be a close ally of the IMF (Roberto Russell. Personal interview. June 26, 2010).[86] There is ground to argue, therefore, that although their win-set was gradually expanding, Argentine chief negotiators had a political incentive to emphasize their divergence from the Fund's preferences. This trend would become even clearer under the Kirchner administration, during which the President's hardened rhetoric against foreign creditors contributed to feed his soaring approval rates (Levitsky and Murillo, 2005).[87]

Focusing next on the IMF's win-set, various factors contributed to change the position of some of the Fund's most powerful constituents. First of all were the Argentine government's threats to default on its multilateral obligations, which clarified what the cost of non-agreement would be if the approval of a new program continued to be postponed. There are, however, contrasting views about the extent to which these threats truly forced the hand of the Fund's principals. Whereas former Minister Lavagna and the IMF's former representative in Buenos Aires Ernesto Ramírez attributed a central importance to the November 2002 threat and to the September 2003 temporary default on Argentina's multilateral obligations, former Secretary of Finance Leonardo Madcur argues that this was a secondary issue and that the agreements that were

[86] In the run-up to the elections, the leaders of the Peronist candidates could not agree on a single candidate. As a result, three Peronists contended in the elections: Kirchner, Menem and Rodríguez Saá.
[87] Illustrating Kirchner's position, in his inaugural address he already warned international creditors that his government would not honour its obligations "at the price of the hunger and exclusion of Argentines". A few weeks later he openly blamed the IMF for the Argentine crisis during Horst Kohler's visit to Argentina, and during his first address to the UN General Assembly he stated that "no one is known to have succeeded in getting their money back from the dead" (Economist, 2003b; Economist, 2003c).

eventually reached with the IMF should be interpreted as the result of the compromises made possible by months of policy discussions (Roberto Lavagna. Personal interview. July 20; Ernesto Ramírez. Personal interview. 28 April 2011; Leonardo Madcur. Personal interview. 29 July, 2010). The then US Executive Director at the IMF's Board, Nancy Jacklin, also considers that the Argentine default threats played a marginal role in the Board's decision to approve both the short and the long SBAs (Nancy Jacklin. Personal Interview. 16 May 2011).

A second factor that altered the positions held by some of the Fund's constituents was the pressure that private financiers were beginning to exert on the IMF. Luis Cubeddu, former IMF representative in Buenos Aires, describes the controversy that resulted from the fact that while the debt instruments in the hands of private investors remained in default, the IMF and the other IFIs were being paid in full in spite of which these institutions continued to refuse to provide new lending (Luis Cubeddu, Personal interview, April 22, 2011). Because this anomalous situation was used as an argument to question the IFIs' preferred creditor status, the US government among other constituents began to view the approval of a new program not only as a solution to an uncomfortably lengthy conflict with Argentina but also as a necessary step to avoid controversies about the Fund's position in the international financial system (Nancy Jacklin. Personal Interview. 16 May 2011).

A third factor that altered the contours of the Fund's win-set was the rapprochement that began to take hold between the Argentine and the US governments as year 2002 went by. Former ambassador to the US Eduardo Amadeo describes intense Argentine efforts to re-establish transnational alliances with IMF constituents (Eduardo Amadeo. Personal interview. 26 July, 2010). He argues that in early 2002 the only relevant allies on which the Argentine government could count in the negotiation of a new program were middle range powers such as Cardoso's Brazil or Aznar's Spain. Given that these countries have a limited weight in the Executive Board, their support was insufficient to substantially alter the contours of the Fund's win-set. However, Amadeo argues that their collaboration was important to gradually change the perceptions of other larger IMF constituents and, in particular, those of the US administration. On top of these diplomatic efforts, the Argentine government hired two Washington-based lobbying firms to re-establish a dialogue with the US Treasury and the State Department.

Although it is impossible to assess the extent to which this strategy paid off, it is clear that the US administration's willingness to become involved in Argentina increased during the second half of 2002. This tendency could already be discerned in July 2002, when the US Treasury suggested that a panel of independent advisors be formed in order to mediate between Argentina and the IMF.[88] A few weeks later, in August, the US Treasury Secretary Paul O'Neill visited Argentina for the first time. Roberto Lavagna argues that during this visit Paul O'Neill was positively surprised to learn that the government was only asking to roll-over existing obligations and that the economy was exhibiting some signs of recovery (Roberto Lavagna. Personal interview. July 20, 2010). Soon after a proper draft Letter of Intent for a new program began to be drafted, although the negotiations dragged for a few more months (Amadeo, 2003: 254, 255). In mid-December the US Treasury took the bolder step of coordinating the position of its G-7 counterparts to instruct the Fund's management to take the necessary steps for the roll-over of Argentina's multilateral obligations (Amadeo, 2003: 326; Bonelli, 2003: 285-287; Economist, 2003a).

One of the most extraordinary features of the period that preceded the approval of the 2003 SBAs was that up until a very late stage in the negotiations the Fund's management continued to oppose the temporary roll-over of Argentina's obligations.[89] How can this divergence between the preferences of the Fund's chief-negotiators and of some of its largest constituents be explained? A first possible explanation is related with the fact that in spite of the increased receptiveness of the US administration, a consensus on the approval of a new program was far from being reached in late 2002. In fact, various G7 countries such as Germany and Japan as well as other industrial countries like the Netherlands and Switzerland were still reluctant to compromise and explicitly opposed the approval of a new program (Amadeo, 2003: 265). In the face of

[88] This panel was eventually formed by a group of prominent central bankers: Andrew Crocket (General Manager of the Bank for International Settlements), John Crow (former Governor of the Bank of Canada), Luis Angel Rojo (former Governor of the Bank of Spain) and Hans Tietmeyer (former President of the Deutsche Bundesbank). It produced a report that was only partially disclosed. Minister Lavagna argues that this "outsourcing" was resisted by IMF staff on the grounds that it undermined its authority.

[89] In a Board meeting held on December 20th, 2002, the Fund's management explicitly recommended not to approve the transitory SBA (Amadeo, 2003; Bonelli, 2003). Although the staff report discussed on the day in which the transitional SBA was eventually approved recommended the roll-over of Argentina's obligations, it did so reluctantly, the perception being that it was an imposition of the G-7 (Roberto Lavagna. Personal interview. July 20, 2010; Economist, 2003a).

this fuzzy win-set, the Fund's negotiators may have overestimated their autonomy in the negotiations with Argentina. A complementary explanation is rooted in the Fund's internal bureaucratic politics. At a time in which the institution was being so heavily criticized for its past largesse with Argentina, Horst Kohler and Anne Krueguer may have perceived that reasserting their independence was of crucial importance (Claudio Loser. Personal interview. April 26 2011). A third explanation is related with the fact that the cost of no agreement may have been perceived to be larger for the Fund's constituents than for the IMF itself. There is no denying that an Argentine default constituted an obvious risk for the Fund's balance sheet. However, because the Fund's constituents are also the shareholders of the other multilateral institutions, their assessment of the costs and benefits of approving the transitory SBA is likely to have been influenced by the additional risks posed by the World Bank and the Inter-American Development Bank's large exposure to Argentina (Ernesto Ramírez. Personal interview. 28 April 2011).

Summing up the discussion about the factors that made the resumption of a program relationship possible, it has been argued that the onset of an economic recovery played a fundamental role by altering Argentine negotiators' preferred outcome and bargaining tactics. Another central development was the broadening of the Fund's win-set, which was brought about by a rapprochement between the Argentine and the US governments, by growing concerns about the Fund's preferred creditor status and by the government's threats to default on its multilateral negotiations. Although these factors restored a win-set overlap, this cooperative equilibrium in the two-level game was a fragile one as a result of the incentives facing both sides' negotiators. On the side of the IMF, it has been argued that negotiators had a bureaucratic incentive to maintain a hard stance on Argentina in order to restore their reputation and reassert their independence. In turn, on the Argentine side the negative reverberation of the negotiations with the IMF on the Argentine domestic political debate created an incentive for the government to appear tough on the institution.

As mentioned above, after the resumption of a program relationship, the Argentine sovereign debt restructuring process came to play a central role in the negotiations with the IMF, gradually feeding the disagreements that were to result in the unilateral suspension of the SBA. Argentine chief-negotiators perceived that an excessive IMF interference in this process stood in the way of the maximization of the haircut to be extracted from bondholders (Ministerio de Economía y Producción, 2004; Tenembaum, 2005). This was due to the fact that setting a deterministic adjustment path in the program's macroeconomic conditionality was feared to leave the losses required from private creditors to restore the sustainability of Argentina's debt as a residual variable, thus restricting the government's discretion to make restructuring offers on its own terms. Furthermore, rather than relying on the macroeconomic framework elaborated by IMF economists, Argentine negotiators wanted to back their restructuring offers with their own intentionally pessimistic growth projections, which would also have an impact on the calculation of the necessary haircut (Sebastián Katz. Personal Interview. July 19, 2010). On top of these considerations about the SBA's macroeconomic framework, Argentine negotiators were increasingly reluctant to accept the validity of the Fund's assessments on their good faith, which under the policy of lending into arrears had become a part of the program's conditionality (see Chapter 3). In fact, this concept's vagueness became a recurrent source of contention not only with the Argentine government but also with private creditors.

It is in this context that the Argentine chief-negotiators refused to include fiscal targets for 2005 and 2006 in the three years SBA approved in September 2003. This constituted another glaring departure from the Fund's practice, which explains why both management and various IMF constituents opposed the concession of a program in these terms. On this occasion, the Argentine government went further than before, missing a payment to the IMF and, even more importantly, threatening to leave the institution altogether.[90] However, the key factor behind the approval of this SBA was the support of the US government, which was only partially aimed at avoiding the cost of no agreement described above. Rather, as emphasized by Helleiner (2005), the US position on Argentina was largely motivated by the Bush administration views on the role that 'bail-ins' should play in the international financial architecture. Furthermore, after the demise of the SDRM debate, senior officials in the US administration were

[90] According to former minister Lavagna, the government seriously considered this option because the Fund's charter establishes that those countries that decide to drop their membership have the legal obligation to cancel their debt within a period of five years. Leaving the IMF, therefore, would have been equivalent to automatically rolling over Argentina's obligations to the Fund for a maximum of five years without requiring the continuous negotiation of new SBAs and the periodic discussions about the government's policies in subsequent program reviews (Roberto Lavagna. Personal interview. July 20, 2010).

committed to the idea that sovereign debt restructurings should be market-based and that the IMF should accompany these processes without exerting too great an influence on their final outcome (John Taylor. Personal Interview. 5 April, 2011; Nancy Jacklin. Personal Interview. 16 May 2011). In the words of the Assistant Secretary of the Treasury for International Affairs Randal Quarles: "(…) it is not the IMF's role to impose the terms of the deal. The fiscal component of the [Argentine] program intentionally left the primary surplus for future years unspecified above a 3 per cent floor in order to give Argentina and its creditors the flexibility to reach a sustainable agreement".[91] Given the ideological inclinations of the Bush administration, it made sense for the Argentine chief-negotiators to cultivate a transnational alliance with the US Treasury, which by then had become the mainstay of the cooperative equilibrium in the two level game.[92]

However, after the government disclosed the Dubai terms, and given the increasingly generalized perception that Argentina was not doing enough to settle with private creditors, it proved to be increasingly difficult for the US Treasury to coordinate the positions of its counterparts at the Executive Board. Indeed, as many as eight Executive Directors abstained from voting at the Board meeting that approved the first program review, including the representatives of three G7 countries: Italy, Japan and the United Kingdom. These growing internal dissentions among the Fund's largest constituents increased the cost for the US to continue siding with the Argentine government, as a result of which the reduction in the size of the IMF's win-set could no longer be contained with the transnational alliance described above. After another Argentine threat to default on its multilateral obligations, the second program review of March 2004 was eventually approved following John Taylor's intervention and the Argentine government's acceptance of the GCAB as a valid counterpart in the debt restructuring negotiations. However, this would be the last program review to be approved by the Board: after delays in the approval of the third review, the Argentine government communicated in August 2004 that it would unilaterally postpone further reviews until

[91] http://www.ustreas.gov/press/releases/js1288.htm

[92] According to Roberto Lavagna, the key difference between the Clinton and the Bush administrations that made this transnational alliance possible was that the latter was less captured by the interests of the financial sector (Roberto Lavagna. Personal interview. July 20, 2010). In his views, the fact that, as opposed to Robert Rubin and Larry Summers, both Paul O'Neill and John Snow originated from the 'productive' sector influenced their views about the need for financial investors to absorb the cost of their wrong decisions.

the completion of the debt restructuring, continuing to honour its obligations to the Fund but voluntarily giving up the right to draw from the 2003 SBA (Nielsen, 2006).

The unilateral suspension of the program, therefore, was the result of a narrowing IMF win-set after the US Treasury decided not to continue intervening in favour of the Argentine government at the cost of antagonizing its G7 counterparts. It constituted another innovation in the Fund’s engagement in emerging countries given that it is normally the case that the institution suspends a program in the face of departures from conditionality rather than the other way around. Why did the Argentine chief-negotiators resort to such an unusual reframing of their relationship with the IMF, and why did the IMF accept it? To some extent, the Argentine decision was made possible by a legal vacuum in the sense that the possibility for a country to refuse to take part in program reviews at the cost of giving up its right to draw from the program had never been contemplated. On the Argentine side, this move made sense in order to prevent the Fund from interfering in the debt restructuring process. Although this would have also been the result of a more traditional suspension of the program by the IMF, the authorities did not want the Board to issue a final negative assessment about their good faith, which would have somewhat de-legitimized their bargaining stance with private creditors (Leonardo Madcur. Personal interview. 29 July, 2010). On the IMF side, given that the government committed to continue honouring its multilateral obligations as they came due, the unilateral freeze of the program allowed the institution to gradually reduce its exposure to Argentina. Furthermore, the suspension of the program was consistent with the US objective of limiting the Fund’s interference with the debt restructuring without causing further rifts at the Executive Board. In other words, the Argentine move was instrumental to mask the fact that the Fund’s main constituents were finding it increasingly difficult to agree on a best course of action for Argentina.

After August 2004, therefore, the innovative unilateral suspension of the program described above was the last resort to avoid another collapse of cooperation in spite of the fact that the overlap between the Argentine and the IMF win-sets had by and large disappeared. Apart from the 2005 Article IV consultation, discussions about the government’s economic policies were kept at a bare minimum as suggested by the fact that even when the IMF agreed to extend repurchase expectations in September 2004 and May 2005 it was clarified that such decisions were not based on the assessment of the authorities' economic program (IMF, 2004b). Although after the completion of the debt exchange the Fund's Managing Director announced the beginning of talks on a new program, such negotiations led nowhere (IMF, 2005c). This was partly due to the fact that, under the policy of lending into arrears, a new program would have required the Argentine government to act in good faith in order to settle with holdout creditors, which it was not willing to do. In October 2005, President Kirchner triumphed in the legislative elections, obtaining 54% of the vote. Again, rather than using the expanded room for manoeuvre that this electoral success provided to compromise with the IMF, he adopted a policy stance that further departed from the preferences of the Fund's constituents.[93] The reluctant cohabitation between Argentina and the IMF was eventually brought to an end in December 2005 when President Kirchner announced that his government would anticipate the cancelation of its outstanding obligations under the SRF. This final move was presented to the public almost like a second declaration of independence, which illustrates the symbolism that the IMF had acquired in the Argentine political debate.[94]

4.5 Conclusion

This chapter has applied an adapted version of Putnam's two level games in order to study a decade of IMF involvement in Argentina. The period under analysis (1996-2005) departs from a cooperative equilibrium sustained by converging preferences and large win-sets on both sides of the negotiating table. The progressive political weakening of the Menem administration, however, gradually eroded the Argentine win-set, while creating a domestic incentive to depart from the Fund's preferences in order for the government to retain the support of its Peronist bases. Given that the Fund had reasons to emphasize at least one success story in the context of the criticism elicited by its management of the Asian and Russian crises, its win-set remained large, conferring a bargaining advantage to Argentine negotiators. As a result, the Executive Board systematically tolerated Argentina's non-compliance with the programs' conditionality,

[93] That President Kirchner would harden his rhetoric after the elections became obvious in the fourth Summit of the Americas held in November in Mar de Plata, during which he made a heated speech criticizing the role played by multilateral organizations in Argentina and elsewhere in Latin America (http://www.summit-americas.org/NextSummit_eng.htm).
[94] http://www.lanacion.com.ar/nota.asp?nota_id=765314

which contributes to explain the build-up of the fiscal fragilities that were to aggravate the crisis subsequently.

After the De la Rúa administration took office in December 1999 preferences reconverged, but Argentine negotiators' win-set continued to narrow, especially after the contentious resignation of vice-President Álvarez. Although this trend may have conferred them a bargaining advantage during the negotiations of the two augmentations and of some program reviews, growing concerns about the ability of the Argentine government to ratify the measures contemplated in the SBA would eventually contribute to destabilize the co-operative equilibrium. In addition, two developments altered the contours of the Fund's win-set, contributing to explain the suspension of the program in December 2001. First was the adoption of a new doctrine on multilateral bailouts by the Bush administration, which was much less keen to put tax-payers' money at risk in order to rescue emerging markets than its predecessor. Second were the September 11th attacks, which turned the Argentine crisis into a secondary issue, reducing the perceived cost of non-agreement that had sustained the Level I game's cooperative equilibrium throughout most of 2001.

The subsequent conflict was rooted in diverging preferences on the emergency measures required to address the crisis and in narrow win-sets on both sides of the negotiation. In Argentina, this period was initially characterized by the political weakness of the Duhalde administration and by the profound divisions that the economic debacle had unfolded. As a result, ratifying the measures that the IMF demanded in order to resume a program relationship was nearly impossible. In turn, the Fund's negotiating position was hardened by the institution's internal bureaucratic political dynamics and by the hands-off approach adopted by the G-7, which increased the autonomy of IMF negotiators throughout most of 2002. A new program could eventually be approved after the first signs of an incipient economic recovery allowed Argentine negotiators to revise their aspirations and to reconstitute a transnational alliance with the US Treasury. In other words, shifting Argentine preferences with regard to the size of the program together with the broadening of the Fund's win-set that resulted from the support of the US government helped reconstitute a win-set overlap.

However, this proved to be a fragile cooperative equilibrium due to the presence of domestic political incentives for the Argentine government to depart from the Fund's preferences on economic policy and to increasing dissent among IMF constituents on the Argentine program. When the loss of a win-set overlap became obvious, the Argentine government avoided a complete collapse of the cooperative equilibrium by unilaterally giving up its right to draw from the IMF in order not to be subject to the obligations associated with a normal program relationship. This reluctant cohabitation lasted until the Kirchner administration considered that the domestic political benefits of severing its relationship with the Fund outweighed the financial cost of anticipating the cancellation of the program.

What are the hypotheses that this case study helps unveil about the relationship between domestic ratification politics and the bargaining interaction between the IMF and its member states? Focusing first on borrowing countries' ratification politics, the Argentine case brings support to the hypothesis of a non-linear relationship between the intensity of domestic political constraints and chief-negotiators' bargaining power vis-à-vis the IMF described in Chapter 2. Ceteris paribus, the emergence or deepening of such constraints can be turned into a bargaining advantage. However, beyond a certain threshold, difficulties to ratify the program's conditionality domestically can result in the suspension of multilateral support.

Second, depending on the government's preferences and on public perceptions about the IMF, a program relationship can serve different domestic political purposes. If the government's preferences are aligned with those of the IMF and if the IMF is not excessively stigmatized in the domestic political debate, as was the case during the De la Rúa administration, a cooperative program relationship may be used to legitimize certain courses of action consistent with the Fund's prescriptions. Instead, if the government's preferences are not aligned with those of the IMF and if the IMF is stigmatized in the domestic political debate, as was the case during the Kirchner administration, a conflictive program relationship may be used to garner support for courses of action that depart from the Fund's prescriptions. The Argentine case study suggests that in both situations national politicians tend to exaggerate the importance of the IMF in the domestic decision making process. However, whereas in the first scenario this incentive tends to sustain the cooperative equilibrium, in the second scenario it tends to undermine it.

Focusing next on the Fund’s ratification politics, the Argentine case study brings support to the idea that the perceived cost of no agreement associated with a particular intervention is negatively associated with the autonomy of IMF officials in the negotiations with borrowing countries. When the cost of no agreement is perceived to be high, the Fund’s constituents’ strategic calculations tend to dominate the decision-making process. Instead, when the cost of no agreement is perceived to be low, the Fund’s technical considerations and internal bureaucratic politics tend to dominate. Borrowing country chief-negotiators may have some leeway to influence the perceived cost of no agreement either by manipulating international public opinion and market expectations, as Minister Cavallo allegedly tried to do, or by threatening to default on multilateral obligations, as Minister Lavagna did.

A final question that deserves attention is whether the Argentine case study provides evidence about the causal relationship between multilateral rules and IMF interventions. On the one hand, it can be argued that the reform of the international financial architecture described in chapter 3 legalised the sort of large-scale official support that the Fund provided with the two augmentations of December 2000 and August 2001. Furthermore, the Prague Framework approved in 2000 contributes to explain why these two augmentations emphasized the adoption of PSI measures to complement official finance in order to handle the Argentine crisis. On the other hand, there are various instances in which multilateral rules were breached during the decade under analysis. For a start, the macroeconomic conditionality associated with the Fund’s programs often failed to constrain the behaviour of the Menem administration in the relevant policy dimensions. Later on, the second augmentation of the 2000 SBA was approved in the absence of an agreement about macroeconomic adjustment and structural reform, and the 2003 SBA established short-term macroeconomic objectives that did not cover the entire period of the program.

In sum, although the evolving doctrine on multilateral interventions in emerging market crises mattered, rules did not always constrain the negotiations between Argentina and the IMF. In this context, the relevant empirical question becomes when and why are rules binding in the issue area of international crisis lending? The Argentine case study suggests that rules tend to be breached when they conflict with the interests of the Fund's most powerful constituents. More specifically, there seems to be a negative association between the cost of no agreement and the relevance of rules as an explanatory factor. When the G7 considered that the cost of not agreeing with Argentina was high, as was the case during the Asian Financial crisis or throughout most of 2001, rules were easy to breach. Instead, when the cost of not agreeing dropped, as was the case after the September 11 attacks, the need to comply with multilateral rules became a binding obstacle to resume a program relationship.

The Argentine case study also illustrates how borrowing countries can exploit their transnational alliances with powerful creditors in order to breach multilateral rules. This was especially clear during the design and implementation of the 2003 SBA, which departed from the Fund's practice on such critical issues as the period to be covered by macroeconomic conditionality or the interpretation of the good faith criterion. What is particularly interesting about this case is that the transnational alliance between the Kirchner and the Bush administrations that made these departures possible was not sustained by material interests or political affinity. Rather, the US supported the Argentine position because it was more consistent with its own views about sovereign debt restructurings and the convenience of limiting the Fund's influence in such processes. In other words, at that particular instance breaking existing multilateral rules was instrumental for the US administration to reshape the reform of the international financial architecture according to its preferences. Rules, therefore, should not only be seen as a possible determinant of specific IMF interventions, but also as a potential outcome of these interventions. This gives rise to an endogeneity problem that complicates the empirical analysis on the explanatory significance of rules in the issue area of multilateral crisis lending.

CHAPTER 5

Uruguay and the IMF

As was the case in Argentina, the decade that followed the Tequila crisis witnessed an intense IMF involvement in Uruguay. The Fund's role in both countries had a similar starting point in the precautionary arrangements of the 1990s and some parallels can be established between the initial management of their respective financial crises in the early 2000s. However, the final outcome of these two interventions turned out to be very different. Whereas the defining moment of the Fund's involvement in Argentina was the suspension of the program in December 2001, in Uruguay it was the massive multilateral disbursement of August 2002, which put an end to run on the banking system that was having devastating economic consequences. As a result, Argentina's relationship with the IMF became much more conflictive than that of its neighbour across the River Plate. This is not to say that the Fund's intervention in Uruguay was exempted from disagreements and controversies. Most notably, the aforementioned August augmentation was approved against the will of the Fund's senior management after dramatic negotiations that could only be unblocked with the direct intervention of the US Treasury. The sovereign debt restructuring launched subsequently constituted another important source of contention that resulted in a brief suspension of the program. This case study, therefore, also presents a number of instances in which the cooperative outcome of the negotiations was extremely fragile.

Following the same structure as Chapter 4, this chapter applies a process tracing approach and a two-level game framework to analyse the relationship between Uruguay and the IMF from the approval of a precautionary SBA in March 1996 until the early cancellation of the 2005 SBA in November 2006. As was the case in Chapter 4, given its longitudinal approach, this chapter will concentrate primarily on the time-varying factors that contribute to explain variation in the outcome of interest, with an emphasis on electoral processes, bureaucratic incentives or multilateral rules. Other more static explanatory factors related with the structural features of the Uruguayan polity and institutions will be analysed cross-sectionally in Chapter 6.

The evidence provided in this Chapter challenges the assertion that there is an inevitable trade-off between policy stability and policy adaptability (Tsebelis, 2002; Haggard and McCubbins 2001). Indeed, the Uruguayan polity was able to provide both outcomes at different points in time. During the implementation of the precautionary arrangements of the 1990s, the presence of multiple veto-points resulted in a narrow win-set, making it difficult to move forward with the structural transformation of the economy that the IMF may have wished to catalyze through its programs' conditionality. However, during the worst months of the crisis, Uruguayan political actors were able to compromise in order to expedite the ratification of the policy package on which the Fund´s bailout was conditioned. This observation is consistent with Scartascini et al. (2010), according to whom the presence of strong checks and balances encourages political actors to engage in inter-temporal bargaining processes, which may contribute to yield policy stability in ordinary times and policy adaptability in extraordinary times.

The Uruguayan case study also illustrates some of the complexities that characterize the causal association between multilateral rules and the outcome of specific IMF interventions. On the one hand, rules imposed a generally soft constraint on the negotiation of the Uruguayan program. This was particularly clear during the Bush administration, which was willing to renege on its commitment to impose strict limits on the size of its IMF loans during the Uruguayan crisis. On the other hand, this decision was linked to broader normative considerations and to the Bush administration's desire to make sure that the sovereign debt regime would be reformed according to its preferences. Indeed, not agreeing to a multilateral bailout could have turned Uruguay into an obvious candidate to inaugurate a statutory debt restructuring mechanism, which by then had lost the support of the US Treasury Department. In other words, that the course of action to be adopted in the Uruguayan crisis was linked to the SDRM debate may have enabled that country's government to punch above its weight, contributing to explain the crucial multilateral decision of massively augmenting the program in August 2002.

The remainder of this chapter is organized as follows. Section 5.1 starts by offering a descriptive account of the negotiations between Uruguay and the IMF. This is aimed at presenting the variation observed in the Level I game that subsequent sections will explain in terms of the preferences and win-sets of the parts involved in this process. Three different phases are identified in the relationship between Uruguay and the IMF: a first phase during which IMF programs were aimed at preventing financial crises, a second phase of crisis management and a third phase during which the negotiations were centred on restoring the sustainability of Uruguay's sovereign debt. The chapter concludes with a summary of the hypotheses that this case study helps unveil about the relationship between domestic ratification processes and the Fund's interventions in emerging economies.

5.1 A decade of financial programs

Uruguay was uninterruptedly under successive IMF programs from March 1996 until November 2006 (see Table 5.1). Although this relationship was overall cooperative, the nature and intensity of the Fund's engagement in Uruguay displayed a wide variation. Until the early 2000s, the programs were precautionary, carried low access to the Fund's resources and were primarily aimed at providing a seal of approval on the government's policies. A second phase began with the eruption of a severe banking crisis in 2002, to which the IMF responded with the approval of a larger SBA and, reluctantly, with two augmentations of exceptional magnitude. This culminated in the massive multilateral disbursement of August 2002, which succeeded in restoring confidence in the banking system and, therefore, put an end to the financial crisis. The third phase begins with the stabilization of the Uruguayan economy and with an interlude of intense disagreements between the government and IMF officials about how best to deal with a sovereign debt burden that had surpassed 100% of GDP. During that time, the program was temporarily suspended, threatening to trigger another wave of financial instability. An agreement was eventually reached early in 2003, bringing about the resumption of IMF disbursements as well as the launching of a comprehensive debt restructuring. This program relationship was brought to an end by the Tabaré Vázquez administration, which anticipated the cancellation of Uruguay's outstanding obligations to the Fund in late 2006, thus following the steps of Argentina and Brazil.

Table 5.1

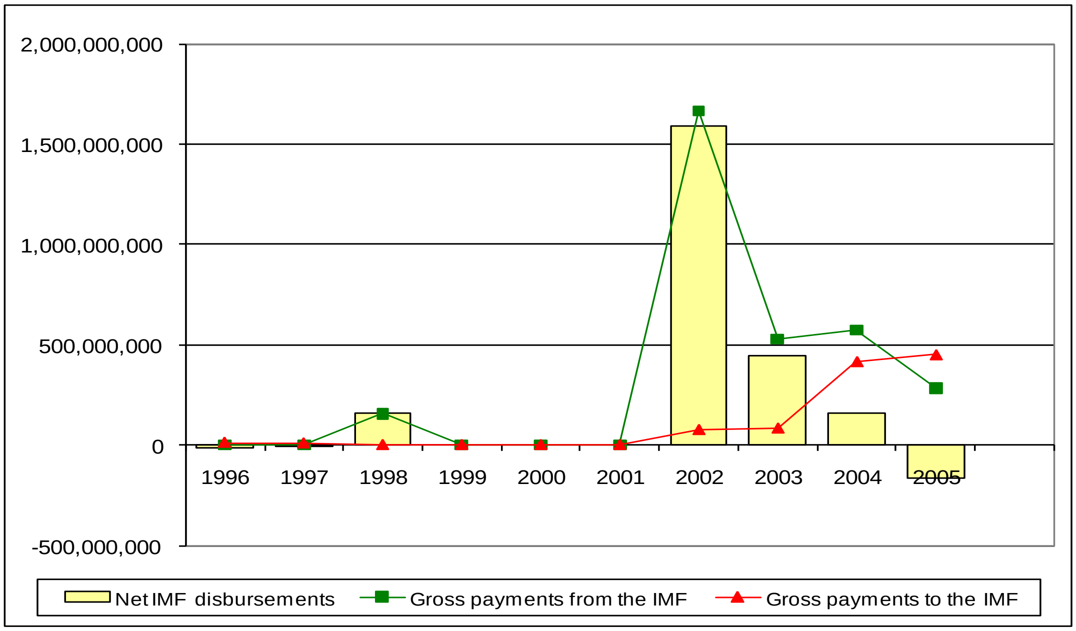
IMF programs in Uruguay (1996-2005)

Program Type	Date of Approval	Duration	Amount committed in SDR and in % of quota	Amount disbursed in SDR and in % of total	Macroeconomic conditionality	Structural conditionality	Compliance with conditionality
SBA	Mar-96	13 months	SDR 100mn 44% of quota	SDR 0 0%	Gradual reduction of inflation and fiscal consolidation.	No formal structural conditionality. However, the program supported a pension system reform and an efficiency savings seeking reform of the central government.	Good compliance with program conditionality
SBA	Jun-97	21 months	SDR 125mn 55% of quota	SDR 114mn 91%	Gradual reduction of inflation, de-indexation of public sector wages and fiscal consolidation	No major structural reforms contemplated: reduction of public sector emplyment; sale of public bank (Caja Obrera); submission of new bankruptcy law to Congress	Good initial compliance with macroeconomic conditionality; problems to meet the program targets in late 1998 and 1999 as a result of recession; mixed compliance with structural conditionality
SBA	Mar-99	12 months	SDR 70mn 31% of quota	SDR 0 0%	Focus on fiscal adjustment	No major structural reforms contemplated: subscription to SDDS; improvement of the monetary data produced by the CB and of national accounts statistics; audit to three State-owned financial institutions	Mixed compliance: as a result of worst than expected recession fiscal targets had to be reviewed; structural reforms' pace slowed and most conditions contemplated by the program not observed
SBA	May-00	22 months	SDR 150mn 50% of quota	SDR 150mn 100%	Fiscal adjustment: halving of overall deficit to 1.8% of GDP	External audit of State-owned banks and public enterprises; iniciation of reform of special pension funds (banks, universities, police, military); study on quasi fiscal operations of public sector	Mixed compliance: fiscal targets missed as a result of deepening recession but most other quantitative performance criteria met; most structural conditions observed
SBA	Apr-02	24 months (Extended by one year on March 03)	SDR 594.1mn 194% of quota	SDR 594.1mn 100%	Focus on fiscal adjustment: overall deficit targeted to fall to 2.5% of GDP in 2002	More demanding structural conditionality: reform and restructuring of banking system; rationalization of the tax system; liberalization of telecom and oil sectors; reform of special pension funds	Poor compliance with macroeconomic conditionality, which had to be comprehensively resigned in subsequent augmentation; most structural conditions observed
1st augmentation (with SRF)	Jun-02	-	SDR 1.16bn 378% of quota Of which SDR 386 mn under the SRF	SDR 1.16bn 100%	Freely floating of the peso (highly controversial decision)	Focus on the restructuring of the banking sector leading to a modification of the government's crisis resolution strategy; creation of FFSB.	The new strategy also failed to solve the crisis, and was modified again for the second program augmentation
2nd augmentation (the SRF component cancelled)	Aug-02	-	SDR 376mn 123% of quota	SDR 376mn 100%	By the time of the second augmentation it was understood that some drastic measures would need to be adopted in order to address the debt overhang	Focus on the banking system: creation of FESB; reprogramming of time deposits held in public banks; suspension of activities of intervened banks; tax reform	Mixed compliance with macroeconomic and structural conditionality. Disagreements over the debt restructuring strategy.
SBA	Jun-05	36 months	SDR 766.3 mn 250% of quota	SDR 263.59 34%	Maintenance of a discipline fiscal stance, with a medium target for the primary balance of 4% of GDP	Focus on the financial system; continued restructuring of state banks; enhancement of central bank independence; measures to bolster private investment; tax reform	Fiscal targets outperformed; monetary policy slightly loosened with respect to original targets; mixed compliance with structural conditionality

Source: IMF

Figure 5.1

Financial transactions between Uruguay and the IMF (US$)



Source: IMF

5.1.1 Crisis prevention

As was the case in Argentina, contagion from the Tequila crisis abruptly pushed the Uruguayan economy into recession, after which the government engaged in a series of precautionary arrangements with the IMF. [95] The first of these SBAs was approved in March 1996 for an amount of close to US$ 150 million and had a duration of 13 months. Its macroeconomic conditionality envisaged a moderate contraction in the public sector's budget deficit and supported an exchange rate based stabilization strategy aimed at gradually bringing inflation down to single digit levels.[96] In turn, although the Sanguinetti administration that took office in 1995 had initiated some reforms, most notably in the pension system and the modernization of public administration, the 1996 SBA included no

[95] After various years of robust growth in the early 1990s, real GDP contracted by 2% in 1995.

[96] This exchange rate based stabilization strategy was adopted in the early 1990s. As opposed to Argentina's hard peg (the Convertibility regime), Uruguay's strategy relied on a crawling band system that was periodically adjusted to targeted levels of inflation. Together with the widespread indexation mechanisms present in the Uruguayan economy, this resulted in a much slower reduction of inflation: only in 1998 was an inflation rate of less than 10% recorded for the first time.

formal structural conditions. The program's macroeconomic targets and conditionality were broadly met, which was facilitated by a faster than expected recovery: real GDP growth reached 5% in 1996 as opposed to the 1% expansion originally projected in the SBA. In retrospect, however, a 2005 IMF staff report criticized the 1996 SBA for its lack of structural conditionality, which it described as a missed opportunity to have pressed the Uruguayan government to correct the shortcomings of the financial sector's regulatory and supervisory framework (IMF, 2005d). According to this report, this lack of progress with financial reform would later contribute to aggravate the 2002 banking crisis.

The 21 months SBA signed in June 1997 was similar in spirit to the 1996 program. It gave access to a credit of US$ 174 million and its conditionality continued to be centred on the exchange rate based macroeconomic stabilization described above. Although it also carried a light structural conditionality, this program included some benchmarks such as the reform of the bankruptcy regime or a commitment to extend the period for adjusting civil-servants wages to inflation in order to progress towards the de-indexation of the economy. The 1997 SBA remained broadly on track until its expiration. Meeting its macroeconomic targets, however, proved to be more challenging after August 1998 as a result of a worsening international environment. Indeed, the Russian crisis and the resulting wave of contagion that swept through emerging markets impacted Uruguay's access to global financial markets, which prompted the government to make use of the program's resources in spite of having originally committed to treat this SBA as a precautionary arrangement. Nonetheless, in 1998 Uruguay remained one of the few Latin American countries with investment grade and that year real GDP expanded by 4.5%, suggesting that both the government and the IMF still had reasons to believe that the disturbances that followed the Russian default would only have a modest and temporary effect.

The 1999 SBA, therefore, did not alter the basic premises of the Fund's previous engagement in Uruguay: it gave access to a US$ 98 million credit in precautionary terms, it continued to support the government's medium-term stabilization effort, and it included few structural conditions. Given that presidential elections were scheduled for October 1999 and that a new government was due to take office in March of the following year, this program had a duration of only 12 months to support the outgoing administration. The implementation of the 1999 SBA turned out to be particularly difficult due to the larger than anticipated impact of the external shocks that were affecting the Uruguayan economy.[97] Most notably, the sharp devaluation of the real in January 1999 severely undermined the competitiveness of Uruguayan exports, a third of which were being absorbed by the Brazilian market prior to the crisis. In the face of this unanticipated economic slump (in 1999 GDP contracted by more than 3% against a projected 1%) fiscal targets had to be revised in July in order for the first review of the program to be approved (IMF, 1999c). Compliance with structural conditionality was also incomplete.

