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Introduction

In the summer of 1985, in the midst of the debt crisis, two newly elected Latin American presidents set out to transform the domestic and international political economy trajectories of their respective countries. Despite the shared economic and political challenges facing Bolivia and Peru as poor, highly indebted new democracies, the two new leaders moved their countries into opposite directions: in Bolivia Victor Paz Estenssoro ended the country’s prolonged economic and political paralysis, and instituted a radical program of orthodox economic reforms, which transformed the country from a regional basket case to an unexpected showcase example of successful neoliberalism and IMF cooperation. Meanwhile, the newly elected Peruvian President, Alan Garcia, reversed his country’s earlier cooperation with the International Monetary Fund (IMF), and initiated a heterodox domestic adjustment program combined with a unilateral reduction of debt payments, which ultimately resulted in Peru’s international economic isolation and a disastrous stagflationary crisis by the end of the decade.

More than a decade later, in the spring of 1997, the newly elected Bulgarian and Romanian governments also set out to redirect their countries’ prior reform trajectories but unlike their Latin American counterparts, their goals were virtually identical: both governments, in close cooperation with the IMF, intended to tackle the economic crises and partial reform legacies of their ex-communist predecessors by instituting ambitious neoliberal reform programs modeled after the shock therapy of Poland in 1990 (and Bolivia in 1985/6). Despite these similar policy intentions of the two governments, and the broadly comparable institutional and structural environments of the two neighboring countries, the policy trajectories of Bulgaria and Romania diverged significantly after late 1997: thus, the Bulgarian government maintained its political cohesion and pursued a consistent neoliberal economic policy course under close IMF
supervision during the following four years, whereas the Romanian reform coalition suffered from continuous infighting, which resulted in much more inconsistent economic reforms and a patchy record of IMF compliance.

These brief snapshots from two of the most significant recent episodes of crisis-driven economic adjustment raise a number of important questions about the politics of IMF programs and neoliberal reforms in the developing world. On one hand, even these brief sketches illustrate the prominent involvement of the IMF in the politics of economic reforms in the last two decades. The dramatic expansion of the Fund's geographic reach and the expansion of IMF conditionality into new policy areas since the 1980s has prompted many observers to view the IMF as a key driver of Western geopolitical interests and economic neoliberalism in the developing world. But if the Fund is really such a powerful reform “bully,” then why do countries such as Romania fail to comply with IMF programs, while others such as Peru from 1985-90 manage to avoid these programs altogether?

At the opposite end of the spectrum other analysts have treated economic reforms as almost exclusively domestic affairs with the Fund playing at most a supportive role of providing political alibis for reformers. Such a view, however, does not adequately explain the uniformity of IMF-supported economic policies in Romania and Bulgaria, and in much of the rest of the developing world. Nor can an exclusive emphasis on domestic economic and political interests account for the steep price paid by Peru for its defiant stance towards IMF conditionality or for the acrimonious nature of many IMF program negotiations. Nonetheless, the great cross-national diversity of reform trajectories and IMF interactions raises important questions about the domestic political drivers of this diversity. Under what constellations of domestic interests and institutions are governments more willing to initiate and more capable to implement IMF-style
reforms? How are the pressures of IMF conditionality filtered through the domestic politics of program countries?

Finally, these snapshots also question the Fund’s own conception of its mission: if the IMF really lives up to its stated goal of providing technocratic policy advice and financial and technical support for troubled developing countries, then why do IMF programs spark such intense domestic political resistance as in pre-1985 Bolivia and post-1985 Peru? Moreover, why does this resistance appear to have been stronger in Latin America than in post-communist Eastern Europe?

This book addresses these questions by analyzing the interplay between IMF conditionality and the domestic politics of developing countries in two prominent recent episodes of large-scale economic adjustment: Latin America during the debt crisis of the 1980s, and Eastern Europe and the former Soviet Union during the post-communist transition of the 1990s. For additional analytical leverage the final part of the book also compares these two episodes to the experience with IMF conditionality of Latin American countries in the 1990s. This explicitly cross-regional and cross-temporal comparative setup facilitates the systematic comparison of political processes across a range of international and domestic contexts. By integrating domestic and international political explanations of IMF programs, this book shows how changes in the international arena interacted affected the process of economic policy making at the national level. Both the theoretical framework and the empirical tests employed in this book emphasize the importance of focusing not only on individual factors and variables but also on the interplay between economic pressures, domestic institutional constraints and the partisan political preferences in driving the politics of economic reforms.
This systematic cross-sectional and cross-regional comparison reveals that the extent to which IMF policy prescriptions can be reconciled with democratic politics in the developing world depends on a large extent on the nature of the broader international economic and political environment, which shapes the agenda of IMF interventions and sets the broad cost-benefit parameters of IMF programs for developing countries. When the international environment offers powerful economic incentives for cooperation – as it did during the global financial boom and the unprecedented international dominance of Western economic and political liberalism in the 1990s – elites and citizens in developing countries become more likely to embrace IMF-style neoliberal reforms. Under such circumstances, IMF programs are compatible with democratic politics and ideologically-based policy disagreements are minimal, particularly in the face of economic crisis. By contrast, the book shows that in periods with weaker and/or contradictory international incentives, such as the debt crisis of the 1980s (and to some extent the post-9/11 era), the politics of IMF programs are more likely to reflect the domestic tensions between the redistributive demands of democracy and the uneven gains of neoliberal economic policies. However, the book also demonstrates that the domestic political dynamics of IMF programs and neoliberal reforms do not simply mirror the changing fortunes of international financial markets and geopolitics. Instead, the extent to which these tensions between IMF policy demands and domestic economic interests affected the politics of IMF programs was mediated to a great extent by the organizational capacity of societal actors (such as business and labor organizations), which helps explain the more confrontational and ideologically charged nature of neoliberal reform politics in Latin America than in post-totalitarian Eastern Europe.

The theoretical framework developed in this book approaches economic reforms as the product of IMF conditionality refracted through the domestic political and institutional
conditions in program countries. By applying this framework to the comparative analysis of IMF programs in Eastern Europe and Latin America, the book reveals a series of significant differences in the political dynamics of IMF programs in the two regions. First, the analysis shows that IMF conditionality varied significantly across the two program episodes, as well as between countries within each region, depending on the economic and geopolitical interests of IMF creditor countries. Thus, during the debt crisis of the 1980s, Western concerns about international financial stability led to intense policy pressures on Latin American governments to curb domestic consumption in order to repay external debt obligations, and large debtors received preferential treatment during IMF program initiation and implementation. The main Western priorities during the post-communist transition were to integrate the East European economies into international markets and to promote market reforms while minimizing their domestic and international political fallout. These priorities were more closely aligned with the interests of mainstream domestic political forces in the region, and resulted in a less confrontational relationship between the IMF and program country governments.

Second, the differences in the international economic and ideological context of IMF interventions had important reverberations on the domestic responses to economic crises. The partisan political preferences of domestic actors mattered differently in the two program clusters: in Latin America governments of different ideological persuasions interpreted the roots of economic crises differently, and, therefore, economic crises promoted IMF-style reforms only for right-leaning governments, who shared the Fund’s crisis diagnosis but not for the Left, which questioned the Fund’s motives and policy advice. By contrast, in Eastern Europe the analysis suggests that ex-communist governments overcame their partisan aversion to market reforms in the face of mounting economic crises. Finally, in terms of domestic institutional constraints to
reforms, the comparison of the two program episodes suggests that democratic politics were at odds with IMF programs during the Latin American debt crisis but actually supported economic reform efforts in Eastern Europe. Meanwhile, IMF programs in transition countries were affected to a much greater extent by weak bureaucratic institutions than was the case in Latin America.

The different program dynamics revealed by the comparison of the Latin American debt crisis and the post-communist transition show that the politics of IMF programs can only be properly understood if we take into account the changing nature of the international context and the structural and institutional differences across different regions. The final part of the book, which extends the analysis to Latin America in the 1990s, suggests that both cross-temporal and cross-regional differences matter for the political economy of IMF programs. Thus, the policy convergence among governments from different parts of the ideological spectrum and the less adversarial relationship between the Fund and Latin American governments in the 1990s emphasize the importance of the much more favorable international economic environment, which created strong financial incentives for developing countries to follow the broad prescriptions of the Washington consensus. On the other hand, even in the 1990s, democratic politics in Latin America were still less conducive to IMF-style economic reforms than in Eastern Europe, which, combined with the lower prominence of bureaucratic capacity constraints, suggests that the different social and institutional fabrics of the two regions nonetheless continued to matter even after the end of the Cold War and the resolution of the debt crisis. Overall, these findings suggest that rather than looking for a single explanation for the Fund’s involvement in the developing world or for a magic formula for successful IMF programs, scholars and policy practitioners would be better advised to focus on the complicated
and context-dependent interaction of economic pressures, partisan politics, and domestic structural and institutional constraints.