In spite of the difficulties undergone during 1999, the new government of President Jorge Batlle negotiated another low access precautionary SBA amounting to US$ 197 million that was based on rather optimistic projections: a GDP growth rate of 2% for years 2000 and 2001. This reflected the assumption that the Mercosur economies would recover relatively fast from the 1998/99 crisis and that, as had been the case in past episodes of regional instability, an acceleration of inflation in Brazil would soon offset the impact that the devaluation of the real had had on the competitiveness of Uruguayan exports (Ariel Davrieux. Personal interview. July 7 2010; Carlos Steneri. Personal interview. September 16 2010). The program approved in May 2000, therefore, had a macroeconomic conditionality that was similar to its predecessors, focusing on a moderate medium-term fiscal adjustment effort. In contrast, however, it incorporated a more demanding structural conditionality, including plans to deepen the pension system reform, to improve the efficiency of public banks and enterprises and to clarify the scope of their quasi-fiscal operations. Due to increasingly de-stabilizing spillovers from the Argentine crisis and to an outburst of foot-and-mouth disease in the cattle industry, the Uruguayan economy continued to plunge in 2000 and even more so in 2001. As a result, the government was forced to request various modifications of the program's targets as well as some waivers for

[97] However, the government did not make use of the resources committed under the program reflecting the fact that in 1999 it still retained good access to international financial markets and, hence, could cover a widening external financing gap without resorting to multilateral assistance .

the non-observance of fiscal performance criteria.[98] In spite of these worsening conditions, Uruguay retained a relatively good access to international financial markets throughout all of 2001, which enabled the authorities not to make use of the resources committed under the program. In 2002, however, the situation continued to deteriorate, which would eventually give way to fundamental changes in the form and scale of the Fund's engagement in Uruguay.

5.1.2 Crisis management

Uruguay's banking crisis erupted in the first weeks of 2002 when the introduction of the *Corralito* across the River Plate led cash-strapped Argentine nationals to withdraw a significant proportion of the deposits they held in Uruguayan financial institutions.[99] In March, the propagation of the panic to domestic depositors forced the monetary authority to pump increasing volumes of liquidity into troubled banks, leading to a downgrading of Uruguay's sovereign debt that resulted in an abrupt loss of access to global financial markets.[100] A central difficulty facing the authorities was the banking system's degree of dollarization (almost 90% of deposits were denominated in US$), which implied that the central bank had to use hard currency in order to provide lender of last resort (LOLR) assistance. As a result, the stock of foreign exchange reserves was fast to dwindle, prompting the government first to draw from the 2000 SBA and then to negotiate a much larger program.

A new crisis resolution SBA was approved in early April 2002 giving access to a credit of US$ 740 million. Its conditionality included a fiscal consolidation effort as well as a number of structural benchmarks centred on the reform and restructuring of the Uruguayan

[98] As opposed to the 2% GDP growth projected by the program for 2000 and 2001, the Uruguayan economy contracted by 1% in 2000 and by 3.1% in 2001. In turn, the consolidated public sector deficit reached 3.7% of GDP in 2000 compared with a program target of 1.8%.

[99] The Uruguayan financial system has traditionally functioned as a safe haven in a region used to financial instability. Indeed, prior to the crisis 44% of total deposits were held by non-residents, primarily Argentines (IMF, 2003f). The 2002 run on deposits by Argentine nationals came as a surprise because even though there were obvious concerns about the possibility of a financial contagion, in past episodes of regional instability the stock of Uruguayan deposits had tended to increase as a result of capital flight.

[100] Another trigger of the run on banks was the unearthing of problems at Banco Comercial and Banco Galicia, which further undermined the public's confidence in the resilience of the banking system. (see Appendix D).

financial system. The new program, however, failed to stabilize the situation. This was largely due to the fact that its tranched structure resulted in an upfront disbursement of less than US$ 200 million, which guaranteed a proportion of the deposit base that was too small to stop the run. Indeed, as the Fund's staff would later recognize, this intervention tried to address a banking panic with an instrument inherently designed to deal with a balance of payment problem, resulting in an inadequate disbursement schedule (IMF, 2005d).

Shortly after the 2002 SBA was approved, therefore, it was already clear that a different strategy would have to be sought in order to stop the run on deposits. It is for that purpose that an augmentation of approximately US$ 1.5 billion began to be negotiated in May and was approved in late June. For reasons that will be discussed later in more detail, one of the policy strings attached to this augmentation proved to be particularly contentious: the floating of the peso. In addition, this augmentation was conditioned on a second fiscal adjustment, although its main focus was on the banking system. Indeed, together with the additional resources provided by the World Bank and the Inter-American Development Bank, the first augmentation of the SBA was used to constitute a fund to provide liquidity to the banking system: the so-called *Fondo de Fortalecimiento del Sistema Bancario* or FFSB. However, and even if the total amount of resources committed under the IMF program was brought to almost US$ 2.3 billion, only US$ 500 million were disbursed immediately. One more time, this proved to be insufficient to guarantee a sufficient proportion of deposits. As a result, the FFSB was soon perceived to be underfunded and the run on the banking system continued unabated.

By mid-July 2002 more than 40% of deposits had fled the banking system since the beginning of the crisis. Further evidencing the failure of the crisis resolution strategy adopted so far, the resources of the FFSB were nearly depleted and the central bank was running dangerously short of international reserves. This did eventually force the resignations of the Economy Minister Bensión and of the President of the Central Bank Rodríguez Batlle, which added more uncertainty while making it clear that the adoption of new extraordinary measures was urgently needed. At that point, the international community was faced with the choice of either substantially expanding and frontloading its support to the Uruguayan government in a last attempt to stabilize the situation or of letting it fall. After a week of dramatic negotiations in late July the former course of action was adopted and a second augmentation of US$ 500 million was approved.[101] Even more important than the augmentation was the acceleration of disbursements and the additional commitments that were obtained from the World Bank and the Inter-American Development Bank, resulting in a total multilateral upfront disbursement of close to US$ 1.5 billion.[102] This decision was adopted thanks to the support of the US Treasury, which not only pressed the IMF to agree on the augmentation but also provided a bridge short-term loan of US$ 1.5 billion that turned out to be crucial for the success of this intervention.[103] Given that a GDP contraction of 11% was now projected for 2002, the SBA's macroeconomic targets were substantially altered at that time. More importantly, a new strategy was adopted to comprehensively restructure the Uruguayan banking system: the FSSB was substituted by a new fund (the *Fondo de Estabilización del Sistema Bancario* or FESB) endowed with the US$1.5 billion provided by the international institutions to guarantee domestic banks' sight and savings deposits; time deposits for a total amount of US$ 2.2 billion were re-programmed; the operations of four financial institutions were suspended; the government committed not to re-open unviable banks.

5.1.3 Restoring debt sustainability

As opposed to previous interventions, this new strategy succeeded in stopping the run and the deposit outflow began to be reversed soon after the August augmentation, giving way to the third phase analysed in this chapter. In the context of this successful intervention, it is somewhat paradoxical that the relationship between Uruguay and the IMF was so difficult during the months that followed. However, agreeing on how best to address what the IMF considered a debt overhang proved to be extraordinarily difficult. Indeed, since the mid-

[101] Upon deciding that the augmentation would be approved, a banking holiday was declared in order to provide some breathing space for details on the large multilateral disbursements to be negotiated.
[102] In addition, the SRF component of the SBA was cancelled, which made the Fund's credit cheaper.
[103] The decision to support Uruguay was made at a time in which Uruguay's foreign exchange reserves were almost depleted. In this context, the US Treasury bridge loan gave the authorities the breathing space that was needed to finish negotiating the details of the augmentation with the IMF, the World Bank and the IADB. This bridge loan was redeemed with the resources provided by the multilateral disbursement once the augmentation was approved.

1990s the government's stock of public debt had jumped from less than 50% of GDP to almost 100% of GDP as a result of the long-lasting recession, of the fiscal cost of the banking crisis and of the sharp depreciation of the peso (most of the debt was denominated in US$). The key point of contention between Uruguay and the IMF was whether such a debt burden could be considered sustainable and, hence, whether the authorities were facing a liquidity or a solvency problem. By mid-October, the negotiations between Uruguay and the IMF had reached a stalemate and the second review of the SBA could not be approved on time. For some agonizing months, therefore, the program's disbursements were postponed, generating a renewed sense of uncertainty that was on the verge of reviving the banking crisis.[104] In early March, however, a settlement was reached when the government agreed to launch a market friendly preventive debt restructuring in order to alleviate its liquidity pressures in the medium term. This allowed for the second review of the SBA to be approved and for the Fund's disbursements to resume.[105]

The decision to launch a comprehensive restructuring was announced in mid-March. Reflecting the government's intention to act as swiftly as possible, a proactive consultation process with creditors was initiated soon afterwards, and a restructuring offer was disclosed by mid-April, after which the tender was opened. The exchange was officially closed at the end of May, implying that it took less than three months to complete the entire exercise.[106] Although the IMF did not take part in the design of this debt restructuring operation, it provided incentives for creditors to exchange their bonds. This was done primarily through a public letter issued by the Fund's Managing Director to the members of the financial community explicitly stating that the success of the restructuring would constitute a precondition for the approval of the third review of the SBA (IMF, 2003d). The implications for creditors were clear: an insufficient participation in the exchange would cause the suspension of the Fund's support to Uruguay, which would substantially increase the odds of a much costlier default. Participation in the bond exchange reached 92%, which

[104] The potential consequences of a longer-lasting suspension of the program were made clear in late January 2003 when a new bout of deposit outflows was registered.
[105] The second review also extended the duration of the SBA by 12 months until March 2005. In addition, the program's disbursements were re-phased and two waivers were granted for the non-observance of fiscal conditionality and of one of the structural performance criteria.
[106] The central bank, however, continued to allow those bondholders that had not participated in the exchange to tender their bonds after the official closure of the exchange.

was broadly considered a success. As a result, projected principal debt repayments due in the period 2003 to 2007 were brought down from US$2.1 billion to US$ 300 million, which the government expected to provide enough breathing space to consolidate a solid recovery (IMF, 2003f). However, because this operation carried a very moderate haircut in net present value terms and no nominal loss at all, the question of whether this debt re-profiling strategy managed to restore the sustainability of Uruguay's debt remained a matter of much debate in the aftermath of the exchange.[107]

In the aftermath of the debt restructuring, the Fund's relationship with Uruguay focused on the following three areas. First, it backed an ambitious fiscal consolidation effort targeting a primary surplus of 4% of GDP in the medium term in order to ensure the sustainability of Uruguay's sovereign debt. Second, it emphasized the restructuring of the banking system and, in particular, the reform of public financial entities and the disposal of liquidated banks' assets. Third, it supported other structural reforms such as the rationalization of the tax system or the reform of specialized pension schemes. Progress in these three areas of economic policy was uneven. The government's macroeconomic framework remained on track and fiscal targets were outperformed in 2004 and thereafter, which was facilitated by an unexpectedly robust economic recovery.[108] Instead, the reform of the banking system lagged behind, becoming a source of friction with the IMF in late 2003 and early 2004. These delays prompted the government to request various waivers for the non-observance of some of the program's structural performance criteria and resulted in a slight postponement of the program's fourth review.[109] Upon the expiration of the SBA in March 2005, however, the Fund's staff recognized that progress in this area was well under way and that the programs' targets for the banking sector had overall been met (IMF, 2005f). In turn, very little progress was achieved with the other structural reforms envisaged by the

[107] The Uruguayan authorities' strategy has eventually been vindicated by the substantial reduction of its debt burden that has been observed since 2003.Indeed, by 2006 Uruguay's debt to GDP already stood at 66% (IMF, 2008a). To a large extent, this has been due to an exceptionally positive international environment, a surge in the price of primary products and buoyant liquidity in international financial markets.

[108] By the first half of 2004, the recovery of the Uruguayan economy had already taken hold, and real GDP would end up registering a 12% expansion that year. Furthermore, the peso began appreciating sooner than had been anticipated, which also contributed to reduce the government's debt to GDP burden.

[109] More specifically, the IMF blamed the Uruguayan authorities for being slow to dispose the assets of liquidated banks. In order to approve the fourth review (which was eventually approved on February 2004) the government was asked to submit a new strategy for the restructuring of the banking system.

program. As this chapter will explore below in more detail, this was largely due to opposition in the Uruguayan Congress, which blocked the reforms of the tax system and of the specialized pension schemes.

In spite of Uruguay's rebound from the crisis, the last reviews of the 2002 SBA made it clear that a new program would be necessary in order to consolidate the recovery (IMF, 2005e). This was primarily due to the fact that in the absence of a new arrangement, the amortization payments due from the Uruguayan government to the Fund were projected to average 8% of GDP over the medium-term, threatening to generate severe liquidity problems. The SBA negotiated by the new administration of Tabaré Vázquez, therefore, was primarily aimed at assuring the sustainability of the government's external debt through a partial roll-over of its multilateral obligations, which would facilitate a more gradual exit from the Fund's financial support. The three years SBA approved in June 2005 gave access to a credit of US$1.1 billion, covering close to 60% of Uruguay's outstanding obligations falling due during the program period. Although the victory of a left of centre coalition (*Encuentro Progresista - Frente Amplio – Nueva Mayoría* or EP-FA-NM) in the 2004 elections brought the traditional dominance of the Colorado and the Blanco parties to an end, the conditionality that the Tabaré Vázquez administration agreed with the IMF was not dissimilar from that of the program that expired in March 2005. Hence, the Fund's intervention in Uruguay continued to target a large primary surplus of 4% in the medium term, the restructuring of the banking system and a number of structural reforms aimed at encouraging private investment and bolstering growth prospects.

The implementation of the 2005 SBA continued to be aided by a robust recovery that allowed the government to outperform the program's macroeconomic targets. This was particularly apparent with respect to the external sector, which exhibited a surge in exports, a substantial increase in the stock of international reserves and a faster than expected recovery of access to international financial markets. As a result, the government began anticipating repayments to the IMF in mid-2006, thus following the pattern set by the Argentine and the Brazilian governments a few months earlier. In November of that same year, the government took the decision of completing the cancellation of the 2005 SBA, fully honouring its outstanding obligations to the IMF. By that time, progress with the program's structural conditionality had been mixed. Although the government had managed to implement some of the measures contemplated by the program, such as the tax reform for which the Batlle administration failed to obtain a sufficient congressional support, it lagged behind on others such as the reforms of the specialized pension schemes. For that reason, various waivers had to be granted to approve the last review of the SBA that brought a decade of IMF financial involvement in Uruguay to an end.

5.2 Crisis prevention

As described above, the first phase of the Fund's engagement in Uruguay was characterized by a cooperation of relatively low intensity that lasted for almost 6 years. As presented in Chapter 2, in terms of Putnam's two level games this cooperative outcome should be understood as the product of an overlap between the win-sets of Uruguayan and IMF negotiators. This overlap could have resulted from converging preferences or, when in the presence of divergences, from a sufficiently large win-set on Uruguay's side, on the Fund's side or on both. In the divergent preferences scenario, the specific outcome of the negotiations is determined by the two sides' relative bargaining power, in turn determined by the relative size of their respective win-sets. Using this framework, this and subsequent sections try to unveil the dynamics that explain the Fund's interventions in Uruguay as well as the specific factors that fed into actors' preferences and win-sets to explain the observed outcomes of the bargaining process during the decade under analysis.

The key features of the four SBAs signed by the Uruguayan government between 1996 and 2001 can be summarized as follows. First, these were low access precautionary arrangements and, therefore, were not aimed at providing multilateral financial assistance to the Uruguayan authorities. Indeed, as described above, the government made use of the resources committed under these SBAs only once in the aftermath of the contagion effect triggered by the Russian default of August 1998. Second, the four programs consistently supported a gradual medium-term exchange-rate based stabilization aimed at bringing inflation down from over 50% to single digit levels. This strategy relied on a crawling exchange rate band with a predictable depreciation path and on the implementation of prudent macroeconomic policies including a moderate fiscal consolidation effort. Overall, Uruguay had a good record of compliance with the programs' macroeconomic conditionality. Toward the end of this period, however, a pronounced and long-lasting recession made it increasingly difficult for the government to meet the SBAs' fiscal targets. Third, the programs signed during this period carried a weak structural conditionality. In fact, the 1996 SBA did not include a single structural benchmark. Although the structural component of subsequent SBAs was moderately reinforced, it remained insubstantial and the government complied with these conditions only partially. The only program that carried a relatively ambitious structural conditionality was the SBA signed by the Batlle government in 2000.

How can the evolution of actors' preferences and win-sets explain the outcome of the Level I game described above? Regarding preferences about these programs' objectives, the precautionary nature of the various SBAs approved during this phase implies that these interventions were not aimed at covering an immediate financial need. Instead, as suggested by former economy minister Bensión, their main purpose was to improve Uruguay's access to international financial markets, which was achieved through the periodic awarding of an IMF seal of approval on the government's policies in the context of the programs' reviews (Alberto Bensión, Personal interview. July 6 2010). According to Ariel Davrieux, the head of the Planning and Budget Office under the Sanguinetti and the Batlle administrations, the signalling power of the Fund´s precautionary programs was particularly valued after Uruguay attained investment grade status in 1997, the maintenance of which was considered of strategic importance (Ariel Davrieux. Personal interview. July 7 2010). Given that one of the Fund's priorities during the 1990s was to facilitate emerging markets' integration into global capital markets, the institution's preferences converged toward those of the Uruguayan authorities on the programs' central objective. Furthermore, the aforementioned investment grade, a rare privilege for a Latin American country at the time, vindicated the use of precautionary SBAs to catalyze private capital inflows, a strategy that gained momentum in the mid-1990s (IMF, 1995). Combined with the fact that due to their low volume these programs generated very little risk on the Fund's balance sheet, this is likely to have resulted in a relatively wide win-set on the side of the IMF.

In terms of policy-making and conditionality, the precautionary SBAs' key ingredient was their support to a gradual exchange-rate based macroeconomic stabilization. This strategy was adopted in 1990 and successive governments supported it until the 2002 crisis brought it to an abrupt end. Since the late 1980s and early 1990s the IMF had been an active supporter of various disinflation processes based on the use of the exchange rate as a nominal anchor, many of which took place in Latin America where central banks had fallen in a particularly acute disrepute (Eichengreen, 1999; Singh et al., 2005). The preferences of IMF and Uruguayan negotiators, therefore, are also likely to have initially converged with regard to this macroeconomic framework, further evidence of which is provided by the authorities' eagerness to meet the program's fiscal targets during this period and to comply with the conditions more closely related with the disinflation strategy.[110] After the collapse of the European Exchange Rate Mechanism in 1992-93 and especially following the Mexican, Asian and Brazilian crises, however, the bi-polar view on exchange rate regimes gradually gained prominence among academic and IMF economists, implying that intermediate regimes like the Uruguayan crawling band began to be viewed with increasing scepticism (Fisher, 2001).[111] If anything, therefore, the Fund's preferences on Uruguay's monetary and exchange rate policies should have progressively departed from those of the government in successive SBAs.

In spite of the reservations that IMF economists might have developed about Montevideo´s monetary and exchange rate framework, there are no indications of pressures on the Uruguayan authorities to reconsider the use of the exchange rate as the disinflation strategy's nominal anchor. In other words, until the eruption of the 2002 crisis, Uruguay's exchange rate regime does not seem to have constituted a point of contention in the bargaining process between the IMF and the Uruguayan government (IMF, 2000b; Ariel

[110] A case in point were the aforementioned measures to weaken the link between inflation and wages. The de-indexation of the economy was considered important to moderate the appreciation of the real exchange rate, a trend that tends to characterize this type of disinflation strategies.
[111] The bi-polar view on exchange rate regimes argued that "corner solutions" such as free floats or hard pegs (currency boards, currency unions or dollarized regimes) were sustainable in the long term.

Davrieux. Personal interview. July 7 2010; Carlos Steneri. Personal interview. September 16 2010). Why wasn´t this issue raised in the negotiations? A first reason is that, albeit slowly, the crawling band was successfully bringing inflation down: a single digit rate was registered in 1999 for the first time since the high levels of inflation that characterized the 1980s. In this context, it might have made little sense for the Fund to press for a drastic change in Uruguay's macroeconomic framework motivated by an abstract concern about its long-term sustainability (IMF, 2005d). Furthermore, as established in the Fund's letters of agreement, member states are free to choose their exchange rate regime and the IMF tends to openly questions exchange rate policies only when a regime change is considered necessary for the success of a program.[112] This usually occurs during currency crises, which was obviously not the case of Uruguay in the second half of the 1990s.

Although the Fund's silence about an exchange rate regime that was falling out of favour may be justified, the programs' leniency with structural reform is more surprising. Indeed, a growing awareness about the risks associated with intermediate exchange rate regimes could only have encouraged IMF negotiators to insist on the adoption of measures to address other underlying sources of vulnerability. However, with the exception of the program signed by the Batlle administration in 2000, the precautionary SBAs analysed here included few structural conditions. A case in point is the lack of structural conditionality in the specific area of financial sector reform, which is referred to by the aforementioned 2005 staff report on Uruguay's long-term use of the Fund's resources as a missed opportunity to have addressed the factors that would later contribute to aggravate the 2002 banking crisis (IMF, 2005d). In spite of this lack of structural conditionality, various documents suggest that IMF negotiators and constituents were not unconcerned about the slow pace of the financial reforms undertaken by the Sanguinetti administration. In fact, some of the Fund´s communiqués explicitly call for an intensification of the government's structural agenda. During the discussion on the 1998 Article IV consultation and with the occasion of the announcement of the 1999 SBA, for instance, Executive Directors enticed the Uruguayan government to reform public banks (IMF, 1998; IMF 1999b).

[112] There are a few exceptions to this rule. Multiple exchange rate regimes, for instance, are explicitly banned under the IMF's Articles of Agreement.

A relevant question, therefore, is why these concerns did not translate into a meaningful intensification of the program's structural conditionality. A possible explanation lies in some specific constraints in the Uruguayan domestic ratification process. A first constraint is related with the political weakness of the Sanguinetti administration, which lacked an absolute majority in Congress and had to govern in coalition with the National Party. Furthermore, the factionalism that characterizes the Uruguayan party system implies that in order to secure a sufficient legislative support, elected presidents do not only have to negotiate with the opposition but also with competing factions within their own party (Altman, 2000). [113] In fact, the structural transformation of the economy is one of the issues on which the different factions of the Colorado party have disagreed more markedly (Jorge Batlle. Personal Interview. July 4, 2010; Moreira, 2004; Garcé and Yaffé, 2005).

A second constraint is related with the frequent use of direct democracy mechanisms in the Uruguayan political system. As the 1993 referendum on the partial privatization of utility companies demonstrated, such mechanisms have constituted a particularly powerful instrument for specific pressure groups to slow down the pace of structural reform in Uruguay (Bergara et. Al, 2006; Panizza, 2008).[114] In this context, the perceived risk of a potentially successful referendum to revert the implementation of a reform contemplated by an IMF program constituted a reason to be particularly cautious in the negotiation of structural conditionality.[115] By reducing the size of the government's win-set, these two constraints may have given rise to a bargaining advantage for Uruguayan negotiators vis-à-vis their IMF counterparts, explaining the paucity of the structural conditionality included

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[113] The factionalism of the Uruguayan party system is primarily due to the fact that parties have well institutionalized factions that are individually represented in congress. The Double System Vote has also been often identified as a source of factionalism. This system was such that each party could present various candidates belonging to different factions, and victory went to the party that accumulated more votes and, within the party, to the most voted candidate. Although the Double System Vote was eliminated in 1996, the electoral reform adopted that year did not restrict voters' right to vote for specific party factions in parliamentary elections, as a result of which factionalism has continued to be a relevant feature of the Uruguayan system.

[114] Indeed, this referendum not only overturned the privatization of the telecommunication monopoly ANTEL. It was also presented as a plebiscite on the Lacalle administration's (1990-1995) to substantially liberalize the Uruguayan public sector. Moving ahead with this reformist agenda proved to be much more difficult afterward (Maiztegui Casas, 2010).

[115] As this chapter explores later in more detail, this is exactly what happened with one of the structural benchmarks included in the 2002 SBA, which required the government to liberalize the oil sector, and which was overturned by a referendum in December 2003.

in the precautionary SBAs. This idea is implicitly recognised in the 2005 staff report: "(…) conditionality seems to have been imposed on measures that went in the right direction, but only at a speed that the authorities felt would not generate excessive frictions in Uruguay's consensus-based polity" (IMF, 2005d: 23).

A last question about the first phase of the Fund's involvement in Uruguay is why, in spite of the aforementioned constraints, the precautionary SBA signed by the Batlle administration included as many as 17 structural conditions as opposed to 5 in the 1999 SBA, 3 in the 1997 SBA and none in the 1996 SBA. To a large extent, this was due to the fact that although they belonged to the same party, President Batlle and his faction (Lista 15) had a more neo-liberal outlook than President Sanguinetti (Espíndola, 2001; Maiztegui Casas, 2010: 477-479).[116] This implies that the political transition that followed the 1999 elections resulted in a convergence in negotiators' preferences about market reform, which made it easier for the Fund to demand the inclusion of a more ambitious structural conditionality. In addition, as a result of its reliance on coalitions and of the factionalism described above, the Uruguayan political system is particularly prone to generating cycles of cooperation and stalemate. (Altman, 2000). This creates an incentive for elected governments to implement reforms as fast as possible at the beginning of each presidential term because of the anticipated difficulties to obtain congressional support as the next general election approaches. In this context, the inclusion of a more ambitious structural conditionality in the 2000 SBA may have been partly aimed at generating a sense of urgency about a structural reform agenda that the Batlle administration knew would only be possible to enact at the beginning of its term (Ernesto Talvi. Personal interview. July 27, 2010). In other words, the government may have viewed the 2000 SBA as an instrument to pursue domestic political objectives.

Summing up the main trends observed during this first phase, both sides departed from converging preferences about the precautionary nature of the IMF programs and about the exchange rate based disinflation strategy, which sustained the cooperative equilibrium. As the bi-polar view on exchange rate regimes gained ground, however, IMF preferences

[116] President Sanguinetti headed the so-called Foro Batllista, a faction of the Colorado party that defines itself as social democrat and that has tended to favour a stronger role for the state in the economy than Lista 15.

began to diverge from the Uruguayan government's preferred outcome. Although the Fund's mandate makes it difficult for the institution to press for a modification of its members' exchange rate regimes in "tranquil" times, these growing concerns about Uruguay's crawling band should have led to an intensification of the SBAs' structural conditionality. Yet, the reforms contemplated in successive IMF programs were for the most part insubstantial, suggesting that the Uruguayan government had the sufficient leverage to resist the Fund's pressures in this area of policy-making. This bargaining power was derived from the government's narrow win-set, itself the result of the Sanguinetti administration's political weakness and of the presence of veto-players empowered by their prerogative to trigger referendums against the Fund's structural conditionality. The SBA negotiated by the Batlle administration, instead, carried more ambitious structural conditions. This was not due to a stronger IMF bargaining position but to a realignment of negotiators' preferences and to the political instrumentation of the Fund's conditionality to facilitate the ratification of the economic policy reorientation that the new government desired.

5.3 Crisis resolution

During the second phase of the decade under analysis the Fund's interventions in Uruguay were centred on the resolution of the 2002 financial crisis. This period's landmark was the second augmentation of the IMF program. Indeed, the multilateral disbursement of August 2002 successfully stopped the run on deposits and paved the way for what turned out to be a swift economic recovery. However, this period was also characterized by the reluctance and even opposition with which IMF negotiators and senior management were forced to accept some of the key decisions that shaped this multilateral intervention. As a first step in the application of the two-level game framework, this section analyses the reasons that were behind the divergences between the preferences of both sides' negotiators. As a second step, it focuses on the evolution of win-sets in order to identify the factors that preserved cooperation and that explain the ultimate outcome of the negotiations.

The preferences of IMF and Uruguayan negotiators began to diverge soon after the approval of the 2002 SBA in March when it became increasingly clear that this intervention was failing to stabilize the situation of the banking system.[117] At that point disagreements were centred on the SBA's disbursement structure. Whereas Uruguayan negotiators gradually came to the conclusion that the SBA should be exceptionally front-loaded in order to signal that the central bank would have the capacity to provide LOLR assistance, IMF negotiators were reluctant to depart from the usual template of gradual disbursements that characterizes SBAs (Alberto Bensión, Personal interview. July 6 2010). To a certain extent, this was due to differences in the diagnosis of the proximate cause of the crisis. The Western Hemisphere Department (WHD) leaned towards the view that the Uruguayan economy was primarily undergoing the effects of a cross-border contagion from Argentina rather than a generalized loss of confidence in domestic financial institutions rooted in the central bank's limited resources to prop up the banking system.[118] This contributes to explain why that department was disinclined to go beyond the tranched provision of balance of payment support that characterizes traditional IMF programs. Nonetheless, according to the former president of the central bank Julio de Brun and to the head of the Planning and Budget Office Ariel Davrieux not all IMF economists agreed with that view. Both argue that after a mission to Montevideo in March 2002 the Monetary and Exchange Affairs Department (MAE) concluded that the crisis was rooted in the banking system and that it needed to be addressed as such rather than as a balance of payment problem (Julio de Brun. Personal interview. July 27 2010; Ariel Davrieux. Personal interview. July 7 2010).

A relevant question, therefore, is why IMF negotiators tended to resist the MAE's recommendation (and the government's request) to adapt the 2002 SBA to the nature of the crisis that was unfolding in Uruguay. To some extent, the pre-eminence of the WHD was due to the fact that regional departments are ultimately responsible for the design of

[117] Preferences were still broadly aligned during the initial negotiations of the SBA in February and March. At that stage, the Uruguayan authorities believed that the deposit outflows would be a temporary phenomenon. Indeed, the stock of deposits in Uruguay had traditionally tended to increase during regional crises as a result of capital flight from neighboring countries (Carlos Steneri. Personal interview. September 16 2010). Hence, the authorities still had faith in the potential for a "traditional" SBA to restore confidence.

[118] Gilbert Terrier, the chief of the IMF mission in Uruguay, continues to argue that the Uruguayan crisis was essentially a balance of payment crisis. He justifies this point of view arguing that a large proportion of deposits were in the hands of foreigners (Gilbert Terrier. Personal Interview. April 26, 2011).

financial programs, relegating the MAE to a secondary position. However, given that the MAE concentrated most of the Fund's expertise on banking issues, its hierarchical position does not fully explain the WHD's reluctance to frontload the SBA's disbursement schedule.

Instead, senior Uruguayan officials tend to attribute this position to the consequences that the Argentine debacle was having on staff and senior management. According to Alberto Bensión, a central problem was that in early 2002 most of the WHD negotiators were being replaced by non Latin-American economists with a shallow knowledge of the Uruguayan economic and institutional context (Bensión, 2004: 66-68). As a result, the mutual confidence on which the Fund's relationship with Uruguay had been constructed over the years was abruptly lost. Furthermore, Bensión argues that the Argentine crisis generated a deep suspicion about the region and that the new WHD team was keen to signal the Fund's willingness to adopt a tougher negotiating stance in the future, for which Uruguay constituted a perfect test case (Alberto Bensión, Personal interview. July 6 2010). According to Uruguay´s former representative at the IMF, such an approach was supported by the Fund's senior management given that both Helmut Kohler and Anne Krueguer felt "personally betrayed" by the Argentine authorities (Carlos Steneri. Personal interview. September 16 2010). These internal bureaucratic dynamics increased risk aversion among IMF negotiators, making them reluctant to consider the use of the SBA for alternative purposes such as the provision of domestic LOLR assistance.

The first augmentation approved in July ended up including elements consistent with the two aforementioned diagnoses about the Uruguayan crisis and, hence, is best interpreted as a middle ground compromise between the positions defended by both sides' negotiators. On the one hand, it constituted a large increase in the size of the program, which was aimed at constituting the FFSB, a fund to assist domestic banks. On the other hand, the augmentation did not frontload disbursements and a significant part of its conditionality targeted the balance of payment. This was the case of the floating of the peso, which the Uruguayan authorities resisted on the grounds that the fall in the stock of international reserves registered since January was only marginally due to the central bank's interventions in foreign exchange markets and that a sharp devaluation of the peso would further feed the banking panic (Julio de Brun. Personal interview. July 27 2010; Carlos Steneri. Personal interview. September 16 2010). [119]

When it became clear that the first augmentation was also failing to stop deposit outflows, the Fund's negotiators opposed the Uruguayan request to further augment the program, giving way to the dramatic negotiations of July 2002. Against the background of an intensifying run on banks and of a nearly depleted stock of foreign exchange reserves, IMF negotiators pressed for the introduction of restrictions on deposit withdrawals, an option that Uruguayan officials considered would reenact the disaster of the Argentine Corralito (Jorge Batlle. Personal Interview. July 4, 2010; Ariel Davrieux. Personal interview. July 7 2010; Isaac Alfie. Personal Interview. 23 July 2010). [120] However, the intervention approved in early August ended up being aligned with Uruguayan rather than IMF preferences: instead of imposing drastic banking restrictions, it provided the resources with which the newly created FESB could guarantee the entire stock of sight deposits. [121] At some point, therefore, Uruguay's negotiators gained the leverage that was needed to mobilize the multilateral rescue package according to their own terms, which needs to be explained in terms of both sides' evolving win-sets.

On the Uruguayan side, the Batlle administration was in a weak political position throughout the negotiations of the 2002 SBA: not only did the Colorado party lack a majority in Congress, but differences emerged between the coalition partners as a result of the crisis. Reflecting these tensions, the National party forced the resignations of economy minister Bensión and of the central bank's board in July 2002 and in October it withdrew its ministers from the cabinet (Paolillo, 2004: 313-320; Maiztegui Casas, 2010: 571-578). Nonetheless, the responsiveness and institutional resilience of the Uruguayan political

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[119] According to Julio de Brun, of the more than US$2 billion fall in international reserves experienced between January and August 2002, only US100 million can be attributed to interventions aimed at sustaining the exchange rate. The remainder was due to the provision of LOLR assistance in a dollarized system (Julio de Brun. Personal interview. July 27 2010).

[120] On July 20 2002, the Fund's Deputy Managing Director of the IMF Eduardo Aninat phoned Jorge Batlle to recommend the imposition of a widespread deposit freeze. Uruguay's President replied that his government would never go that route (Jorge Batlle. Personal Interview. July 4, 2010; Maiztegui Casas, 2010: 576; Paolillo, 2004: 336).

[121] The banking holiday holiday decreed in July 30 lasted only for one week and was aimed at providing some breathing space to finalize the negotiations of the new augmentation.

system is often emphasized as a factor that gave the government substantial leeway during the crisis, allowing it to adopt some crucial emergency measures that would have probably faced an insurmountable opposition in normal times (Jorge Batlle. Personal Interview. July 4, 2010; Luis Alberto Lacalle. Personal Interview. July 23, 2010). Indeed, the government continued to count on the support of the National Party in Congress, which enabled it to pass the two fiscal adjustment packages adopted in February and May 2002 as well as a banking restructuring of unprecedented scope, which was launched a few weeks later (Alejandro Atchugarry. Personal Interview. July 5, 2010).

Equally important, the subdued unrest that was witnessed during the Uruguayan crisis has been attributed to the fact that social discontent could be channelled through the political system (Panizza, 2008). Indeed, although the EP-FA-NM was vocal about its opposition to many of the measures adopted by the government, it proved willing to exploit its connections with civil society and trade unions in order to contain the type of mobilizations that had resulted in the failure of various adjustment packages and, eventually, in the collapse of institutional order in neighbouring Argentina (Luna, 2007; Maiztegui Casas, 2010: 585).[122] There is ground to argue, therefore, that the perceived cost of failing to agree with the IMF was such that the actors involved in the domestic ratification process were able to reach far-reaching compromises, which more than offset the constraints that the government's political weakness imposed on Uruguay's negotiators. As a result, their win-set was sufficiently large to commit to the conditions demanded by the IMF in the negotiation of the 2002 SBA and its augmentations.

Although a relatively large win-set on the Uruguayan side may have contributed to preserve cooperation, it does not explain the shifting bargaining power that resulted in the approval of the second augmentation on terms that departed so markedly from the preferences of IMF negotiators. In fact, following the logic of the two-level game, such a broadening of the Uruguayan win-set should have reduced the Batlle administrations' chances to prevail in the negotiations. In order to understand this puzzle it is necessary to have a look at the

[122]One of the reasons why Alejandro Atchugarry was chosen to replace Bensión was that he was believed to be in a much better position to negotiate with the left and hence to reach the political compromises that were necessary in the midst of the crisis (Maiztegui Casas, 2010: 578).

evolution of the Fund's win-set. Most IMF constituents appear to have been initially willing to intensify cooperation with Uruguay when the 2002 crisis erupted (Nancy Jacklin. Personal Interview. 16 May 2011). This may be due to the perception that Uruguay was a "serious country" and an "innocent bystander" suffering from a cross-border contagion rather than from the consequences of its own misplaced economic policies (Alberto Bensión, Personal interview. July 6 2010). Such a relatively large win-set facilitated the approval of the SBA in March and influenced the bargaining process that resulted in the compromises that shaped the first augmentation.

When this intervention failed, however, much of the initial goodwill vis-à-vis Uruguay seems to have evaporated. The government's financial representative in Washington DC contends that most creditors opposed a further increase in the Fund's exposure to Uruguay and that some constituencies (the Italian and Scandinavian EDs in particular) received the government's request of a second augmentation with outright hostility (Carlos Steneri. Personal interview. September 16 2010). In his views, memories of the Argentine program's failed augmentations were still fresh, explaining the reluctance of most members of the G-7 to engage in what was perceived as another desperate move with uncertain prospects. Nonetheless, Nancy Jacklin, the US Executive Director at the time, contends that such a negative disposition was offset by the support of the US government (Nancy Jacklin. Personal Interview. 16 May 2011). In fact, the support of the US Treasury is the single most important factor to explain the success of the Uruguayan authorities in the negotiations of the second augmentation. Indeed, in late July the US Treasury put its full weight behind Uruguay's negotiators when the Under Secretary for International Affairs John Taylor and his team got directly involved in the design of a new rescue package and when the resources of the Exchange Stabilization Fund were mobilized in order to give time for the Board to approve this intervention (Taylor, 2007b).[123] In other words, the Uruguayan government managed to exploit its trans-national alliance with the US to

[123] According to Gilbert Terrier, the view that the United States government should back Uruguay the way it did was not shared by everybody in the Bush administration. This would explain why the IMF's Second Managing Director Eduardo Aninat told the Uruguayan negotiators that a second augmentation was out of the questions days before the Taylor team eventually put that augmentation in place (Gilbert Terrier. Personal Interview. April 26, 2011).

expand the IMF's win-set beyond the preferences of the institution's staff, senior management and most other constituents.

Why was the US government willing to impose the adoption of a course of action to which most other constituents were opposed? President Batlle attributes this decision to the alliance that his government nurtured with the Bush administration in the context of the FTAA negotiations (Jorge Batlle. Personal Interview. July 4, 2010; Maiztegui Casas, 2010: 526-528).[124] Former Minister Bensión, in turn, emphasizes the working relationship that he developed with John Taylor, which created a direct channel of communication with the US Treasury that became crucial when the negotiations with the IMF turned sour in July 2002 (Alberto Bensión, Personal interview. July 6 2010). His successors Alejandro Atchugarry and Isaac Alfie, as well as the government's financial representative in Washington Carlos Steneri, consider that the US government was willing to act swiftly because in the aftermath of the Argentine crisis and given the difficulties that Brazil was facing prior to Lula's electoral victory there was a growing concern about on-going de-stabilizing trends in South America (Alejandro Atchugarry. Personal Interview. July 5, 2010; Isaac Alfie. Personal Interview. 23 July 2010; Carlos Steneri. Personal interview. September 16 2010). Furthermore, although the August disbursement was large in relative terms, it was small in absolute terms, turning the Uruguayan rescue into a "cheap" instrument for the US government to signal that it was still willing to support its Latin American allies if necessary.

In turn, John Taylor argues that the US willingness to force the hand of the IMF had the following motivations. First, the Treasury was quite confident that a multilateral disbursement large enough to guarantee the bulk of dollar denominated deposits would restore confidence in the banking system (Taylor, 2007b). Second, this intervention was

[124] Furthermore, President Jorge Batlle had developed a strong personal affinity with George W. Bush, which was facilitated by an alphabetic coincidence: in these summits the president of the United States sat in between the Uruguayan and the Venezuelan leaders. In Jorge Batlle's view, his support to the FTAA as well as his willingness to confront President Chávez impressed George W. Bush on various occasions. In addition, Jorge Batlle points out that he mediated in favour of the United States during Jiang Zeming's visit to Uruguay, which happened to take place right after the Hainan Island incident on April 2001. According to Batlle, George Bush did personally thank him for that mediation in the Quebec summit of the Americas. Another measure adopted by the Batlle administration partly in order to reinforce its alliance with the US was the rupture of diplomatic relations with Cuba in May 2002.

consistent with the Bush administration's preferences on how the international community should respond to cross-border financial contagions.[125] Indeed, the augmentations of the Uruguayan programs were intended to signal that although the international community would not back those countries that were implementing "wrong" policies, it was willing to stand behind those with "good" policies but affected by a contagion process (John Taylor. Personal Interview. 5 April, 2011; Nancy Jacklin. Personal Interview. 16 May 2011). Third, Uruguay was "a friend in need" and "good relations between the presidents of two countries led to good cooperative relations between the experts" (Taylor, 2007b: 2).

In sum, during the second phase covered in this section the preferences of both sides' negotiators diverged markedly not only as a result of different diagnoses about the underlying causes of the 2002 crisis but also because of the increased risk aversion that the Argentine meltdown had unleashed within the IMF. In spite of these diverging preferences, a cooperative outcome could be preserved and even intensified during this period. To a large extent, this was due to the responsiveness of the Uruguayan opposition, which expanded the size of the government's win-set precisely when the domestic ratification of the compromises that were being negotiated with the IMF was more urgent. However, the reluctance of the Fund's negotiators could only be overcome when the Uruguayan authorities successfully managed to exploit their transnational alliance with the US in order to expand the Fund's win-set towards their preferred outcome. As a result, the second augmentation of the SBA could be approved in extremis, giving way to a new stage in Uruguay's relationship with the IMF.

5.4 Restoring debt sustainability

The massive multilateral disbursement of August 2002 put an end to the banking panic, paving the way for the recovery of the Uruguayan economy. However, one of the legacies left by the crisis was a sovereign debt burden close to 100% of GDP, which was to become the central issue in the policy discussions with the IMF. This section initially focuses on the

[125] Yet, Republicans had consistently been critical of the use of the Exchange Stabilization Fund in past financial crises. Furthermore, as described in Chapter 3, the Bush administration committed to a policy of not topping up IMF programs which was not followed during the Uruguayan crisis.

bitter negotiations that were necessary to agree on the launching of Uruguay's sovereign debt re-profiling. It then concentrates on its aftermath, during which the Fund's intervention was primarily aimed at consolidating the recovery and softening the amortization of Uruguay's multilateral credit.

The dispute that characterized the weeks and months that followed the second augmentation was centred on whether Uruguay was facing a liquidity or a solvency problem. Some IMF economists argued that in order to restore the solvency of the Uruguayan State its debt to GDP ratio would have to fall to no more than 60%, which would only be possible with a moratorium on debt repayment and a debt restructuring imposing substantial losses on private creditors (Ranjit Teja. Personal interview. May 2, 2011). Instead, the government argued that Uruguay's debt could be endogenously brought down to more sustainable levels with the correction of the exchange rate overshooting that had followed the floating of the peso (Ariel Davrieux. Personal interview. July 7 2010; Isaac Alfie. Personal Interview. 23 July 2010; Carlos Steneri. Personal interview. September 16 2010).[126] Eventually, the compromise that unblocked these negotiations was the government's commitment to launch a preventive debt restructuring without neither defaulting nor imposing nominal losses on creditors. In order to do so, this operation would be carried out in as voluntary and market friendly terms as possible, focusing on re-profiling the debt servicing payments due in the short run rather than on reducing the face value of Uruguayan sovereign debt. To some extent, therefore, this strategy was based on a middle ground interpretation of Uruguay's debt problems: the government acknowledged that even with the Fund's support its liquidity shortages called for the adoption of extraordinary measures, but it did not accept that restoring sustainability required a sovereign default and the imposition of a large haircut on investors (Alejandro Atchugarry. Personal Interview. July 5, 2010).[127]

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[126] The exchange rate depreciated by about 27% in the weeks that followed the floating of the peso induced by the IMF in June. Given that the bulk of the government´s sovereign obligations were denominated in foreign currency, this had a sizeable impact on Uruguay´s debt to GDP ratio.

[127] Julio de Brun, the former President of the Central Bank, argues that there were very few people in the Uruguayan administration that had even followed the debate on the SDRM. To some extent, this was due to the investment grade status that Uruguay had up until February 2002, which turned a sovereign debt restructuring in such a remote possibility (Julio de Brun. Personal interview. July 27 2010)..

What were the factors behind this new divergence between the preferences of IMF and Uruguayan negotiators? Given the Fund's position in the international monetary and financial system, that IMF negotiators pressed the Uruguayan government to breach its contractual obligations seems counterintuitive.[128] To some extent, however, the position of IMF economists was entirely consistent with the Prague framework for the resolution of financial crises approved by the international community a few years earlier, which established that insolvency crises should be addressed through temporary payment suspensions and comprehensive debt restructurings (see Chapter 3). Furthermore, the SDRM proposal was being debated at the time, and Uruguay may have been considered a perfect candidate to become the first user of the statutory debt restructuring mechanism that the Fund's senior management was advocating for. Indeed, senior government officials recall meetings during which IMF negotiators more or less explicitly offered the possibility of applying Krueger´s plan to restructure Uruguay's debt (Ariel Davrieux. Personal interview. July 7 2010; Carlos Steneri. Personal interview. September 16 2010). [129] The government, however, refused to play the role of a guinea pig in the reform of the international financial architecture (Alejandro Atchugarry. Personal Interview. July 5, 2010). This was primarily due to its unwillingness to jeopardize Uruguay's hard won credibility in international financial markets. Furthermore, at that particular juncture the government considered that it was essential for Uruguay to distinguish itself from Argentina.

In addition, the Uruguayan win-set tended to narrow around the government's preferred outcome on the sovereign debt issue, which may have conferred a bargaining advantage in the negotiations with the IMF. Indeed, as these negotiations dragged on and the postponement of the SBA's second review began to generate a growing public concern, a consensus emerged domestically about the need to avoid a default. Revealingly, this position was not only supported by the Colorado and National parties, but also by various

[128] In fact, IMF insiders continue to argue that although they considered that imposing a haircut on private creditors was necessary, they never explicitly asked the Uruguayan government to default (Ranjit Teja. Personal interview. May 2, 2011; Gilbert Terrier. Personal Interview. April 26, 2011).

[129] Ariel Davrieux describes a meeting held in October 2002 in Washington DC to discuss the debt issue with about 30 participants on the IMF side. The presence of such a large number of IMF economists coming from various departments made the Uruguayan delegation understand that what was being negotiated went beyond the Uruguay and the SBA itself (Ariel Davrieux. Personal interview. July 7 2010).

factions of the left of centre opposition even though some of the traditional leaders of the EP-FA-NM had in the past advocated for the repudiation of Uruguay's external debt. Most notably, Danilo Astori, the leader of Asamblea Uruguay (a social democratic faction of the EP-FA-NM) and economy minister between 2005 and 2008, stated publicly in February 2003 that the entire political spectrum should "close ranks to oppose the line defended by the IMF" and that in order to retain Uruguay's credibility it was crucial to continue honouring external debt (La República, 2003). Tabaré Vázquez maintained a more ambivalent position, stating on some occasions that he considered a debt re-negotiation necessary to restore the solvency of the Uruguayan state and to pave the way for a sustainable recovery (Maiztegui Casas, 2010: 600). The leader of the EP-FA-NM, however, was criticized for his views on this particular issue both from within and from outside his coalition, which may have contributed to moderate his rhetoric in the run up to the 2004 elections (El Pais, 2003; Panizza, 2008).

The Fund's win-set, instead, was broader and not centred on the preferences of IMF negotiators. To a large extent this was due to the fact that by late 2002 and early 2003 international support for the SDRM proposal had already faded away. As described in Chapter 3, this was especially the case in the United States, where Paul O'Neil's initial hesitations were followed by John Taylor's counterproposal to deal with sovereign debt restructurings through market-based mechanisms such as the generalization of collective action clauses in sovereign bond contracts (Taylor, 2002). It is clear that the Uruguayan plan to launch a market-friendly preventive debt exchange fitted the preferences of the US Treasury better than IMF negotiators' idea of using the SDRM (Taylor, 2007b). This is not to say that the US officials or other creditor constituencies intervened to force the hand of the IMF as they had done at the time of the August 2002 augmentation. In fact, Julio de Brun argues that, revealingly, President Batlle obtained no response when he tried to involve the US government in the negotiations in late 2002 (Julio de Brun. Personal interview. July 27 2010). However, that the statutory approach to sovereign debt restructurings had fallen out of favour could only have weakened the bargaining power of IMF negotiators, especially given Uruguay´s resolve not to default (Carlos Steneri. Personal interview. September 16 2010). In other words, the direction that the debate on the reform of the international financial architecture was taking may contribute to explain both the origin and the outcome of the brief conflict that characterized the relationship between Uruguay and the IMF from August 2002 to March 2003.

After March 2003 the tensions that had characterized the relationship between Uruguay and the IMF during the negotiations on the debt restructuring began to gradually subside. This was primarily due to a new convergence between the preferences of both sides' negotiators, which produced an agreement on the terms of a policy mix based on the following three pillars: an ambitious fiscal consolidation effort to ensure the long-term solvency of the state; the restructuring of the banking system and the upgrading of its regulatory and supervisory framework; the implementation of a number of targeted structural reforms aimed at accelerating growth and improving the competitiveness of the Uruguayan economy (IMF, 2003f). Various factors sustained this re-alignment of preferences. First of all was the liberal orientation of the Batlle administration, which paved the way for an ideological rapprochement with the IMF once the controversies that surrounded the management of the debt crisis had been settled. Second, the robust recovery exhibited by the Uruguayan economy created an opportunity for the IMF to capitalize on the success of a recent intervention at a time in which the institution was still being heavily criticized for its involvement in the Argentine collapse. Third, the size of the 2002 SBA was such that it provided incentives for both sides to cooperate in order to find the proper pace at which the government could amortize its multilateral obligations without neither jeopardizing the recovery of the Uruguayan economy nor putting the Fund's resources at risk (Carlos Steneri. Personal interview. September 16 2010; Ranjit Teja. Personal interview. May 2, 2011). Given that after the two augmentations Uruguay's outstanding credit to the IMF amounted to close to 18% of GDP, it soon became clear that a new program would be required to partially roll-over the 2002 SBA upon its expiration (IMF, 2005d).

During this period, however, the Batlle administration found it increasingly difficult to secure the domestic political support that was needed to ratify the structural conditions included in the 2002 SBA. This trend became particularly clear after a referendum held in December 2003 forced the government to derogate a decree that fostered competition in the oil sector. In addition, as a result of congressional opposition, the reform of public banks and the disposal of liquidated assets suffered significant delays and the attempts to reform the tax system and the specialized pension schemes were never completed (Maiztegui Casas, 2010: 610, 611; IMF, 2004c; IMF, 2005d). [130] The intensifying opposition faced by the government during this period was partly due to a popular disaffection with the Batlle administration after years of recession, high unemployment and unprecedented levels of poverty. In addition, the heated political context that preceded the 2004 general elections was much less conducive to the sort of compromises that had been reached during the crisis. Given that the National Party was perceived to have stood so close to the Batlle administration, as the elections approached it had an incentive to distinguish itself from the Colorado Party. As a result, it adopted a more left-leaning political rhetoric and became increasingly reluctant to support the government (Altman and Castiglioni, 2006). In turn, the EP-FA-NM had a unique opportunity to bring the hegemony of the two traditional parties to an end and, therefore, had no reason to cooperate with the government. Finally, the stronger than expected economic recovery gradually eliminated the sense of urgency that had facilitated the ratification of many of the measures that were adopted during the crisis. These trends substantially eroded Uruguayan negotiators' win-set, which had an impact on the bargaining process with the IMF.

A narrowing win-set on the side of the government combined with a relatively wide IMF win-set could only have generated a bargaining advantage in favour of Uruguayan negotiators, which was evidenced in Executive Directors' willingness to concede various waivers for the non-observance of the program's structural conditions (IMF, 2004c). As a result, these slippages with the program's conditionality generated minor frictions with the government.[131] What were the factors that sustained a relatively large win-set on the IMF side? Given that a priority for IMF constituents was reducing the institution's exposure to Uruguay, Executive Directors were primarily concerned about the fulfilment of those

[130] The reform of the oil sector, of the special pension schemes and of the tax system were structural benchmarks under the IMF program. However, the disposal of liquidated assets was a performance criterion and, therefore, could give rise to a suspension of the program.

[131] The only significant friction was the postponement of the fourth review, which was scheduled to take place in October 2003 and could only be approved in February 2004. This was attributed to delays with the reform and restructuring of the banking system.

conditions related with the government's capacity to repay the Fund. In this sense, the outperformance of the SBA's fiscal targets might have increased Executive Director's tolerance with slippages in other areas of the program's conditionality. Furthermore, the Fund's constituents had reasons to be cautious about the potentially adverse reactions of market participants to the signals sent by the Executive Board. Indeed, the upward pressures on sovereign spreads that the non-completion of a review would have triggered could not only have undermined the government's ability to honour its private debt, but also to amortize its multilateral obligations.[132] This was explicitly stated in the 2005 staff ex-post assessment of the Fund's engagement in Uruguay: "a key criterion for exit from IMF arrangements over the next few years will be Uruguay's ability to tap international financial markets for the necessary amounts at reasonable spreads" (IMF, 2005d: 27). In this context, delaying the program's reviews was perceived to be not only against the interests of the government but also against the interests of the IMF.

What was the impact of the EP-FA-NM electoral victory on the relationship between Uruguay and the IMF? A priori, the preferences of the new government could be expected to have departed quite substantially from those of the IMF. Indeed, most of the EP-FA-NM's factions had traditionally opposed the neo-liberal policies promoted by the Bretton Woods institutions. The transition from the Batlle to the Tabaré Vázquez administration, however, turned out not to result in major changes in economic policy. The strategic considerations and constraints that explain the moderation of the EP-FA-NM go beyond the scope of this chapter and have been analysed in various recent academic contributions (Panizza, 2005; Panizza 2008; Luna, 2007). What is more relevant to this analysis is that the preferences of the new administration in its relationship with the IFIs were quite closely aligned to those of the outgoing administration, facilitating the preservation of a cooperative relationship with the IMF.

Tabaré Vázquez's intentions in this respect were made clear during a trip to Washington DC in July 2004, 8 months before his government took office. Following Lula's example, he met senior IFI officials in order to signal the future direction of Uruguay's economic

[132] The Uruguayan government had already issued an international bond by October 2003, implying that access to international financial markets was recovered quite fast.

policies and to reduce the risk of an adverse market reaction to the political transition. Further evidencing his intentions, during that trip Vázquez offered the post of economy minister to Enrique Iglesias, the Uruguayan President of the Inter-American Development Bank (Altman and Castiglioni, 2006). When Iglesias declined this offer, he announced that Danilo Astori, the leader of the social democratic faction of the EP-FA-NM and a moderate economist well respected by the market would be his economy minister (Maiztegui Casas, 2010: 637, 638). The sixth and seventh reviews of the 2002 SBA explicitly welcomed this appointment and expressed no concerns about the incoming government's commitment to fiscal discipline (IMF, 2005e; IMF 2005f). Converging preferences, therefore, continued to characterize the relationship between Uruguay and the IMF, which could only have facilitated the negotiations of an SBA to succeed the 2002 program.

Another factor that contributed to preserve a cooperative outcome in the negotiations was the enlarged Uruguayan win-set that resulted from the 2005 political transition. Indeed, the EP-FA-NM government obtained an absolute majority in both chambers of Congress and maintained strong links with civil society, which was expected to facilitate the domestic ratification of the conditions to be negotiated for the new SBA (IMF, 2008a). In fact, the program approved in June 2005 included quite an ambitious structural agenda in areas such as the reinforcement of the central bank's independence, the upgrading of the financial sector's regulatory and supervisory framework, the introduction of a deposit insurance scheme or the creation of a favourable environment for foreign direct investment. It is worth noting that the new SBA did also include some of the conditions that the Batlle administration had failed to ratify as a result of its weak political position, such as the reforms of the tax system and of the specialized pension schemes (IMF, 2005g). The most salient difference between the economic policies outlined in the new SBA and those of its predecessor was the creation of an emergency fund to finance a welfare program to alleviate the social consequences of the 2002 crisis. In order to make room for that program, IMF negotiators accepted primary surplus targets slightly below what they had initially bargained for (IMF, 2008a). [133] This was the only meaningful compromise that was required on the part of the IMF in order to agree on the terms of the 2005 SBA.

Converging preferences and a relatively large win-set on both sides of the negotiations, therefore, created a strong basis for cooperation between Tabaré Vázquez's administration and the IMF. In this context, how to explain the early cancellation of the 2005 SBA? As described in section 4.1.3, this cancellation was made possible by a faster than anticipated economic recovery led by a surge in exports and foreign direct investment. However, the strengthening of Uruguay's external position does not provide an economic rationale to the government's decision to substitute the Fund's support with other more expensive sources of finance.

Ultimately, this decision was primarily motivated by domestic political considerations. Indeed, although the moderation of the EP-FA-NM is crucial to understand the electoral success of the coalition in 2004 as well as its economic policies while in office, it also alienated some of the coalition's more leftist constituencies (Panizza, 2008). These tensions were laid bare during the congressional ratification of some of the structural conditions attached to the 2005 SBA, which proved to be more difficult than had been anticipated during the negotiations of that arrangement. For instance, the reforms of the tax system and the specialized pension schemes, the adoption of a new law to enhance the independence of the central bank or the restructuring of a public housing bank were substantially delayed (IMF, 2007). As a result of these difficulties, the Executive Board had to concede ten waivers during the implementation of the 2005 SBA (IMF, 2008a). In this context, there is ground to argue that anticipating the cancellation of this program was primarily aimed at placating internal tensions within the governing coalition. Furthermore, after the early cancellations of the Brazilian and the Argentine programs in 2005, such a move also had a symbolic content, signifying that Uruguay was taking part in the region's emancipation from the IMF (Ariel Davrieux. Personal interview. July 7 2010; Ernesto Talvi. Personal interview. July 27, 2010).

[133] IMF negotiators were initially bargaining for a primary surplus target of 4% of GDP for 2005 and 2006. Ultimately the Fund accepted primary surplus targets of 3.5% of GDP in 2005 and 3.7% of GDP in 2006 (IMF, 2008a).

5.5 Conclusion

This chapter has applied Putnam's two level game framework to analyse the IMF's involvement in Uruguay from early 1996 until late 2006. During the first phase of this relationship, the negotiations' cooperative outcome was sustained by converging preferences on a medium term disinflation strategy and on the use of precautionary SBAs as a signalling device to facilitate Uruguay's integration in international financial markets. The successive programs signed during the second half of the 1990s were also characterized by their weak structural conditionality. This was primarily due to a narrow win-set on the Uruguayan side, which constrained the Fund's leverage in this particular area of policy-making. More specifically, the weakness of the coalition government during the Sanguinetti administration together with the factionalism that characterizes Uruguayan political parties constituted an important obstacle to ratify the type of market reforms that are usually included in SBAs' conditionality. In addition, the threat of referendums being called to block such initiatives was another impediment to the structural transformation of the Uruguayan economy and, hence, constrained the negotiation of successive IMF programs. As a result, the SBAs approved during the late 1990s were focused on macroeconomic adjustment but did little to address other underlying sources of vulnerability, most notably in the banking system.

When contagion from the Argentine crisis evidenced these vulnerabilities the Fund's intervention successfully put an end to a banking panic that was pushing the Uruguayan economy to the brink of disaster. The August 2002 multilateral disbursement broke new ground not only because of its size but also because it was ultimately designed to support the central bank's capacity to provide LOLR assistance in a dollarized financial system, a function that departed from SBAs' traditional focus on the balance of payments. The decisions that shaped this intervention, however, were only reluctantly accepted and sometimes even opposed by the Fund's senior management, whose preferences increasingly diverged from those of the Uruguayan government as the crisis unfolded. To a large extent, this reflected IMF negotiators' accentuated risk aversion in the aftermath of the Argentine program's debacle.

A first factor that contributed to preserve cooperation was the government's ability to extract compromises from the opposition during the crisis, which increased the size of Uruguay's win-set, thus facilitating the domestic ratification of far reaching emergency measures. Ultimately, however, the August disbursement could only be approved when the US Treasury decided to put its full weight behind Uruguayan negotiators, expanding the Fund's win-set beyond the preferences of the institution's senior managers.

Although the second augmentation had an almost instantaneous and positive effect, severe divergences between the Uruguayan government and the IMF were fast to resurface, this time about the sustainability of the sovereign debt burden. The position of IMF negotiators on this issue may have been influenced by the idea that Uruguay constituted a good candidate to inaugurate the statutory insolvency regime that was being debated at the time. However, the Uruguayan government's proposal of launching a market based pre-emptive restructuring turned out to be a much more appealing option for the most powerful IMF constituents given that most of them opposed the SDRM project. This turn of events in the international financial architecture debate reinforced the Uruguayan government's bargaining position.

After the completion of the debt restructuring, the Fund's intervention in Uruguay focused on the consolidation of the economic recovery and on smoothening the amortization of the government's multilateral obligations. As the sense of urgency that had characterized the crisis period subsided and as the 2004 elections approached, the Uruguayan win-set narrowed and the domestic ratification of the program's structural conditionality became more difficult. Nonetheless, the Fund's constituents were willing to tolerate slippages with these conditions because the program's macroeconomic targets were outperformed and because delays in the SBA's review process could have impaired Uruguay's recovery of access to international financial markets, another crucial requisite for the timely amortization of the 2002 SBA.

The landslide victory of Tabaré Vázquez in the 2004 elections did not substantially change Uruguayan negotiators' preferences while expanding the size of their win-set. This created a strong basis for cooperation evidenced in the scope of the conditionality that was included in the 2005 SBA. The moderation of the government's economic policies, however, alienated some of the traditional constituencies of the EP-FA-NM. As a result, the ratification of the conditionality included in the 2005 SBA proved to be more difficult than had originally been anticipated. It is in order to appease these constituencies that the Vázquez administration took the symbolic step of anticipating the cancellation of its IMF program, which was made possible by a robust external recovery.

What are the hypotheses that this case study helps unveil about the influence of domestic ratification politics on the Fund's program relationship with emerging economies? An analysis of the Uruguayan case before and after the 2002 crisis suggests that a highly participative political system and the presence of multiple veto points constitutes an obstacle to the domestic ratification of the conditions associated with IMF programs. During the 2002 financial crisis, however, the Uruguayan political system proved to be particularly adept at producing the type of short-term domestic compromises that was required for the timely ratification of the emergency measures on which the multilateral bailout was conditioned. This brings support to the hypothesis that a greater reliance on consensus decision-making may increase the size of borrowing countries' win-set during a crisis while decreasing it in tranquil times. Such a feature of the domestic political system is likely to improve the prospects of cooperation with the IMF when a financial program is most needed. However, it may also reduce the likelihood of policy changes being instilled by precautionary programs or by other types of multilateral arrangements not designed to address a crisis situation. It is worth noting that this hypothesis challenges a common assertion in comparative politics: that there is a trade-off between policy stability and policy adaptability (Tsebelis, 2002; Haggard and McCubbins 2001). Indeed, the Uruguayan case study did not display such a trade-off given the capacity of its political system to produce stable outcomes in normal times, but also to adapt in times of crisis.

The Uruguayan case study is particularly useful to illustrate the potential divergences that can emerge between the preferences of the Fund's senior management/negotiators and the institution's constituents. As suggested by the August 2002 multilateral disbursement on which much of this chapter has focused, these divergences may be due to borrowing countries' ability to exploit their trans-national alliances with powerful constituents in order to force the hand of the IMF. However, these divergences may also be rooted in other strategic considerations that go beyond the borrowing country itself. Indeed, the Fund's position during the discussion on the Uruguayan sovereign debt overhang was influenced by the institution's preferences with regard to the reform of the international financial architecture. In turn, IMF constituents' scepticism about the SDRM project ended up reinforcing the Uruguayan government's bargaining power in this particular issue. Even more clearly than the Argentine case study, this suggests the presence of a reverse causality between rules and IMF interventions: it is not only that rules may impose a constraint on the design of multilateral rescue operations but also that specific interventions may push the reform of the international financial architecture in one or the other direction. As a result, IMF negotiators and constituents are likely to have a particularly strong incentive to push for a specific course of action when this course of action is perceived to potentially influence the rules that will shape future interventions.

Chapter 6

Cross-sectional Variation:
The Argentine and Uruguayan Case Studies in Comparative Perspective

The last two chapters have adopted a process-tracing approach to explore the determinants of the longitudinal variation observed in the Fund's involvement in Argentina and Uruguay during the decade that followed the Tequila crisis. This chapter, instead, analyses variation across these two cases, comparing the Argentine and Uruguayan experiences in order to generate additional hypotheses about the relationship between ratification politics at the levels of the IMF and of borrowing countries, and the bargaining process that shapes the design and implementation of IMF-supported programs. As was argued in Chapter 1, comparing these two case studies makes analytical sense because it maximizes variation in the dependent variable while concentrating variation in a limited set of potential explanatory dimensions. Applying this most similar system design, the empirical exercise presented below tries to infer causation from the covariation identified between the outcome of interest and the explanatory dimensions that have not been controlled for as a result of the similarities between the Argentine and the Uruguayan cases.

Indeed, the suspension of the Argentine program in December 2001 stands in stark contrast with the Uruguayan rescue of August 2002, an outcome that cannot be explained in terms of the characteristics shared by these two countries. Among these similarities are their common cultural heritage, their middle income status and their exposure to comparable external shocks as exporters of agricultural products reliant on international capital flows to fund private investment and to cover public deficits. Furthermore, the episodes of financial instability undergone by the two countries in 2001-02 were relatively similar, combining elements of a currency, banking and sovereign debt crisis. Finally, at the beginning of the decade under analysis Argentina and Uruguay were at a comparable historical juncture, having recently emerged from a military dictatorship and from the 1980s debt crisis. This gave way to the overlapping transformation of their political and economic structures, namely the restoration of democratic rule and a market reform process that put an end to the import substitution industrialization strategy that both countries had followed for decades.

And yet, Argentina and Uruguay are markedly different in some other potentially significant explanatory variables. A first obvious difference is their size: whereas Uruguay is a small economy with a population little over 3 million, Argentina is a relatively large emerging market with 40 million inhabitants and was an important attractor of cross-border capital flows during the 1990s. Therefore, whereas a full-blown crisis in Argentina could have been feared to have a systemic impact, Uruguay was practically irrelevant on a global scale. Other potential sources of cross-sectional variation include some specific features of the Argentine and Uruguayan institutional and political frameworks. For a start, the Argentine federal structure contrasts with Uruguay's unitary state, which may have influenced the domestic ratification of some of the conditions associated with IMF programs. In addition, whereas national referendums are common in Uruguay, direct democracy mechanisms are seldom used in Argentina, at least at the Federal level. Differences in the democratization and market reform paths followed by Argentina and Uruguay may also have played a relevant role. Whereas President Menem concentrated executive power in such a way as to expedite the liberalization of the economy during his first administration, the Lacalle and the Sanguinetti administrations moved by consensus, resulting in a more gradual approach to market reform. The key question addressed here is whether these differences had an impact on the Argentine and Uruguayan relationship with the IMF, especially during the 2001-02 financial crises.

The evidence provided in this chapter suggests that the size of borrowing countries' economies can exert a substantial influence on the negotiation of IMF-supported programs. However, a comparison between the Argentine and the Uruguayan experiences with the Fund also indicates that economic might as such is not necessarily a consistent predictor of the multilateral response to a specific financial crisis. The fact that Argentina was an important emerging market contributes to explain the Fund's initial responsiveness to the financial difficulties that emerged in that country in the late 1990s. However, Argentina's global relevance at the time did not avoid the suspension of the program in December 2001. In the meanwhile, the Fund's initial reaction to the Uruguayan crisis was somewhat slower, which could be partly due to the modest cross-border spill-over effects that this episode of financial instability was feared to unleash. However, that Uruguay is a small economy made it easier to mobilize the amount of resources that was needed to successfully put an end to that country's banking panic in 2002. In other words, being large or being small seems to have constituted an advantage or a disadvantage for Argentine and Uruguayan negotiators at different points in time, which illustrates this variable's ambiguous effect on the Fund's decision-making process.

This chapter's main conclusion is that a substantial amount of the cross-sectional variation observed in the outcome of interest can be explained by certain differences in the configuration of Argentine and Uruguayan political institutions. More specifically, the different position of veto-players within these two countries' polities appears to have played a particularly relevant role, imposing localized constraints on the negotiations of those conditions that threatened to alter the status quo defended by these veto-players, which chief negotiators seem to have managed to turn into a bargaining advantage vis-à-vis the IMF. This is why the veto power of the Argentine provinces resulted in a weaker fiscal conditionality in that case while the right of specific interest groups to trigger referendums in Uruguay resulted in a weaker structural conditionality across the River Plate. In addition, the comparative study presented below brings further support to the idea that political actors' propensity to cooperate is a significant determinant of policy adaptability during a financial crisis. The cross-sectional variation observed in this analytical dimension might be associated with the aforementioned differences in the democratization and market reform paths followed by the two countries, which contributes to explain why the system of checks and balances that was allowed to emerge in Uruguay was stronger than that of Argentina.

The remainder of this chapter is structured as follows. Section 6.1 will briefly describe the main differences observed in the Fund's interventions in Argentina and Uruguay during the period under analysis. Section 6.2 will try to explain this variation, concentrating on the international level of analysis and identifying the factors that may have influenced IMF constituents' strategic calculations vis-à-vis Argentina and Uruguay during the negotiation of the programs. In turn, section 6.3 will concentrate on the domestic level of analysis, focusing on the political and institutional factors that determined the bargaining position of the Argentine and the Uruguayan governments as well as their ability to ratify and implement the conditions agreed with the IMF. Finally, the chapter will conclude with a summary of the hypotheses that this comparative analysis helps unveil.

6.1 Cross-sectional variation

Focusing first on the cross-sectional variation observed during the crisis prevention phase, a first difference between the two cases is that the Argentine programs were both longer and larger (in absolute and relative terms) than the Uruguayan SBAs.[134] Upon approval they had an average duration of 31 months and gave access to 146% of quota, against an average duration of 23 months and a size of 45% of quota in Uruguay.[135] That the program approved for Argentina in 1998 was a three year EFF and not a shorter SBA, as was the case for Uruguay, suggests the presence of differences in the two countries' bargaining position with the Fund during this period.[136]

A second difference is that Argentine negotiators successfully bargained for the systematic accommodation of larger than programmed budget deficits in a way that was much less prevalent in the Uruguayan case. Indeed, both during the Menem and the De la Rúa

[134] The larger size of the Argentine programs was partly due to their longer duration, itself partly determined exogenously by the electoral cycle. Given that upon taking office new governments tend to re-negotiate the conditionality associated with IMF programs inherited from outgoing administrations, the duration of such programs is usually influenced by the date at which the next general elections will be held. The Argentine 1998 EFF, however, had a duration of three years even though the next elections were scheduled for late 1999.

[135] If measured in terms of yearly access to the Fund's resources, the Argentine programs were also substantially larger than the Uruguayan SBAs: 57% of quota per year against 36% of quota per year.

[136] At least *de Jure*, Extended Fund Facilities are used to address structural balance of payment problems, which is why these facilities typically have a longer duration than SBAs together with a more extended repayment period. In practice, however, the criteria according to which an EFF or an SBA is approved for a given country have never been entirely clear. The Argentine alternation between EFFs and SBAs during the 1990s is a case in point.

administrations IMF Executive Directors repeatedly granted waivers for the non-observance of the government's fiscal targets. In the case of Uruguay, Executive Directors also proved willing to tolerate some departures from the program's macroeconomic targets as the late 1990s recession got worse. However, these breaches with conditionality were both smaller and rarer.

Finally, it is worth noting that the IMF itself has identified differences in the failures of the Argentine and Uruguayan programs approved during this period, which refer to specific areas of their conditionality. In Argentina, the IEO argued that successive programs had been too soft on the fiscal front (IEO, 2004). In turn, the Fund's staff recognized that it did not pay sufficient attention to Uruguay's structural reform agenda and, more specifically, to the governance of the financial system (IMF, 2005d).

Focusing next on the second phase identified in previous chapters, the IMF was initially similarly responsive to the two unfolding crises. By the time of their first augmentation the Fund's programs in Argentina and Uruguay were comparable in size: 546% and 572% of quota respectively. Other multilateral and bilateral creditors, however, responded more quickly to the Argentine crisis, topping up the additional commitments that the IMF provided with the first augmentation. With the second augmentation the overall size of the Argentine program reached almost 900% of quota, thus becoming substantially larger than the Uruguayan SBA. However, only a portion of this second augmentation was actually disbursed, implying that in relative terms the Fund's exposure to Argentina was never much larger than that to Uruguay.

Regarding macroeconomic conditionality, given that the Uruguayan government was in a sounder fiscal position, the budget cuts that the Batlle administration was asked to adopt were more moderate than in Argentina. But the Uruguayan crisis resolution program was more demanding in other areas: whereas the IMF explicitly required the Batlle administration to float the peso against its will, the Argentine government systematically refused to discuss the possibility of abandoning the convertibility regime. On the structural front, the Fund's interventions in Uruguay were centred on the banking system, while the conditions negotiated with Argentina were more generally aimed at re-igniting growth and restoring external competitiveness. Another aspect in which the early response to the two crises differed was private sector involvement. Whereas PSI measures were already included in the first augmentation of the Argentine program, this issue would only begin to be discussed with the Uruguayan authorities after the worst of the crisis was over.

Again, the Uruguayan government had a better record of compliance with macroeconomic conditionality. Indeed, the fiscal adjustments approved in Uruguay contrast with Argentina´s successive failed attempts to regain control over public finances. Furthermore, by August 2001 the negotiations between Argentina and the IMF had entered a chaotic stage and the second augmentation was not clearly subject to a specific conditionality, which contrasts with the case of Uruguay where all program related decisions were tied to precise policy conditions.

But the turning point in the evolution of cross-sectional variation in the two cases came with the suspension of the Argentine program in December 2001 vs. the augmentation of the Uruguayan program in August 2002. As a result of these decisions, the combinations of official financial assistance, conditionality-induced macroeconomic adjustment and structural reform, and private sector involvement with which the two crises were ultimately addressed turned out to be very different. In spite of these divergences, the restoration of a program relationship with the Duhalde administration in January 2003 re-established some parallels between the two cases during the third phase of the negotiations. Indeed, once that program was approved, both interventions were driven by the same overarching purpose: restoring the solvency of the Argentine and the Uruguayan states. However, Argentina's relationship with the IMF continued to be much more conflictive than that of Uruguay until the end of the decade under analysis. This was partly due to the fact that whereas Uruguay continued to receive net IMF disbursements until 2005, Argentina was forced to make net repayments to the Fund from 2002 onwards.

Cross-sectional variation is also apparent in the conditionality associated with the post-crisis SBAs. Fiscal conditionality was tighter in the Uruguayan programs, which set a primary surplus target of 4% of GDP against 2.5% of GDP in Argentina. Furthermore, Argentina's long SBA established short-term fiscal objectives but left medium-term targets undefined. In terms of structural conditionality, the Uruguayan programs were also more ambitious than the Argentine SBAs. But compliance turned out to be relatively similar in both cases: Argentina and Uruguay outperformed the programs' fiscal targets but lagged behind on structural conditionality. Regarding PSI, although both countries restructured the bulk of their bonded debt during this period, these two processes were completed in a very different manner. While the Argentine restructuring followed the largest sovereign default in history and was extremely contentious, the Uruguayan government remained current on its obligations and maintained a market-friendly attitude throughout the process. The role played by the IMF in the two restructurings was also very different. Whereas the Argentine default was a consequence of the suspension of the 2000 program but not an outcome explicitly negotiated with the IMF, the launching of the Uruguayan debt restructuring was jointly agreed with the Fund. Furthermore, whereas the Argentine government was keen to minimize the Fund's interference in the negotiations with private creditors, the Uruguayan government relied on the support of the IMF to encourage participation in the debt exchange.

6.2 The international level of analysis

This section will try to identify the international factors that contribute to explain cross-sectional variation in the Argentine and Uruguayan case studies. The focus will therefore be placed on the side of the IMF and of its constituents rather than on domestic political dynamics in Argentina and Uruguay, which will be discussed in the next section. Chapter 2 argued that the IPE literature that has concentrated on the international level of analysis is more helpful to study the origins and evolution of the IMF as an international organization than the cross-sectional variation observed in its financial programs. Nevertheless, some of the international variables identified in this literature contribute to explain why the IMF may respond differently to similar crises, as was the case in Argentina and Uruguay. More specifically, the interests of powerful states and the bureaucratic incentives of the Fund's management and staff have been proved to be potentially significant determinants of the multilateral response to financial crises in emerging economies. Therefore, the analysis presented below will pay special attention to these two categories of variables.