**Book approach and contributions**

Since IMF programs unfold at the intersection of domestic and international political economy, academic efforts to analyze them have spanned several different disciplines and sub-disciplines. As a consequence, the present analysis addresses several different bodies of literature, which are concerned with various aspects of the Fund’s involvement in the developing world: the largely econometric literature in the effects of IMF programs, the international political economy literature on the role of the IMF in international financial markets, and the comparative political economy literature on the domestic politics of economic reforms in developing countries. In doing so, the book contributes to each of these largely separate bodies of literature, and it will hopefully help bridge the artificial divide between the different approaches by providing a broader framework for understanding the economic and political drivers of IMF programs at both the domestic and the international level.

**Econometric assessments of IMF program effects**

The group of studies most directly concerned with IMF programs has grown out of policy concerns about the economic, political, and social repercussions of IMF programs, and has focused primarily on econometric assessments of these program effects. Despite the steadily growing number of such studies, the evidence from the various large-N analyses has so far been largely inconclusive and contradictory. The only relatively robust finding of this literature is that IMF programs are generally effective in terms of one of their primary tasks: improving the
overall balance of payments position of program countries. However, with respect to other significant repercussions, such as program effects on inflation, economic growth, savings rates and income inequality, findings have generally been contradictory or inconclusive. While many of these studies suffer from a series of widely acknowledged methodological difficulties, this book addresses three fundamental and insufficiently appreciated shortcomings of this literature. First, as Stone (1999:4) aptly puts it, most of these studies “relegate the discipline of political science to the error term.” Since IMF programs do not occur in a vacuum, however, both the role and the effects of IMF programs depend on the interaction between Fund conditionality and country-specific political/institutional constellations, and as such the emphasis of this book on the domestic and international politics of IMF programs should contribute to a better understanding of program effects.

Second, compliance with IMF conditionality has been consistently low, and even though this has been widely acknowledged, the large-N “IMF effects” literature has largely ignored the different degrees of compliance with IMF programs. But ignoring the politics of program initiation and compliance is the logical equivalent of trying to assess the effectiveness of a drug (in this case IMF conditionality), without asking whether or not the patient took the prescribed drug, and what his/her reasons were for taking or not taking it. The present book addresses this

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1 See for example Gylafson (1987), Khan (1990), Pastor (1987), and Killick (1995). For some other studies, however, these improvements failed to reach statistical significance (Edwards 1989, Goldstein & Montiel 1986.)

2 Thus, Stone (1999) and Donovan (1982) found statistically significant improvements in the inflation records of program countries, but most other studies were inconclusive (Khan 1990, Killick 1995, Gylafson 1987 etc.), and Pastor (1987) actually detected a statistically significant increase of inflation for Latin American IMF programs.


4 See for example Heller et al. (1988) and Loxley (1984), though more recent work by Vreeland (2003) finds that IMF programs result in higher inequality.

5 See for example Przeworski and Vreeland (2000) for an up-to-date discussion of these methodological quandaries.

6 Less than half of Latin American programs in the 1980s were fully implemented and the former communist countries in the 1990s fared no better.

significant gap in the literature\textsuperscript{8} by analyzing economic and political drivers of different compliance levels in Latin American and East European IMF programs. Understanding the political roots of IMF program compliance has important policy implications because it can help with the design of politically feasible IMF programs. Political feasibility and program completion are particularly important since, as Joel Hellman (1998) has argued in the case of transition economies, doing half the reforms does not necessarily yield half the benefits, but may actually produce worse results than avoiding reforms altogether.

Finally, the explicit cross-temporal and cross-regional comparative analytical approach of this book questions the implicit assumption of much of the IMF-effects literature that IMF programs can be considered uniform treatments across space and time. Returning to the earlier medical analogy, the study shows that the nature of the treatment has changed over time (as IMF conditionality has evolved in response to the changing international economic and political environment), and that even similar treatments can provoke very different results depending on patient-level characteristics (such as domestic economic and political conditions at the outset of a program.) Therefore, the present analysis calls for more fine-tuned assessments of IMF programs, which balance the demand for generalizable assessments of the dynamics and implications of IMF conditionality with the need to account for the specific domestic and international context in which programs unfold.

\textit{International political economy of IMF programs}

This book also contributes to the international political economy debates about the broader role of the Fund in international financial markets in the context of globalization. One

\textsuperscript{8} More recently, a few studies have started to pay closer attention to compliance patterns (Edwards 2001, Ivanova et al 2003) but the political dynamics of compliance are still significantly under-studied.
important debate concerns the trade-off between uniformity and flexibility in the design and enforcement of conditionality. Due to the ideal of technocratic impartiality, IMF conditionality has traditionally stressed uniformity of treatment at the expense of flexibility (Buira 1983, David 1985), thus leading to criticisms of a cookie-cutter approach based on outdated economic principles (Edwards 1989, Stiglitz 2000). Others have criticized the IMF for applying different strictness standards to different countries as a function of the political priorities of large Western donors, a practice which undermines the credibility and effectiveness of IMF conditionality (Stone 2002). Based on its analysis of the Fund’s track record in Latin America and Eastern Europe, this book suggests that in response to the criticisms raised by its handling of the debt crisis in the 1980s, the Fund placed a greater emphasis on domestic program ownership in the 1990s, which contributed to a less adversarial relationship between the Fund and program countries. On the other hand, in both decades the Fund’s approach to conditionality has been simultaneously too flexible (towards countries that benefited from politically motivated preferential treatment) and too rigid (towards most other countries.) This inconsistency arguably undermined not only the effectiveness of IMF conditionality in the politically privileged countries but also hurt its legitimacy and political feasibility in other countries of the two regions.

Another unresolved debate has focused on the appropriate balance between funding and conditionality in IMF interventions. Opinions have ranged from proposals to establish the Fund as an international rating agency without lending capabilities (Minton-Beddoes 1995) to calls for a more active IMF role in both providing its own funds and mobilizing outside credits to program countries (Sachs 1994). In this respect the findings of the present book suggest that while direct IMF funding played an important role in promoting reforms in certain individual

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countries (e.g. Moldova) there is weak statistical evidence that under the current institutional constraints more generous IMF loans have a tangible catalytic effect on program implementation.

Finally, depending on the vantage point of the observer, IMF conditionality has been criticized as being too soft,\textsuperscript{10} too harsh,\textsuperscript{11} or alternatively completely ineffective.\textsuperscript{12} While steering clear of such broad assessments, the analysis in this book provides a number of insights into this difficult question. First, the economic and political costs of compliance varied significantly over time, and were likely to be exacerbated in unfavorable international economic environments, such as the early years of the debt crisis in Latin America. In other words, when international financial stability is at stake, the Fund appears to be less concerned with the domestic repercussions of the required adjustment policies. Second, several of the cases discussed in this book suggest that there are important tradeoffs between the stringency of short-term IMF conditionality and the long-term feasibility of reforms: where IMF programs exacted steep economic or political costs from developing countries, governments were more likely to abandon reform efforts (e.g. in Bolivia in 1982-5 and Slovakia in 1993-5) or else to be punished by the electorate and be replaced by less reformist governments. Finally, the effectiveness of IMF conditionality depended to a large extent on the domestic political constellation in the program country, a finding that emphasizes the importance of incorporating country-level characteristics into the assessment and design of IMF programs.

Comparative political economy of economic reforms

Despite the prominent involvement of the IMF as a supporter, arbiter, and instigator of

neoliberal economic reforms, IMF programs have played a relatively marginal role in
comparative politics accounts of the drivers of these reforms.\textsuperscript{13} Therefore, one of the tasks of the
present analysis is to “bring IMF programs back in” to the comparative political economy
literature by identifying the extent and the limits of the Fund’s influence on neoliberal policy
reforms in Latin America and Eastern Europe. In this respect the case studies analyzed in this
book present a mixed picture: on one hand, the IMF played a crucial role in designing and
promoting the neoliberal reform efforts of successive governments in Moldova, Bulgaria, and
Romania in the early to mid-1990s, and it certainly affected (though perhaps less decisively) the
economic policies of Chile and Peru in the early 1980s, as well as Argentina and Bolivia in the
later years of the debt crisis. On the other hand, the Fund was less effective in curbing heterodox
experiments such as Argentina’s Plan Austral, or the populist policy “rebellions” of the Garcia
government in Peru or the Meciar government in Slovakia.