The comparison conducted in the previous section suggests that during the crisis prevention phase the Argentine government had more bargaining power than the Uruguayan authorities in the negotiations with the IMF. This materialized in larger and longer programs and in a greater willingness on the part of the Fund's Executive Board to tolerate slippages with the programs' conditionality. Given that supplementary financiers reacted faster to the difficulties of the Argentine government at the onset of the crisis and that the IMF never really openly questioned the convertibility regime while forcing the Uruguayan government to float the peso against its will, this greater leverage is also visible during the initial stage of the crisis management phase.

Such a pattern of cross-sectional variation is consistent with the neo-realist hypothesis according to which those countries in which powerful nations have more interests at stake will receive a better treatment from international organizations like the IMF. As mentioned in the introduction, one of the clearest differences between Argentina and Uruguay is their size and economic weight. Given that by the late 1990s Argentina had consolidated its position as a leading emerging market to the point of becoming a founding member of the G-20, the Fund's most powerful constituents had reasons to be more concerned about the possibility of a financial crisis in that country than in Uruguay, which was a minor player in international finance. This translated not only into a greater complacency in the Fund's dealings with Argentina but also in a tendency to underestimate the increasingly worrisome signs that the Argentine economy was beginning to exhibit in the late 1990s. It seems clear that Uruguayan negotiators had none of these advantages, resulting in less leverage in their negotiations with the IMF.

However, the crucial multilateral decisions on which much of this chapter is focused can seldom be explained from a purely neo-realist perspective. If Argentina had truly become such a systemically important emerging economy and Uruguay was so irrelevant, why did the international community suspend the former's program fall while adopting such extraordinary steps to rescue the Uruguayan banking system a few months later? The next section will argue that delving into the domestic level of analysis is particularly important to explain this outcome. But there are some international factors that also deserve attention.

First of all, the September 11th attacks disrupted the negotiations between Argentina and the IMF, which at that time were at a critical stage. As was pointed out in Chapter 4, the attacks suddenly detracted attention from the Argentine crisis, reducing the cost of no agreement perceived by the Fund's constituents and contributing to eliminate the win-set overlap that had previously sustained the negotiations' cooperative outcome. Given that a few more months had elapsed since September 11th, the negotiations of the Uruguayan rescue package took place at a slightly less unfavourable time. In fact, right after the attacks the Argentine government could never have received the same amount of attention that the US Treasury devoted to the Uruguayan authorities in the summer of 2002 (John Taylor. Personal Interview. 5 April, 2011). To some extent, therefore, the cross-sectional variation observed in this study's dependent variable was due to differences in the way in which an exogenous event impacted on the preferences and interests of the US and other important creditors. This illustrates the fact that when negotiating the terms of a crisis resolution program, emerging economies have to compete for the attention of the Fund's constituents. As a result, the international conjuncture at the time of the crisis can be a relevant explanatory dimension of the negotiations with the IMF.

In addition, the divergence in the multilateral response to the two crises may also be linked to differences in the strength of the Argentine and Uruguayan transnational alliances with the US government. Whereas Finance Minister Cavallo ultimately alienated many in the Washington establishment and the Duhalde administration had a weak connection with the US Treasury, President Batlle turned Uruguay's relationship with the US into the main priority of his government's foreign policy, a strategy that proved to pay off during the financial crisis. In fact, his personal connection with George W. Bush was instrumental to establish a direct line of communication between Uruguayan and US Treasury senior officials, which contributed to unblock the bargaining process that led to the approval of the rescue package in August 2002. However, given Uruguay's irrelevance on a global scale, in and of itself this transnational alliance seems insufficient to explain why the US Treasury decided to put its full weight behind the Batlle administration unless this move is linked to more pressing international issues or to other strategic calculations.

The fact that the financial crisis that the Brazilian economy was undergoing in the run-up to Lula's first electoral victory broadly coincided with the worst phase of the Uruguayan crisis is a relevant factor in this respect. In the context of the uncertainties that characterized the regional context in 2002, the Bush administration may have considered that, whatever the outcome of the Brazilian crisis, the Uruguayan rescue package could be instrumental to signal that Latin America was still in the radar of American foreign policy. Furthermore, given that Uruguay is such a small economy, the financial cost of this rescue was relatively low in absolute terms while having reasonable chances of success. That rescuing Uruguay was 'cheap', therefore, constituted an advantage that Argentina lacked in late 2001, which goes against the argument that important emerging economies are systematically better placed to obtain the financial support of the international community.

In addition, previous chapters have identified various instances in which the US interfered in the negotiations of the programs not with the purpose of defending its material or political interests in Argentina and/or Uruguay but in order to shape the reform of the international financial architecture according to its own preferences. This trend was particularly clear during the debate on the SDRM, which coincided with the decisions to massively augment the Uruguayan program and to restore a program relationship with Argentina. Both of these decisions were consistent with the US Treasury's views about the desirability of a market-based sovereign debt restructuring regime. The Uruguayan rescue ruled out the possibility that this country would become the first user of the SDRM, as the Fund's senior management may have had in mind when the government of that country was being pressed to default on its obligations. In turn, the Argentine SBAs approved in 2003 were deliberately vague about macroeconomic adjustment, which the US saw as a way not to impose a further constraint on the government's debt restructuring negotiations with private creditors.

This illustrates an interesting pattern in the direction of the causal relationship between rules and IMF programs: rather than rules constraining the negotiation of crisis lending operations, IMF constituents may view specific interventions as opportunities to influence the content of rules. Such strategic calculations are more likely to prevail when far reaching reform proposals are on the table, as was the case during the SDRM discussions in 2002 and 2003. However, it would difficult to argue that the Argentine program was suspended in 2001 because the US or other G-7 members were trying to re-direct the reform of the international financial architecture at that particular juncture. Therefore, this argument can only explain part of the story about why the multilateral management of the Argentine and the Uruguayan crises ended up diverging so markedly.

Bureaucratic politics at the level of the IMF also contribute to explain cross-sectional variation in the Fund's programs at various stages of the negotiations. Chapter 4 already emphasized that as a result of the criticism elicited by the management of the Asian financial crisis, the Fund's senior management was particularly keen to emphasize the institution's role in what by then was still perceived as an Argentine success story. This predisposed IMF negotiators to respond quickly to the financial difficulties that the government began to experience in the late 1990s and contributes to explain why the IMF continued lending after it was already clear that Argentina's economic policies were no longer sustainable (Mussa, 2002; IEO, 2004). Instead, Uruguay was much less relevant in the Fund's bureaucratic political process, at least prior to the Argentine collapse. In fact, given the small size of its economy and the more moderate market reforms that had been implemented in that country, it would have made little sense for the Fund's senior management to point at the Uruguayan experience in order to boast the institution's involvement in emerging markets. This brings support to the idea that the size and international relevance of borrowing countries also influences their bargaining power through a bureaucratic channel.

However, it would be difficult to argue that IMF negotiators' bureaucratic incentives had fundamentally changed when the Argentine program was suspended in December 2001. This argument is even weaker when it comes to explaining why the Uruguayan program was massively augmented in August 2002. In fact, chapter 5 argued that the Fund's internal bureaucratic political dynamics played against the interests of the Uruguayan government during the negotiations of that rescue package. Indeed, one of the consequences of the Argentine debacle was that the Western Hemisphere Department was revamped and that the mission chiefs to Uruguay were substituted by economists supposedly less likely to be co-opted by Latin American governments. This reflected management's determination to adopt a tougher negotiating stance in the future and to avoid the mistakes that were perceived to have been made in the management of the Argentine crisis. This line of reasoning explains why the Fund's senior management was opposed to the second augmentation of the Uruguayan program and to the re-establishment of a program relationship with Argentina. And yet, the mediation of the US Treasury ultimately unblocked both negotiations, resulting in the approval of the Uruguayan rescue package and of the 2003 Argentine SBAs. Therefore, these two experiences suggest that although bureaucratic politics matter, when other strategic considerations prevail, powerful constituents can impose the adoption of a course of action on the Fund's managers and negotiators.

Summing up, this section has examined the cross-sectional co-variation between a number of international variables and the Fund's interventions in Argentina and Uruguay. It has been argued that differences in these two countries' economic weight were particularly relevant to shape powerful constituents' preferences as well as the Fund's internal bureaucratic political process during the crisis prevention phase and the beginning of the crisis resolution phase. However, these variables' explanatory power is much weaker when it comes to answering why the Argentine program was suspended while the Uruguayan program was massively augmented. The September 11th attacks and the different strength of the Argentine and Uruguayan transnational alliances with the US government had an impact on the bargaining process that led to these two decisions. Furthermore, it has been argued that during the discussions on the SDRM proposal, the US Treasury interfered in the program negotiations in order to influence the rule-making process, which also contributes to explain why Uruguay could punch above its weight at various instances of the negotiations. But, ultimately, the contrasting multilateral response to the two crises cannot be understood unless the domestic level of analysis is brought into the picture.

6.3 The domestic level of analysis

This section will focus on the domestic determinants of cross-sectional variation in the Fund's interventions in Argentina and Uruguay. When reviewing the IPE literature that has concentrated on the domestic level of analysis, Chapter 2 identified three explanatory dimensions that may be relevant for this comparative study. The first one refers to veto-players and their influence on the politics of macroeconomic adjustment and reform. The second one refers to political actors' ability to cooperate in times of crisis. The third one is related with the domestic politicization of IMF-supported programs. To what extent do these variables contribute to explain differences between the Argentine and the Uruguayan case studies?

In line with Tsebelis (1995), Haggard and Mc Cubbins (2001) or MacIntyre (2001), although the presence of veto players is important to underpin the stability and credibility of economic policies and institutions, in times of crisis such actors can constitute a major obstacle to macroeconomic adjustment and reform. Therefore, a first possible domestic explanation for the cross-sectional variation observed in the Fund's interventions is related with the role played by veto-players in different polities: it might be that the intensity of the policy constraints imposed by these actors on the Argentine and Uruguayan ratification processes differed, thus affecting the negotiation and implementation of successive IMF programs. Two are the most common variables used in the relevant empirical literature in order to proxy the obstacles to policy change induced by the presence of veto-players. CHECKS, from the Database of Political Institutions, counts the number of veto actors present in different political system (Beck et al., 2001). In turn, the variable POLCON, from the Political Constraint Index Database, captures both the number of institutional veto players and the extent to which the preferences of these actors diverge (Henisz, 2000).[137]

[137] This variable, therefore, is more consistent with Tsebelis's central hypothesis, according to which departing from the status quo is more difficult when the number of veto-players is high and when their preferences diverge (see Chapter 2).

The evolution of these two variables in Argentina and Uruguay is presented in the following table.

Table 6.1

Veto players

		96	97	98	99	00	01	02	03	04
Argentina	CHECKS	2	2	5	5	4	4	4	4	2
	POLCON	0,5	0,5	0,48	0,48	0,41	0,41	0,47	0,47	0,55
Uruguay	CHECKS	4	4	4	4	4	4	4	4	4
	POLCON	0,56	0,56	0,56	0,56	0,51	0,51	0,51	0,55	0,55

Sources: Database on Political Institutions; the Political Constraint Index Database

No clear picture emerges from the data presented in Table 6.1. According to the variable POLCON, Uruguayan chief-negotiators were slightly more constrained than the Argentine government throughout the period under analysis. However, the evolution of the CHECKS variable suggests that the Menem administration was initially much less constrained than the Sanguinetti government, a situation that was reverted after the 1997 mid-term elections in Argentina. In turn, the De la Rúa, Batlle and Duhalde administrations faced the same exact number of veto actors during the crisis management phase. Based on the evolution of these variables it cannot be argued that veto-players were a significant determinant of cross-sectional variation in the Argentine and Uruguayan case studies, at least from the late 1990s onwards.

However, the CHECKS and POLCON variables may be too generic to capture some of the complexities that characterize the connection between domestic ratification politics and the design and implementation of IMF programs. Indeed, a comparison between the Argentine and the Uruguayan experiences suggests that borrowing country negotiators may not be equally constrained in all areas of policy-making: whereas the Argentine government was primarily constrained in the fiscal front, the Uruguayan authorities' main constraints were centred on structural reform. This can be attributed to differences in the location of veto players in the Argentine and Uruguayan institutional and political structures. More specifically, the Argentine Federal structure empowered Argentine provinces to veto the government's ability of limiting public spending whereas the constitutional right to trigger a referendum empowered certain interest groups to block privatizations and other market reforms in Uruguay. These veto-points reduced the Argentine and Uruguayan room for manoeuvre to change the status quo of specific policies. Furthermore, these constraints also conferred the Argentine and Uruguayan governments a localized bargaining advantage in the negotiation of the programs' policy conditions that affected the interests of the most powerful veto-players that they faced domestically.

That the federal structure undermined fiscal consolidation in Argentina became increasingly clear during the second half of the 1990s. To a large extent, this was due to the inflexible inter-governmental relations that were inherited from the fiscal pacts signed with the provinces in the early 1990s (Eaton, 2005; Jones and Hwang, 2005).[138] In addition, the provinces became more reluctant to cooperate with the Federal government after the 1999 elections because most of them remained under the control of the Justicialist Party. In this context, the De la Rúa administration was forced to concentrate fiscal adjustment at the Federal level of government, which further reduced its chances of success. Although the Uruguayan budgetary process also exhibited some rigidity, the Sanguinetti and the Batlle administrations were confronted by less powerful veto-players in this area of policy-making (Bergara et al. 2006). As a result, complying with macroeconomic conditionality and reacting to falling tax revenues was comparatively easier. A case in point was the de-indexation of public salaries, which was a specific condition associated to the 1997 SBA. This contributes to explain why fiscal conditionality did not strain Uruguay's relationship with the IMF to the same extent than it did in Argentina.

On the structural front, instead, the Uruguayan government was more constrained. This was already evidenced during the Lacalle presidency (1990-1995) when a referendum triggered by a labour union blocked a privatization process that was intended to initiate a broader economic liberalization program (Maiztegui-Casas, 2010). On top of the fact that President Sanguinetti was less inclined to liberalize the economy than his predecessor, the perception that a successful referendum could potentially reverse a reform agreed with the IMF

[138] With the 1992 and 1993 pacts provincial governors gave up their entitlement to a fixed share of total revenue collection in exchange for a minimum floor (*piso mínimo*) of revenue transfers to the provinces. These arrangements benefited the Federal government during phases of strong economic growth in which tax collection exceeded expectations, partially explaining Menem's fiscal adjustment successes in the early 1990s.

increased the Uruguayan capacity to resist the Fund's pressure in the negotiation of the structural conditionality included in subsequent programs. The shock approach to market reform adopted by Menem's first administration indicates that the Argentine government had more room for manoeuvre in this area of policy-making. This is not to say that Argentine negotiators were unconstrained with regard to structural conditionality.[139] However, the Menem administration managed to compensate and co-opt the labour movement as well as other interest groups associated with the old ISI model, successfully incorporating them to the reform coalition (Etchemendy, 2005).[140] In other words, as opposed to the Uruguayan case, during the 1990s the Argentine government managed to partially neutralize the veto players that opposed the structural transformation of the economy.

In sum, the position of veto-players in the Argentine and Uruguayan polities contributes to explain cross-sectional variation in IMF interventions during the crisis prevention phase as well as the nature of some of the vulnerabilities built up in the run-up to the crises. But this variable is less significant when it comes to explaining the contrasting multilateral response to the 2001-02 crisis, i.e. the suspension of the Argentine program vs. the Uruguayan financial rescue. Instead, differences in the propensity of Argentine and Uruguayan political actors to cooperate in difficult times offers a more promising avenue to understand the cross-sectional variation observed during the crisis management phase. Indeed, a major difference between the cases under analysis is that whereas Uruguayan constituents were able to compromise when the need arose, the Argentine political and institutional structure repeatedly failed to generate the level of cooperation that would have been needed to ratify the terms of a crisis resolution strategy in coordination with the IMF. The key question is why domestic constituents were able to cooperate in one case but not in the other.

[139] In fact, the *Confederación General del Trabajo* (CGT), the Peronist labour union, has traditionally played a very significant role in Argentine politics. Its ability to de-stabilize the government was amply demonstrated under Raúl Alfonsín, during whose presidency it launched 13 general strikes, bringing it to an early end in 1989.

[140] According to Etchemendy, there are four types of payoffs that were required for the unions to be incorporated in the reform coalition: the adoption of minor changes in the highly corporatist labour legislation; the preservation of the role of unions in the administration of the health care system; a privileged position in the private pension funds' market; a share of the privatizations (Etchemendy, 2005).

The timing of the two crises is one of the factors that explain the contrasting patterns of domestic political cooperation described above. When the augmentations of the 2002 SBA were being negotiated, Uruguayan constituents had already witnessed the chaotic events of December 2001 in Argentina, which increased their propensity to cooperate in order to avoid a repetition of that outcome across the River Plate. This played a particularly relevant role in shaping the position of the Frente Amplio, which maintained a relatively cooperative attitude throughout the crisis. As a result, the actors more likely to have opposed macroeconomic adjustment and structural reform restrained from triggering a referendum against the conditions that the government negotiated with the IMF, at least during the crisis management phase.[141] Partly because there was a much less clear idea of how the crisis would evolve in Argentina, neither the Justicialist Party, the provinces nor the *Piquetero* movement compromised to facilitate the adjustment process when the economy was teetering on the brink of collapse in 2001.

A more subtle determinant of domestic constituents' propensity to cooperate is related with differences in the Argentine and Uruguayan democratization and market reform processes. It has already been argued that the pace and depth of market reform in Argentina contrasts with the gradual approach adopted by subsequent governments in Uruguay during the 1990s (Blake, 1998). The key idea introduced here is that the Menem administrations' urge to expedite this reform process is partly at the origin of an uncooperative political culture that undermined domestic constituencies' ability to compromise in difficult times. In Uruguay, instead, a stronger system of checks and balances was allowed to emerge from the military dictatorship. This consolidated the position of veto-players with the power to block departures from the status quo and, hence, to derail structural reform attempts. However, by forcing successive governments to move by consensus, these checks and balances also generated a more cooperative political culture, which was turned into a decisive advantage during the 2002 crisis, widening the size of the Uruguayan win-set precisely when an agreement with the IMF was most urgently needed.

[141] It was not until December 2003, when the recovery was well underway, that a popular initiative triggered a referendum to derogate various structural reforms in the oil sector and the banking system.

How did President Menem's "shock therapy" of the early 1990s undermine domestic constituents' ability to engage in an inter-temporal bargaining process in Argentina? For a start, the large majorities obtained by the PJ in successive elections, at least until 1997, allowed the Argentine executive to disregard the opposition, relegating it to a marginal role in the decision-making process that shaped the Argentine reform process. Furthermore, the 1990 Law of Economic Emergency and State Reform entitled the President to rule by decree, sidestepping the Argentine Congress and weakening its oversight capacity over the management of the economy (Levitsky and Murillo, 2005). The independence of the judiciary was also severely curtailed when the Supreme Court was packed in 1991 in order weaken another potential veto-point that could have hindered the ratification of Menem's economic liberalization program (Helmke, 2005). In addition, that President Menem silenced most of the voices that could have opposed the neo-liberal agenda through his compensatory policies contributes to explain the development of new forms of protest epitomized in the *Piquetero* movement, which had a huge role in de-stabilizing the De la Rúa government (Etchemendy, 2005).

In Uruguay, instead, the National and the Colorado parties were forced to work together in successive coalition governments, creating strong connections and even an ideological affinity between the two dominant political forces. Although the Frente Amplio did not take part in any of these coalitions, its ability to mobilize veto-players ensured that no major structural reform could be launched without the Left's more or less explicit acquiescence. This was a consequence of the prevalence of direct democracy in the Uruguayan political system, which empowered labour unions and other civil society groups with strong connections with the Frente Amplio to initiate popular referendums against specific government measures. The constraints imposed by the need to govern in coalition and the more or less constant possibility of referendums being triggered slowed down the pace of reform, but broadened political participation and reinforced trust among constituents and in Uruguayan institutions. As a result, the Uruguayan political environment was more conducive to cooperation when it became clear that the economy was teetering on the brink in 2002.

The analysis presented above is consistent with Scartascini et al. (2010), who argue that the presence of strong checks and balances does not necessarily undermine the responsiveness of polities to an economic crisis, but rather the opposite (see Chapter 2). Menem's strategy of weakening potential veto-players enabled his first administration to drastically re-orient Argentina's economic policies. But these reforms also introduced severe rigidities in the decision-making process, such as the convertibility law or the fiscal pacts reached with the provinces, which resulted in a low level of policy adaptability during the crisis. In Uruguay, the government was more constrained during the 1990s. But these very constraints contributed to consolidate a political arena in which Uruguayan constituents could engage in an inter-temporal bargaining process that catalysed cooperation during the crisis. As a result, the Argentine and Uruguayan political systems produced policy stability and policy adaptability at very different points in time, which had a marked impact on the negotiations with the IMF, especially during the crisis resolution phase.

Veto-players and political actors' propensity to compromise, however, do not fully explain why the Fund's relationship with Uruguay was much more cooperative than that with Argentina during the years that followed the 2001-02 events. A first domestic explanation for this divergence is related with the financial incentives facing the two governments during this period. For a start, whereas Argentina only opted to roll-over its multilateral debt, Uruguay was still borrowing in net terms from the IMF and had obvious motives to try to avoid losing this crucial source of hard currency. Even more importantly, given that Argentina had defaulted on its bonded debt while Uruguay remained current on its sovereign obligations, the value that these two countries' negotiators attached to the IMF's role as a mediator with private creditors was very different.

Indeed, the Argentine and the Uruguayan case studies illustrate the different role that the IMF can play in pre-emptive and in post-default sovereign debt restructurings (Díaz-Cassou et al., 2008). After the sovereign default of December 2001 the Argentine government stopped honouring its private obligations and was in no rush to resume debt repayments: its main priorities were to consolidate the economic recovery and to extract the best possible deal from bondholders. When the IMF began to insist on the need to comply with the 'good faith criterion' (see Chapter 3) it became clear that the program could hinder the objective of maximizing the restructuring's haircut, weakening the government's incentives to cooperate with the Fund. Instead, that the Uruguayan government avoided defaulting implied that the debt relief resulting from the restructuring would only be felt after reaching an agreement with private creditors. In other words, the Uruguayan government had a clear incentive to complete the debt exchange as fast as possible. This turned the IMF program into a much more valuable tool to expedite the debt restructuring process and to signal both the government's good faith and the support of the international community to the debt restructuring.[142]

A last factor that contributes to explain cross-sectional variation in the two cases under analysis is the different way in which the negotiations with the IMF reverberated within Argentine and Uruguayan politics after the crucial multilateral decisions of 2001 and 2002. Chapter 4 emphasized how cultivating the image of being tough negotiators with the IMF and with private creditors gradually became an asset for Argentine politicians in the years that followed the suspension of the SBA in December 2001, and especially during Néstor Kirchner's first administration. Partly because of the success of the 2002 SBA's second augmentation in stopping the run on deposits, the international negotiations with the IMF never acquired such a symbolism in the Uruguayan political debate. Otherwise, the Frente Amplio would not have given publicity to Tabaré Vázquez's visit to Washington DC in the 2004 electoral campaign, during which the presidential candidate made clear his intentions to cooperate closely with the IMF and the other IFIs should he win these elections. Although the Vázquez administration did eventually jump on the regional bandwagon when it decided to anticipate the cancellation of the SBA in 2006, most factions of the Frente Amplio coalition maintained a relatively moderate rhetoric vis-à-vis the IMF, the other IFIs and private creditors during this period. In other words, domestic political incentives to depart from the Fund's preferences were substantially weaker in Uruguay than in Argentina.

[142] A clear example of the Fund's mediating role was the Managing Director's announcement that the third review of the Uruguayan SBA would only be approved if a sufficient proportion of bondholders participated in the debt exchange. Given the understanding that a suspension of the IMF program would inevitably result in a much costlier default, this provided an incentive for private creditors to tender their bonds.

Summing up, this section has focused on the domestic determinants of the cross-sectional variation observed in the Fund's interventions in Argentina and Uruguay. It has emphasized four variables that played a significant role at various points of the negotiations. First, although changes in the intensity of the constraints imposed by veto-players contribute to explain longitudinal variation both in the Argentine and the Uruguayan case study, cross-sectionally the location of veto-players mattered more. Second, differences in political actors' propensities to cooperate are crucial to explain why the Argentine program was suspended in December 2001 while the Uruguayan SBA was massively augmented in August 2002. In turn, these differences are related with the way in which the Argentine and Uruguayan democratization and market reform processes were conducted during the 1990s. Third, the fact that Argentina defaulted on its debt and that Uruguay remained current on its sovereign obligations shaped the two governments' financial incentives to cooperate with the Fund during the debt restructuring negotiations. Fourth, the contrasting way in which the multilateral response to the 2001-02 crises reverberated within domestic politics contributes to explain why the relationship with the IMF continued to be much more cooperative in the Uruguayan case towards the end of the decade under analysis.

6.4 Conclusion

Complementing the longitudinal analysis of the causes of IMF interventions in Argentina and Uruguay presented in previous chapters, this chapter has compared these two case studies in order to identify the variables that co-varied cross-sectionally with the outcome of interest. This strategy has been justified on the grounds that the Argentine and Uruguayan case studies fit the logic of most similar system designs relatively well: this empirical set-up maximizes variation in the dependent variable while controlling for the potentially explanatory variables that did not vary across Argentina and Uruguay. In this way the problem of over-determination that inevitably characterizes small-N analyses is somewhat mitigated.

The explanatory significance of a number of international variables has been examined first with a special focus on their impact on powerful nations' interests in specific multilateral interventions and on the Fund's internal bureaucratic political dynamics. Differences in the Argentine and Uruguayan weights in the world economy were found to have an unclear effect on the negotiation of IMF-supported programs. On the one hand, part of the reason why the international community initially responded more decisively to the Argentine crisis was that this country had been an important attractor of emerging market finance during most of the 1990s. On the other hand, the Uruguayan economy was easier to rescue because of its small size, which is one of the reasons why the US Treasury supported this course of action. Given that borrowing countries' size is positively associated both with their systemic importance and with the cost of rescuing them, the Argentine and Uruguayan case studies yield ambiguous evidence about the causal association between this variable and the multilateral response to individual crises.

It has also been argued that the international conjuncture shapes powerful countries' strategic calculations vis-à-vis specific countries and crises, exogenously affecting the multilateral negotiation of IMF-supported programs. Indeed, whereas the September 11th attacks abruptly reduced the cost of not agreeing with Argentina, the Brazilian crisis increased the relevance of the Uruguayan rescue package as an instrument to signal that Latin America was still in the radar of US foreign policy. In addition, this comparison brings support to the idea that the causal association between rules and IMF interventions is bi-directional. Although rules can pose a constraint on multilateral negotiations, when important proposals such as the SDRM are on the table IMF constituents tend to view individual interventions as an opportunity to shape the reform process according to their preferences. In these situations, IMF interventions shape rules rather than the other way around.

Although the international variables reviewed above mattered at various points of the negotiations, delving into the domestic level of analysis has proved to be crucial to understand the contrast between the multilateral response to the Argentine and the Uruguayan crises. This cross-sectional study brings support to the idea that different configurations of political institutions have a profound impact on the negotiation of IMF-supported programs. First of all, the position of veto players within the Argentine and Uruguayan polities imposed localized rather than global constraints on the negotiation and implementation of those policy conditions that challenged the status quo defended by these actors. This explains why Argentina lagged behind on the fiscal front while Uruguay was slow with structural reform. Second, political actors' propensity to compromise was a central source of cross-sectional variation during the 2001-02 crisis. This variable was deeply influenced by some specific features of the democratization and market reform paths followed by Argentina and Uruguay. More specifically, it has been shown that although a stronger system of checks and balances slows down the pace of reform in tranquil times, by encouraging political participation it provides a better institutionalized arena for the type of inter-temporal bargaining dynamics that can increase policy adaptability in times of crisis.

Finally, differences in the financial and political incentives facing Argentine and Uruguayan negotiators also contribute to explain cross-sectional variation, especially towards the end of the decade analysed here. To a large extent, these differences were a more or less direct result of the crucial multilateral decisions that were adopted in 2001 and 2002. First, that Argentina defaulted while Uruguay remained current on its sovereign obligations implies that the latter had a much greater interest in engaging the IMF as a mediator in the negotiations with private creditors. This illustrates the different roles that the Fund tends to play in pre-emptive and in post-default sovereign debt restructurings. Second, that Uruguay was rescued while Argentina was left to fall resulted in very different political reverberations of the post-crisis program negotiations with the IMF. As a result, whereas Argentine negotiators had a political incentive to harden their bargaining position, Uruguayan negotiators had an incentive to cooperate with the Fund even after the electoral triumph of the Left in 2004.

Chapter 7

The Consequences of IMF interventions in Argentina and Uruguay

Previous chapters have focused on the causes of the longitudinal and cross-sectional variation in the multilateral response to the Argentine and the Uruguayan financial crises. It was argued that IMF interventions in these two cases were relatively similar until the crucial decisions adopted by the international community in December 2001 and August 2002: the suspension of the Argentine program and the massive augmentation of the Uruguayan SBA. In turn, this chapter will try to shed some light on the consequences of this variation on the economic, political and institutional trajectories of Argentina and Uruguay. In order to do so, the aftermath of these decisions will be compared, an empirical exercise based on the idea that what happened in Argentina after the suspension of the Fund's support provides an indication of what might have occurred in Uruguay had the SBA been suspended rather than augmented, and vice versa. In other words, this chapter uses the two case studies as counterfactual scenarios in an attempt to overcome a common shortcoming of the relevant literature: the failure to identify a valid yardstick against which to evaluate the observed outcomes of IMF interventions.

This comparative analysis finds that the economic impact of IMF interventions in the Southern Cone is more subtle than at first might be expected. The Uruguayan rescue package did not result in a more moderate recession or in a faster economic recovery in that country than in Argentina. However, the evidence presented below suggests that in the medium term the second augmentation of the program preserved Uruguay's integration into global financial market and that the suspension of the Argentine program contributes to explain why this country has never recovered access to international capital markets after the crisis. It is also argued that variation in the Fund's response to the Argentine and the

Uruguayan crises had significant political and institutional consequences both in the short-term and in the medium-term. More specifically, the multilateral decisions adopted in 2001 and 2002 help explain why the De la Rúa administration collapsed while President Batlle could complete his term in office. In addition, the contrasting ways in which the two crises were addressed is partly behind the political radicalization of the Justicialist Party under President Kirchner and the moderation that has characterized the Uruguayan Left while in office. Finally, there is ground to argue that the emergency measures adopted in Argentina after the suspension of the Fund's support, most of which were avoided in Uruguay thanks to the August 2002 rescue package, had significant institutional consequences.

The remainder of this chapter is organized as follows. Section 7.1 will review the empirical literature on the effects of IMF intervention and clarify the empirical strategy that will be used subsequently. More specifically, the counterfactual approach will be justified and some methodological challenges identified. Section 7.2 analyses the economic consequences of the multilateral response to the Argentine and Uruguayan crises. Finally, section 7.3 will analyse the politico-institutional consequences of IMF interventions in Argentina and Uruguay. This chapter, therefore, has distinguished between different types of consequences. However, it is worth noting upfront that the various effects identified below are deeply inter-linked and mutually reinforcing. Indeed, the medium-term performance of the Argentine and Uruguayan economies or the evolution of capital inflows after the crisis was influenced by political developments in these two countries and vice versa. As a result, the distinctions around which this chapter is structured are somewhat artificial, albeit necessary for presentational purposes given the need to categorize the various causal mechanisms at play.

7.1 Review of the Literature and Empirical Strategy

A vast empirical literature has tried to evaluate the economic impact of IMF programs in emerging and developing economies. This section begins with an overview of the most relevant contributions and continues with a description of the analytical approach that will be used subsequently to assess the consequences of IMF interventions in Argentina and Uruguay.

Most of the articles reviewed here have adopted an econometric panel data methodology to determine whether IMF interventions affect variables such as GDP growth, capital flows, income inequality, social spending, the budget deficit, inflation or the real interest rate. Much of this literature yields rather pessimistic conclusions about the effects of IMF interventions. In fact, the Fund is rarely found to systematically improve its borrowers' economic performance in any of the dimensions that have received most scholarly attention, which is partly attributable to the so-called selection problem. This refers to the fact that some of the factors that determine whether countries participate in an IMF program will also affect their economic performance after the program is approved. As a result, it is only possible to isolate the effect of IMF interventions once the determinants of program participation have been properly identified and accounted for (Steinward and Stone, 2008). Because the countries that request the Fund's assistance are usually in worse circumstances than those that do not, when not properly addressed the selection problem tends to bias coefficients, attenuating, neutralizing or even reversing the true effect of IMF programs.[143] This is compounded by the fact that some of the factors affecting both selection into IMF programs and subsequent economic performance are inherently unobservable.

Therefore, the econometric specifications that have been used to assess the impact of IMF programs are as good as the models and methods adopted to correct the selection problem described above, which is why table 2.2 only reports the contributions that have tried to address this issue. Starting with the articles that have focused on the most common indicators of economic performance, a substantial body of empirical evidence has found

[143] However, not all scholars agree on the direction of this bias. Vreeland, for instance, discusses two unobservable factors affecting both selection into treatment and the outcome of IMF programs: the government's political will to reform and levels of public trust (Vreeland, 2003). He argues that because these unobservable variables are positively associated both with countries' decision to participate in a program and with the success prospects of the program, they tend to introduce an upward bias on the coefficients that capture the relationship between IMF interventions and economic performance. Taking these unobservable variables into account, therefore, would result in even more pessimistic conclusions about the economic consequences of IMF programs.

that IMF programs undermine GDP growth even when the selection bias is corrected. This may be an inevitable consequence of the conditionality with which the IMF tries to correct its members' macroeconomic disequilibria. In fact, Atoian and Conway (2005) find that IMF programs succeed in reducing budget deficits, which is most likely to have a contractionary impact on the broader economy. However, this result also turns participation in IMF programs into somewhat of a paradox: why would borrowing countries continue to request the Fund's financial support if these interventions are found to systematically worsen economic performance?

One possible explanation for this apparently irrational behavior is related with the distributional effects of IMF interventions. If such multilateral loans turn out to benefit certain elites (for instance through the structural conditionality associated with multilateral loans) these constituencies may have an incentive to press their government to request the Fund's assistance in spite of the program's overall effect on economic performance. Bringing support to this hypothesis, Vreeland (2003a) found that IMF programs increase inequality as measured by the income share of labor, implying that borrowing countries' elites may benefit from these multilateral interventions. However, not all empirical contributions yield the same results. Garuda (2000), for instance, found that IMF programs increase the income share of labor and improve income distribution in countries in which the economic situation has not deteriorated too much. The distributional argument about countries' participation in IMF programs, therefore, is not entirely convincing.

An alternative explanation is that spurring GDP growth may not be the main economic motivation behind the decision to participate in an IMF program. Instead, borrowing countries' governments may have shorter time horizons, turning to the Fund for assistance when they need to cover an urgent balance of payment gap irrespective of the overall impact that this decision may have on the broader economy. This motivation is likely to have gained importance in the context of financial globalization because reversals in the capital account tend to be more abrupt and pronounced than in the current account.

Therefore, it is not surprising that the question of whether IMF programs catalyze private capital inflows has attracted so much scholarly attention in the last decades.[144]

Table 7.1

Macroeconomic effects of IMF programs[145]

	GDP Growth	Inequality (income share of labor)	Inequality (Gini coefficient)	Budget deficit	Education spending	Portfolio capital flows	FDI	Bond spreads	Cross-border bank lending	Private debt
Garuda, 2000		- [1]	+/- [2]							
Prezeworski and Vreeland, 2000	-									
Eichengreen and Mody, 2001						+ [3]				
Bird and Rowlands, 2002										-
Mody and Saravia, 2003								- [4]		
Hutchinson, 2003	-									
Vreeland, 2003a	-	+								
Jensen, 2004							-			
Barro and Lee, 2005	-									
Edwards, 2005						+	-			
Butkiewicz and Yanikkaya, 2005	-									
Atoian and Conway, 2006				-						
Dreher, 2006	-									
Eichengreen et al. 2006	-									
Díaz-Cassou et al., 2006							+ [5]		-	
Nooruddin and Simmons, 2006			-		-					

Source: Díaz-Cassou et al. (2006), Steinward & Stone (2008)

[1] Only for countries in middle to high range of economic health indicator
[2] Decreasing inequality for countries in middle to high range of economic health indicator. Increasing inequality in low range countries
[3] For countries with intermediate credit ratings
[4] Negative impact on spreads for countries in an intermediate situation
[5] For preventive IMF programs

[144] This line of research has also been motivated by the fact that catalyzing capital flows has become an explicit policy objective of the IMF since the wave of emerging market crises that began in the mid-1990s. A case in point is the Prague Framework for the resolution of financial crises analysed in chapter 3.
[145] The table reports the signs of the statistically significant correlations found in the literature.

The literature on the catalytic role of the IMF, however, also yields rather pessimistic results and no study has concluded that there is an across the board positive impact of multilateral lending on cross-border capital flows. But some contributions find that under certain circumstances the IMF can increase the propensity of private investors to lend to a country. More specifically, the catalytic effect appears to be more intense in borrowing countries that are in an intermediate situation in terms of credit ratings or where the economic situation has not deteriorated too much (Eichengreen and Mody, 2001; Mody and Saravia, 2003; Bordo et al., 2004). This may be due to the fact that investors interpret countries' request for the Fund's support as evidence of unforeseen problems in strong countries and as insufficient measures to cope with the problems of weaker economies. Instead, in intermediate situations requesting the Fund's support may be interpreted as a sign of borrowing governments' determination to tackle vulnerabilities of which investors are to some extent somewhat aware. In addition, there is some evidence to argue that precautionary programs do a better job at attracting investment and that the catalytic effect is more pronounced in bond markets, where investors allocate less resources to analyze conditions in borrowing countries, relying instead on the IMF as their "delegated monitor" (Mody and Saravia, 2003; Eichengreen et al., 2004; Díaz-Cassou et al., 2006).

Complementing the econometric literature summarized above, the consequences of IMF interventions have also been analyzed using case studies.[146] This disaggregated approach has the advantage of offering a context dependent methodology to capture the complexities that characterize specific multilateral interventions. However, most of these contributions have a common shortcoming: they have failed to compare observed outcomes with a valid counterfactual, i.e. with the outcome that would have resulted had there been no IMF program in place. This is hardly surprising given that, by definition, counterfactuals are unobservable. But in the absence of such a yardstick, case studies tend to yield weak evidence about the causal effect of IMF interventions, which is why some contributions

[146] A few examples are: Brett, 1983; Bird et al., 2000; Mussa, 2002; Stone, 2002; IEO, 2004; Pop-Eleches, 2009; Arpac and Bird, 2009.

have tried to identify or construct hypothetical counterfactuals.[147] Kaplan and Rodrik (2002), for instance, used the economic performance of the countries that participated in an IMF program during the East Asian crisis as the counterfactual to evaluate Malaysia's decision not to request the Fund's support and to rely instead on the imposition of capital controls. They found that the Malaysian capital controls produced better economic outcomes than the IMF-supported programs with which the other countries of the region responded to the crisis.[148] In turn, Díaz-Cassou et al. analyzed the catalytic effect of IMF programs comparing the evolution of capital flows in pairs of countries undergoing comparable crises and as similar as possible in terms of their attractiveness to foreign investors, one having resorted to the IMF for assistance but not the other (Díaz-Cassou et al., 2006).[149] They found that crisis resolution programs tend to have a positive impact on foreign direct investment but a negative one on cross-border bank lending.

The analysis presented in this chapter goes in the direction of the few case study contributions that have tried to evaluate the consequences of IMF interventions using the yardstick of a hypothetical counterfactual. The basic idea exploited here is that the aftermath of the suspension of the Argentine program can be used as a counterfactual to assess the impact of the massive augmentation of the Uruguayan SBA, and vice versa. This is based on the contention that had Uruguay not been rescued in August 2002, the government of that country would have been probably forced to adopt measures similar to those to which the Argentine authorities resorted after December 2001, such as a moratorium on sovereign debt repayments or a freeze on bank deposits among others. Conversely, the Argentine government may not have had to resort to such drastic measures had the support of the international community been augmented to cover the entire stock of sight deposits, as was the case in Uruguay.

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[147] For a discussion of the importance of counterfactuals in case study research see George and Bennett (2005).

[148] The Malaysian economic recovery was faster and the fall in employment and real wages more subdued than in the other countries of the region.

[149] More specifically they compare Malaysia and South Korea around the 1997 crisis and Brazil and Colombia around the 1998 wave of financial instability in emerging economies.

Therefore, differences in the post-crisis trajectories followed by Argentina and Uruguay can be partly attributed to these two multilateral decisions, justifying the use of the comparison conducted in the following sections as an empirical strategy to assess the causal impact of IMF interventions in the Southern Cone. In doing so, this chapter differs from previous case study analyses in two respects. First, rather than concentrating on one or a few dependent variables, it adopts a broad perspective, using a wide array of indicators to capture the economic, political and institutional consequences of the multilateral response to the 2001-02 crisis. Second, instead of focusing on the short-term, it analyses the impact of these interventions in the medium-term, covering the decade that followed the onset of the crisis.

It was argued in Chapter 1 that Argentina and Uruguay are relatively similar countries, which is why the choice of these two case studies helps concentrate variation in a few explanatory dimensions. However, as emphasized in Chapter 6, there are some important structural differences between these two countries.[150] Failing to factor in this heterogeneity could bias the assessment of the consequences of IMF interventions, which is why the comparative analysis presented here tries to adopt a differences-in-difference approach (Angrist and Pischke, 2008). Wherever possible, therefore, the focus will be placed on the evolution of the differences between Argentina and Uruguay before and after the multilateral decisions of December 2001 and August 2002. Another methodological challenge arises from the fact that the two units of analysis on which this comparison is conducted are not independent. Given the level of integration between these countries, events in Argentina tend to have a heavy impact on Uruguay. This implies that the hypothetical counterfactual that is being used as a yardstick to evaluate the effects of the augmentation of the Uruguayan SBA may have had a causal effect on that outcome. It is also worth noting that the economic and the politico-institutional consequences of IMF programs are inter-related and possibly mutually reinforcing. This makes it difficult to disentangle between the two effects, as the following sections try to do.

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[150] For example, institutional resilience, the location of veto players and political actors' ability to cooperate were identified as important differences between Argentina and Uruguay.

Finally, the empirical exercise presented below may be subject to an endogeneity problem because some of the variables that are analysed as outcomes were identified as explanatory determinants of the Fund's response to the Argentine and Uruguayan crises in previous chapters. Although it is impossible to establish the magnitude of the biases to which this and the aforementioned methodological caveats give rise, whenever relevant and depending on the outcome under analysis, subsequent sections will try to identify their direction.

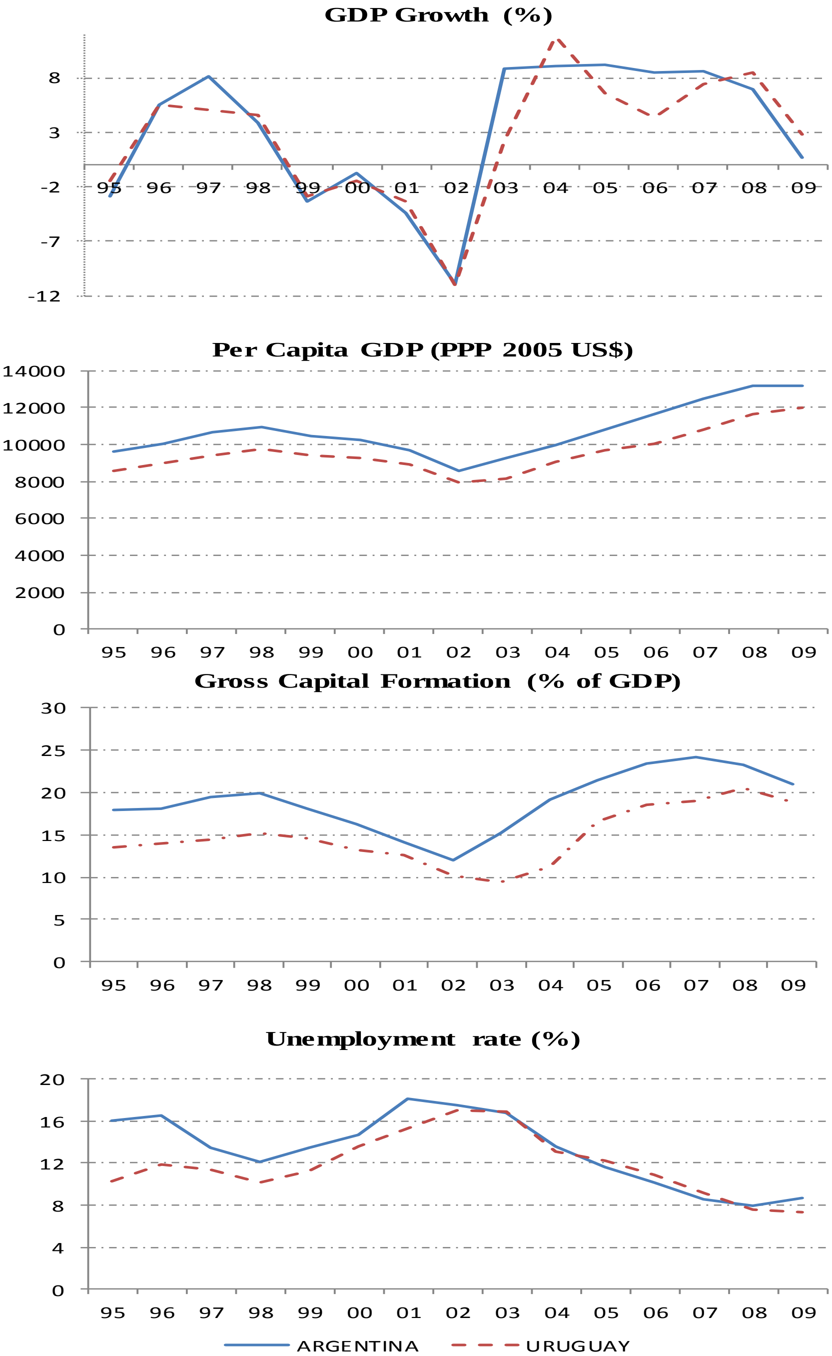
7.2 Economic Performance

Applying the analytical framework described above, this section reviews the evolution of a number of indicators in order to assess the economic impact of IMF interventions in Argentina and Uruguay during the period that surrounds the 2001-02 crisis. After comparing the recovery from the two crises, the performance of the external sector will be analysed, first on the side of the current account and then on the side of the capital account. The focus will then be placed on macroeconomic management and on the question of whether variation in the multilateral response to the Argentine and the Uruguayan crises had a lasting effect on the fiscal, monetary and exchange rate policies implemented in these two countries. Finally, this section will review the evolution of financial intermediation and of various poverty and inequality indicators that may have been affected by these interventions.

Figure 7.1 shows the evolution of a number of real economy indicators between 1995 and 2009. The trajectory of GDP growth in the two countries exhibits a high correlation throughout this period and, in particular, before and during the recession associated with the 2001-2002 crisis. In fact, the cumulative contraction experienced by the Argentine and the Uruguayan economies between 1999 and 2002 was of the same exact magnitude: 18% of GDP. The subsequent recoveries were also equally impressive, with growth rates peaking at 9% in Argentina and 11% in Uruguay in 2005. Afterwards, however, the correlation between GDP growth in Argentina and Uruguay declined, suggesting that the two economies may have somewhat decoupled. More specifically, between 2005 and 2008 Uruguay exhibited a slower economic expansion than Argentina. As a result, Argentina's cumulative GDP growth during the seven years (2003-2009) that followed the crisis was 45% against 31% in Uruguay. Subsequently, however, the Uruguayan economy has outperformed that of Argentina, albeit by a relatively narrow margin.

Figure 7.1

Real economy indicators



Source: International Financial Statistics and World Development Indicators

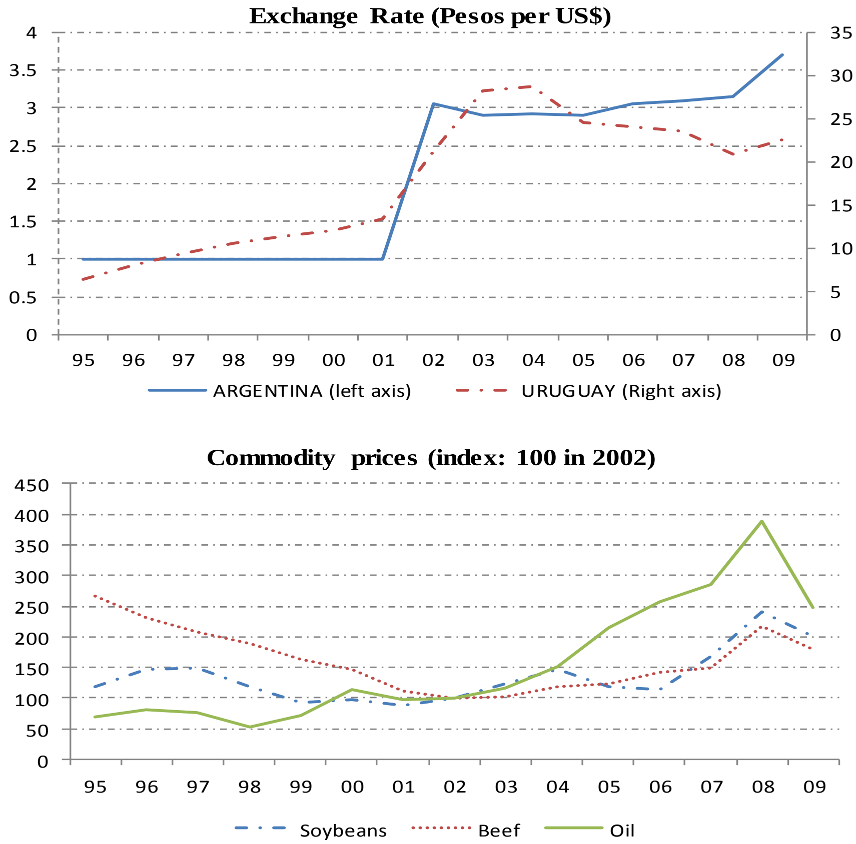
Per capita GDP and gross capital formation as a share of GDP also exhibited a high cross-sectional correlation during this period. For both variables the gap between Argentina and Uruguay changed only marginally before and after the crisis, making it difficult to assign a significant explanatory power to the multilateral decisions adopted in 2001 and 2002. A different picture emerges with regard to the rate of unemployment. This variable converged only in the aftermath of the crises, which is quite a remarkable development given that in the mid-1990s unemployment was almost twice as high in Argentina as in Uruguay. Together with the data on GDP growth described above, this suggests that the August 2002 bailout may not have helped the Uruguayan real economy to recover faster than that of Argentina. If anything, the evolution of the indicators presented in Figure 7.1 suggests that Argentina fared better than Uruguay in spite of the suspension of multilateral support.

Although the absence of a discernible positive impact of the Uruguayan multilateral rescue on that country's economic recovery may seem surprising, it is consistent with the econometric literature on the relationship between IMF programs and growth summarized above. However, a word of caution is in order. This result could be biased as a result of one of the aforementioned methodological caveats: the causal link between the hypothetical counterfactual, i.e. the aftermath of the suspension of the Argentine program, and the outcome of interest. Given that the Uruguayan economy is so exposed to developments in Argentina, the potentially beneficial impact of the SBA's augmentation may have been offset by the economic consequences of the suspension of the Argentine program.[151] In principle, therefore, this bias should be expected to have resulted in an underestimation of the role played by the IMF in the recovery of the Uruguayan real economy.

[151] Reflecting the significance of the trade linkages between Argentina and Uruguay, in year 2000 over 30% of Uruguayan exports were directed to Argentina. In between year 2000 and 2002 Uruguayan exports to Argentina fell by 72%. In contrast, only 6% of Argentine exports went to Uruguay in 2000 (data from the IMF's balance of payments statistics). As the crisis all too clearly illustrated, the financial linkages between these two economies are also intense, with a substantial portion of Uruguayan bank deposits in the hands of Argentine nationals.

Figure 7.2

Terms of Trade



Source: International Financial Statistics

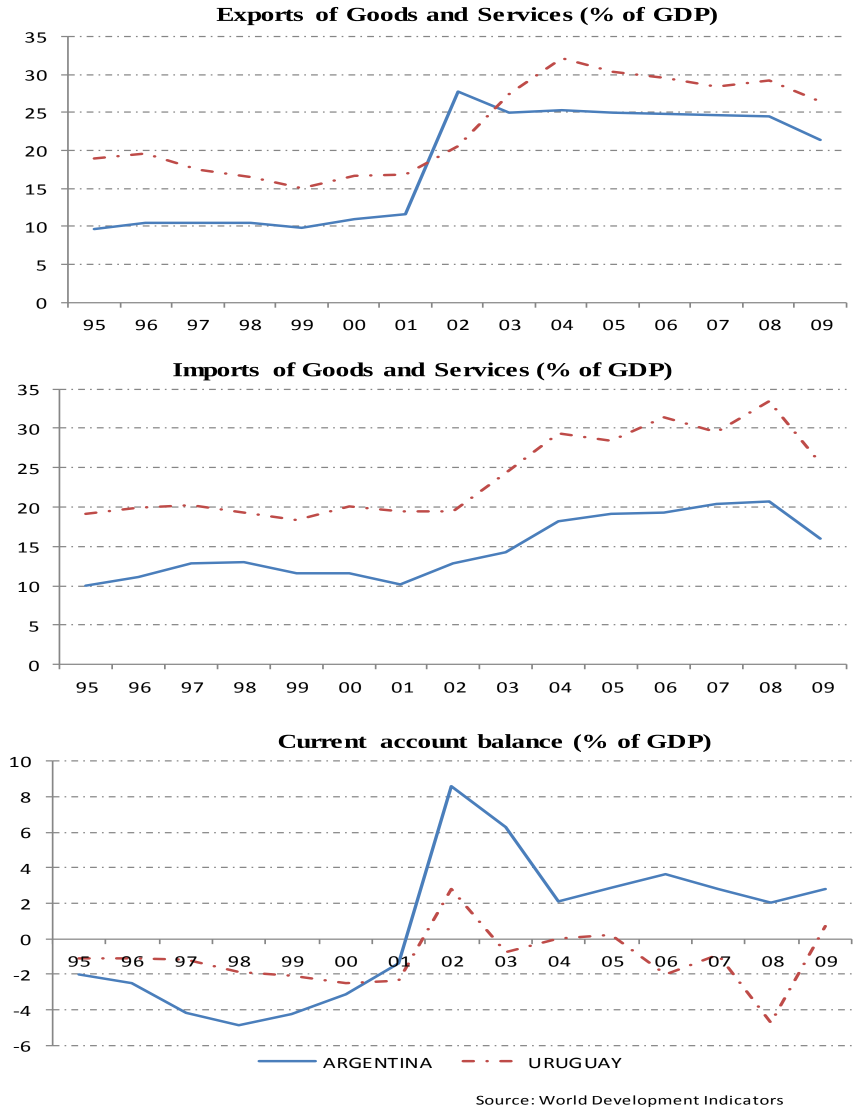
In addition, another factor that contributes to explain why variation was so modest in the evolution of the real economy variables under review is that the two recoveries were largely driven by the same factor: a terms-of-trade shock that enabled Argentina and Uruguay to export their way out of the crisis. Figure 7.2 displays the evolution of exchange rates and of the price of key commodities exported by the two countries. The devaluation of the Argentine and the Uruguayan pesos that took place between 1995 and 2002 was of a comparable magnitude: about 300%. However, this trend was smoother in Uruguay because of the nature of its exchange rate regime, which was more flexible than Argentina's currency board. After 2003 the exchange rate stabilized in both countries, with the Argentine peso exhibiting a mild depreciating trend and the Uruguayan peso a moderate appreciation. On top of these heavily devalued exchange rates, after 2002 the price of key commodities began to rise markedly, contributing to alleviate the tight external restrictions that both economies had suffered prior to the crises. In particular, the price of soybeans more than doubled between 2002 and 2008, unleashing a boom in the Argentine and Uruguayan agricultural sectors. This exogenous development has tended to reduce the significance of IMF interventions as a determinant of the Argentine and Uruguayan recoveries.

Illustrating the significance of the aforementioned terms of trade shock, Figure 7.3 shows the evolution of exports as a share of GDP, which doubled in both countries after the crisis. However, the behaviour of the Argentine and the Uruguayan current account balances has diverged markedly. Whereas after 2003 Argentina has systematically reported surpluses in the range of 2 to 4% of GDP, the Uruguayan current account has registered substantial deficits since 2005, which contrasts with the second half of the 1990s, during which Argentina was systematically running larger current account deficits than Uruguay. This divergence is partly due to the different impact that the surge in oil prices that took place during the second half of the 2000s had on Argentina, a net exporter of that commodity, and on Uruguay, a net importer. However, variation in the trajectory of the current account can also be attributed to the Fund's response to the two crises. As will be argued later in more detail, the suspension of the IMF program and the events that followed curtailed Argentina's access to public and private sources of credit, making it more difficult to finance current account deficits.[152] Instead, the augmentation of the SBA helped Uruguay persistently run current account surpluses. In addition, the surge in capital flows towards Uruguay after 2004, which may also be partly attributed to the confidence instilled by Fund's tight involvement in that country, had a strong impact on the tradable sector and, hence, on the current account (IMF, 2008).

[152] In fact, in recent years current account surpluses have been necessary to cover net capital outflows.

Figure 7.3

The Current Account



In fact, an area where changes in the divergences between Argentina and Uruguay are more apparent is precisely the behaviour of capital inflows. Figure 7.4 shows that although Uruguay temporarily lost access to international capital markets, by 2005 it was already able to issue debt abroad on a substantial scale. Argentina, instead, has not yet been able (or willing) to normalize its situation in international financial markets. This contrasts with the pre-crisis period, when Argentina was a much more active player in international financial markets than Uruguay. Such a development is primarily related with the contrasting ways in which the Argentine and the Uruguayan governments restructured their sovereign debt.

But that Uruguay adopted such a market-friendly debt restructuring approach whereas the Argentine authorities maintained an aggressive stance vis-à-vis private creditors can only be understood in the context of the multilateral actions on which this chapter is focused. Having reached a 100% debt to GDP ratio, it is clear that without the official financial support that it secured in August 2002 the Uruguayan government could not have remained current on its obligations and restructured on such market-friendly terms, imposing no nominal losses on investors and leaving no holdout creditors behind. Instead, had the Argentine program been massively augmented rather than suspended in December 2001, the government might have had the option of avoiding a default and of offering a better deal to bondholders, a larger proportion of which would have probably participated in the debt exchange.[153] The contrasting multilateral response to the two crises, therefore, was a significant determinant of the subsequent variation in the Argentine and Uruguayan capacity to access international financial markets, which brings support to the idea that IMF interventions can have an impact on the behaviour of private capital flows in the medium-term.

The suspension of the Fund's program and the subsequent default, therefore, impaired Argentina's access to private finance. However, as was argued in Chapter 4, this sequence of events also contributes to explain why the Argentine government adopted such a tough stance in the negotiations with private creditors, allowing it to reduce its debt stock faster than Uruguay. This is illustrated in Figure 7.5, which shows that although the Argentine external debt to GNI ratio was significantly higher during the second half of the 1990s and increased much more sharply in the immediate aftermath of the crisis, by 2005 it had converged to Uruguay's level. This illustrates a policy trade-off facing governments in the midst of a sovereign debt restructuring: a market-friendly approach such as that adopted by Uruguay is likely to improve future access to financial markets, but a more aggressive strategy vis-à-vis private creditors such as that adopted by Argentina is likely to bring about

[153] In fact, at the time of the suspension of the program the Argentine authorities had already initiated a pre-emptive debt restructuring process.

a faster public de-leveraging. What matters more to this analysis is that in this case the adoption of one or the other strategy was influenced by the choices made available to the authorities after the suspension of the IMF program in Argentina and the augmentation of the SBA in Uruguay. The multilateral response to the 2001-02 crisis, therefore, contributes to explain the subsequent evolution of debt stocks in the two countries.

Figure 7.4

Gross financing via international capital markets (% of GDP)

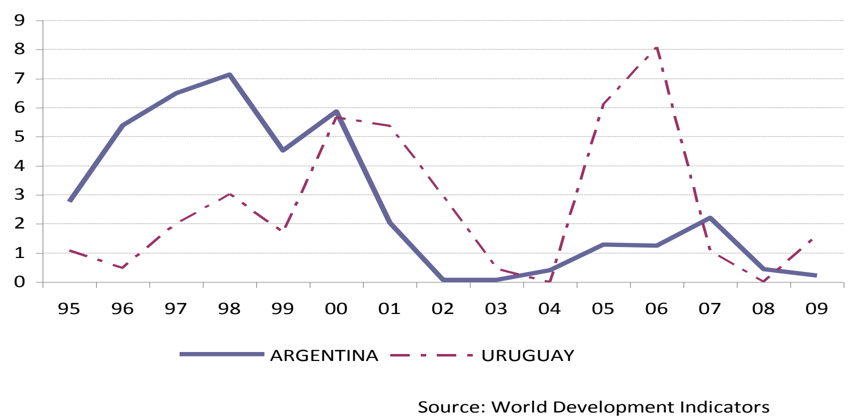


Figure 7.5

External debt (% of GNI)

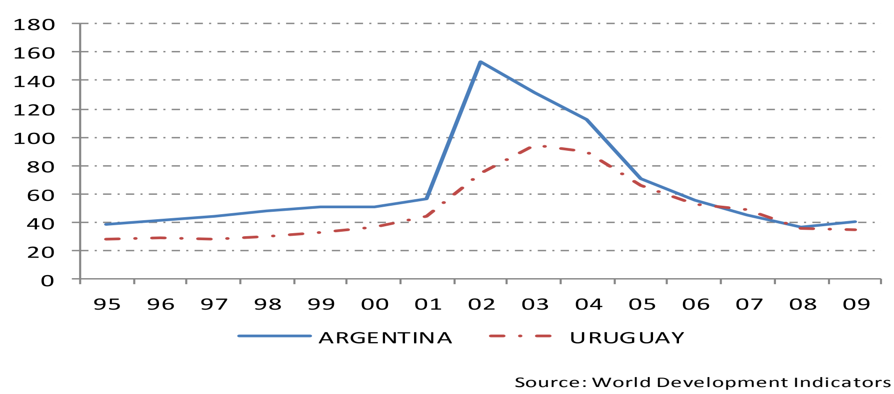
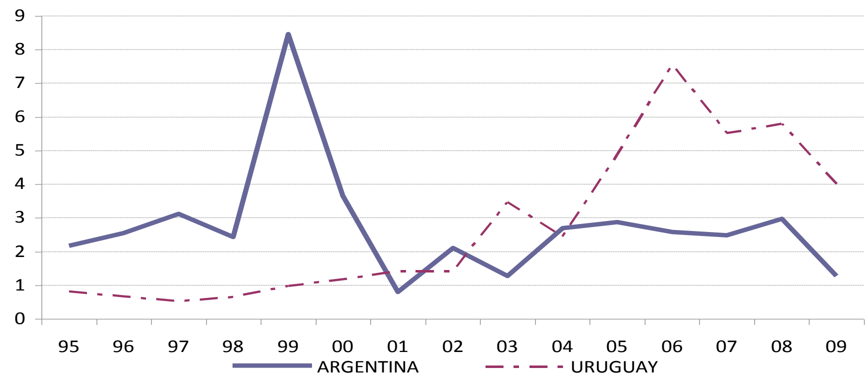


Figure 7.6

Foreign Direct Investment (% of GDP)



Source: World Development Indicators

In turn, Figure 7.6 suggests that foreign direct investment flows could also have been influenced by the Fund's interventions in Argentina and Uruguay. Whereas prior to the crisis the Argentine economy was attracting more FDI flows, after 2002 Uruguay has received proportionally much larger volumes of FDI. There are various direct and indirect channels through which the contrasting multilateral response to the two crises may have contributed to cause this reversal. It might be that long-term investors were reassured by Uruguay's willingness and ability to maintain a tight engagement with the IMF, which stood in stark contrast with the conflict that characterized Argentina's relationship with the Fund in the aftermath of the crisis. Changes in the patterns of FDI flows could also have been the result of the evolving confidence on the part of long-term investors in the policies implemented by the Argentine and the Uruguayan governments, over which the IMF had a very different leverage after the decisions adopted in 2001 and 2002. This comparative analysis, therefore, provides some evidence to argue that the IMF also had a medium-term catalytic effect on FDI flows.

How did macroeconomic management compare in Argentina and Uruguay during the period under analysis? Figure 7.7 displays the evolution of two key variables to capture the authorities' fiscal and monetary stance: the primary balance and CPI inflation. Focusing first on fiscal policy, Figure 7.7 shows that Argentina and Uruguay departed from a similar situation in the mid-1990s with, at least in appearance, relatively healthy public finances[154] However, the two countries responded differently to the onset of the recession: whereas the Uruguayan government could adopt a moderately countercyclical position, Argentina tightened its fiscal policy precisely when the situation began to deteriorate in 1999. To a large extent, this divergence reflects the different constraints imposed by the two countries' exchange rate regimes, with the Uruguayan crawling band providing more room for manoeuvre than the Argentine currency board.

Of more relevance to this analysis, after 2002 both countries have registered substantial fiscal surpluses of a comparable magnitude. This outcome has been the result of the robust economic recoveries described above, but also of the adoption of a conservative fiscal stance both in Argentina and in Uruguay. Although it could be argued that the IMF had an influence over the design of Uruguay's post-crisis macroeconomic policies, it seems clear that the institution had little leverage over Argentina. This converging fiscal trend, therefore, cannot be explained by the contrasting multilateral response to the two crises. In other words, based on the evidence presented above it is difficult to argue that the IMF played a disciplining role in this policymaking dimension.

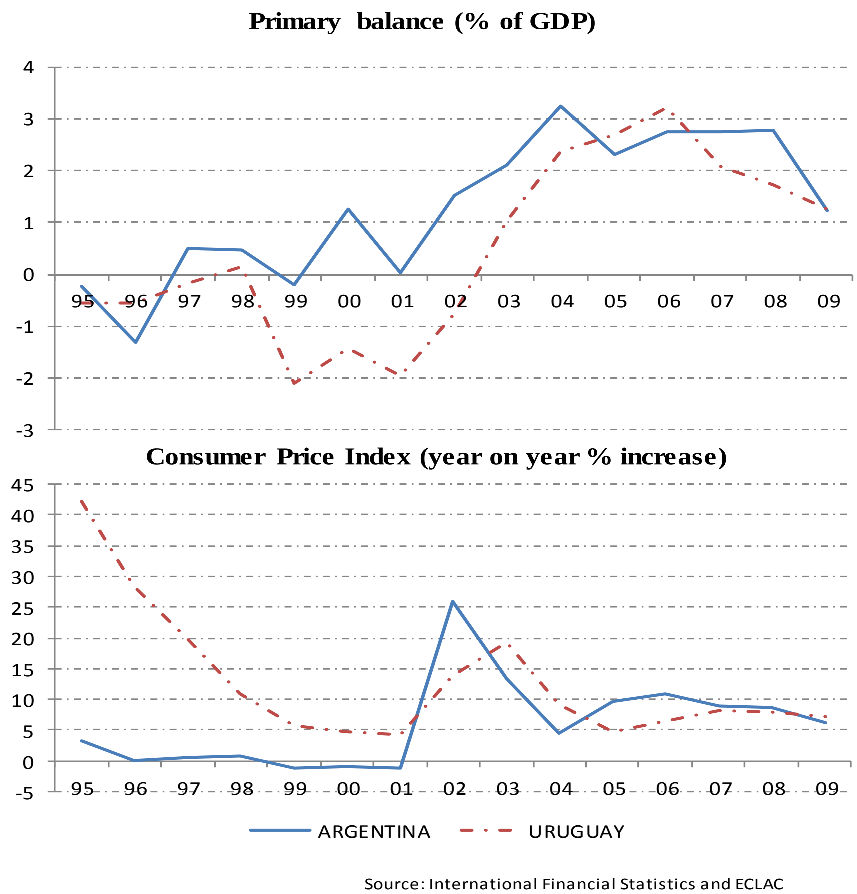
At first sight, Figure 7.7 also suggests the presence of a converging trend in the monetary policy stance adopted by the Argentine and Uruguayan authorities. Indeed, the pre-crisis period departs from wide inflation differentials that gradually narrowed over time and, in particular, after the crisis. Again, these initial differentials were primarily due to the exchange rate regimes in place in these two countries: whereas Uruguay adopted a gradual disinflation strategy with its monetary policy anchored to a crawling band with a pre-announced depreciation path, Argentina's currency board constituted a shock therapy that had already brought inflation down to single digit levels by the early 1990s. After the collapse of the two countries' pegs to the dollar, the Argentine and the Uruguayan central banks sought a new anchor for their monetary policy, focusing on inflation targets rather than on the exchange rate. In spite of the large depreciation of the Argentine and Uruguayan pesos that took place during the crisis and of the hyperinflation fears that

[154] As argued in Chapter 4, the situation of public finances in Argentina turned out to be much more problematic due to the fiscal relationship between the Federal State and the Provinces.

prevailed at the time, both countries managed to keep price pressures under control. This was broadly perceived as a crucial achievement differentiating this from past episodes of financial instability, an outcome that is difficult to relate to variation in the Fund's response to the two crises.

Figure 7.7

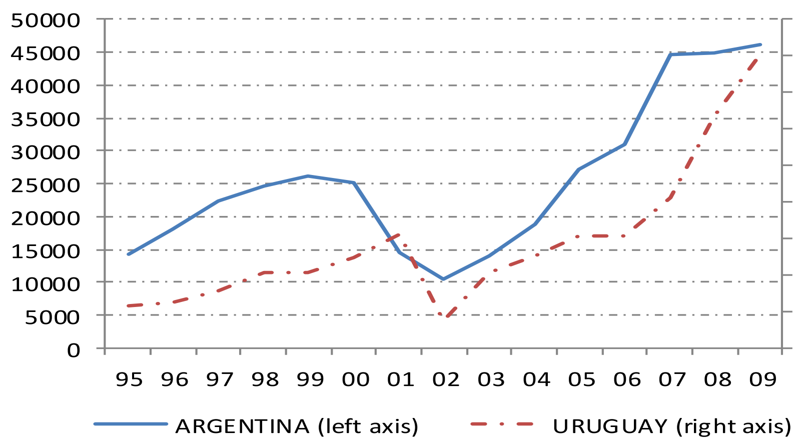
Macroeconomic Management



Although a new inflation differential emerged after 2004 with Argentina experiencing significantly more intense price pressures than Uruguay, Figure 7.7 suggests that inflation rates re-converged in 2007 and thereafter. However, as a result of the Argentine government's interference with the National Statistics Institute (INDEC), official figures are believed to be unreliable (Noriega, 2010; The Economist, 2008). Private estimates of Argentina's yearly rates of inflation are as high as 14.5% for 2008, 20.4% for 2009 and around 25-30% thereafter.[155] In other words, rather than narrowing, as official data would suggest, the inflation differential between Argentina and Uruguay has continued to widen in recent years. This trend indicates that after hyperinflation failed to materialize in the immediate aftermath of the crises, price stability has constituted a more important policy objective for the Uruguayan authorities than for their Argentine counterpart. Variation in this outcome could be partially attributed to the disciplining effect of Uruguay's active engagement with the IMF and, therefore, to the multilateral response to the 2001-02 crisis.

Figure 7.8

Foreign exchange reserves (US$ million)



Source: International Financial Statistics

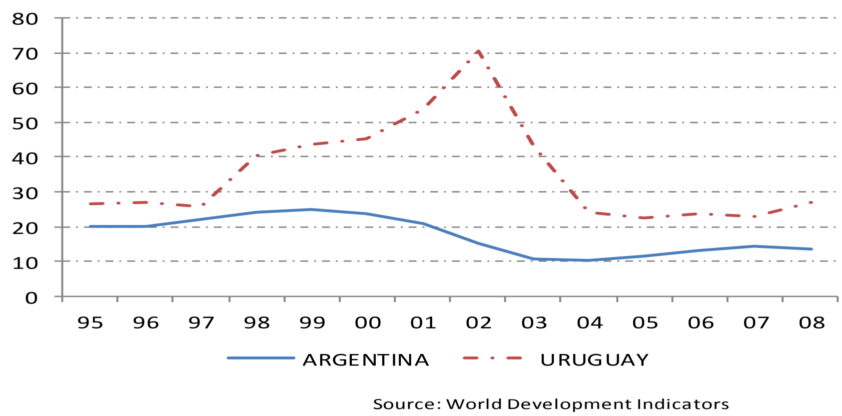
In turn, the Argentine and the Uruguayan exchange rate policies have tended to converge over time. As already mentioned several times, in the second half of the 1990s both countries were pegged to the dollar, although the Argentine currency board was much more rigid than Uruguay's crawling band. The crisis forced both countries to abandon their peg, in Argentina because sustaining it was impossible after the suspension of the IMF program and in Uruguay because floating the peso was a pre-condition to augment the SBA. Since then both countries have had a dirty float. Figure 7.8 shows the evolution of the stock of foreign exchange reserves held by the Argentine and the Uruguayan central banks, which has exhibited similarly robust growth rates after the 2001-02 crisis. This implies that both monetary authorities have intervened in foreign exchange markets on a substantial scale,

[155] Source: http://www.inflacionverdadera.com/

leaning against the wind in order to avoid or to moderate the appreciation of their currency that the Argentine current account surpluses or the capital inflows to the Uruguayan economy would have otherwise generated. However, this trend could also be partly attributed to the objective of increasing their self-insurance capacity, which has been identified as a common motivation behind emerging economies' accumulation of foreign reserves (International Relations Committee Task Force, 2006). In principle, the Uruguayan rescue of 2002 could have been expected to reinforce that country's confidence in the multilateral safety net provided by the IMF. However, the accumulation of foreign exchange reserves was faster than in Argentina, suggesting that this was not necessarily the case.

Figure 7.9

Credit to the private sector (% of GDP)



Focusing next on financial intermediation, Figure 7.9 shows the evolution of credit to the private sector as a share of GDP. Both countries depart from a relatively similar position in the mid-90s, with a ratio of 20% in Argentina and about 25% in Uruguay. After 1998, however, substantial divergences emerged as credit boomed in Uruguay, peaking at 70% of GDP in 2002 only to collapse thereafter in the context of the banking crisis. Although also exhibiting a swing, the evolution of this indicator was much smoother in Argentina. What is more relevant to this analysis is that the stock of credit to the private sector has remained proportionally higher in Uruguay than in Argentina by a substantial margin that has tended to widen in recent years (IMF, 2011).[156] The low level of financial intermediation in Argentina (11-14% of GDP) is mostly due to high inflation, to the uncertainty that surrounds price statistics and to the fact that boosting credit has not been a priority for the Argentine government.[157] Instead, the Uruguayan authorities have attached more importance to price stability, to transparency and to financial deepening (Adler et al., 2009). It has already been argued that a tight engagement with the IMF imposed an additional constraint on Uruguay's monetary authorities that was absent in Argentina. In addition, Uruguay's greater integration into global financial markets after the crisis, which was also made possible by the 2002 bailout, has eased domestic banks' access to external sources of liquidity, thus contributing to the recovery of financial intermediation. Therefore, the contrasting trajectories of domestic credit to the private sector in Argentina and Uruguay can be argued to form part of a broader process in which the multilateral decisions of 2001 and 2002 played a part.