Besides its contribution to our understanding of the domestic political dynamics of IMF
program initiation and implementation, the analysis presented in this book engages several
theoretical questions at the core of the extensive academic literature on the politics of economic
reforms. For example, the findings in this book confirm earlier arguments that deeper initial
economic crises facilitate the initiation and implementation of market-oriented reforms.\textsuperscript{14}
However, such explanations have a hard time accounting for the failure of many countries to
implement reforms despite experiencing long periods of severe economic crisis (e.g. Bolivia in
1982-5, Peru in 1987-9). The statistical and case evidence presented in this book provides an
answer to this puzzle, by showing that crisis-driven reforms hinge on the government's

\textsuperscript{13} Moreover, even to the extent that IMF programs were explicitly considered, their importance has tended to be
downplayed, as in Remmer's (1998) analysis, which found that IMF conditionality was counter-productive in
initiating durable economic reforms.

\textsuperscript{14} See for example Remmer (1998), Rodrik (1994).
willingness and ability to take advantage of a crisis to create a durable political coalition in favor of economic reforms. Moreover, the political constellations conducive to such reform efforts differed across space and time: thus, in Latin America in the 1980s, crises triggered reform efforts only for right-leaning governments, whereas in Eastern Europe ideological differences were irrelevant in high-crisis situations but success depended to a greater extent on the bureaucratic capacity of the state.

The present analysis also enters the broader debate about the importance of partisan differences on economic policy making. Even though the question about the role of globalization in reducing domestic partisan differentiation has attracted a fair amount of scholarly attention, most of these works have focused on advanced industrial countries\(^\text{15}\) and their findings about the temporal dynamics of partisan differences have been contradictory.\(^\text{16}\) Judging by the partisan dynamics of IMF programs in Latin America and Eastern Europe, partisan differentiation in the developing world followed a somewhat different temporal trajectory: thus, following the ideologically polarized reaction of Latin American countries to the IMF interventions of the 1980s, the effects of partisanship played a marginal role in both Latin America and Eastern Europe in the more consensual 1990s but recent developments suggest an interesting reversal of this trend in Latin America (but not in Eastern Europe). Moreover, the analysis reveals an interesting variation in the strength of partisan differences at different crisis levels: thus, during the debt crisis, partisan differences in Latin America increased substantially in serious crisis situations, whereas in the 1990s partisan differentiation was a “luxury” that East European and


\(^{16}\) Thus, Pierson (2001) and Huber and Stephens (2001) find that the effect of government partisanship has declined since the 1970s with respect to social policy outcomes, whereas Kwon and Pontusson (2005) show that partisan effects increased from the 1970s to the mid-1990s but then declined dramatically afterwards.
Latin American politicians abandoned in times of crisis.

The book also addresses a series of related debates concerned with the relationship between democratic politics and neoliberal economic reforms. Much of the work drawing on the experience of the 1980s noted that authoritarian regimes had generally been more successful in implementing reforms,\textsuperscript{17} while others questioned the ability of democracies to overcome the popular resistance toward the high short-term costs of economic reforms.\textsuperscript{18} On the other hand, several studies of the post-communist transition have emphasized the positive correlation and reinforcing nature of political and economic reforms in the former communist countries.\textsuperscript{19} The present analysis confirms that democracy was hard to reconcile with IMF-style reforms during the Latin American debt crisis but was no longer an obstacle in Latin America in the 1990s and even improved the program implementation prospects in East European countries. These different reform implications of democratic politics can be traced to differences in how economic crises were perceived by both elites and citizens: thus, the book shows that in Latin America the roots of the debt crisis were widely perceived as being of an external nature, which resulted in a lower willingness to bear the economic costs of adjustment policies, and therefore made it much more difficult for governments to implement reforms in a democratic context. Meanwhile, in Eastern Europe the domestic roots of the economic crises were much less disputed, and, therefore, voters were more likely to support or at least tolerate neoliberal reforms despite their considerable short-term costs.

The comparative analysis of Latin American and East European IMF programs also addresses several other aspects of the relationship between democratic politics and economic

\textsuperscript{17} See Kaufman and Stallings (1989), Sheahan (1987). On the other hand Remmer's (1996) analysis of Latin America has argued that authoritarian regimes had no advantage over their democratic counterparts in terms of either political stability or economic performance.
\textsuperscript{18} Przeworski (1991).
\textsuperscript{19} Fish (1998), Bunce (1999) but see Kurtz and Barnes (2002).
reforms. For example, the analysis of the Bolivian reform trajectory in the 1980s confirms earlier arguments about the importance of the concentration of authority in the state leadership and the insulation of the executive branch from societal interests as a key factor in ensuring the success of neo-liberal reforms.\(^{20}\) However, the book also shows that in the East European context, where interest groups were generally much weaker than in Latin America, executive insulation was less advantageous for reforms and could even backfire.\(^{21}\) Important cross-regional differences also emerged with respect to political fragmentation, which Haggard and Kaufman (1995: 370) identified as one of the most serious obstacles to successful economic reforms. Thus, in Latin America during the debt crisis, fragmented governments had a much harder time implementing IMF reforms, whereas in Eastern Europe fragmentation only undermined reform efforts of non-communist governments, but actually promoted reform implementation among former communists and nationalists.

In addition to its contribution to the different ongoing debates discussed in this brief review, this book is an attempt to bridge the current gap between the international political economy literature and works focusing primarily on the comparative politics of economic reforms, a theoretical task whose relevance increases as the distinction between domestic and international political economy becomes progressively blurrier in the context of globalization. Since IMF programs are located at the nexus of domestic and international interests, the subject of this book lends itself to the creation a unitary framework for studying the interaction of internal and external political and economic factors in driving the dynamics of economic reforms more broadly in the developing world.

\(^{21}\) This point is illustrated by the greater success of the more inclusive governing approach the Kostov government in Bulgaria, compared to the top-down strategy of successive Romanian governments after 1997.
The Analytical Framework

The analytical framework used in this book, and developed in more detail in Chapter 2, is based on the conceptualization of IMF programs as the interaction between the IMF and developing country governments in the context of a number of economic and political constraints at both the domestic and the international level. Even though IMF programs are negotiated by two primary actors – representatives of the IMF staff and the program country government - the actual dynamics of Fund programs are decisively shaped by the complex web of political and economic constraints under which the two main actors function. Therefore, to explain the trajectories of IMF programs in the developing world, we must consider a series of analytical steps. First, we have to understand how the nature of IMF conditionality towards a given country at a given point in time is shaped by the competing imperatives of the Fund’s multiple agendas. These include ensuring international financial stability, imposing prudent economic policies in program countries, and (occasionally) helping large donor countries pursue their broader economic and geopolitical interests. This broad international policy environment, combined with the country's financial need and domestic economic imbalances, establish the broad parameters of what the government needs to do to address the demands of the country's economic situation in the context of an IMF program. Next, we have to determine how the partisan interests of the parties and politicians in power affect their interpretation of the country’s economic situation and, therefore, shape what the government would like to do in the absence of domestic constraints. Finally, we need to consider how governments are constrained domestically in what they can do to resolve economic crises. The severity of these constraints depends on the government’s ability to overcome potential political resistance from reform opponents, as well as on the capacity and willingness of the state apparatus to implement the policies desired by the
government.

**Choice of regions**

To allow for a systematic comparative analysis of the changing political dynamics economic reforms, this book departs from most statistical analyses of IMF programs, which use samples spanning a broad range of countries and time periods,²² and instead analyzes two temporally and geographically bounded country clusters: Latin America during the debt crisis of the 1980s and the transition economies of Eastern Europe and the former Soviet Union in the 1990s. The final chapter of the book places these two reform episodes into additional comparative perspective by discussing the broad political dynamics of Latin American IMF programs in the 1990s.

While Eastern Europe and Latin America have been fruitfully compared before in the political economy literature,²³ the choice of the Latin American debt crisis and the post-communist transition as the two main sets of cases for the present analysis was based on several theoretical criteria. First, the two clusters represent the two most extensive episodes of IMF interventions in recent history, which not only signals the prominence of the two crises on the agenda of the Fund and its largest Western shareholders but also has the advantage of offering a broad range of reform trajectories within each region. Second, the two regions displayed a broad and roughly comparable spectrum of political institutions and socio-economic development levels, which made them more comparable to each other than each of them would have been to

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Africa, for example.\textsuperscript{24} Third, the Latin American debt crisis and the post-communist transition capture critical junctures in the economic and political development of the two regions in that they involved a massive and costly economic reform push in the delicate political context of democratic transitions.