Table 7.2

Poverty and inequality

		96	98	00	02	04	06	08
Poverty headcount ratio at $1.25 a day (% population)	Argentina	2	2	n.a.	9,92	8,4	3,39	n.a.
	Uruguay	2	2	2	n.a.	n.a.	2	2
Poverty headcount rate at $2 a day (% population)	Argentina	7,02	8,9	n.a.	19,73	15,98	7,34	n.a.
	Uruguay	3	3,09	2,26	n.a.	n.a.	4,18	4,25
Poverty headcount rate at urban poverty line (% of urban population)	Argentina	n.a.	28,8	n.a.	53	n.a.	n.a.	n.a.
	Uruguay	n.a.	24,7	n.a.	n.a.	n.a.	n.a.	n.a.
GINI Index	Argentina	48,58	49,84	n.a.	52,52	51,28	48,81	n.a.
	Uruguay	43,76	45,18	44,56	n.a.	44,83	46,24	47,06

Source: World Development Indicators

Finally, Table 7.2 displays the evolution of various indicators of poverty and inequality. Although the series are incomplete and may not be fully comparable, some patterns seem to emerge. During the crisis poverty increased more sharply in Argentina than in Uruguay, an outcome that may be associated with differences in the volumes of external financial support available for the two countries to address social emergencies. More recently,

[156] Uruguay's credit stock has already surpassed 40% of GDP whereas Argentina's has remained stagnant.
[157] Evidence of the low priority attributed to financial intermediation is the fact that the so-called cheque tax has not been repealed since it was introduced in 2001. The check tax is a tax on financial transactions imposed on both credit and debit operations on bank accounts.

however, poverty ratios and inequality have fallen quite markedly in Argentina while continuing to rise moderately in Uruguay. These diverging trends may be a reflection of a more ambitious social agenda in Argentina, which in turn could stem from the harder constraints facing the Uruguayan authorities as a result their tighter engagement with the IMF and with international financial markets.

Summing up, this section has used evidence from the Argentine and the Uruguayan case studies to assess the economic consequences of multilateral interventions in financial crises. One of the most salient results of this analysis is that both countries recovered similarly fast from the crisis, which makes it difficult to argue that the Uruguayan rescue had a distinctively positive medium-term impact on economic growth. More variation, however, is found in other areas. For instance, whereas Uruguay recovered access to international financial markets relatively fast, capital flows towards Argentina have remained low. This was primarily a consequence of the different way in which the two debt restructurings were completed, which in turn was determined by the crucial multilateral decisions of 2001 and 2002. As a result, it has been argued that the Argentine and the Uruguayan case studies bring support to the contention that in the medium-term IMF programs can have a catalytic effect on private investment. Regarding macroeconomic management, little variation is found in the realm of fiscal and exchange rate policies, with both countries exhibiting primary surpluses of a comparative magnitude and accumulating reserves at a similar pace after 2002. However, Uruguay's monetary policy has been more conservative, which could be partly attributed to the disciplining effect of an active engagement with the IMF. Credit to the private sector also appears to have stabilized at a substantially higher level in Uruguay than in Argentina, which is another outcome that may be partly attributed to the multilateral decisions adopted in 2001 and 2002.

7.3 Politics and Institutions

This section tries to shed some light on the political and institutional impact of the multilateral response to the Argentine and Uruguayan crises. Focusing first on the political dimension, it is convenient to distinguish between the short-term and the medium-term consequences of the multilateral interventions on which this chapter is focused. In the short-term, the contrast between the two cases could not be greater: whereas the suspension of the Argentine program was followed by the succession of events that culminated in the abrupt fall of the De la Rúa government, after the last augmentation of the Uruguayan SBA President Batlle was able to complete his term in office. In the longer term the Left has come to dominate politics in both countries, implying that cross-sectional variation in the Argentine and Uruguayan cases is more subtle. A superficial interpretation of these trends would suggest that IMF interventions had a marked political impact in the short-term that tended to fade away with time. However, it is argued below that the extent to which short-term cross-sectional variation in the outcome of interest can be attributed to the Fund's interventions is not entirely clear. In contrast, the medium and long-term consequences of the way in which the two crises were addressed by the international community turn out to be deeper than at first might appear.

The use of the Argentine case study as a hypothetical counterfactual to assess the short-term political consequences of the augmentation of the Uruguayan SBA is subject to an endogeneity problem stemming from the fact that, as argued in previous chapters, these interventions were partly determined by political conditions in the two countries. Indeed, the Argentine program was suspended partly because the climate of political disunity that prevailed in the second half of 2001 made it virtually impossible to articulate a coherent crisis resolution strategy. In turn, the Uruguayan program was augmented partly because political actors in that country were able to cooperate in order to make sure that the government could commit to implement the policy conditions that were needed to secure the financial support of the international community. Therefore, basing this empirical exercise on a simple comparison between the aftermaths of the two crises without taking into account that political factors had a causal effect on the multilateral treatment received by each country would overestimate the real impact of IMF interventions on the outcome of interest.

In spite of this potential bias, the Argentine experience following the suspension of the IMF program is informative about what might have occurred in Uruguay in the absence of the financial support that this country received in August 2002. As was clear during the negotiations with the IMF, given the intensity of the run on deposits that was taking place at that time in Uruguay, the only alternative to a massive injection of official financial resources would have been the imposition of draconian banking restrictions not dissimilar from the ‘Corralito’. In Argentina these restrictions were the ultimate catalyser of the wave of social unrest that brought the De la Rúa administration down, and it is unlikely that the adoption of such a course of action would have left the Batlle administration unscathed. At the same time, there is ground to argue that the very same factors that made political cooperation possible when the augmentation was being negotiated with the IMF (see Chapters 5 and 6) would have mitigated the short-term political consequences of a suspension of the Uruguayan SBA, resulting in less instability than that experienced in Argentina right after the program was suspended.[158]

What would have been the political outcome of a suspension of the Uruguayan SBA in July-August 2002? Given the strains that already existed in the relationship between the Colorado and the National parties, it is likely that the imposition of tight limits on deposits’ withdrawals would have resulted in the definitive break-up of the coalition.[159] In turn, the severity of the economic situation combined with the authorities’ limited room for manoeuvre in the context of the government’s minority support in Congress would have forced President Batlle to call early elections, anticipating the victory of the EP-FA-NM. In other words, a failure in the negotiations with the IMF would probably have resulted in the fall of the Uruguayan government within a matter of weeks or months. But that political transition would have caused less stress on the democratic process than in Argentina, and the succession of short-lived presidencies and interim administrations that governed that country for more than a year after the suspension of the Fund’s financial support could have probably been avoided in Uruguay.

[158] Chapter 6 contended that Uruguay’s more gradual approach to market reform had allowed for the emergence of a stronger systems of checks and balances, which resulted in a more participative and cooperative political culture.
[159] Illustrating these strains, the National Party forced the resignation of the Finance Minister and the President of the Central Bank in July 2002. However, it continued providing congressional support to those measures that were required to comply with the Fund´s conditionality.

Although its success in the negotiations of the multilateral rescue package constituted a vital lifeline for the Batlle administration in the short-term, in the longer term it did not avoid the disastrous results obtained by the Colorado party in the 2004 elections.[160] In other words, the Uruguayan government ended up paying a heavy price for its management of the crisis, which paved the way for the historical victory of the EP-FA-NM that culminated Uruguay's shift to the Left. As emphasized above, in Argentina the Justicialist Party took over right after the events of December 2001, which might lead to believe that the political shift to the Left occurred faster in that country. But although under President Duhalde the Justicialist Party had already distanced itself from Menem's neoliberal policies while beginning to retrieve some elements of the old Peronist rhetoric, it was not until Néstor Kirchner's administrations, especially after his landslide victory in the 2005 mid-term elections, that the Argentine government embraced a left-nationalist discourse (Russell, 2010).[161] This preliminary analysis of the Argentine and the Uruguayan medium-term political trajectories, therefore, suggests the presence of a converging trend that is difficult to attribute to the contrasting multilateral decisions adopted in 2001 and 2002.

In practice, however, there are significant differences between the economic policies implemented by the left-of-centre governments of Argentina and Uruguay. In spite of its former anti-neoliberal rhetoric, the EP-FA-NM has maintained a cautious stance, adopting some ambitious pro-poor redistributive programs but avoiding deep transformations in the economic structures that it inherited from previous governments (COHA, 2006). In line with Lula da Silva in Brazil or Michelle Bachellet in Chile, Tabaré Vázquez and the Uruguayan Left have governed from the centre, sticking to economic orthodoxy rather than searching for an alternative development model (Tussie, 2009). In contrast, a backlash against neo-liberalism has taken place in Argentina, where the Justicialist Party has adopted an incrementally heterodox and interventionist policy mix, overturning some core elements

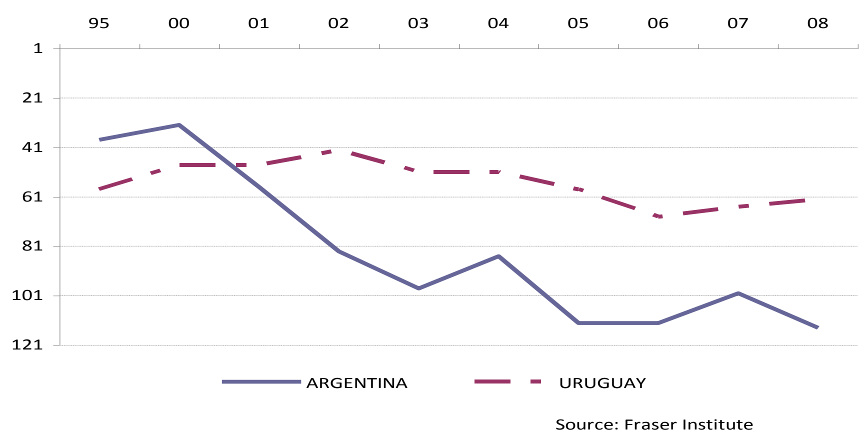
[160] Guillermo Stirling, the Colorado candidate, obtained 10.6% of the vote, almost 30% less than Jorge Batlle in 1999.

[161] Prior to the 2005 elections, Duhalde remained the Justicialist Party's strongman, restraining Néstor Kirchner's power and autonomy (Sax, 2004). This internal power struggle within the Justicialist party was settled with the 2005 Senatorial contest for the Province of Buenos Aires between Néstor Kirchner's wife, Cristina Fernández de Kirchner, and Duhalde's wife, Hilda Chiche González de Duhalde, which was won by the former (Jones and Micozzi, 2008). Soon afterwards, Néstor Kirchner asked Finance Minister Lavagna to step down, getting rid of Duhalde's last and most prominent ally in the government and further cementing his presidential authority.

of the economic liberalization process that was embraced during the 1990s (Riggirozzi, 2009).[162] Illustrating these contrasting trajectories, Figure 7.10 displays the evolution of the Fraser Foundation's economic freedom index for Argentina and Uruguay.[163] It is clear from that figure that although by the turn of the century both countries were in a relatively similar position according to that index, in the aftermath of the crisis the Argentine and Uruguayan commitment to free markets has diverged quite markedly. In sum, notwithstanding their common identification with the Left, substantial differences seem to have emerged between the policy preferences of the Argentine and the Uruguayan governments.

Figure 7.10

Economic freedom index (ranking out of 141 nations)



Comparing Argentina and Uruguay's relationship with the United States provides another indication of these two countries' contrasting medium-term political trajectories following the 2001-02 crises. In November 2005 Uruguay and the United States signed a bilateral

[162] Riggirozzi (2009: 106) describes this policy mix as follows: "What it all points to is the adoption of a qualitatively different approach to state responsibility and state spending that stands in sharp contrast with the belief in the market of the 1990s and, that, at the same time, echoes some practices from the past, in particular from the Peronist government of the mid-1940s. But instead of a semi-closed economy based on national promotion of domestic markets and import-substitution, the post-crisis political economy is based on a strong state and (governmental) leadership in the economy while taking advantage of the regional and international market dynamics that offered opportunities for Argentine export markets."

[163] This index of economic liberalization is constructed from a series of indicators that try to reflect conditions in five main areas: size of government; legal structure and security of property rights; freedom to trade internationally; regulation of credit, labour and business. For More information, see http://www.freetheworld.com/release.html.

investment treaty which entered into force in November 2006. A few months later, in January 2007, a trade and investment framework agreement was signed in order to further reinforce Uruguay's economic ties with the US. At this stage, President Tabaré Vázquez and some of his Ministers were openly talking about the possibility of signing a free trade agreement with the US, a project that ultimately fell short as a result of the opposition of some of the more radical factions of the EP-FA-NM and of Uruguay's Mercosur allies (Porzecanski, 2010). In contrast, the Kirchners' administrations have consistently refused to strengthen Argentina's commercial ties with the United States. Prior to Néstor Kirchner's victory in the 2005 parliamentary elections, the Argentine government was careful to avoid direct confrontations with the United States, which is partly related with the occasional support that it obtained from the Bush administrations during the negotiations with the Fund (see Chapter 4). However, right after these elections, during the Fourth Summit of the Americas held in Mar del Plata in November 2005, Néstor Kirchner staunchly opposed President Bush's plan to re-launch the FTAA negotiations while staging his rapprochement to Hugo Chávez's bloc, which marked a turning point in Argentina's diplomatic relationship with the US (Russell, 2010). Subsequently, the Kirchners' dissent with American unilateralism, neo-liberalism and the rules of the world economy became increasingly noisy. A case in point was their rebellious stance vis-à-vis the bilateral investment treaties inherited from the 1990s, a result of the wave of cases brought by foreign investors to the International Centre for the Settlement of Investment Disputes (ICSID) against the Republic of Argentina following the crisis.

At this point, the question that poses itself is whether the contrasting multilateral response to the two crises contributes to explain this cross-sectional variation in long-term political outcomes. There are reasons to argue that this might be the case. Chapter 4 described how in 2002 and 2003 the leaders of the Peronist movement gradually came to the realization that the economy could survive and even thrive without normalizing Argentina's relationship with the IMF. In the meanwhile, as the popular conviction that the international community was treating Argentina unfairly gained ground, it became increasingly attractive for politicians to portray themselves as tough negotiators with the international financial community, further reinforcing the government's incentives to depart from the Fund's orthodoxy. In Uruguay the process was exactly the opposite. The perception that the multilateral rescue of August 2002 had prevented Uruguay from following the path of Argentina provided support to the idea that a close engagement with the international community had to be maintained. As a result, the EP-FA-NM was forced to reconsider some of the ideological positions that it had traditionally defended.[164] Therefore, it can be argued that while the suspension of the Fund's support to Argentina contributed to the gradual radicalization of the Justicialist Party, the August 2002 bailout contributed to moderate the Uruguayan Left.

In addition, there is another indirect channel through which the contrasting multilateral response to the Argentine and the Uruguayan crises had long-term political consequences. It was shown in section 7.2 that one of the clearest economic effects of these interventions was that whereas Uruguay's integration into the international financial system was ultimately preserved, the Argentine government has been unable or unwilling to recover market access after the crisis. Given the need to periodically roll-over substantial volumes of sovereign obligations, the leaders of the EP-FA-NM have had obvious reasons to be cautious about the potential impact of their policies on international investment flows. In contrast, the Argentine government has been much less concerned about market sentiment and, therefore, freer to adopt a more ideological stance. In other words, reinforcing the effect of the diverging policy preferences analysed above, as a result of variation in the multilateral response to the two crises international financial markets have imposed different policy constraints on the Argentine and the Uruguayan governments.

Long-term political developments in Argentina and Uruguay can also be related with these two countries' institutional contexts. In his analysis of the resurgence of the Latin American Left, Francisco Panizza (2005) argued that radical populism has tended to prevail in countries with weak institutions. Substantiating this point, he contends that "the electoral victory of Néstor Kirchner has to be framed in the context of the de-institutionalization of

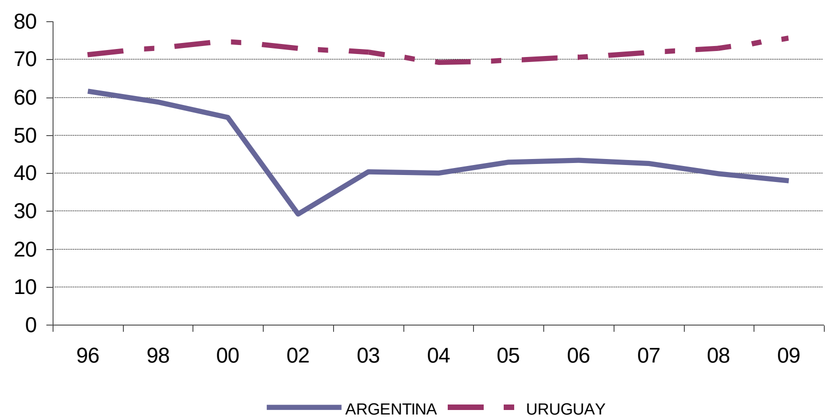
[164] Clear evidence of this trend was the harsh criticism to which Tabaré Vázquez was confronted, also from members of his own party, when he insinuated during the crisis that Uruguay might have to reconsider its relationship with private creditors. (Panizza, 2008). Partly as a result, Vázquez flew to Washington DC prior to the elections that he won in order to reassure international financial institutions about the direction of his government's economic policies in a move that resembled that of Lula in 2002.

the country's party system that followed the 2002 economic collapse" (Panizza, 2005: 722). Instead, the Left has leaned towards a more moderate social democratic tradition in countries with stronger institutions such as Uruguay, contributing to explain the ideological stance adopted by the EP-FA-NM while in government. It follows logically from Panizza's analysis that institutions were less affected by the crisis in Uruguay than in Argentina and that this contributes to explain these two countries' divergent political trajectories. At this point, the questions to be addressed are whether this was really the case and whether this outcome can be partly attributed to variation in the Fund's interventions.

In order to compare the Argentine and Uruguayan institutional performance during the period that surrounds the 2001-02 crisis, Figure 7.11 displays the evolution of a simple average of the six aggregate governance indicators elaborated by the World Bank Institute.[165] The data suggests that the crisis had a heavy impact on Argentine institutions, whose governance indicators collapsed after 2001. Instead, Uruguay's governance indicators remained fairly stable throughout this period, suggesting that in this case the crisis had a relatively modest impact on institutions.

Figure 7.11

WBI composite governance indicator (ranked from 0 to 100)



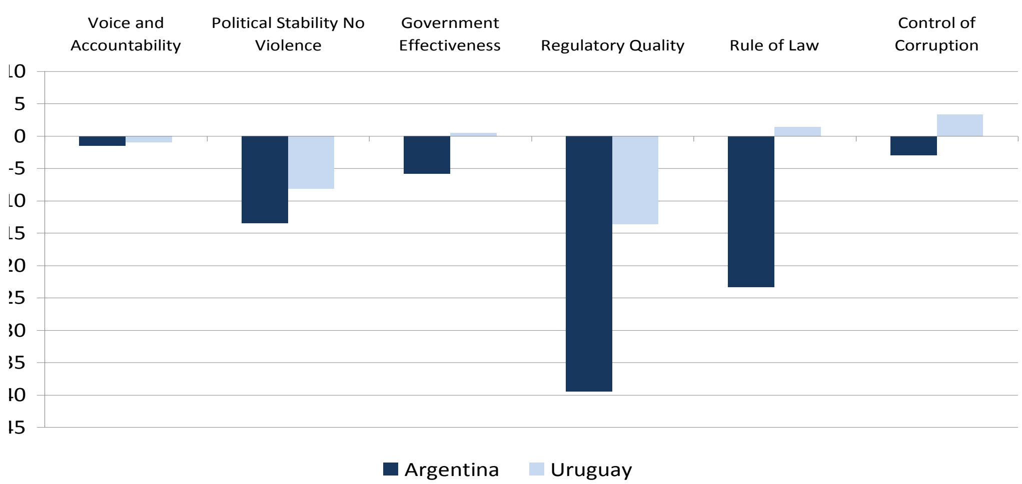
Source: World Bank Institute

[165] These six indicators cover the following areas: voice and accountability; political stability without violence; government effectiveness; regulatory quality; rule of law; control of corruption. For more information about how these indicators are constructed see Kaufman et al. (2010).

In order to complement the data analysed above, Figure 7.12 displays a disaggregation of the WBI composite indicator, comparing the change experienced by each of its six components in Argentina and Uruguay between 2000 and 2003. A contrasting trajectory is apparent in four of the six indicators, suggesting that the diverging behaviour of Argentine and Uruguayan institutions was rather widespread during the years that surround the crisis. Regulatory quality, an area that is often addressed by the conditionality associated with IMF programs, exhibited the widest cross-sectional variation. However, substantial divergences between the Argentine and the Uruguayan case are also observed in dimensions that go beyond the narrow focus of IMF conditionality, such as the rule of law, government effectiveness or political stability without violence.

Figure 7.12

Change in the WBI governance indicators (between 2000 and 2003)

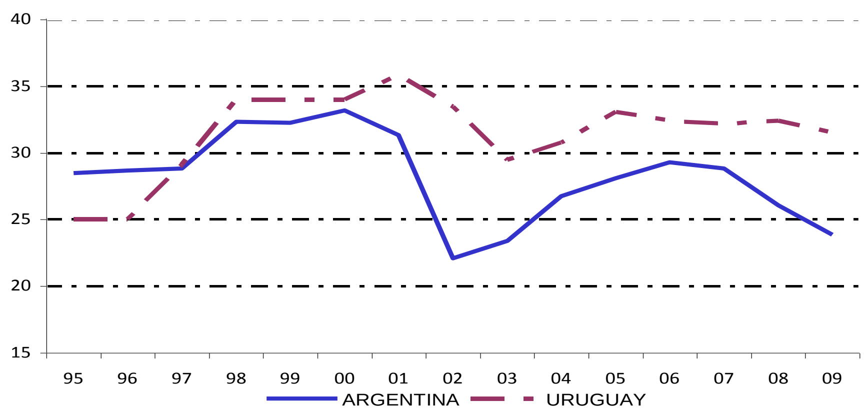


Source: World Bank Institute

It is worth noting that the WBI Governance Indicators have been the subject of recent scholarly criticism, among other reasons for reflecting policy choices rather than the quality of institutions per se (Knack and Langbein, 2010). In order to contrast the validity of the results presented above with different data, Figure 7.13 displays the evolution of an alternative indicator that aggregates the following six indexes of the International Risk Country Guide (IRCG) database: government stability, investment profile, corruption, law and order, democratic accountability and bureaucratic quality.[166] As was the case with the WBI composite indicator, the evidence presented in Figure 7.12 suggests that the institutional impact of the crisis was significantly stronger in Argentina than in Uruguay. Furthermore, disaggregating the ICRG composite governance indicator, as is done in Figure 7.14, also suggests that the institutional impact of the contrasting multilateral response to the Argentine and Uruguayan crisis was widespread. Indeed, the contrast between the two cases is apparent in all but one indicator: bureaucratic quality. According to the ICRG data, the two areas where the diverging trajectories followed by Argentina and Uruguay were more profound are law and order, and investment profile.[167]

Figure 7.13

IRCG composite governance indicator



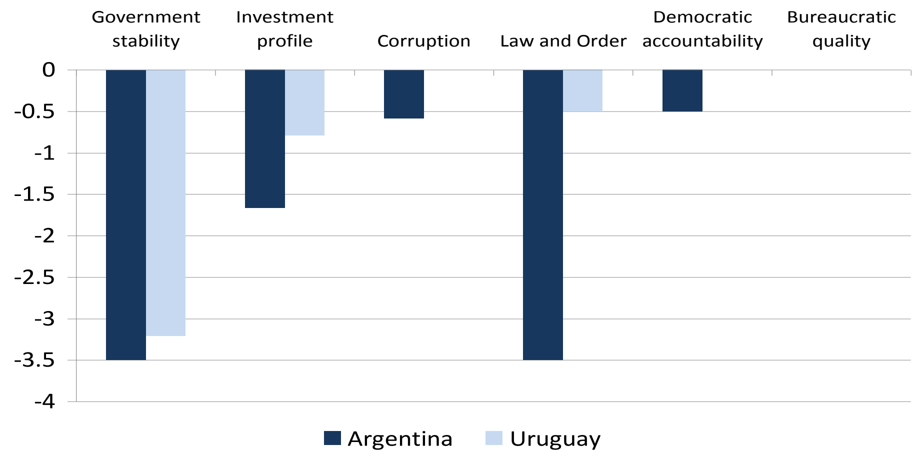
Source: International Country Risk Guide

[166] Given their irrelevance for this analysis, there are six IRCG indicators that are not used to construct this composite index: socioeconomic conditions (already analysed in section 7.2), internal conflict, external conflict, military in politics, religion in politics, ethnic tensions.

[167] Law and Order refers to the strength and impartiality of the legal system and to the popular observance of the law. In turn, the Investment Profile indicator assesses a number of factors that may affect investment risks, such as the viability of contracts or the likelihood of expropriations, profit repatriation regulations and payment delays.

Figure 7.14

Change in the ICRG governance indicators (between 2000 and 2003)



Source: International Country Risk Guide

The contrasting institutional developments described above may be partly due to the fact that Uruguayan institutions were already stronger in the late 1990s and, therefore, more resilient to a crisis. In fact, it has been argued above that a suspension of the Fund's support would have probably had a milder impact on political institutions in Uruguay than in Argentina, facilitating the transition to a new democratically elected government. But it is also likely that the emergency measures that any Uruguayan government would have had to adopt in the absence of the multilateral financial support that was secured in August 2002 would have tended to erode property rights and other economic institutions in much the same way as in Argentina. For instance, strict restrictions on deposits' withdrawals and, hence, the quasi-confiscation of people's savings would have been very difficult to avoid. Furthermore, as a result of the financial collapse that would have followed a suspension of the IMF program it is likely that the EP-FA-NM would have been much less keen not to alter the basic pillars of Uruguay's economic model, resulting in more volatility in institutions such as the central bank or the financial regulator. At least to some extent, therefore, a comparison between the Argentine and the Uruguayan case studies suggests that IMF crisis resolution interventions can have a significant impact on long-term institutional developments.

Summing up, this section has argued that even after acknowledging the presence of an endogeneity problem that may bias the results of this empirical exercise, there is evidence to argue that the Fund's interventions had a significant impact on the Argentine and the Uruguayan political and institutional post-crisis trajectories. In the short-term, it is clear that the suspension of the Argentine program contributed to the fall of the De la Rúa government and that the augmentation of the Uruguayan SBA constituted a vital lifeline for the Batlle administration. But because political conditions in the two countries were important determinants of these multilateral decisions, simply comparing the aftermath of the crisis is likely to somewhat overestimate the short-term political consequences of IMF interventions. In the longer-term, although the Left has eventually become the dominant political force both in Argentina and in Uruguay, the policy stance adopted by the Justicialist Party and the EP-FA-NM have diverged quite markedly. This outcome is partly attributable to the multilateral response to the two crises, which had a long-term impact on the Argentine and Uruguayan governments' policy preferences and policy constraints, radicalizing Argentine Peronists while moderating the Uruguayan Left. The Argentine and Uruguayan institutional post-crisis trajectories also appear to have diverged. This may have been a direct result of some of the emergency measures adopted by the Argentine government after the suspension of the SBA, which were avoided in Uruguay thanks to the official financial support obtained in August 2002.

7.4 Conclusion

This chapter has compared the aftermaths of the Argentine and Uruguayan crises, using these two case studies as counterfactual scenarios in order to evaluate the consequences of IMF interventions. It has been found that the massive augmentation of the SBA did not enable the Uruguayan real economy to recover faster than that of Argentina, a result that is consistent with the findings of the econometric literature on this subject. But variation in the Fund's response to the two crises had other important economic consequences, particularly on the behaviour of capital flows. Given that the multilateral rescue enabled the government to complete a market friendly restructuring, it has been argued that this intervention contributed to preserve Uruguay's integration into the global financial system.

Argentina, instead, has not yet normalized its relationship with international creditors since the suspension of the Fund's program in December 2001 and the subsequent sovereign default.

In turn, the analysis on the impact of IMF interventions on macroeconomic management has yielded mixed results. Whereas the fiscal and exchange rate policies implemented by the two governments after the crisis were relatively similar, Argentina's monetary stance has been significantly laxer than Uruguay's. This development can be related with the policy constraints that have resulted from the preservation of Uruguay's tight engagement with international public and private creditors, which was made possible by the multilateral support secured by the Batlle administration during the crisis.

On the political side, variation in the multilateral response to the Argentine and Uruguayan crises also appears to have had significant consequences. It seems clear that the Fund's interventions contribute to explain why the De la Rúa administration collapsed while President Batlle could complete his term in office. But these multilateral decisions also had more subtle and longer-lasting effects. For a start, the way in which the 2001-02 crises were addressed had a marked impact on policy preferences, moderating the rhetoric of the Uruguayan Left while radicalizing the position of the Justicialist Party in Argentina. On top of these diverging policy preferences, variation in the Fund's interventions has shaped the two governments' policy space. More specifically, Argentina's rupture with the IMF and with international financial markets provided more leeway for the authorities to overturn some of the core elements of the neoliberal model. The Uruguayan government, instead, has been more constrained by its debtor position and by its willingness to remain financially integrated into the global economy. Finally, IMF interventions also had an impact on institutions, which collapsed in Argentina and were much less affected by the crisis in Uruguay.

The analysis presented in this chapter points at the need to go beyond the narrow scope of most of the econometric literature on the consequences of the multilateral response to emerging market crises. Although crisis resolution IMF programs may turn out to have a rather modest impact on the real economy variables that have received more scholarly attention, the Argentine and Uruguayan experiences suggest that these interventions can have profound consequences on the political economy of the countries concerned. Indeed, these two case studies confirm that financial crises can be important catalysts of change, and given that the Fund's influence is enhanced during these episodes, a deeper understanding on the institution's impact on its borrowers' political and institutional post-crisis trajectories is still needed. A particularly relevant extension of this research, therefore, would be the testing of the external validity of the causal links identified in the cases of Argentina and Uruguay.

Chapter 8

Conclusion

Three tasks remain for this concluding chapter. The first is to restate the research questions and to justify the analytical framework and the empirical strategy that have been used to address them. The second is to recapitulate the empirical findings and to put them in the context of the IPE literature. The third is to propose avenues for future research, including an approach to test the external validity of some of the causal relationships that have been examined and the identification of new case studies for the analysis of which this dissertation's analytical framework could be usefully replicated. More specifically, it will be argued that the Eurozone crisis provides fertile ground to continue analysing why and to what effects specific countries receive different multilateral treatments during episodes of financial instability.

8.1 Recapitulating the research design

Over the past decades the IMF has been extensively involved in the management of several financial crises. Conventional wisdom holds that IMF interventions are fairly homogenous, forcing crisis stricken countries to adopt painful macroeconomic adjustment programs in exchange for the emergency financial assistance that the international community provides through the Fund. However, finding differences across multilateral crisis resolution interventions is not difficult notwithstanding the presence of certain regularities. Some of the most relevant axes of variation include the following: the size of programs both in absolute and relative terms; the specific macroeconomic and structural conditions demanded from debtor nations; the extents to which countries comply with this conditionality and the international community tolerates these slippages; the more or less coerced involvement of private creditors in the resolution of the crises. Contributing to identify the factors that are behind this variation constitutes a first aim of this dissertation.

But explaining variation in the multilateral response to financial crises is relevant insofar as these interventions have an impact on the trajectories of debtor nations or, more broadly, on the performance of the global economy. Identifying divergences in the aftermath of the crises and of their multilateral treatment is also relatively straightforward. In most of Latin America during the 1980s debt crisis or in Indonesia during the Asian financial crisis, the policy package associated with the Fund's interventions contributed to bring about the adoption of new development models and, in some cases, far-reaching political transitions. By contrast, in Mexico (1994-95), Brazil (1999) or South Korea (1997-99), the multilateral response to the crisis prevented rather than induced a major change in the courses of action of the countries concerned. Given this array of potential outcomes, gaining a more precise understanding about the economic, political and institutional impacts of IMF loans has been the second major objective of this research.

The two central questions that this dissertation has addressed through the lenses of the Argentine and the Uruguayan case studies, therefore, can be summarized as follows: what accounts for the variation observed in the Fund´s response to financial crises and what are the consequences of these multilateral interventions? As shown in Chapter 2, the determinants and the impacts of IMF loans have received a great deal of scholarly attention on the part of both economists and political scientists. What are this dissertation's analytical and methodological contributions to this vast literature? First, this research has relied on primary data gathered from extensive interviews with many of the government and IMF officials that were involved in the negotiations of the Argentine and Uruguayan programs, providing new insights into the way in which these two crises were handled. Second, as opposed to most existing contributions, the Argentine and Uruguayan experiences with the IMF have been analysed not only on a stand-alone basis but also from a comparative perspective. Third, an adaptation of Robert Putnam's two-level game framework has been used to discern the ways in which national strategies and international priorities interact to produce distinct outcomes in the Argentine and the Uruguayan cases. Fourth, a hypothetical counterfactual approach has been adopted to establish an analytical yardstick against which to compare observed outcomes and, hence, to better approximate the impact of the IMF interventions under analysis. Fifth, rather than focusing only on the short-term and a narrow set of potential impacts, a broad perspective has been taken to analyse the causal relationship between IMF programs and the medium-term trajectories of debtor nations' political economies.

Various reasons justify the selection of the Argentine and Uruguayan case studies to address the research questions summarized above. Most of all, the IMF has been a crucial and often controversial actor in the contemporary economic histories of Argentina and Uruguay, which was the main motivation behind the choice of this dissertation's topic. Furthermore, the Argentine and the Uruguayan case studies pose an analytical puzzle. Although most IPE scholars with a research interest in international organizations would tend to agree that systemically important countries are more likely to be rescued than small players in the global economy, in these cases the international community chose to do the opposite, adopting extraordinary measures to support Uruguay while ultimately letting Argentina fall. Adding to this puzzle is the absence of clear evidence to argue that the multilateral bailout helped the Uruguayan economy to recover faster than that of Argentina. This raises questions not only about the effectiveness of IMF interventions but also about the motivation behind national governments' decision to engage in crisis resolution multilateral loans conditioned on painful adjustment programs.

In addition, because the choice of the Argentine and the Uruguayan case studies maximizes variation in the dependent variable while concentrating variation in relatively few potential explanatory dimensions, it fits the logic of a most similar system design relatively well. Indeed, although these two countries and their crises share several characteristics, the multilateral treatment that they ultimately received ended up diverging markedly. This reduced the number of potential explanatory dimensions that could covary with the outcome of interest and, hence, from which causation could be inferred, contributing to mitigate the problem of over-determination that is inherent to small-N comparative analyses.

Finally, the Argentine and the Uruguayan case studies are well suited to apply the hypothetical counterfactual approach that is used to assess the consequences of the Fund's interventions in the Southern Cone. Given the similarities between the two crises, had it lost access to the Fund´s resources the Uruguayan government would have been forced to adopt a policy package not dissimilar from that to which the Argentine authorities resorted after its program was suspended in December 2001, including a sovereign default and strict controls on deposit withdrawals. In turn, if the Argentine loan had been augmented to match the size of the Uruguayan program in relative terms, thus allowing the authorities to guarantee the financial system's entire stock of sight deposits, some of the most drastic measures adopted in that country after December 2001 would have probably been avoided. The Uruguayan case, therefore, provides a hypothetical counterfactual to assess the consequences of the suspension of the Argentine program, and vice versa.

In order to address the research questions summarized above, this dissertation has taken the following steps. Chapter 2 presented an overview of the literature on the determinants of IMF interventions, arguing that in order to gain a more holistic understanding of the factors that shape multilateral crisis lending it is necessary to bridge the gap between the domestic and the international levels of analysis. For that purpose, an adaptation of Robert Putnam's two level games was developed, from which a number of testable hypotheses were derived. However, it was also argued that because the size of win-sets is unobservable and given that two-level games are for the most part agnostic about the factors that determine the intensity of domestic ratification constraints, this analytical framework is more useful to generate new inductive hypotheses linking observable variables with observed outcomes than to test deductive hypotheses. This is why a central objective of this dissertation's empirical chapters has been to identify rather than confirm causal associations between observable factors pertaining to the ratification processes that take place at the levels of the IMF and of its borrowers, and some of the specific features of the multilateral response to the Argentine and the Uruguayan crises.

In turn, Chapter 3 analysed the evolution of rules in the issue area of multilateral crisis lending in order to approximate the structural constraints facing IMF officials in the negotiations of the Argentine and the Uruguayan programs. The decade under analysis witnessed an intense debate about the reform of the so-called international financial architecture that resulted in several changes to the rules governing access to the Fund's resources, the conditionality associated with multilateral loans, and the involvement of private creditors in the resolution of financial crises. However, Chapter 3 also argued that in the absence of a supra-national authority with the prerogative of hierarchically enforcing the rules of the game, the institutional design of the IMF is such that its largest constituents, and in particular the US and the G7, retained the power to discretionally break or amend these rules. In this context, whether the negotiations of specific IMF programs were constrained by rules was ultimately presented as an empirical question.

The core of this dissertations' empirical analysis was presented in Chapters 4 to 7. The Argentine and the Uruguayan experiences were initially analysed separately, adopting a process-tracing approach to unearth the causal paths that explain the longitudinal variation observed in the Fund's interventions in these two countries from 1995 until 2005. Given its longitudinal approach, the within-case analysis provided in chapters 4 and 5 focused primarily on those explanatory variables that varied more clearly over time, such as the outcome of electoral processes, the strength and cohesion of governing coalitions, bureaucratic interests or multilateral rules. In turn, Chapter 6 presented a comparative analysis, focusing on the cross-sectional variation between the Argentine and Uruguayan case studies and, therefore, on more permanent explanatory factors such as some of the structural features that differentiate these two countries' political systems or their size and importance in the world economy. Finally, Chapter 7 adopted a hypothetical counterfactual approach to approximate the medium-term economic, political and institutional consequences of the multilateral decisions adopted during the 2001-02 crisis.

8.2 Main empirical findings

Starting with the recapitulation of this dissertation's most relevant empirical results, the evidence provided by the within case longitudinal analysis is consistent with the hypothesis of a non-linear association between the intensity of domestic ratification constraints and borrowing countries' bargaining power vis-à-vis the IMF. In line with Stone (2008), during the crisis prevention phase and the initial stages of the crisis both the Argentine and the Uruguayan governments exploited their limited political room for manoeuvre on various occasions in order to moderate the scope of the conditionality demanded by the IMF and to obtain waivers for the non-observance of some specific conditions. In the Argentine case, however, the gradual intensification of these ratification constraints ended up eliminating the overlap between the government and the Fund's win-sets, and hence the possibility of sustaining the negotiations' cooperative equilibrium. Once that point of rupture was reached the Argentine government lost the bargaining power that it had previously had, illustrating the risks associated with exploiting domestic political divisions as a bargaining tool in the negotiations of an IMF program.