At the same time, however, the two crises differed significantly along a number of important dimensions, which shaped the political dynamics of IMF programs and of neoliberal economic reforms more broadly.\textsuperscript{25} As the following section will show in more detail, the changes in international financial markets and Western political priorities since the 1980s contributed to important shifts in the agenda of IMF interventions in the developing world. These changes in the international environment, combined with the different roots and nature of the domestic economic crises in the two regions, contributed to different domestic political reactions to neoliberal reform initiatives. Finally, the two regions also differed with respect to their domestic political and institutional landscape, including political parties and state institutions, which contributed to noticeable differences in the dynamics of reform initiation and implementation. In view of these changes, I argue that the systematic comparative analysis of the two episodes, along with the comparison to Latin America’s subsequent reform trajectory in the 1990s, creates a more nuanced and comprehensive picture of the politics of crisis-driven reforms in developing countries than the traditional approach of treating IMF programs as uniform treatments across time and space.

\textit{The two crises in comparative perspective}

\textsuperscript{24} The East Asian crisis was another plausible candidate for comparison but it had the disadvantage of involving a much shorter time period and a significantly smaller number of countries than the Latin American debt crisis and the post-communist transition.

\textsuperscript{25} For a more detailed theoretical discussion about the tradeoffs entailed in comparing East and South, see Bunce (1998).
This section provides a broad overview of the key parameters affecting the dynamics of IMF program initiation and implementation during the two main episodes of IMF interventions discussed in this book. The discussion focuses on three broad categories of factors: (1) the international economic and geopolitical environment and its effect on IMF conditionality; (2) the nature and depth of the economic crises experienced by the two regions; and (3) the domestic political and institutional environment in which these crises unfolded.

**IMF conditionality in a changing international environment**

Since 1982 the world has undergone a number of fundamental economic and political transformations, which have affected the mission and the nature of IMF conditionality. While a detailed discussion of these changes is beyond the scope of this section, it is nevertheless important to place the analysis of IMF programs in the broader context of globalization and the end of the Cold War.

Over the last two decades we have witnessed a rapid rise in international trade, capital movements and commercial lending, as well as important qualitative changes in the composition of transnational investments. The 1980s essentially marked the end of the era of bank finance, while the 1990s emerged as the “era of equity finance,” in which portfolio investments (bonds and equity) and foreign direct investment (FDI) gradually started to displace commercial bank lending, particularly in Latin America and Asia (Eichengreen and Fishlow 1996). The magnitude of these changes has been remarkable: net FDI flows to the developing world increased from $35.7bn in 1991 to $185.4bn in 1999. Net bond financing jumped from $10.9bn in 1991 to

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26 Following the traumatic experience of the debt crisis, most commercial banks significantly reduced their exposure to developing country debts.
$62.5bn in 1996, before declining to $30.3bn in 2000. Net equity flows went from $7.6bn in 1991 to $47.9bn in 2000, despite a temporary decline following the East Asian crisis.\(^{27}\)

The rising volume and changing nature of international capital flows has affected the Fund's ability to regulate and control international financial markets. During the debt crisis of the 1980s the IMF played a pivotal role as an intermediary between creditors and debtors and extracted significant concessions not only from debtor countries but also from Western commercial banks by threatening to withhold funding unless the banks agreed to a substantial debt rescheduling. By contrast, in the 1990s the rising volume and complexity of international capital flows, amplified at least in part by the Fund’s active promotion of financial deregulation, led to a marked reduction of the Fund's ability to control and regulate international financial markets.\(^{28}\) While the reduced IMF leverage over an increasingly diverse group of international lenders arguably reduced the attractiveness of IMF programs in the 1990s - and even prompted critics to call for closing down the Fund – two other aspects of the international economic and political environment mitigated and possibly reversed these effects. First, the high mobility of capital flows in the 1990s arguably raised the importance of the Fund’s seal of approval, particularly for countries with limited or mixed track records in international financial markets. Second, the end of the Cold War triggered an increase in merit-based bilateral and multilateral aid to developing countries, and the IMF’s role as a gatekeeper for much of this funding gave it significant leverage over poor, aid-dependent countries.

The economic and political priorities of the advanced industrial countries were also quite different both from each other and from previous interventions during the two episodes. Given the high potential impact of the debt crisis and the post-communist transition on crucial Western

\(^{27}\) Data from *World Bank* (2001:36).
\(^{28}\) This loss of control was particularly visible in the Fund’s widely criticized handling of the East Asian financial crisis of 1997.
economic and political interests, and the West's control of the majority of IMF voting rights, the IMF interventions in the two program clusters differed from the narrow traditional balance-of-payments approach used in earlier periods. Due to the high degree of exposure of many leading Western commercial banks the prospect of a massive default on Latin American debt was seen as a serious threat to the stability of the financial systems of the main creditors (Eichengreen and Fishlow 1996: 2-3). Therefore, Western governments and banks explicitly conditioned the much-needed debt rescheduling on the adoption of strict IMF-led adjustment programs, meant to ensure the continuation of debt servicing by Latin American debtors. Given the primacy of economic concerns in the Western agenda for Latin America during the debt crisis, IMF conditionality showed little concern for domestic social and political consequences and the resulting austerity measures left little room for “adjustment with a human face” (IADB 1990:3).

Following the collapse of Communism, Western interests in the former Soviet bloc were arguably as much geo-political and ideological as economic in nature. While the marketization and international integration of the former communist countries undoubtedly coincided with the economic interests of influential Western businesses, the double transition from one-party dominated command economies to liberal capitalist democracies had important geo-political and ideological repercussions for the shape of the post-Cold War “new world order.” As a consequence, the Fund’s role in the region differed significantly from the debt repayment focus of Latin American interventions in the 1980s. The first consequence was that the Fund adopted a more politically sensitive approach to IMF conditionality. While this change came at least partly in reaction to harsh criticisms for the Fund’s handling of the debt crisis, it was reinforced by the

29 While some observers have argued that the prosperity of a few international banks was erroneously equated with the stability of the international financial system (Diaz Alejandro 1985:25), the massive political effort starting with the IMF-led debt renegotiations up to the 1989 Brady Plan indicated the depth of the Western commitment to control the international fallout from the crisis.
broader geopolitical agenda of the West for post-communist Eastern Europe, which was shaped by several key considerations: (1) security concerns related to the existence of nuclear arsenals in the former Soviet republics as well as the political tensions related to the Yugoslav crises (particularly Bosnia and Kosovo); (2) the geographical proximity between Eastern and Western Europe (and in particular Germany) raised the stakes of complete economic collapse in the former Soviet bloc; and (3) the lingering memories of the Cold War ideological rivalry between East and West, which may have contributed to the temptation to export the full “package” of Western political and economic liberalism to the ex-communist countries, rather than the traditional emphasis on economic liberalism.

IMF conditionality in the 1990s also changed along a different dimension compared to earlier decades. While the Fund’s approach to the debt crisis had been criticized for failing to respond to evolving financial markets and economic theory advances, in the late 1980s the Fund started to expand its mission beyond the traditional narrow balance-of-payments focus to promote of a more comprehensive economic reform agenda for the developing world. This focus shift in the Fund's agenda during the late 1980s and early 1990s is illustrated by the chart below, indicating the average number of structural benchmark conditions in IMF programs from 1987-1999. Thus, particularly during the early and mid-1990s, there was a veritable explosion of structural conditions in IMF programs, which increased eight-fold between 1987 and 1997 before starting to decline again in 1998 and 1999.

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30 According to this logic political turmoil in Eastern Europe (as proven by the Yugoslav crisis) can easily translate into waves of refugees into Western Europe in addition to the costs of military intervention to avoid a spread of the conflict.

31 See, for example, Edwards’ (1989) sharp critique of the IMF financial programming model.
The nature of IMF conditionality differed not only temporally but also regionally. Thus, according to a recent IMF study (IMF 2001), the number of structural conditions in Fund programs involving the former communist countries during the 1990s was consistently and significantly higher than for other regions in the same time period (with the exception of the East Asian programs of 1997 and 1998). On average, transition economies had almost twice as many structural benchmarks in their IMF programs than other countries. This trend was particularly visible starting in 1995, when the average number of structural conditions in IMF programs involving former communist countries jumped to fifteen from about eight in the preceding year and stayed at or above that level for the rest of the decade, whereas in other countries the average number of such benchmarks oscillated between five and ten. Moreover, whereas in the 1980s structural conditions emphasized exchange rate and fiscal measures (primarily spending cuts), the IMF programs in the transition economies during the 1990s were primarily concerned with tax reforms, privatization and financial sector reforms, which accounted for more than half the structural conditions during this period (Mercer-Blackman and Unigovskaya 2000:9).
Part of this greater emphasis on structural reforms in IMF conditionality can be traced to the broader economic and geopolitical changes discussed earlier. Thus, the shift in international financial markets towards portfolio investment and foreign direct investment placed a greater premium on enacting a broader range of pro-market economic policies (especially privatization and deregulation) than had been required by the relatively indiscriminate bank lending of the 1970s. Moreover, particularly in the post-communist countries, a rapid dismantling of the large state sector was widely regarded as the best guarantee against a resurgence of political challenges to the liberal world order of the post-Cold War era. However, this transformation was also driven by the theoretical and ideological convictions of the IMF staff, which reflected the ideological ascendancy of neoliberalism in academic and policy circles starting in the 1980s. As Kahler (1989) points out, the traditional dominance of neo-classical prescriptions in stabilization matters was complemented by the gradual intellectual strengthening of its structural policy prescriptions starting in the 1970s, which, however, only gradually started to be applied in practice in the 1980s following the collapse of the import-substitution (ISI) models.  

While the nature of the adjustment tasks of the 1990s (particularly in the transition countries) may have required complementing monetary and fiscal policy measures with comprehensive structural reforms, this expansion occurred in an area outside the Fund's traditional area of expertise with managing balance of payments crises. While the IMF has since announced an initiative to streamline conditionality by restricting the number of conditions and maintaining only crucial structural benchmarks, there is little doubt that the nature of IMF programs in the 1990s was profoundly

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32 In Eastern Europe, these ideological undertones became particularly clear during the heated debates between neoliberals and market socialists about the appropriate trajectory of the post-communist economic reforms (Greskovits 1998:29-34).

33 Given that structural reforms had traditionally been primarily the World Bank's preoccupation, the IMF's expanded reach during the 1990s may explain the increasingly frequent and open tensions between the two Bretton Woods sister institutions.
influenced by the prominence of structural conditions in IMF conditionality.

**The nature of the adjustment challenge**

The crises experienced by the two regions during the massive episodes of IMF intervention differed significantly in both their depth and their nature. In terms of their external position, Latin American countries were much more vulnerable at the outset of the crisis in 1982. The crises experienced by the two regions differed significantly in both their depth and their nature. In terms of their external position, Latin American countries were much more vulnerable at the outset of the crisis in 1982. The crisis followed more than a decade of massive lending of recycled oil-money by Western commercial banks to Latin America and other developing countries. The wide availability of low-conditionality loans had enabled the Latin American countries to finance their massive fiscal deficits and continue to keep up with the soaring interest payments charged by the commercial banks. However, starting in 1979 the recession affecting advanced countries, the rise of interest rates, the lower lending willingness of commercial banks, and the deteriorating terms of trade combined to undermine the ability of Latin American governments to continue with their debt-financed expansionary policies (Eichengreen & Fishlow 1996:22). Thus, beginning in 1980 much of Latin American borrowing was channeled into maintaining external liquidity (IADB 1990) until 1982, when the net inflow of international loans was insufficient to cover the spiraling interest payments and resulted in the insolvency of the most indebted nations (Brovedani 1985:24-25).

By comparison, most of the former communist countries had relatively low debt burdens at the outset of transition. Thus, whereas by 1982 debt servicing accounted for more than 46% of the Latin America's export earnings (and then declined gradually to around 30% by the end of the decade), for the transition economies the corresponding figures fluctuated between 10% and
18% during the 1990s. Similarly, interest payments for the transition economies amounted to less than 1% of GNP before 1994 (and did not exceed 2% at any point during the 1990s), whereas in Latin America interest payments absorbed on average 4.5% of GNP between 1982-89. In Eastern Europe (with the notable exceptions of Poland, Hungary and Bulgaria), the main problem following the collapse of Communism was not too much debt, which accounted for only 13% of GNP in 1990, but the extremely low international reserves and very limited access to capital markets.

Despite the severity of the Latin American debt crisis, the initial assessment of the crisis was that the underlying adjustment task was to deal with the spiraling external payments but did not require a fundamental revision of the region's developmental strategy (Jorge 1985:11). Therefore, it is not surprising that large segments of the populace in Latin America were receptive to politicians who blamed the high adjustment costs on the foreign imposition of IMF conditionality, thereby creating a tense and ideologically charged political environment surrounding IMF programs. Meanwhile, at the outset of the post-communist transition, it was much less credible to blame the region’s economic woes on the West. Even though neoliberal reforms were not necessarily embraced enthusiastically by post-communist elites and citizens, the reform agenda promoted by the IMF nevertheless played (or had the potential to play) a much more constructive role in promoting the post-communist transition process by providing the expertise and mobilizing the external funding necessary for a smoother international reintegration. Therefore, we would expect to see fewer political tensions in connection with IMF programs in the post-communist context.

While East Europeans may have had fewer reasons than Latin Americans to distrust the Fund’s economic policy advice, their economies and societies suffered much greater disruptions

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34 All of the statistical data in this section is based on the 2001 CD-ROM version of Global Development Finance.
particularly in the early part of the transition. Even though the 1980s were rightfully called “the lost decade” in Latin America, the magnitude of the output loss was much larger in Eastern Europe, where it exceeded 50% of pre-1989 output in many transition countries. Since this economic shock was compounded by the underdeveloped framework of market institutions, ex-communist countries had a significant disadvantage compared to their Latin American counterparts, which could at least depend upon the basic legal and institutional framework necessary for the functioning of a market economy. Therefore, even to the extent that IMF programs emphasized similar policy measures, the economic response to these measures were bound to differ between the two regions, as well as between countries of the same region.35

Political and social actors

Finally, we need to analyze the domestic social and political constellations of the two regions, and their likely implications for the politics of IMF programs. While program initiation may frequently be an elite initiative, the implementation process inevitably involves a broader set of social and political actors. At first sight, the two regions are fairly similar in terms of regime type patterns, in that both span a wide spectrum ranging from liberal democracies to semi-authoritarian and authoritarian regimes. Moreover, a significant number of countries in both regions had to tackle the painful and unpopular economic reforms in the volatile political context of democratic transitions, thereby facing similar tradeoffs between the political and economic objectives of the new democratic regimes.

Nevertheless, even a cursory overview of the two regions reveals a number of crucial

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35For example, tightening domestic credit is likely to have the expected anti-inflationary effect only if state firms face hard budget constraints and banks have the expertise necessary for selective credit allocation. If these conditions are not fulfilled, the measure is likely to "choke" both sick and healthy companies, thereby creating not only unnecessarily deep recessions but also limiting the effectiveness of anti-inflationary policies.
differences in terms of their political and social fabric. At the most basic level, it may be worth remembering that of the 28 former communist countries in Eurasia, only six - Albania, Bulgaria, Hungary, Mongolia, Poland and Romania - existed in their current geographic form in 1989. Therefore, particularly in the early part of the decade, the overarching tasks of nation- and state-building complicated the pursuit of economic reforms in many transition economies. Even abstracting from the often disruptive and violent nature of this process in Yugoslavia and the former Soviet Union, the need to create entire state apparatuses from scratch proved to be a formidable challenge for many of the former communist countries.

In addition to the existence of basic state institutions, the successful conduct of economic policy requires a set of reasonably stable and coherent political organizations representing the interests of relevant social actors. In this respect, too, most Latin American countries had a superior starting point compared to their Eastern European and former Soviet counterparts. While Latin America can hardly be considered the textbook case of consolidated and institutionalized democracy, the spells of authoritarian rule prior to the third wave of democratization were shorter and less totalitarian in Latin America than the communist regimes in the Soviet bloc. As a consequence, many Latin American political parties could draw on their pre-authoritarian experience and social constituencies, whereas in the former communist countries (with the partial exception of Poland and Hungary) the only coherent political organizations were the deeply compromised and unpopular Communist parties. This organizational deficit, which remains an acute problem in most transition countries after more than a decade of (more or less) democratic politics, explains the high degree of electoral turnover and political instability in the post-communist countries. While such instability certainly

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36See for example O'Donnell's (1991) discussion of delegative democracy in Latin America.
37Also, in several cases (e.g. Colombia, Costa Rica, Venezuela) did not experience authoritarian regimes in more than a decade prior to the outbreak of the debt crisis.
undermines the coherence of economic policy conduct, the vaguely defined ideological platforms of post-communist parties, combined with the reduced maneuvering room between impoverished populations and strict Western conditionality have resulted in surprisingly low levels of radical policy reversals compared to the more partisan nature of Latin American politics in the 1980s.