But why didn't the Uruguayan win-set contract to the same extent even though that country was undergoing an equally devastating financial crash in 2002? The explanation for this diverging outcome is to be found primarily in the different propensity to cooperate exhibited by Argentine and Uruguayan political actors during the crisis. That the Argentine government's stakeholders refused to compromise during the months that led to the 2001 default made it impossible to gather the political support that would have been needed to articulate a coherent response to the crisis and, by extension, to comply with the demands of the international community or to bargain for the adoption of a different course of action. By contrast, the Uruguayan opposition's willingness to collaborate with the government in order to maintain the support of the international community preserved a larger win-set, thus avoiding the collapse of the cooperative equilibrium in the two-level game.

The question then becomes, why was political actors' propensity to cooperate greater in Uruguay than in Argentina during the worst phase of the crisis? Cross-sectional variation in this analytical dimension was related with certain differences in the systems of checks and balances that were allowed to emerge from these two countries' democratization and market reform processes. The structural constraints faced by the Uruguayan executive after the fall of the military regime forced successive administrations to move by consensus. Although this slowed down the pace of economic reform in tranquil times, it encouraged political actors to engage in inter-temporal bargaining processes, which fostered cooperation when the country was teetering on the brink of collapse. By contrast, President Menem centralized power and marginalized the opposition in order to expedite the structural transformation of the economy. This brought about a more conflictual decision-making culture that was not conducive to the sort of inter-temporal bargaining dynamics that catalysed political cooperation in Uruguay during the crisis. That both Argentina and Uruguay exhibited policy stability and policy adaptability at different points in time challenges the view that there is an inevitable trade-off between these two outcomes (Tsebelis, 2002; Haggard and McCubbins, 2001). In line with Scartascini et al. (2010), if countries with stronger systems of checks and balances are better prepared to respond to an emergency, the concepts of policy stability and policy adaptability may be complementary rather that substitutive.

The position of veto-players within the Argentine and the Uruguayan polities is another variable that contributes to explain cross-sectional variation in some relevant analytical dimensions, such as the content of conditionality. Given that these actors are primarily focused on the measures that affect their interests, but not necessarily on the complete policy package associated with IMF programs, they impose localized rather than global constraints on the negotiations with the Fund. As a result, conditionality tends to be weaker in areas where veto players' capacity to block departures from the status quo is stronger. This is why the veto power of the provinces resulted in a weaker fiscal conditionality in the Argentine case while the right of specific interest groups to trigger referendums resulted in a weaker structural conditionality in Uruguay. Mapping out the location of veto actors and anticipating how conditionality is likely to impact them, therefore, may help identify which components of an IMF program will be more difficult to negotiate and to implement.

Previous paragraphs have focused on borrowers´ ratification constraints as an explanatory variable, but the Argentine and the Uruguayan case studies suggest that the causal association between domestic politics and the negotiation of multilateral lending operations can also go in the opposite direction. Depending on the government's preferences and on public perceptions about the IMF, a program relationship can serve different domestic political purposes. Consistent with Vreeland (2003b), if the preferences of both sides' negotiators converge and the Fund is not too stigmatized in the domestic political debate, the conditionality associated with IMF programs can be exploited by borrowing governments as an instrument to legitimize certain courses of action, as was the case during the De la Rúa and the Batlle administrations in Argentina and Uruguay. But the Argentine case also shows that if negotiators' preferences diverge and the IMF is stigmatized in the domestic political debate, a conflictive program relationship can be exploited to garner public support for courses of action that depart from the Fund's prescriptions, which tended to be the case during Néstor Kirchner's presidency. In both situations the government has an incentive to overstate the importance of the Fund's prescriptions in its decision-making process. However, whereas in the first scenario this incentive tends to sustain cooperation with the Fund, in the second scenario it tends to undermine it.

Focusing next on the multilateral ratification arena, the Argentine and the Uruguayan case studies suggest that there is an association between the cost of no agreement perceived by the Fund's constituents and the autonomy of IMF officials in the negotiations with borrowing countries. If the cost of no agreement is perceived to be high, powerful states are more likely to interfere in the negotiations, which is broadly consistent with the conditional delegation model outlined by Stone (2008). Instead, when the cost of no agreement is perceived to be relatively low, technical considerations and bureaucratic politics at the level of the IMF tend to dominate the process. Borrowing governments have some leeway to influence the cost of no agreement perceived by the Fund's constituents. For instance, Finance Minister Cavallo tried to manipulate international public opinion, Finance Minister Machinea threatened to default on Argentina's debt with multilateral institutions and President Batlle exploited his government's transnational alliance with the US. The extent to which these actions tipped the balance in the multilateral decision-making process, however, is not entirely clear, suggesting that borrowing governments' room for manoeuvre is relatively limited in this respect.

This dissertation shows that the causal association between rules and the design of specific IMF programs is more complex and bi-directional than at first might be expected. On the one hand, rules have been found to impose a generally soft constraint on the negotiation of multilateral rescue operations. This was particularly clear in the Uruguayan case when the Bush administration did not hesitate to breach recently adopted rules on exceptional access to the Fund's resources and to provide a bridge loan in spite of having committed not to put American money at risk in emerging market rescue operations. On the other hand, powerful creditors tend to link specific IMF programs to broader normative considerations, which can increase the explanatory significance of rules in certain contexts. Some interventions may come to be perceived by the Fund's constituents as an opportunity to change rules according to their policy preferences, which will be more likely to occur when important reform proposals are on the table, as was the case during the SDRM discussions. That the course of action to be adopted in the Uruguayan crisis was linked to the debate about the statutory vs. contractual approaches to reforming the sovereign debt regime enabled that country's government to punch above its weight. This contributes to explain why Uruguay received a better multilateral treatment than Argentina.

Another variable that had an impact on the Fund's ratification process was the different size of the Argentine and the Uruguayan economies. However, this factor's overall effect on the negotiations is ambiguous. On the one hand, the perception that Argentina had become an important emerging market influenced the position of the G7 and the Fund's internal bureaucratic political process, resulting in a prompt reaction to the financial difficulties that began to be experienced in 1999. This observation is consistent with a realist view of the world according to which the distribution of power is crucial to explain most international outcomes. On the other hand, the small size of the loan that was needed to rescue the Uruguayan economy made it easier to bail out that country than Argentina, which was a decisive factor in 2002. This implies that being large or small constituted an advantage for Argentine and Uruguayan negotiators at different points in time. Borrowers' economic might, therefore, does not appear to be a consistent predictor of the multilateral response to financial crises, although the Argentine and the Uruguayan case studies confirm that this variable can play an important role in the Fund's decision-making process.

Moving on to the consequences of the Fund's interventions in Argentina and Uruguay, the contrasting multilateral response to the two crises had a relatively minor impact on the evolution of real economic variables such as GDP growth or unemployment. However, these IMF interventions had other important economic implications. More specifically, the Argentine and the Uruguayan experiences support the hypothesis that the Fund can catalyze cross-border capital flows in the medium term. By allowing the government to restructure pre-emptively and on market-friendly terms, the multilateral rescue helped preserve Uruguay's integration into the global financial system. By contrast, the suspension of the Fund's support led to a massive sovereign default that contributed to turn Argentina into a pariah state for private creditors. A comparison between the aftermaths of the 2001-02 crises also suggests that, partly through their impact on the medium-term evolution of cross-border capital flows, IMF programs can have a disciplining effect on the conduct of monetary policy, which was significantly laxer in Argentina than in Uruguay after 2002. By contrast, the Fund had a minor impact on fiscal and exchange rate policies, two analytical dimensions that exhibited little cross-sectional variation in the aftermath of the crises.

The last relevant result of the empirical analysis presented in this dissertation is that the contrasting multilateral response to the Argentine and the Uruguayan crises had important consequences on these two countries' political and institutional trajectories. In the short term, the suspension of the Argentine program was one of the factors that triggered the collapse of the De la Rúa administration. By contrast, the Uruguayan multilateral rescue package was crucial for President Batlle to be able to complete his term in office. Of more subtle significance is the argument that over the medium term variation in the Fund's interventions contributed to shape the post-crisis policy preferences and policy space of the Argentine and the Uruguayan governments. This is why the multilateral response to the two crises helps to explain the moderation of the Uruguayan left while in government and the radicalization of the discourse of the Kirchners' Peronist administrations. In addition, the drastic measures that the Argentine authorities were forced to adopt after the suspension of the Fund's support had negative institutional consequences, which were by and large avoided in the Uruguayan case partly as a result of the August 2002 bailout.

8.3 Extensions

Focusing next on the identification of avenues for future research, a first natural extension of this dissertation could be to test the external validity of the hypotheses that have been discussed in this dissertation. Encapsulating the complexities of the two-level game analytical framework in a large-N analysis, however, would be nearly impossible, which makes it difficult to find an alternative to the case study approach applied in previous chapters. Nevertheless, at least some of the causal associations that have been generated and explored in previous chapters could be examined in a larger sample of multilateral interventions using a well-defined econometric specification. For that purpose, an appropriate codification of the Fund's Monitoring of Fund Arrangements (MONA) database, which tracks the evolution of all programs approved from 1993 onwards, could be particularly useful. This database provides comparable data on the evolution of some of the defining characteristics of IMF interventions, such as their objectives and the extent to which program targets were met, their conditionality and the waivers conceded by the Executive Board in successive reviews and whether there were delays in the disbursement schedule.[168]

The MONA database could be used to proxy debtor governments' bargaining power vis-à-vis the IMF in order to regress this variable against a relevant set of explanatory factors. For instance, the number of waivers conceded in subsequent program reviews or the proportion of the resources committed under a program that were disbursed could be used as the dependent variable. In turn, the intensity of the constraints imposed by domestic ratification politics, as measured by the POLCON or the CHECKS variables (see Chapter

[168] Although the complete MONA was only released in 2011, it has already been used by some scholars who were given access to it prior to that date (Ivanova et al., 2003; Stone, 2008). These contributions illustrate the potential usefulness of this research tool to conduct econometric studies about the determinants of multilateral interventions' success or about the factors that shape the negotiation of IMF conditionality.

6), could be included among the regressors. This would be instrumental to test some of the predictions of the adapted two-level game framework, such as the presence of a non-linear association between the intensity of domestic ratification constraints and borrowers' bargaining power.

Alternatively, the extent to which the location of veto players within domestic polities influences the content of the policy strings attached to IMF programs could be examined through the 19 categories under which the MONA classifies conditionality. This could be done by fitting a categorical dependent variable capturing these various types of conditions into a multinomial logit model. The regressors included in such a specification could include proxies to locate the position of veto points, such as dummy variables capturing whether borrowing countries have a decentralized structure of government or whether referendums can be triggered by labour unions or other interest groups. Such a set-up could be used to test whether fiscal conditionality (or compliance with fiscal conditionality) is weaker in more decentralized states, and whether structural conditionality (or compliance with structural conditionality) is weaker in countries in which triggering a referendum is possible, as the Argentine and Uruguayan case studies suggest.

An econometric approach could also be used to explore the medium-term impact of IMF programs on borrowing countries' political economies. For that purpose, the dependent variable could be derived from the Database of Political Institutions (DPI), the Worldwide Governance Indicators (WGI) or the International Country Risk Guide (ICRG), which provide measures of political stability and polarization, government effectiveness, regulatory quality, the rule of law, corruption, democratic accountability or bureaucratic quality among others. In turn, some of the dependent variables included in this econometric specification could be obtained from the MONA database, which would be instrumental to detect correlations between some of the specific features that characterize IMF interventions and the evolution of the aforementioned political and institutional outcomes. For instance, in line with Ivanova et al. (2003) a proxy for the "success" of IMF interventions could be constructed in an attempt to determine whether this variable is statistically associated with "better" institutional trajectories in the medium term.

Finally, another extension of this dissertation could be the application of its analytical framework to study other more recent multilateral rescue operations. As was the case in the Southern Cone, the programs that have been approved to support European countries evidence the complex inter-connections between domestic and international factors that are present in this particular issue area. Therefore, a two-level game analytical framework would be appropriate to study these interventions.

However, there are important differences between the Argentine and Uruguayan experiences and the Eurozone crisis that are especially apparent at the international level of analysis. Whereas Argentina and Uruguay are at the periphery of the world economy, the current crisis has unfolded at its core, affecting countries that belong to a coalition with a heavy weight in the Fund's decision-making architecture. As a result, the cost of no agreement perceived by the Fund's most powerful constituents has been much higher during this crisis. This is why even in relative terms the Argentine and the Uruguayan programs pale in comparison with the volumes of financial assistance that have been mobilized to support Ireland, Portugal or Greece.

Another difference between the two situations is that the management of the Eurozone crisis has involved various supra-national institutions like the European Commission or the ECB, with which the IMF has formed a so-called Troika in charge of the negotiations. Given the peculiarities of the European decision-making architecture, the level II game has been extremely complex, empowering not only large creditors such as Germany and France but also much smaller players such as Finland or the Netherlands. The multiplicity of veto players and of ratification arenas present in this complex institutional framework has generated a sense of sclerosis, and European leaders have often been blamed for their inability to gain the upper hand on economic issues and to address the contradictions of the monetary union.

In spite of these differences, some of the causal mechanisms outlined in this dissertation could be at play in the Eurozone crisis. For instance, domestic political divisions may have been exploited by some of the governments in distress in order to gain leverage in their negotiations with the Troika. A case in point is Georges Papandreu's decision to hold a referendum on the conditions of the Greek rescue package. This move might have been aimed at gaining some political room for manoeuvre domestically in order to expand Greece's win-set at a time in which the cooperative equilibrium of the negotiations with the Troika had come under intense pressures. However, it might also be that the referendum was announced in order to put the spotlight on the narrowness of the Greek win-set and, in this way, to press the Troika into softening the policy conditions of the rescue package. Such episodes deserve an in depth analysis in order to deepen our knowledge about the causal link between domestic ratification constraints and the negotiation of financial rescues.

In light of this dissertation's empirical results, another question that would merit a close examination is whether differences in borrowing countries' configurations of political institutions are having an impact on the various crisis mitigation operations in place. The location of veto-players within these countries' polities together with differences in political actors' propensity to cooperate could contribute to explain the cross-sectional variation observed in these processes. A preliminary interpretation of events suggests that this has been the case. For instance, the veto-power exerted by labour unions and other vested interests in the Greek bureaucracy has been emphasized as one of the main factors that have made it difficult to progress with structural reform in that country. In turn, political actors' inability to cooperate in order to pass a fiscal consolidation plan is one of the reasons why the Portuguese government ended up being rescued in April 2011. Similarly, the polarization and fragmentation of the Italian party system has stood on the way of macroeconomic adjustment, triggering various rounds of financial instability. Finally, the decentralized structure of the Spanish state is making it difficult to reign on public finances in that country.

The Argentine and the Uruguayan case studies are also useful to speculate about the potential consequences of alternative courses of action. It is likely that if official support was to be suspended, the Greek government would be forced to adopt emergency measures similar to those implemented by the Argentine authorities after December 2001. A sovereign debt default would be unavoidable, the euro would most likely be substituted by a new currency and strict controls would have to be enacted in order to avoid the complete bankruptcy of the banking system. In addition, contracts would have to be redenominated into a new currency, which would probably entail a re-allocation of the costs of crisis among debtors, creditors and other economic interests. If the Argentine experience is of any guide, all these measures would result in an economic, political and institutional collapse with profound consequences. However, a sharp devaluation of the new drachma could also become an engine for economic growth that is currently missing, as was the case in Argentina when the convertibility regime was dropped.

Alternatively, maintaining or expanding the Greek rescue package could make the resolution of that crisis look closer to the Uruguayan case. A pre-emptive rather than a post-default debt restructuring might be successfully completed, the euro could be maintained and hence the economy's contracts would not have to be re-denominated and the aforementioned banking and capital controls could be avoided. This might mitigate the political and institutional costs of the crisis. However, keeping the euro would make it much more difficult to regain competitiveness. This constitutes a crucial difference with the Uruguayan experience, where the recovery was primarily fed by a terms-of-trade shock in the absence of which the outcome of the crisis could have been very different. Therefore, the Uruguayan case study provides an imperfect guide of what may occur in Greece or in any of the other European country in distress if the financial muscle of the rescue packages was to be maintained or reinforced. Indeed, the policy trade-offs that are being confronted in the management of the Eurozone crisis look even starker than those faced in the Southern Cone a decade ago.

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Appendix A

List of Interviews

Buenos Aires

- Eduardo Amadeo, Ambassador to the United States (2002-2003). July 26, 2010.
- Daniel Artana, Chief Economist at Fundación FIEL (Fundación Investigaciones Económicas Latinoamericanas). July 27, 2010.
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Appendix B

The Reform of the International Financial Architecture: Key Decisions

	G7 summit - Halifax, 1995 - June	IMF Board 1995 - September	G7 summit - Lyon, 1996 - June	Rey Report issued by the G-10
Official Finance	• In the aftermath of the Mexican financial crisis, the G-7 urges the IMF to create an "International Financing Procedure". • Call for doubling the resources available through the General Agreement to Borrow. • Urge to complete the quota review.	• The Board approves the International Financing Procedure. •The new procedure was expected to accelerate program negotiations in a situation of emergency. •It has been used on 6 occasions by the Philippines, Thailand, Indonesia, Turkey and Georgia.	• Few mentions to financial crises. • However, the communiqué raises the issue of the possible issuance of SDRs.	
Private Sector Involvement	• There are no explicit mentions to PSI. However, the G10 Ministers and Governors are encouraged to explore "other" ways to address financial crises.			• The Report rejected Jeffrey Sachs proposal of creating an international bankruptcy court. • Collective Action Clauses proposed for the first time. • The IMF urged to lend into arrears also on bonded debt.
Conditionality	• The new Emergency Financing Mechanism will be subject to a "strong"conditionality.			

	G7 summit - Denver, 1997 - June	Annual meetings, Hong-Kong, 1997 - September	IMF Board 1997 – December	G7 summit - Birmingham, 1998 - May
Official Finance	• Again, little mention to the reform of the International Financial Architecture. • However, the need for an equity" allocation of SDRs is mentioned.	• Agreement for a quota increase, pending approval from US Congress.	• The Board approves the SRF in order to help countries facing "exceptional" pressures in their BoP. • "Normal" access limits were not to apply to the new facility, which would be subject to higher charges.	• The Asian financial crisis has already erupted. • The G7 welcomes the SRF as the right instrument to address exceptional BoP pressures.
Private Sector Involvement			• Although no mention to PSI is made yet, the Board emphasizes the need to ensure the participation of private creditors until the BoP pressures are overcome.	• For the first time, the emphasis is placed on PSI as a crucial instrument to address financial crises. • Influenced by the Korean experience, the idea of coordinated bank roll-overs is high on the agenda.
Conditionality				

	G7 Leaders' Statement on the World Economy 1998 – October	IMF Board 1998 – October	IMF Board 1999 – April	G7 summit - Cologne, 1999 - June
Official Finance	• They welcome the establishment of a “precautionary facility, which was the first step towards the establishment of the CCL. • A mention is made about the desirability of an emergency facility at the World Bank.	• Reform of the policy of Lending Into Arrears. • The Fund is allowed to countries that have fallen into arrears in their bonded debt.	• Introduction of the Contingent Credit Line (CCL), a “precautionary line of defense against future balance of payment problems that may arise from contagion”. • Demanding eligibility criteria, as a result of which no country requests it.	• The G7 states that no financial assistance should be provided to countries that are heavily intervening in F/X markets if the exchange rate is not considered to be sustainable.
Private Sector Involvement		• This measure seen as crucial step to reinforce the Fund’s potential role in sovereign debt restructurings in contexts of securitized debt.		• Much emphasis placed on PSI. Wherever possible, crisis management should be aimed at promoting cooperative agreements between debtors and creditors. •It is stated that CACs should be promoted in bond contracts. •Claims on bondholders should not be senior to bank loans.
Conditionality				• Enhanced monitoring to succeed program conditionality introduced.

<table>
<tr><th></th><th>Meltzer Commission Report, 2000 - March</th><th>G7 summit – Okinawa 2000 - July</th><th>Prague Framework 2000 - September</th><th>Interim Guidance Note 2000 - September</th></tr>
<tr><td>Official Finance</td><td>• The Commission argued that the IMF should act as a quasi lender of last resort to solvent but illiquid EMEs.
• It also recommended shortening the maturity of IMF loans, which should carry a penalty rate.</td><td>• Streamlining of IMF facilities: CCL; SBA/EFF; SRF; PRGF
• Reform of the CCL to make it more attractive financially, and more automatic. However, eligibility standards remained unchanged.</td><td>• Welcomed the review of IMF facilities.
• In pure liquidity crisis in which the combination of catalytic official financing and policy adjustment should allow the country to regain market access.</td><td rowspan="3">•Fund conditionality should cover only structural reforms that are relevant for a program's macroeconomic objectives.
• Among the structural reforms that maybe considered macro-relevant, only thosethat are critical to meet the program's macroeconomic objectives should be included. In other words, to be part of conditionality, reforms should be both relevant and critical.
• If certain structural reforms are critical for the program but outside the Fund's core area of responsibility, the Fund should seek advice from the World Bank or other institution both to design and monitor that condition.</td></tr>
<tr><td>Private Sector Involvement</td><td>• The Meltzer Report made little mention to PSI.</td><td>• Promotion of CACs.
• All programs should include DSAs.
• Distinction between pure illiquidity situations, intermediate cases and situations of insolvency.
• Emphasis on comparability of treatment to private creditors.</td><td>• In intermediate cases emphasis should be placed on encouraging voluntary approaches to overcome credit coordination problems.
• In pure solvency crises a comprehensive debt restructuring should be considered.</td></tr>
<tr><td>Conditionality</td><td>• The commission advocated for the introduction of an ex ante conditionality articulated through a number of pre-conditions establishing countries’ financial soundness.</td><td>•Conditionality should focus on macro issues and on structural reforms that have a macro impact.
• Ownership critical for success of IMF programs
•Post program monitoring to keep track of policies implemented while IMF loan is still outstanding.</td><td>• EB urged to review all aspects of policy conditionality.
• The IMF must focus on its mandate of macro stabilization and adjustment, monetary, ER, fiscal policies, financial sector issues, especially systemic issues.</td></tr>
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<tr><th></th><th>Review of Fund Facilities
2000 - November</th><th>G8 Finance Ministers Meeting, Rome
2001 - June</th><th>G8 summit – Genoa
2001 - July</th><th>Anne Krueguer launches first SDRM proposal. 2001 - November</th></tr>
<tr><td>Official Finance</td><td rowspan="2">• Elimination of a few obsolete facilities.
• Further attempts to enhance CCL.
•Changes in the EFF's Time-Based Repurchase Expectations.
• Changes in the charges on the use of Fund resources. In particular, increase of the charges on exceptional access credit, and reduction in the charges of the CCL. The surcharge was now to start at 150 bp rising with time up to 350 bp.</td><td>• Calls for a review the requirements and procedures used to determine access to IMF financing.
• Commitment not to top-up the resources provided by the IMF</td><td>• Few mentions to IFA issues, reflecting the relative calm of the moment (the Argentine crisis yet to erupt).</td><td></td></tr>
<tr><td>Private Sector Involvement</td><td>• Calls for a review of the policy of Lending Into Arrears.
• Emphasis placed on the need for Debt Sustainability Assessments.
• Emphasis on CACs and information sharing.</td><td></td><td>• The debate about the contractual vs. statutory debt restructuring mechanism begins.</td></tr>
<tr><td>Conditionality</td><td>• Post-program monitoring: presumption that countries will engage in PPM after the program's expiration when outstanding credit surpasses 100% of quota.</td><td></td><td></td><td></td></tr>
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	Second SDRM proposal. 2002 - April	Taylor's speech at the Institute of International Economics. 2002 - April	G8 Finance Ministers Action Plan on Crisis Prevention and Crisis Resolution. 2002 - April 2	G7 summit – Kananaski 2002 - July
Official Finance			• The agenda for the exceptional access framework is set.	• Few mentions to IFA. • Briefly mentions the Argentine crisis without saying anything substantive.
Private Sector Involvement	• Second proposal somewhat limited the role that the IMF would play in an SDRM.	• Just one day after the second SDRM proposal was issued, John Taylor made a speech which made clear that the US was in favor of CACs rather than a statutory solution to the debt restructuring issue.	• Clear support to the promotion of CACs in debt contracts. • At this stage they still support the IMF's efforts to develop a new approach to sovereign debt restructurings (SDRM). However, they also state that such work should not delay the adoption of CACs.	
Conditionality				

<table>
<tr><th></th><th>IMF Board
2002 - September</th><th>IMF Board
2002 - September</th><th>Mexico issues first bond issuance with CACs. 2003 - September</th><th>G8 Finance Ministers Meeting, Washington. 2003 - April</th></tr>
<tr><td>Official Finance</td><td rowspan="3">• Adoption of the exceptional access framework.
• It defined four criteria for the IMF to lend above normal access limits. First, members should be experiencing exceptional pressures in their capital account. Second, their debt should be sustainable and expected to remain so in the future. Third, they should have a high probability of regaining access to international financial markets quickly after the IMF’s interventions. Fourth, the policy roadmap backing these IMF program should have a strong prospect of success.</td><td></td><td></td><td></td></tr>
<tr><td>Private Sector Involvement</td><td></td><td>• Successful first issuance of bonds with CACs torpedoes the debate about the adoption of an SDRM.</td><td>• Renewed support to the promotion of CACs in sovereign bonds.
• Mentions the Code of Good Conduct, a voluntary attempt at guiding debt restructuring processes.</td></tr>
<tr><td>Conditionality</td><td>• Approval of new Conditionality Guidelines.
• Expected to lead to fewer and more focused structural conditions and to greater involvement of national authorities in program design.</td><td></td><td>• Assessed progress with the reform of conditionality.</td></tr>
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	G7 summit – Evian 2003 - July	IMF Board 2003 - November	G7 summit – Sea Island 2004 - July	G7 summit – Gleneagles, 2005 - July
Official Finance	• Few mentions to the IFA process. • Support to the Brazilian program.	• Due to lack of demand, the Contingent Credit Line is eventually let to expire.	• Global economy in good shape, no financial crisis anywhere in the world. • No mention to IFAs apart from the usual support to CACs and to the Code of Conduct.	• No mention to IFA issues.
Private Sector Involvement				
Conditionality				

Appendix C

The Argentine Financial Crisis: Key Decisions

SBA approval 1996 – April	EFF approval 1998 - February		New Labor Law Passed 1998 – September	1st Program Review 1998 - September
• SDR 720 mn. • 46.8% of quota. • 21 months • Focused primarily on fiscal reform and on privatizations. • It also envisioned a labor market reform. However, it did not set formal benchmarks on this reform. • Structural conditionality not very demanding. • Fiscal targets unmet, in spite of which the program was never interrupted.	• Approved in precautionary terms. Argentina never made use of the resources committed under the program • SDR 2080 mn. (135.3% of quota). • Staff had serious misgivings about this EFF due to a lack of progress with labor market reform. However, management acquiesced to the Argentine demands. • Structural conditionality focused on labor market reform. • Emphasis on fiscal adjustment. In hindsight, however, the IMF recognizes that it failed to press the government into adopting a counter-cyclical macroeconomic stance. • This is the last time a discussion about a possible exit from the convertibility regime was seriously considered.	**Russian** **Default** **1998** **August**	• This labor law fell far short of expectations and the Fund's staff considered it highly Inadequate. Initially, the Fund´s staff argued in favor of postponing the review of the program. • Management and the EB, however, did not share that view, and the first review was approved soon afterwards. • This was partly due to concerns about conditions in international financial markets following Russia's default. • The IEO report considers that this law epitomizes the Fund's failure at being tough on structural conditionality.	• In spite of the disappointment with the labor law, the Fund's document stated that "all quantitative performance criteria have been met and substantial progress has been made in the implementation of structural reforms"

	Fiscal Responsibility Law passed 1999 - August	Presidential Elections 1999 - October	1st Program Review 1998 - September	SBA approval 2000 - March	New Labor Law 2000 - April
Brazilian Crisis (massive devaluation of the real) **1999 January**	• It established a schedule to reduce the deficit at all levels of government, starting in 1999 until 2003. • It failed.	• Fernando de la Rúa and the Alianza wins. • The presidential election gave rise to a small spending spree. • Duhalde, the Governor of the Buenos Aires Province, was the main contender. He spent a lot on patronage. • Menem also spent a lot on the campaign, although he eventually did not contend in the elections. • In 1999 the debt to GDP ratio rose from 41% to 47%. • As a result, departures from the Fund´s fiscal conditionality became increasingly apparent.	• In spite of the disappointment with the labor law, the Fund's document stated that "all quantitative performance criteria have been met and substantial progress has been made in the implementation of structural reforms"	• Originally treated as precautionary • SDR 5.4 billion (US$7.2 bn). • GDP growth expected to rebound to 3.4% in 2000. It ended up being close to 0.8%. • Focus on fiscal consolidation. • Emphasis on structural reform, and especially on the reform of the labor market.	•The new law was aimed at complying with the SBA's structural conditionality. • A corruption scandal related with the approval of this law would later result in the resignation of Vice-President Alvarez.

13% reduction in civil servants wages 2000 -May	Change in the program's targets 2000 - September	The "Blindaje" 2001 – January	Minister Machinea resigns 2001 - March	Minister Lopez Murphy resigns 2001 – March
• This wage reduction was not contemplated in the conditionality of the 2000 SBA. • However, the Fund's staff welcomed this measure	• The IMF agrees to accommodate a higher than expected deficit for year 2000.	• Brought the total resources committed by the IMF to US$13.7 bn, SDR 10.6bn equivalent to 500% of quota • One fifth provided under the SRF • Additional commitments from other IFIs (US$5bn) and from the government of Spain (US$1bn). • The headline figure associated with the program was US$40bn • The program was quite frontloaded: 106% of quota disbursed immediately and 3 more installments of 46% of quota disbursed in 2001. • The package was supposedly backed by other US$20bn committed by Argentine financial institutions and pension funds. However, these resources failed to materialize. • The emphasis that was placed on PSI in the "Blindaje" is explained by the Prague Framework for Crisis Resolution, which had just been approved. • The program relaxed fiscal conditionality, while emphasizing the need to stabilize debt dynamics in the near term. • However, 5 out of 6 Performance Criteria were related with fiscal variables. • Federal deficit targeted at US$6.5bn. • In return for this looser fiscal conditionality, the Argentina government committed to implement an ambitious agenda of structural reforms in the medium-term measures (pension system reform, fiscal, health system reform, etc…)	• The Blindaje was followed by a few weeks of relative stability. •However, the situation deteriorated in February as sovereign spreads resumed their escalation partly because of concerns about contagion from the Turkish crisis. • When Congress fails to pass some of the structural reforms contemplated in the Blindaje, Minister Machinea resigns. • Ricardo Lopez Murphy takes over the Finance Ministry.	• Right after taking office, Lopez Murphy announces a deficit reduction package of US$2 billion. • Various senior Argentine officials react by tendering their resignation, rendering LM's position untenable. • After less than three weeks in office, LM is forced to resign. • Domingo Cavallo takes over the Finance Ministry. • On March 27, Cavallo obtains "superpowers" from the Argentine Congress

Third review of the program approved 2001 – May	Introduction of the "Convergence Factor" 2001 - June	Megaswap 2001 – June	"Zero deficit plan" Announced 2001 - July	Augmentation of the program 2001 - August
• In spite of the controversial measures introduced by Cavallo and of the fact that the program was clearly off-track, the Board approved the review. • The main reasons alleged by staff were: 1- The strength of the new measures adopted by Cavallo, who was given the benefit of the doubt 2- The authorities new found commitment to the program suggested in a show of support of Congress granting exceptional powers to the executive 3- Fear of the impact of an Argentine collapse on the region and on other EMEs. • Waiver for the non-completion of the fiscal target approved.	• The convergence factor was aimed at mimicking the impact of a devaluation through a system of taxes on imports and subsidies on exports. • Both the subsidy and the tax would be calculated according to the difference between the prevailing exchange rate and a basket X/R. • There was a discussion at the Fund to determine whether this did constitute an (illegal) system of multiple X/R. • The market interpreted this measure as a clear sign that the convertibility regime was no longer sustainable.	• Voluntary debt exchange aimed at moderating short-term debt servicing obligations. • The swap yielded a reduction of debt service obligations of US$12bn in between 2001-05 • The swap carried a long-term cost US$66bn in higher debt service obligations after 2005. • It was conducted at a time in which spreads were in the range of 900-1000bp. •This was another decision taken unilaterally by the Argentine authorities. • However, the Fund has been heavily criticized for not opposing it more adamantly.	• This measure followed a failed treasury bill auction. •The zero deficit plan mandated the government to introduce across-the-board proportional cuts in primary expenditure in order to meet any deficit. This would ensure an automatic response to any deficit. • Congress eventually passed it as a law. • Utter failure to reduce country risk: spreads jumped from 1200 bp to 1600 bp. in the aftermath of the plan.	• A total amount of US$ 8 billion of new money: sdr 6.3 BN. • SDR3.97 bn made available through the the SRF. This amount was disbursed immediately. • It raised the size of the program to 800% of quota - SDR17.5 bn ($22bn) • This was the second largest disbursement in the history of the IMF • US$1000mn provided by IADB and WB. • US$3 bn set aside for eventual debt Restructuring, an explicit demand from Paul O'Neill • The zero deficit rule. • Commitment to introduce legislation to reform Argentina's revenue-sharing arrangement with the provinces.

Dismal fiscal figures released 2001 - October	Legislative elections 2001- October	The debt restructuring is announced 2001 - November	Review of the program 2001 - December	Phase I of the debt restruct. completed 2001 – December	The government collapses 2001 - December
• The government announces that revenue have fallen by 14% and that, in accordance with the zero deficit rule, public expenditures will have to be cut by $900 million. • The resulting fiscal restraint on the part of the central government forces various provinces to start issuing their own currencies, such as the PATACON issued by the province of Buenos Aires to pay pensioners, suppliers, etc…	• The Justicialist Party wins majority at both chambers of Congress. • The Peronists also win most governorships. • The election´s results greatly result in a drastic weakening of the Alianza´s political position.	• President De la Rúa addresses the nation to announce the launching of a debt restructuring. • The debt restructuring is to be articulated in two steps: the first one for domestic debt and the second one for external obligations. • Standards and Poors downgrades Argentina to "selective default". • Spreads surpass 2300 bp. • The IMF disagreed with the discrimination between domestic and external creditors.	• The IMF pulls the plug off. • A successful completion of that review would have allowed the disbursement of US$1.24 billion in December. •By the time of the review, the Argentine government had acknowledged that the 2001 budget deficit would be much larger than the target agreed with the IMF ($7.8bn as opposed to$6.5bn). • In addition, the government had failed to reach a convincing agreement with the provinces.	• Domestic debt with a face value of US$41bn and an additional US$10 bn of provincial debt was exchanged for loans collateralized with revenues from the financial transaction tax. • NPV loss of 26%. • Various incentives attached to this exchange, including the tax collateral, the possibility for fin institutions to value the debt at par rather than marked to market • Also, an option was given to claim back the original bonds if any further change was added to the terms of this exch. In fact, many pension funds would claim these bonds back later.	• State of emergency declared on December 19. • President De la Rúa resigns on December 21. • The Justicialist Party takes over, with a rapid succession of short-lived governments.

Default **2001 - December**	**¨Economic Emergency Law¨ passed** **2002 - January**	**¨Corralón¨ approved** **2002 – January**	**¨Amparos¨begin** **2002 - January**	**Mario Blejer becomes President of the CB** **2002 - January**
• On December 23 Rodríguez Saá announces the Argentine default. • Originally, the default amounted to US$66 billion. • It barely affected residents given that phase I had already been completed. • Later, however, and especially following the pesoization, the volume of domestic debt in default became substantial.	• The peso is devalued, and fixed to 1.4 per dollar. • A"free dollar" market established for financial transactions. This measure established a dual exchange rate system: the 1.4 pesos per dollar would only apply to trade. • Multiple exchange rate regimes are explicitly prohibited under the Fund's articles of agreement. • Ratification of the Corralito. • The price of utilities is also peso-ized. • Debts with a value of less than 100,000 dollars are also peso-ized. • In order to avoid the liquidation of bankrupt firms, a new bankruptcy law passed.	• The corralón was the re-programming of time deposits. • According to Levy Yeyati, this is what Cavallo should have done because time deposits corresponds to "savings", which were being drained out of the system and converted to dollars. Instead, sight deposits were crucial for day to day transactions. • These deposits were returned in pesos at an exchange rates of 1.4 to the dollar and indexed to the CER, *Coeficiente de estabilización de referencia*, which did essentially capture inflationary pressures	• Judges begin to order the so-called amparos¨, forcing banks to return deposits in their original currency denomination. • This resulted in a constant leak from the banking system, which was on the verge of resulting in its collapse. • The Amparos triggered a bitter Conflict between the Executive and the Judiciary.	• Before returing to Argentina he was an IMF official. • It is broadly recognized that he made a good job , refusing to print money to finance the government. This was one of the reasons behind the stabilization that was achieved by the Argentine economy in 2002: the dreaded hyperinflation that never materialized.

Modification of the Bankruptcy Law 2002 - January	Remes Lenicov announces a new set of emergency measures 2002 - February	The exchange rate regime is unified 2002 - February	IMF creates a Special Department to deal with the Arg crisis 2002 - February
• The Argentine government weakens creditors rights in order to avoid the widespread bankruptcy of firms to generate a further transnationalization of the economy. • The basic idea was to reduce the right for creditors to become the owner of bankrupt debtor firms. • This was a controversial move, which was supposed to be temporary. • The IMF strongly opposed it.	• Asymmetric pesoization: banks liabilities were converted at a rate of 1.4 pesos to the dollar while their assets were converted at a rate of 1 peso to the dollar. This imposed huge losses on banks, triggering a huge debate on whether bansk should be compensated. • The government was eventually forced to compensate banks through Bonds (according to Bonelli, there was an agreement from the beginning to compensate banks). This measure proved to be very costly for the Argentine government, which throughout 2002 had to issue massive amounts of debt to compensate banks for the losses incurred as a result of the asymmetric pesoization. • Loser argues (pp248) that the asymmetric pesoization was the result of the pressures exerted by important debtors such as Clarin, which wanted to see a substantial portion of their debts written off. • The Argentine peso is floated. According to Amadeo, the floating of the peso was partly aimed at reaching a deal with the IMF. By that time, a dual X/R was de facto functioning: the "parallel" peso was exchanged at more than 2 to the US$. Still, the central bank continued to intervene, which was a source of discussion with Argentina. Later, Argentina was forced to let the peso truly float. • Additional measures of fiscal austerity are announced.	• This enabled Argentina to comply with a legal requirement from the IMF, which bans countries from running dual exchange rate regimes.	• This is a crucial development at the IMF. • It effectively took the WHD out of the way. Anoop Singh is appointed head of this department, signaling the much tougher stance that the Fund was to adopt on Argentina.