Finally, given that the politics of IMF programs are not limited to cabinet meetings and parliamentary debates, it is important to incorporate the role of interest groups in shaping the implementation of IMF-style policy measures. In this respect one must mention several significant inter-regional differences. In Latin America labor unions, business associations, and in many cases the army, acted as well-organized interest groups capable of affecting economic policy-making both directly, by threatening strikes, coups or other forms of direct political action, and indirectly, by influencing the agenda of political parties through electoral pressures. However, in the former communist countries such interest groups were severely underdeveloped. For example, while the business sector was fragmented between a well-connected but diminishingly influential group of SOE managers and a rising number of fledgling and atomized small entrepreneurs, the labor unions were generally fragmented and continued to suffer from their organizational subordination to the Communist Party apparatus in the decades preceding the collapse of Communism. As a consequence, transition governments faced less immediate political pressures than their Latin American counterparts but at the same time they suffered from a much higher degree of social “disconnect,” which hindered the formation of durable reform coalitions and could, therefore, undermine the effectiveness of economic reforms.

Methodological approach

To unpack the multi-dimensional nature of the economic and political drivers of IMF
program initiation and implementation, the book employs a multi-method approach combining the rigor of a formal model, the broad empirical tests provided by large-N statistics, and the richer contextual analysis of comparative case studies. The formal model developed in Chapter 2 facilitates a more systematic analysis of how the interaction between the IMF and program country governments is affected by key parameters of the domestic and international environment. Solving the model yields a series of hypotheses, which do not merely reflect the key assumptions going into the utility functions of the two actors but specify a number of interesting interaction effects between different model parameters. These interaction effects help illuminate the complex interplay of domestic and international drivers of IMF programs and to provide the basis for a more nuanced and targeted empirical analysis in the statistical and case study chapters.

The predictions of the formal model are tested on three geographically and temporally clustered sets of IMF interventions in the developing world. The main statistical tests in this book, presented in Chapters 3 and 5, are based on quarterly data for 22 Latin American countries between 1982 and 1989, and 26 former communist countries of Eastern Europe and the former Soviet Union38 between 1990 and 2001. Chapter 7 tests some of the crucial findings from the two main case clusters in the context of the Latin American IMF programs from 1990-2001. The inclusion of this third set of cases expands the comparative breadth of the study and allows for a clearer analytical assessment of the relative importance of cross-regional versus cross-temporal sources of the significant variation in the political dynamics of IMF programs during the Latin American debt crisis and the post-communist transition.

The statistical approach employed in chapters 3, 5, and 7 has a number of advantages

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38Of the post-Soviet and Eastern European ex-communist countries the only countries excluded were Bosnia-Herzegovina and Yugoslavia, for which very little data was available due to their extended periods of violent internal conflict.
over much of the existing literature on the politics of IMF programs and of economic reforms more broadly. First, statistical tests are run separately for the three program clusters, thereby allowing for the systematic comparison of cross-regional and cross-temporal trends while at the same time allowing for the use of context appropriate political variables and avoiding the problematic assumption of causal homogeneity inherent in statistical analyses spanning multiple regions and time periods. Second, the tests use quarterly data instead of the yearly statistics employed by most large-N studies of IMF programs. Since most IMF programs are between 12 and 18 months long and disbursements are usually made on a quarterly basis and other crucial political and economic variables may also change dramatically over the course of a year, the use of more fine-grained quarterly data facilitates a better understanding of the short-term dynamics of IMF programs. Third, unlike most statistical analyses of IMF programs, these tests focus on the crucial dynamics of program implementation in addition to the drivers of initiation. Moreover, in doing so, the tests account for the important role of selection bias at the implementation stage, and, therefore, contribute to a more accurate assessment of the complex political dynamics of IMF programs.

The comparative case study evidence from four Latin American countries before and after 1990 and four East European countries during the post-communist transition contributes to a better theoretical and empirical understanding of the political dynamics of IMF programs. First, the more detailed accounts of individual reform instances offer useful illustrations of the mechanisms behind the broad correlational trends revealed by the statistical tests. Second, the case studies help identify and systematically analyze theoretically important aspects of the

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39 The use of yearly data runs the risk of missing much of the crucial short-term variation. Take, for example, the case of a country which suffers a sharp reduction in hard currency reserves in the first half of the year, then concludes an IMF agreement during the second quarter and then rebounds in the second part of the year. Using the end-year reserves statistics (for either the preceding or the current year) would fail to pick up the extent of the country’s external crisis.
political economy of IMF programs, which cannot be captured by the statistical tests due to insufficient or unreliable cross-national data for the respective sets of cases. Finally, the analysis of individual cases helps reveal idiosyncratic factors, which may play an important role for the trajectory of a small subset of IMF programs but whose broader cross-country relevance is limited.

**Structure of the book**

*Chapter 2* expands upon existing explanations of recent neoliberal economic reforms in the context of globalization and lays out a theoretical framework for analyzing the domestic and international political dynamics of IMF programs in developing countries. This framework is used as the basis for a formal model of the interaction between the IMF and the program country government during IMF program initiation and implementation. I model the interaction between the IMF and the program country government in bargaining over policy reforms and funding, subject to the constraints of the domestic political opposition and the response of international financial markets. The government's utility function includes its partisan/ideological policy preferences, the degree of financial need, and electoral/political concerns about staying in power. Moreover, the model builds in an uncertainty component, arising from the weakness of administrative institutions, which reflects the government's inability to predict the precise degree of policy implementation and helps account for the frequent breakdowns of IMF programs. Finally, from the point of view of the IMF, the model captures the tradeoff between the Fund's bank-like desire to only lend to “credit-worthy” countries (which comply with conditionality) and the political dimension inherent in the Fund's role as an international lender of last resort.
The model yields a series of hypotheses, which are explored in greater detail in the later empirical chapters.

Chapters 3 and 4 analyze how the changes in the international context between the debt crisis of the 1980s and the post-Cold War “Washington Consensus” of the 1990s led to very different economic and political dynamics of IMF programs in the two episodes. Chapter 3 presents the statistical results based on data from 22 Latin American and Caribbean countries between 1982 and 1989 and 26 ex-communist countries from 1990-2001. These results confirm the centrality of debt repayment concerns for Latin American IMF programs, and reveal the Fund's preferential treatment of large debtors whose default would have threatened international financial stability. By comparison, the primary international goal of post-communist IMF programs was to address the severe shortage of foreign reserves and to integrate transition countries into the world economy, which contributed to a more cooperative interaction between the Fund and program countries. The case study evidence from four Latin American (Argentina, Bolivia, Chile, and Peru) and two East European countries (Moldova and Slovakia), which is presented in Chapter 4, illustrates the statistical findings from the preceding chapter, and provides a more detailed account of the opportunities and constraints faced by the countries of the two regions as a function of their economic and geopolitical status. Thus, the chapter shows how Argentina’s high overall foreign debt levels represented a threat to Western commercial banks, and, therefore, contributed to the Fund’s tolerance towards Argentina’s unorthodox policies in the mid 1980s. Meanwhile, similar measures in were dealt with more harshly in smaller countries, as illustrated by the steep price exacted by the Peruvian government's post-1985 rebellion against IMF conditionality and by the Meciar government’s populist rhetoric in Slovakia in the mid-1990s. On the other hand, the generous financial terms secured by Bolivia
after 1985 and Moldova in the mid 1990s due to their rather close adherence to economic orthodoxy suggest that small countries can occasionally turn their economic marginality into an advantage by playing the role of showcase examples for successful neoliberal reforms.

In Chapters 5 and 6, the analysis focuses on the domestic politics involved in the initiation and implementation of IMF programs in the two regions. Chapter 5 analyzes the statistical patterns of the complex interaction between economic crises, ideological concerns, and institutional constraints that drive the dynamics of IMF programs. The chapter reveals that Latin American countries experienced crisis-driven policy divergence between governments of different ideological persuasions, whereas in Eastern Europe similar crises contributed to policy convergence between ex-communist and reformist governments. Moreover, the analysis shows that implementation of IMF-style reforms was compatible with democratic politics in the post-communist context, whereas in Latin America IMF programs were widely regarded as external impositions, and were therefore much harder to reconcile with democracy. Chapter 7 revisits the six cases discussed in Chapter 5 and adds a paired comparison between Romania and Bulgaria to illustrate some of the causal mechanisms underlying the cross-national statistical findings from the preceding chapter, as well as to identify additional factors not captured by the statistical analysis. The chapter traces the dramatic policy reversals experienced by Bolivia and Peru after 1985, which illustrate the importance of ideological differences in the tense domestic and international political environment of the debt crisis. By comparison, the chapter suggests that in Eastern Europe ideological differences mattered primarily in settings with manageable domestic crises (e.g. in the case of Slovakia) but were largely erased by the combined effect of intense economic crises and weak bureaucratic institutions (e.g. in Romania and Moldova). Moreover, the contrast between the Latin American and the East European reform trajectories discussed in
this chapter emphasizes the greater tension between democratic politics and IMF program implementation during the Latin American debt crisis, whereas in the transition countries the prospects of implementation were actually improved by greater political participation (e.g. in the case of Bulgaria).

Chapter 7 broadens the scope of the comparative analysis developed in Chapters 3-6 by focusing on the political dynamics of IMF programs in Latin America from 1990-2001. Since this third cluster of programs represents a combination between the international political and economic environment experienced by the ex-communist countries in the 1990s and many of the domestic economic and political characteristics of Latin America in the preceding decade, this comparison provides better analytical leverage for understanding the roots of the important differences in the political economy of IMF programs discussed in the preceding chapters. The analysis in this chapter suggests that in the context of the more favorable international economic environment and the ideologically unipolar world of the Washington consensus, Latin American policy responses to economic crises in the 1990s were more similar to the ideological convergence experienced by their East European counterparts in the 1990s than to the ideological divergence among their Latin American predecessors in the 1980s. Despite the Latin American elites’ embrace of neoliberalism, however, popular attitudes towards the IMF remained ambivalent, as suggested by the inconclusive relationship between democracy and IMF program implementation and by the recent widespread electoral turn towards more traditional leftist parties wary of IMF-style economic policies.

The final chapter synthesizes the theoretical contributions and empirical results of the book, not only for understanding the politics of IMF programs but for the political economy of neoliberal economic reforms in the developing world more broadly. The conclusion also
discusses the policy implications of these findings for the design of more politically feasible IMF programs, in the context in which, despite a number of recent calls for its demise, the IMF is likely to remain a key intermediary between developed and developing countries in the context of increasingly complex international financial markets.
Chapter 2

A Theoretical Approach to IMF Program Initiation and Implementation

At first glance, the dynamics of IMF program initiation and implementation are deceptively simple. To set the process in motion, a government facing balance-of-payments difficulties has to approach the IMF with a request for a loan. In order to get access to funding, the borrowing country government, in close consultation with IMF staff, drafts a "letter of intent," which specifies a program of policies designed to redress the country's financial imbalance. The letter includes a series of specific quantifiable goals, a timetable for achieving these goals, and the amount of IMF financial assistance that is tied to the achievement of program targets. Once the program is approved by the IMF Board of Directors, it enters into force and moves to the second - and crucial - stage: implementation. The national authorities of the program country (with varying degrees of technical assistance from IMF staff) attempt to design and implement policy measures intended to fulfill the program targets upon which the disbursement of IMF credit tranches is conditional. The IMF staff periodically reviews the progress and the compliance with program targets and based on its assessment decides to either approve the disbursement of a credit tranche, or to withhold the funds until targets have been met or renegotiated. Such program suspensions may be temporary if the country manages to catch up with program targets, or alternatively, the program can go off-track and be suspended entirely.

The technocratic nature of most practical steps during IMF program initiation, implementation and evaluation seems to imply a fairly de-politicized process in line with the neutral IMF mandate of helping countries "correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity" (IMF 1947, v).
While many of the crucial decisions regarding IMF programs are indeed of a technical nature and are often made during closed-door meetings between technocrats, political consideration are nevertheless present - and often highly significant - at various critical junctures of IMF program initiation and implementation. In order to understand why IMF programs elicit such different responses and produce such a wide range of outcomes across different countries and time periods, we need to identify the key economic and political drivers of IMF programs in the developing world, and provide a theoretical framework for understanding how changes in these parameters affect the political dynamics of program initiation and implementation.

This chapter develops such a theoretical framework, and attempts to capture the complex interaction between international and domestic political actors in the context of IMF programs in developing countries. The first part of the chapter situates IMF programs at the intersection of international and domestic political economy and identifies how this broader environment informs and constrains the political priorities of the two main protagonists - the Fund and the program country government – during their interactions in the context of IMF programs. The second part of the chapter develops a formal model, which incorporates the key elements affecting the preferences of the two main actors and captures the strategic interaction between the government and the IMF during program initiation and implementation. The model yields a number of hypotheses about economic and political drivers of IMF programs at both the domestic and international level, and therefore provides the theoretical basis for the empirical tests in the following chapters.

2.1 Conceptualizing IMF programs

At the most basic level, IMF programs can be conceptualized as the institutional setting
in which the IMF and program country governments bargain over economic policies and access to funding. However, as illustrated in Figure 2.1, this interaction does not occur in a vacuum but is embedded in a complex web of economic and political interests at both domestic and international level. Thus, the IMF attempts to balance the economic priorities arising from its role as an international lender of last resort and overseer of international financial stability with the more specific economic and geopolitical interests of its largest shareholder countries.

Meanwhile, the governments of potential program countries are influenced in their decisions not only by their domestic and international economic priorities but also by domestic political and bureaucratic constraints on the range of feasible economic policy options. The discussion below provides a more detailed justification for the individual components of this theoretical framework and shows how the framework can be applied to explain the changing dynamics of IMF programs.

The international dimension of IMF programs

Even though in the context of globalization the economic policies and politics of developing countries have been increasingly scrutinized and influenced by a wide range of outside actors, ranging from human rights NGOs to international credit agencies and multinational corporations, the International Monetary Fund has consistently ranked among the most prominent and politicized international presences in the political economy of developing countries. This prominence can be attributed to the Fund’s crucial role as an intermediary between the governments of developing countries on one hand and a variety of economic and political interests from advanced industrial democracies on the other.

The most straightforward aspect of the Fund’s mediating role arises from its role as an
overseer of international financial markets in line with its mandate, enshrined in the articles of agreement, to promote international monetary cooperation and stability. To pursue this overarching systemic goal, the Fund was endowed with the authority to make its financial resources available to its members “under adequate safeguards” in order to minimize the national and international repercussions of balance of payments crises. In addition to its control over direct funding, the IMF’s role as a permanent institutional setting for international monetary cooperation gave it considerable gate-keeping powers for third-party funding to troubled debtor countries, especially with respect to official funding from bilateral and multilateral sources. Moreover, the Fund also fulfilled an important mediating role between debtor governments and private lenders with responsibilities ranging from surveillance of economic policies to negotiating compromise solutions to international financial crises. To the extent that a given country’s position in international financial markets made its government dependent on Fund approval for meeting its financing requirements, the IMF could exert significant influence on the economic policies of the respective country. Despite the technocratic nature of the Fund’s conditionality discourse, its interventions in developing countries have provoked significant debates about the political implications of the trade-off between the public good of international financial stability and the national sovereignty of program countries to set their domestic economic policies.

Even though the Fund’s broad mission – to use its control over direct and indirect financing to promote economic policies conducive to international financial stability – has changed minimally in recent decades, the changing nature of international financial markets has greatly influenced both the specific priorities of IMF interventions in the developing world and the relative importance and implications of the different power levers at the Fund's disposal.
Thus, during the commercial lending boom of the 1970s, the Fund primarily fulfilled its traditional mandate of providing financial support to countries experiencing temporary balance-of-payment difficulties but played a fairly marginal role in the many developing countries, which could access the widely available private lending sources. By contrast, the debut of the debt crisis in 1982 and the drastic reduction of private lending to the developing world raised the importance of direct IMF funding, given that many debtors found themselves unable to meet their international debt obligations and (in the absence of willing private lenders) had to resort to the Fund as a lender of last resort. The Fund’s leverage over developing countries during the 1980s was further enhanced by the decision of Western governments to entrust the IMF with the mission of mediating between the heavily exposed Western commercial banks and the equally troubled debtor countries in order to find a solution to the threatened default of Third World debtors and its potentially devastating consequences for international financial stability. As a consequence, IMF agreements became a crucial component in the debt renegotiations of the 1980s for many debtors in Latin America and elsewhere. At the same time, however, the Fund’s emphasis on the continued servicing of the region’s staggering debt meant that the net financial gains of IMF cooperation were minimal (or even negative) for many debtors, as any inflow of funds was almost immediately channeled into debt service, and compliance failed to trigger new loans from private lenders, who were unwilling to further increase their exposure to Third World debt. These trends were once more reversed in the 1990s, when many developing countries regained access to international financial markets: as a result many countries were less dependent on IMF loans, but the Fund’s “seal of approval” was nevertheless important to signal the credibility of a government’s economic policies to international investors, especially for countries with tenuous international standing and during periods of uncertainty triggered by
regional or international financial crises. Besides these broad temporal variations, we would expect the Fund’s agenda and influence in the developing world to vary significantly from country to country, given that some countries are dependent on IMF funding even during periods of global financial expansion, whereas other countries manage to avoid IMF conditionality even during periods of international financial crises.