Agreement with the Provinces 2002 - February	Argentina floats the peso 2002 – February	Pesoization of guaranteed loans 2002 - March	Export taxes introduced 2002 – March	IMF mission to Buenos Aires 2002 – March	The run on the peso aggravates 2002 - March
• The Federal government takes over the debt of the provinces. • In return for financial assistance from the central government, the provinces with the greatest imbalances sign "Programas de financiamiento ordenado" • In essence, the federal government made its financial support conditional on the implementation of a number of provincial policies, among which was the commitment not to use "semi-currencies"	• The argentine government claims in the 2004 paper that the IMF forced it to take this step. • The IMF did not want Argentina to use its reserves, which in fact belonged to the Fund given that Argentina's net reserve position with the Fund was negative. • According to the government, this move had significant inflationary consequences.	• The guaranteed loans that were exchanged by domestic creditors during phase I of Cavallo´s exchange are pesoized at an exchange rate of 1.4 pesos to the US$. •As a result, many domestic creditors exerted their right to claim back the original bonds. • Some other creditors (such as pension funds) were forced to do so when they become too vocal of their criticism about the government.	• These taxes were imposed on primary products, oil and agro-industrial products. • This measure turned out to be crucial, especially with the increase in the price of commodities that was about to begin.	• Revives hopes for an IMF arrangement • Amadeo describes the many reservations that the IMF still had, especially with regards to judicial safety and to provinces´ bonds. • A crucial point of agreement was that the Fund allowed Argentina to negotiate a social safety financial package with the WB and IADB for an amount of 1.7 to 2% of GDP.	• Partly as a result of the increasing pace of the "amparos" and of the lack of progress with the IMF, the peso accelerates its depreciation vis-a-vis the dollar. • This fed the risk of a hyperinflation not only because of the surge in liquidity, but also because many prices were indexed to the dollar.

Program ¨jefes y jefas de hogar¨ launched 2002 - April	Pre-conditions for an IMF program clarified 2002 - April	¨Plan Remes¨ launched 2002 - April	Minister Remes Lenicov resigns 2002 - April	14 points pact 2002 - April	¨Ley Antigoteo¨ passed 2002 - April
A crucial step to soften the social impact of the crisis. • It was a program of fiscal transfers to poor families.	• Anoop Singh tells the press what the Fund expects from Argentina in order to sign a new program: • Fiscal consolidation (zero deficit) • Control over provincial finances, and especially over provincial bonds and quasi-money issuance. • Normalization of the financial system with a gradual eradication of the Corralito. • Changes in the "Law of Economic Subversion" and the "bankruptcy law".	• The Plan Remes was aimed at closing the Corralon by comulsorily exchanging the reprogrammed time deposits by bonds (Bodenizacion). • The parliament rejected it.	• Largely because of the Parliament´s rejection of his plan, Remes Lenicov resigns at a time in which the banking system is one more time on the verge of collapsing due to the Amparos. • Roberto Lavagna takes over.	• Duhalde´s government reaches a pact with the provinces. It outlined a strategy to address the crisis: • Integrate Argentina in the world econ. • Sign individual fiscal pacts with all the provinces within 15 days. • Submit a new coparticipation law to Congress • Maintain prudent fiscal and monetary policies to combat hyperinflation • Find a suitable exit to the Corralito • Take actions to bring about a solid financial system. • Change the bankruptcy law and withdraw the economic subversion law. Etc…	• This law was aimed at stopping the amparos from being enacted.

Interventions in FX markets begin 2002 - May	New Bankruptcy Law 2002 - May	Derogation of the Economic Subversion Law 2002 - May	Compensation to banks agreed 2002 - May	Mario Blejer resigns 2002 – June	The Avellaneda Crimes 2002 - June
• In order to stop the depreciation of the peso. • In addition, capital controls are introduced. • This was done against the will of the IMF, which signals the adoption of a tougher negotiating stance on the part of the Argentine authorities.	• This was one of the precondition that the Fund ask for a program. This step might have been aimed at softening the impact of the FX interventions. • As opposed to the derogation of the law of economic subversion, the modification of this law did not carry a substntial political cost for the Duhalde administration.	• This law had been introduced by the Military, enabling the State to take judiciary actions against those involved in harmful economic activities. • This law had never been used during the democracy. However, after the crises, there was a popular demand to use it to punish the capital flight that preceded the collapse. • The IMF insisted that Argentina should eliminate this law as a prior action to approving a new program. • This was a very tense negotiation in Congress, and eventually the government managed to derogate it.	• The government agrees to compensate banks for the asymmetric conversion of their assets and liabilities. • In order to do so, they will issue new domestic bonds: the BODENs.	• Aldo Pignanelli takes over as head of the Central Bank. • Pignanelli proposed a plan to free the corralito which was substantially different from that of the Ministry in that it was much faster. • This created important rifts between the BCRA and the economy ministry, especially because Pignanelli held parallel talks with the IMF	• Police kills two piqueteros in Avellaneda. • These crimes greatly weakened Duhalde's political position. It would be crucial for him to take the decision to anticipate presidential elections.

¨Expert commission¨ travels to Buenos Aires 2002 - July	The financial system begins to stabilize 2002 – July	Duhalde calls for early elections 2002 – July	Paul O´Neil travels to Buenos Aires 2002 – August	Negotiations of a Letter of Intent with the IMF 2002 – August	Extension of Repurchase Expectations 2002 - September
• This commission, which was Kohler´s idea, was expected to mediate and come up with a basis for an IMF program. It was yet another failure in the negotiating process. • It was formed by Andrew Crocket, John Crow, Hans Tietmeyer and Luis Angel Rojo.	• Primarily through its interventions in F/X markets and through the new LEBAC, the BCRA accumulates reserves for the first time, and the stock of deposits in the banking system begins to expand.	• The President finally concluded that democratic legitimacy was crucial to go forward with the reforms. • Amadeo describes how, early on in the process, Roberto Lavagna tried to build a consensus among the candidates on some central points of consensus about how to manage the economy.	• Lavagna told him that Argentina was not asking for "fresh" resources, but only for a rollover of existing obligations. • Apparently, this greatly softened O'Neill's stance, and after that he began supporting a new program for Argentina.	• The program proposed by the government included an ambitious set of structural reforms, a prudent macroeconomic policy and a plan to free the financial system. • And yet, a series of worrisome developments in August reinforced the sensation of a lack of juduciary security in Argentina: the courts declared Cavallo's reduction of 13% in the salaries of civil servants unconstitutional. This raised the question of whether the government would have the space to implement its programs.	• The repayment expectations of obligations for an amount of SDR 2.8 billion were extended by one year. • These repayment expectations arose from the SRF.

New disagreements emerge 2002 - October	Argentina delays payment to the IMF and the World Bank 2002 - November	End of the Corralito 2002 - December	G7 decides to support Argentina 2002 - December	The Board discusses the Argentine program 2002 – December	Argentina threatens to default on IADB. 2003 – January
• These disagreements were centered on the prior actions that the IMF demand: a primary surplus of no less than 4% of GDP. Argentina was willing to reach 3% of GDP. The Fund demanded tax spikes which the government refused to adopt. The BCRA interventions in F/X markets continued to be controversial. The IMF wanted prices to reach their market equilibrium. • The IMF wanted Argentina to drop all F/X and capital controls. • The IMF wanted Argentina to classify banks into three categories: solvent, undercapitalized, insolvent.	• In the words of Nielsen: "That was properly interpreted as preparation to default to a Bretton Woods institution, sending a signal to the G7 that there would be a price to be paid by the international community for cornering Argentina and the surrender of policy design to a few hardliners in Washington".	• Sight deposits are finally liberated. • The liberation of sight deposits was a success. Not only was it not followed by a run on the peso with the liberated deposits, but most deposits stayed in the banking system.	• The Fund's management is instructed to soften its position and to adopt a more cooperative stance with Argentina.	• The Fund's management and staff argued AGAINST the approval of the program arguing that inconsistencies persisted in the policy mix to which the Argentines were committing. • More specifically, it was feared that the Supreme Court could order the re-dollarization of all deposits, which would cause a collapse of the banking system. • No consensus could be reached to approve the program, as some European EDs opposed it.	• The week before the IMF program was Approved, substantial Argentine following repayments were due to Washington's IFIs: US$681mn to IADB US$998mn to IMF US$ 805mn to WB (the 805mn in default since November). • This happened two days before the program was signed, as new demands emerged on the side of the IMF.

A new transitory 7 months SBA approved 2003 – January	SBA's first review 2003 - March	Kirchner's victory 2003 - April	SBA's second review 2003 - June	Argentina misses payment on IMF 2003 - September
• Amount: SDR2174.5mn (US$2980 or 103% of quota). Together with further extensions of repurchase expectations, this amount fully covered Argentina's repayment expectations until August 2003. To all effects, it was a roll-over of existing obligations. However, it did not compensate for the net repayments that the Argentina was forced to make in 2002. • The program carried a soft conditionality, setting a quantitative PC for the first two months: primary surplus of 2.5% of GDP. • Few well-targeted structural conditions: draft legislation for fiscal reform, regulatory actions targeted at the banking system, appointment of an external advisor for the debt restructuring. • This program was approved under the LIA policy. Disbursements, therefore, required good faith in the negotiations with private creditors. • The overall purpose of the program was to help the political transition in Argentina. It would give the new government resulting from the April elections some space (three months) to negotiate a new "long" agreement with the IMF.	•Disbursement of SDR226mn or US$307mn. • The Federal Government's primary surplus exceeded the program's targets, in stark contrast with previous programs. • However, the Board approved waivers of non observance of the structural performance criteria on the issuance of new banking regulations and on the congressional approval of the fuel tax conversion to an ad valorem tax.	• The new administration had three months to negotiate a new program before the expiration of the January SBA. • Kirchner took an even tougher negotiating stance than his predecessor.	• SDR 226.2 mn (US$320mn released). • Again, some waivers for the non-observance of certain structural criteria had to be granted.	• Argentina missed a payment of US$2.9 billion. • This is the largest payment ever missed to the IMF. • It was a 24 hours default.

3 year SBA approved 2003 - September	¨Dubai Terms¨ disclosed 2003 – September	SBA's first review 2004 – January	Kohler resigns 2004 - March	Argentina on the verge to miss another payment to the Fund 2004 – March
• SDR8.98bn (US$12.55bn or 424% of quota). • Again, a de facto roll-over of Argentina's Obligations to the Fund. • Fiscal conditionality defined as a floor of 3% of GDP primary surplus for 2004. Undefined fiscal targets for 2005 and 2006. As opposed to traditional IMF programs, the fiscal adjustment path was therefore left undefined. • Because the program restrained from specifying a fiscal adjustment path, it provided no guidance as to what the Fund expected the debt exchange to look like. • Few structural conditions including fiscal reform and the modernization of tax administration, establishment of an intergovernmental revenue sharing system, phasing out of distortionary taxes, compensation to banks for asymmetric pesoization. • Hector Torres argues that the weight that the IMF attributed to the negotiation of a new revenue-sharing law with the provinces constituted an obstacle to the approval of such a law, because it provided political weight for the smaller provinces to oppose it, arguing that it was an IMF imposition. • Another point of contention was monetary policy. The Fund argued in favor of a monetary contraction. Instead, Prat-Gay opted for a loosening of monetary policy.	• Coinciding with the IMF/WB meetings in Dubai, the government makes its first restructuring offer to bondholders. • The government was offering 25 cents to the dollar. It did not recognize past due interests. • The offer was received with dismay by bondholders. Because of the non recognition of past due interests, investors valued it as 10 cents to the $.	• This review was delayed as a result of the slow progress with the debt restructuring (bad faith criterion under the LIA policy). Initially, this review was scheduled for December 18. • Various countries abstained from voting in the EB. Some of these countries (Japan, UK, Italy) were members of the G7. • This anticipated the much tougher position that the G7 was about to adopt in the negotiations with Argentina.	• He was always perceived as a hardliner in the negotiations with Argentina. • Rodrigo Rato becomes the new Managing Director.	•The Argentine government threatens with missing a payment of US$3100 mn unless staff recommends the Board to approve the second review. • The G7 is initially opposed to accepting this pressure and Argentina is on the verge of defaulting. • John Taylor intervenes and Argentina does eventually make the payment, as staff commits to recommend the approval of the second review.

SBA's second review 2004 – January	**"Dubai plus" terms disclosed 2004 - May**	**The Fund tells the government that the third review will not be approved 2004 – July**	**Pseudo suspension of the SBA 2004 – August**	**Fiscal Responsibility Law passed 2004 - August**	**Extension of repurchase expectations 2004 – September**
• The key points of contention for the approval of the second review of the SBA were centered on the debt restructuring negotiations. • The Fund asked the Argentine government to accept the Global Committee of Argentine Bondholders as the valid counterpart of the debt negotiations. • It also asked the government to change the Dubai terms. • These demands were drafted in deliberately ambiguous terms.	• New debt restructuring offer. • Investors valued it at close to 25 cents to the dollar. • The government offered three bonds: a par 35 years bond with very low yields; a discount bond with a 66.3 nominal haircut and a higher yield; a quasi par bond designed for pension funds with a 30% nominal haircut, 42 years and low interest rates. • This new offer included past due interests until 31 Dec 2001 and from 31 Dec 03. • The bonds offered by the government were linked to GDP growth.	• The reason was Argentina´s slow progress with structural reform, and especially with the renegotiation of utilities´ prices and with the new fiscal pact with the provinces. • The impression that the government was not acting in good faith in the negotiations with private creditors also played a role.	• The conflict between Argentina and the IMF reaches its apex. • It was not referred to as a suspension as such, although disbursements were discontinued. • In the words of Nielsen: "We also had to stop the leaks coming out of the IMF. In August we decided to continue to make payments to the IMF as they fell due, but would refuse to get involved in program reviews. We had enough of these time-consuming and futile exercises" • Marcelo Bonelli is more objective: his claim is that the Argentine government tried to turn a failure (non-completion of the program) into their decision to interrupt the program, with the excuse of not interfering with the ongoing debt re-negotiations.	• This was an imperfect" substitute to the co-participation which the IMF had asked the government to adopt. • Still, it introduced some additional discipline over provincial finances. •It established limits on the indebtedness of the various levels of the Argentine administration. • It also set GDP growth as a ceiling to primary spending growth.	• It covered an amount of SDR779 mn (US$1.1bn).

New offer to bondholders 2004 - November	The debt exchange is launched 2005 - January	Parliamentary elections 2005 - November	Argentina cancels the SBA 2006 - January
• Bondholders were given 3 options: **1.** A par option: old bonds exchanged at par for a new bond with a 3.2% coupon and 35 years maturity. Choice of currency denomination: CPI indexed pesos, $, yen, € **2.** Discount option: exchange for a new bond at a nominal haircut of 66% with an 8.28 coupon and a 30 years maturity. Choice of currency denomination: CPI indexed pesos, $, yen, € **3.** Quasi-par option: exchange for a consumer price indexed argentine peso denominated bond. It implied a 31% nominal haircut due to pesoization. 3.31% coupon and 42 years maturity. • In addition, a small strip of GDP linked securities was attached to each bond in order to increase payments in case of fast economic growth. • The government tried to discourage holdouts by creating legal obstacles to reopen a restructuring in the future. • All past due interests included in this final offer.	• It was established that it would last until February 25, although it was left open until April 2005. • Participation in the exchange reached 76.15%. • 63% of foreign bondholders • 90% of Argentines living abroad • 98% of residents. • US$62.300 million out of a total of US$ 81.800 million were restructured • New debt issued worth US$35.300 mn • Simplification in the debt structure: from 152 to 11 bond series; from 8 to 4 governing laws; from 6 to 4 currency denom. • Without taking into account holdouts, the debt to GDP ratio fell from 148% in Dec 2002 to 72% in April 2005.	• Kirchner wins with a larger majority. • This is widely believed to have legitimized his government, leading to a change in course in Argentina's policy making.	• This effectively closed the relationship between Argentina and the IMF. In the words of Nielsen: "Better to pay than follow its advice is a sad conclusion for the institutions of world finance but a realistic sacrifice for Argentina." • Argentina repurchased obligations for a total amount of US$9.9 billion

<u>Appendix D</u>

The Uruguayan Financial Crisis: Key Decisions

SBA approved 1996 - March	SBA approved 1997 – March		Uruguay draws from the IMF 1997 - September		SBA approved 1999 - March	First review SBA 1999 - June
• Precautionary arrangement. • SDR 100 million or US$ 148 million •To cover a period of 13 months • Macroeconomic conditionality focused on deficit reduction: budget deficit projected to fall from 1.7% GDP in 1995 to 0.5% GDP in 1996. • Structural measures also contemplated: reform of the pension system; reform of the central gvt aimed at achieving efficiency savings. • Continued de-indexation of the economy. • The Fund's ex-post assessment criticized this SBA for the weakness of its structural conditionality, especially on the management of the banking system.	• Precautionary arrangement. • SDR 125 million or US$ 174 million •21 months • Macroeconomic conditionality: continued fiscal consolidation. Combined public sector deficit projected at 1.7% GDP for 1997 and to 1% GDP for 1998. • Weak structural conditionality focused on the continuation of the pension system reform. • Continuation of the reform of public admin and of the effort to de-index the economy • In the letter of intent for the 1999 SBA the government claims that all the conditions for the program were met.	**Russian** **Default** **1998 August**	•Conditions begin to deteriorate with the Russian default and with problems piling up in Brazil. •Uruguay made a single cumulative draw under the program.	**Brazilian Crisis (massive devaluation of the real)** **1999 January**	• Precautionary arrangement. • SDR 70 million or US$ 95 million • Designed to cope with the Recession: GDP projected to fall by 1% in 99 • Consolidated public sector deficit target: 1.8% GDP in 1999 • A few structural benchmarks considered in the program, but structural conditionality was overall weak.	• The recession worsens, and the gvt predicts GDP to fall by 2% instead of the 1% originally predicted. • The gvt. asked for an increase in the target for the fiscal deficit to 2.1% of GDP. • When approving the review in July, EDs mentioned that Uruguay had slowed the pace of structural reform. • The deficit did eventually reach 4.1% of GDP in 1999.

World Bank approves a Financial Sector Adjustment Loan. 2000 - February	Jorge Batlle becomes President 2000 – March	SBA approved 2000 – May	Government asks for waiver for the nonobservance of fiscal target 2000-December	First review of the SBA completed 2001 - February	Change in the exchange rate regime 2001 - June
• Aimed at supporting a reform of the banking system: (i) to establish a level-playing field between public and private banks; (ii) reduce role of public sector in the financial system; (iii) strengthen banking regulation/supervision. Obviously, this was either too timid or implemented too late. • Some of the measures considered in this reform became structural benchmarks for the Fund's arrangement.	• Colorado party Liberal outlook However, he presided over a hang parliament: it was a coalition government with Partido Nacional. • According to Bension, this weakened the executive's ability to handle the crisis.	• Precautionary program aimed at sheltering Uruguay from the instability in Argentina and Brazil. • 22 months • SDR 150 million (US$197 million) 50% of quota • Macroeconomic conditionality focused on fiscal adjustment. Target: halving the fiscal deficit to 1.8% of GDP. • Stronger structural conditionality including measures to improve transparency and disclosure, increase efficiency in public enterprises and secure a strong and more competitive banking system	• The fiscal deficit and public sector overall debt targets were missed. the consolidated public sector deficit reached 3.7% GDP. However, all the other quantitative targets were met. • This was a result of the fact that the economy did not improve as originally envisioned. As opposed to the projected growth of 2% under the program, GDP contracted by more than 1% in 2000. • The new letter of intent was also based on overtly optimistic Projections: it projected a growth rate of 2% for 2001.	• The government still treating it as precautionary • This review made it possible for Uy to borrow up to SDR74 million if needed. • Fiscal deficit target of 2.6% of GDP in 2001 (from 3.7% in 2000). • Quantitative performance criteria were introduced for end-March and end-June; indicative quantitative targets were established for end-September and end-December.	• As a result of the combined effects of the devaluation of the Brazilian real and of the change in the Argentine X/R regime (which was seen as a devaluation) Uruguay introduced a change in its crawiling peg: 1) the pace of the crawl is accelerated from a monthly 0.6% to a monthly 1.2% (or a yearly 15%) 2) the band was widened from 3% to 6% • Bension mentions that the dollarization of the financial system prevented Uy from adopting more drastic measures at this stage.

Second review of the SBA completed 2001 - October	New change in the exchange rate regime 2002 - January	Scandal unearthed at Banco Comercial 2002 - January	The operations of Banco Galicia suspended 2002 - February	Congress passes a fiscal adjustment law 2002 - February
• Further deterioration of economic activity Outbreak of food and mouth disease. A contraction of 1% now expected for 2001 • The government still treating it as Precautionary. This review made it possible for Uy to borrow up to SDR144 million if needed. • Performance targets met with the exception of the public debt ceiling. • Uy requested a waiver for this PC. Fiscal deficit target for 2001 revised upward to 3.3% GDP. (this 3.3% was actually the quantitative limit under the program) • Some delays with the structural benchmarks	• The band is widened from 6 to 12%. • The pace of the crawl is accelerated from a yearly 15% to a yearly 33%. • This was a direct response to the drop of the convertibility regime in Argentina.	• Vice-president Carlos Rohm is arrested. It was discovered that fraudulent practices had depleted the bank's capital. • This fed a run on Banco Comercial. • The Rohm brohers had three int'l partners: JP Morgan, Credit Suisse and Dresdner Bank. When the scandal is unearthed, these Banks are asked to provide funds to recapitalize Bco Comercial. Their first reaction is not to commit to anything, and quite simply to argue that they are going to leave Uruguay. This gave rise to the beginning of the storm in the financial system, with the banking run intensifying gradually. • The government, however, maintained the negotiations with the international banks, and an agreement was eventually signed	• This was the most exposed bank to the Argentine crisis. It was owned by Banco Galicia, an Argentine bank, and it mostly took deposits from Argentines and lent to Argentines. • As opposed to Banco comercial, the suspension of the operations of Banco Galicia were a direct consequence of what was going on in Argentina. • But the suspension was controversial. The first controversy aroused around the legal status of the bank. It had always been an off-shore institution with deposits from Argentine nationals. However, during the Sanguinetti government it was licensed as a bank, receiving the same legal status and rights as other domestic institutions. Yet, in 2002 the authorities were not willing to provide LOLR assistance because of scarce reserves and becauseit would have been terribly unpopular. This decision contributed to erode Argentine savers confidence in the Uruguayan financial system.	• The first one. Very partial: in less than three months the government would be forced to pass a new one.

Uruguay loses investment grade 2002 - February	**Agreement to recapitalize Banco Comercial 2002 – February**	**Batlle launches talks with the US to sign an FTA 2002 – February**	**Uruguay requests a loan from IADB in support of its financial sector 2002 – February**	**Third and final review of the SBA 2002 – March**
• This downgrade was mostly due to the abandonment of the Covertibility regime in Argentina and to the crisis with Banco comercial.	• This agreement was reached between the Government and the major three international shareholders of Banco Comercial. • The government provided 33mn dollars and the international partners provided 100 million. The conditions in this agreement were quite stringent: 1- the government would manage the bank. 2- they could claim back the 100 mn should the Bank eventually fail. In other words, they did not accept any risk in this operation. 3- the government committed not to initiate legal action with the banks. • This step did eventually fail to avoid the bankruptcy of Banco Comercial. The conditions in the contract turned out to generate a scandal. Minister Bension was its main victim, and would eventually have to resign.	• This was a challenge to Uruguay´s Mercosur allies which, as a custom union, is not compatible with individual countries signing FTAs. However, Batlle felt that Uruguay was being harmed by its neighbors given that the devaluations of the Argentine peso and the Brazilian real had dramatically affected its exports. • Brazil was opposed to these parallel negotiations. In the end, the Uruguay-US FTA would not fructify. Only a BIT was eventually signed.	• They obtain firm commitments from IADB, WB and IMF at the IADB annual meetings in Fortaleza. • Overall, they secured official financial support for an amount of US$1,000 million for 2002.	• Again, the situation continued to deteriorate beyond what was forecasted. By that time the banking crisis was already raging. • The authorities draw the full amount that Uruguay had accumulated under the SBA: SDR 150 million (about US$188 million) • The government requested waivers for the non observance of two PC:the debt ceiling, which was larger than expected as Uy prefinanced its 2002 financing needs and the deficit PC, which was larger than expected as a result of the economic contraction. The consolidated deficit reached 4% of GDP.

New SBA approved 2002 – April	Moody downgrades Uruguay (again) 2002 - May	New fiscal adjustment announced 2002 - May	IMF announces negotiations for an augmentation of the SBA 2002 – May	President Batlle´s famous "gaffe" on Bloomberg TV 2002 - June
• SDR 594.1 million (US$743 mn) 194% of quota. These resources were provided on top of the resources drawn under the previous precautionary SBA. • In 8 instalments of 93 million. It's been often argued that the tranching structure of IMF loans was not appropriate to deal with a banking problem. • The initial SBA failed to stabilize the situation and it had to be augmented twice. • Fiscal consolidation: overall deficit targeted to fall to 2.5% of GDP in 2002. • Structural measures: rationalization of the tax system; reinforcement of the banking system. Requirement not to reopen intervened banks until the restoration of their viability and fulfilment of all prudential norms.	• Fitch followed suit later that month.	• For an amount of approximately US$ 250mn. This announcement was made on a Sunday, with the President almost crying on national TV. • Rather than reassuring markets, it sparked a new mini panic, accelerating the run on banks and the rise in spreads. • US$250 mn was far from the required adjustment. Too low to restore confidence, it simply signaled the gravity of the problems facing Uruguay. • These successive fiscal adjustments have been heavily criticized for relying primarily on tax increases, and not on the contention of public expenditure and a reduction in the size of the large Uruguayan public administration.	• The main cause was a deterioration of the banking crisis: in between April and May there was a 20% reduction of deposits in the Uruguayan financial system.	• His sentence "Los argentinos son una manga de ladrones desde el primero hasta el último" sparks a diplomatic incident with Buenos Aires which would further feed market distress.

First augmentation of the SBA 2002 – June	Uruguay floats the peso 2002 – June	Banco Montevideo and Caja Obrera intervened 2002 - June	The FFSB is created 2002 - June	Aninat calls Batlle to call for drastic action 2002 - July
• SDR 1.16 billion (about close to $1.5 bn) Total amount committed: SDR1.75 bn equivalent to US$2.28bn or 571% quota SDR 386.1 mn made available under SRF. Uy allowed to draw SDR 386.1mn ($508mn) immediately. Resources used to feed the FFSB together with resources committed by IADB and WB (they committed to disburse $500 mn a year in 2002 and 2003)US$2100 mn • Much more emphasis on structural conditionality. Focus on the restructuring of the banking system • The Uruguayan authorities were initially told that the augmentation would only be possible if the government agreed to change its banking crisis resolution strategy: bank holiday, reprogramming of bank deposits, etc…	• This was a response to a Fund´s request. The gvt forced to do that because the stock of F/X reserves reached a low of US$650 million (vs. 3.1 bn in Dec 01) • Various Uruguayan officials consider that this decision was essentially misguided because the CB was not intervening in F/X markets. The problem in Uy was the LOLR assistance of the CB in a dollarized system. • Floating the peso contributed to feed the run on banks, and therefore to deplete the stock of reserves. (Julio de Brun) • The exchange rate depreciates by 27% almost immediately. • Bension also argues that this was a pro-active move to better prepare Uy to cope with a crisis in Brazil, which looked increasingly likely.	• Both banks belonged to Grupo Velox, owned by the Peirano family with operations in Argentina and Paraguay. • The Peiranos were accused of mismanage-ment and fraud and would finish in jail. • Paolillo argues that they did not really mismanage. However, facing a regional run, they began to transfer resources from their different firms, breaking Uruguayan laws. • This further fed the run on banks.	• Aimed at supplementing the decreasing LOLR resources of the CB. • It was a $2.5 bn facility fed mostly by the multilateral resources. • This Fund, however, failed to restore confidence, and by late July it had already provided US$450 mn. • The establishment of this fund was the centrepiece of the strategy submitted by the government in its letter of intent.	• Aninat tells Batlle that the run on deposits is unsustainable. • The Fund was pressing for some sort of Bonex plan: exchange deposits for bonds. • Very rough discussion. • Batlle tells him that he will never follow that path, which was too similar to the Argentine experience.

The Economy Minister resigns 2002 – July	IMF officials threaten to suspend the program 2002 - July	Uruguay and US officials work out an "alternative" plan 2002 – July	Final agreement imposed on the IMF 2002 – July	A new augmentation is announced 2002 – August
• Batlle was very much opposed to his resignation because of the good relationship he had developed with the IMF. The key reason behind • Bension´s resignation was that the Blancos forced a change in the economic team. • The President of the CB Rodriguez Batlle also resigned. • This caused an acceleration of the run on deposits. • Alejandro Atchugarry takes over the Ministry. He was seen as a political profile which could gather the support of the blancos to conduct economic Policy. • Alejandro Atchugarry mentioned that he found a total amount of "usable" foreign exchange reserves of only 100-150 million dollars at the CB.	• The Uruguayan authorities are told that no further IMF resources will be made available unless the government takes the following actions: 1- Freeze deposits 2- Bank holiday 3- Exchange controls 4- Sovereign default	• The situation is deteriorating fast, and Uruguayan officials meet Taylor's team to put pressure on the Fund. • Uruguayans believed that default would further aggravate the run on deposits. They did not want to undermine Uy's reputation as a regional financial centre. • The key to the plan was that enough multilateral resources be provided to fully back dollar checking and savings deposits. US$1.5 bn required for the plan to work • The US was willing to use the exchange stabilization fund until multilateral resources were made available. • The other controversial issue that the Fund´s demand to convert deposits into bonds.	• Three key elements: 1- Creation of the "Fondo de Estabilidad del Sistema Bancario" with enough money to cover all dollar denominated current and sight accounts. 2- reprogramming the time deposits held in the two public banks BROU and BHU 3- Suspension of the activities of the four intervened banks (Montevideo, Comercial, Caja Obrera, Crédito). • A bank holiday is immediately announced. It would only be lifted after the loan with the IMF was agreed, and especially after the US Treasury provided the bridge loan.	• Announcement aimed at eliminating uncertainty regarding the Fund's stance • The stated goal was to facilitate the reopening of the banks. • Further support also announced from WB and IADB, bringing total financial assistance to US$3.8 bn.The Fund also announced the acceleration of a disbursement amounting to US$150 million under the SBA. • In addition, the SRF component of the SBA was cancelled and made available in credit tranches terms. This made the Fund's support cheaper. • Overall, Uruguay obtained a disbursement of US$1500 mn.

Second augmentation of the SBA 2002 – August	Ley de Fortalecimiento del Sistema Bancario 2002 - August	National Party abandons the government´s coalition 2002 - October	Delays in the approval of the second review of the SBA 2002 - October	Uruguayan senior officials travel to Washington 2002 - December
• SDR 376mn ($494mn) Total program: SDR2.13bn ($2.8bn) 695% quota. • In addition, all SRF purchases were cancelled and rephased under SBA terms. • The Fund's ex post evaluation argues that by that te time of this augmentation it was clear that Uruguay's debt was excessive. It was therefore understood that in order for the augmentation to be granted, the debt overhang issue would have to be addressed.	• It established the Fondo de Estabilizacion del Sistema Bancario (FESB) of US$1.4 billion. This was sufficient to back the entire stock of US dollar sight and savings deposits at public and intervened banks. • The US dollar time deposits of the public banks were reprogrammed (for an amount of US$2.2 bn). The terms of the reprogramming included repayment of 25% of principal by the end of the first year, repayment of 35% after two years, and repayment of the remaining 40% in the third year. It carried an interest rate of 6% payable quarterly. • Depositors had the option of converting their deposits into tradable securities. • No restrictions to be applied on foreign banks as long as they relied on their own resources to obtain liquidity support. This essentially required the home banks to take care of their subsidiaries. • The operations of four banks was also suspended in August 2002: Banco commercial, Banco de Montevideo, Banco Caja Obrera, Banco de Credito. • These measures finally managed to put an end to the run on banks.		• This was a hugely controversial moment in the negotiations. • The reason behind postponement was the insufficient progress with the restructuring of the financial system as well as the remaining large residual financing needs for 2003 and for the medium term. • These two concerns were addressed in early 2003 with a more concrete plan to restrucrture the financial system and with the idea of the debt restructuring to cover financing assurances.	• This meeting did not unblock the disburse-ment of the Fund's resources. • Allegedly, the Fund's staff was centered on how to operationalize the default. • The Uy's authorities did not accept this possibility.

New banking law is passed 2002 – December	The Fund announces that a deal has been reached with Uy 2003 - February	Letter of Intent 2003 - February	Government announces comprehensive debt restructuring 2003 - March	Supplementary Letter of Intent 2003 - March
• It established procedures for bank restructuring and liquidation. This was aimed at dealing with the four banks which were intervened in August. • It also re-defined and expand the role of the CB in strengthening the regulatory and supervisory system.		• It would make available an amount of SDR 218.5 million It also requested a rephasing of the remaining repurchases under the program. • No mention to the debt restructuring. • It very vaguely states that Uruguay is "working on the financing assurances for the 2003 program". It seems to assume that this will be possible thanks to the assistance from IFIs. • Request of waiver for the non observance of two performance criteria on the cumulative balance of the combined public sector and the non financial public sector debt. Another waiver for the nonobservance of the performance criterion on exchange restrictions in connection with the reprogramming of time deposits at BHU and BROU.		• In this letter the government adds to the previous one dated Feb 24 that it is going to restructure debt. • The question is whether this delay was due to ongoing negotiations or whether the decision had already been taken and the government simply wanted some time to announce it.

Second review of the SBA approved 2003 - March	**Nuevo Banco Comercial created 2003 - March**	**The debt exchange is launched 2003 - April**	**IMF Managing Director addresses a letter to the financial community 2003 – April**	**The exchange is officially closed 2003 - May**
• SDR 218,5 million made available. The SBA extended by one year. • Repayment expectations under the SRF shifted to an obligation basis. •This delayed the repayment of SDR 128.7 million (178mn) from 2003 to 2004 • Primary surplus targets for 2003, 2004 and 2005: 3.2% of GDP.	• The new bank was created with the assets of all the suspended banks. • This was another requirement of the SBA.	• The government specified upfront that a minimum participation of 90% would be required for the exchange to be completed.	• The letter made clear that the third review of the program was conditional on a successful completion of the debt exchange (it reaching the 90% benchmark). • This was a crucial support for the debt restructuring.	Participation surpassed 92% The total face value of exchanged bonds reached US$ 5 billion.

Third review of the SBA approved 2003 – July	Finance Minister resigns 2003 - July	Article IV published 2003 - August	Uruguay issues debt 2003 - October	Fourth review of the SBA approved 2004 - February
• Allowing a purchase of SDR 145.7 mn (US$204 mn.) • It mentions the fact that the completion of the debt exchange has eliminated residual financing needs. • Primary surplus target of 3% of GDP for 2003, reduced from the originally planned 3.2% as a result of the need to pay the restructuring's commissions. • Uruguay on track with fiscal condition. • However, the IMF criticized delays with the reform of the banking system. In particular, a benchmark was missed with regard to the completion of a strategic plan for the disposal of the remaining bad quality assets of the liquidated banks • Some disagreement about the repayment pace of the reprogrammed time deposits	• Atchugarry is broadly considered to have been an excellent minister.	• Interestingly, the Fund clearly underestimated Uruguay's capacity to return to growth. • It also states at some point that Uruguay's consensus building politics helped it during the crisis. At the same time it states that this consensus building culture may slow down the adoption of important reforms. This claim is especially substantiated by the report's analysis of the banking crisis resolution strategy: "The authorities did very well in claiming ownership on policy initiatives and were very successful in garnering political and social consensus to take action. However, on balance this required too much time in a situation where the need for quick decisions and actions were also of great importance".	• Bond issuance worth US$200 mn. •Oversubscribed • The currency denomination was Uruguayan pesos adjusted by CPI.	• With some delays as a result of disagreements with the banking reform. • Much more optimistic macro outlook. Growth expected at 5% in 2004. Inflation set to fall to 7-9%. Primary surplus of 3.2% projected for 2004. Overall, the recovery was faster than anticipated in the program. • This made SDR93.2 million available (US$141 mn). • In its letter of intent, the govern asked to rephase all remaining repurchases under the agreement for a total amount of SDR559.2 million. Eventually, the Fund agreed to rephase repurchases arising during 2004 for an amount of SDR227mn (US$343mn) • Most quantitative PCs were met and the IMF praised Uy for its effort. • However, uruguay had to ask for three waivers: 1. for the end-december PC on the cumulative primary balance of the combined public sector (2.8% instead of 3%) 2. for the nonfinancial public sector debt 3. structural PC to outsource to third parties the disposal of the assets of liquidated banks in at least two asset groups. In other words, the reform of the banking sector still lagged behind. The restructuring of the public banks clearly took longer than expected (BROU)

Fifth review of the SBA completed 2004 - August	**Tabaré Vázquez wins the elections 2004 – October**	**Sith review of the SBA completed 2004 - November**	**New SBA approved 2005 - June**	**Uruguay begins to accelerate its exit from the Fund's financial support 2006 – July**	**Uruguay anticipates the repayment of all its outstanding obligations 2006 - November**
• Waivers for the nonobservance for two structural performance criteria related with the reform of the banking sector system. • However, the review praises the Uruguayan government for its good compliance with the program.	• First leftist government (Frente Amplio) in the country's history. • The new government did not held drastically different views about the IMF.	• Good compliance with all the program´s conditions.	• Three years • SDR 766.3 mn ($1.13bn, 250% quota) • Mostly aimed at smoothening Uruguay's exit from the Fund's financial support.	• Uruguay advanced obligations due from july 2006 to August 2007 amounting to SDR 619.9 bn (US$916.4 bn)	• The government advances obligations amounting to SDR 726.7mn (close to US$1.08bn)