While even the Fund’s technocratic interventions have been subject to significant political controversies, the politicized nature of IMF programs is particularly obvious in the uneven application of IMF conditionality across different countries. In particular, the Fund's largest shareholders - the United States and other Western industrialized democracies - have used their influence over voting rights and Fund resources to ensure preferential IMF treatment for countries, whose economic and political importance or geopolitical cooperation with the West set them apart from other program candidates (Thacker 2000, Stone 2002). Political favoritism could manifest itself either in more favorable program conditions during the initiation phase (higher loans, easier targets, faster approval) or in more lenient enforcement of conditionality during the implementation phase. While in this respect the greatest differences should obviously occur across different countries, the analytical approach this book also tests and confirms the possibility that the standards for favoritism change over time in response to the shifting geopolitical and economic priorities of the Fund's largest shareholders.

Even though the tradeoff between policy sovereignty and financial rewards lies at the core of IMF conditionality, its nature and intensity have varied significantly across time and space. The discussion so far has revealed several international factors, which systematically affect the interactions between the Fund and program country governments. First, we need to identify the broad parameters of the international economic environment, which determine the
primary goals of IMF interventions to promote international financial stability and cooperation, as well as the relative effectiveness of different sources of IMF influence on developing countries. Thus, we would expect that a systemic threat such as that posed by the debt crisis of the 1980s would result in a much tougher IMF approach to conditionality than during periods of international financial booms (as in the 1970s and 1990s). The more controversial nature of IMF interventions during such crisis episodes is likely to be exacerbated by fact that cooperation with IMF conditionality is likely to yield weak immediate financial rewards from private lenders. At the same time, however, it is important to keep in mind that when it comes to IMF programs not all countries are created equal: even within the confines of a given international context, a country’s interaction with the IMF is likely to be shaped decisively by its specific position in the international economic and political arena. These systematic, internationally rooted differences in the relative costs and benefits of IMF programs across time and space are likely to have a profound impact on the domestic economic and political implications of these programs, which will be discussed in the following section.

*IMF programs and domestic politics*

Even though external pressures from the IMF and international financial markets constrain the policy options of governments in developing countries, IMF programs cannot be properly understood simply as external impositions on powerless and compliant domestic actors. As will be discussed in more detail in the empirical sections, governments can and do avoid the dictates of IMF conditionality even in situations where purely financial considerations would have predicted a much more accommodating stance by the government in question. To
understand when and why this happens, we need to analyze IMF programs within the domestic economic and political environment, which shapes the desire and the ability of governments to implement the economic policies necessary to secure IMF financial support and recognition.

At the most basic level, it matters how the government's partisan policy preferences compare to the orthodox economic policy requirements of IMF conditionality, since the ideological costs of compliance are likely to be much greater for leftist governments than for pro-market politicians. Moreover partisan political considerations shape not only the preferred status-quo policies, but also how policy makers perceive the gravity and the nature of a given economic crisis: for example, the early years of the debt crisis in Latin America witnessed heated and ideologically motivated debates about whether the crisis should be understood as a temporary liquidity crisis provoked by volatile international lending practices or whether it revealed deeper structural flaws of the Latin American ISI development model. The different theories about the roots of economic crises engendered different policy responses: whereas Latin American leftists and populists (such as Peru's Alan Garcia) were more likely to blame the West for their country's economic woes, and, therefore, tended to avoid the IMF's austerity prescriptions in favor of heterodox adjustment measures, neoliberals tended to blame inefficient state sectors and excessive public spending programs and were therefore more likely to appeal to the IMF for both funding and policy advice.

Second, as illustrated in Figure 2.1, domestic economic concerns may complement (and even overshadow) external financial need in driving governments to initiate and implement IMF-style reforms. Thus, fiscal and inflationary crises have traditionally been among the key reasons why governments have enlisted IMF support even in the absence of significant balance of payment difficulties. Moreover, such crises have often been instrumental in undermining
domestic political opposition to economic reforms, thereby facilitating the successful implementation of such IMF supported adjustment efforts. In fact, in extreme situations, pro-market governments may use IMF programs as an alibi to improve their chances of implementing otherwise unpopular neoliberal reforms (Vreeland 2003).

Third, since IMF programs usually require adjustment measures with profound socio-economic and distributional consequences, their initiation and implementation often becomes the focal point of domestic political debates between the government and a range of potential reform opponents in parliament or in the broader society. Therefore, one should expect that the fate of IMF programs would also depend on the partisan orientation and political power of the opposition, as well as on the relationship between the government and the opposition, mediated by institutional features such as the openness of the political process, the relative strength and cohesion of reform supporters and opponents, and the feasibility of political coalitions buttressed by the use of patronage.

Finally, the ability of governments to initiate and implement IMF programs successfully hinges not only on political will and political muscle but also on the sheer capacity of the state apparatus to design and execute a coherent policy program. The successful and timely initiation of an IMF program requires a reasonably competent group of government experts and sufficiently reliable economic data to establish and negotiate feasible performance criteria in cooperation for the IMF staff. Since IMF conditionality usually only set broad policy parameters for the country, the government has to develop a more detailed plan for fulfilling IMF policy targets, such as specific areas of expenditure cuts or strategies for raising new tax revenues. Once such a detailed blueprint is in place and has been promulgated into law (via parliamentary vote or executive ordinance/decree), the government still faces the significant hurdle of ensuring
the timely implementation of the program targets by the different levels of the bureaucratic apparatus. As a consequence, in countries with weak and ineffective bureaucratic institutions, even an ideologically committed, and financially desperate government may not be able to ensure the adequate design and execution of a successful IMF program.

Even this cursory overview of the IMF program initiation and implementation process reveals the variety of actors, interests and interactions, which can be reasonably seen as affecting the likelihood of successful IMF programs. The crucial challenge for any theoretical approach to the politics of IMF programs is to capture the complexity of these interactions while at the same time yielding a sufficiently tractable theoretical model that can be used to derive testable hypotheses about the domestic and international drivers of IMF programs. Therefore, in the remainder of this chapter I present a formal theoretical model of the interaction between the IMF and the program country government in the context IMF programs. Formalizing some of the key empirical observations and intuitions discussed above, presents a number of advantages. First, the modeling exercise requires an explicit and transparent formulation of the theoretical assumptions about the relevant actors, their interests and the nature of their interactions. Second, solving the model and discussing its comparative statics yields testable hypotheses and predicts theoretically interesting interaction effects between model parameters, which go beyond being straightforward reflections of the model's assumptions. Finally, the efforts to define and interpret the formal model's parameters offer useful guidance for specifying the statistical models in the following chapter and thereby constitute a natural link between theory and empirical tests.
Model setup

The model revolves around two main actors - the government and the IMF - who bargain over funding and policy reforms. Since this bargaining takes place in a setting in which domestic and international politics intersect, the model allows for the choices of the two main actors to be affected by the domestic opposition, the Western governments and the international financial community and then illustrates how changes in the economic and political environment affect the dynamics of IMF program initiation and compliance.

There are two stages to the model: program initiation and program implementation. During program initiation, the government decides whether or not to approach the IMF to negotiate a program. If the government does not approach the IMF or if the two sides cannot agree on mutually acceptable program parameters, then nothing happens and both the IMF and the government get their status quo payoffs.\(^4^0\) If the two sides reach an agreement, they establish a set of program parameters \((M_p, q_p)\) consisting of a certain funding commitment \(M_p\) conditional on the fulfillment of a set of policy targets \(q_p\). Throughout this analysis I will treat \(q\) as standing for one-dimensional policy reforms, with higher \(q\) meaning more reforms.\(^4^1\) Thus, we can think of \(q\) as standing for typical IMF program targets such as low budget deficits, low inflation, low domestic credit and money growth, and deep structural reforms. Once the program parameters are set, the game moves to the second stage - implementation.

During program implementation, the government decides on a policy level \(q_0\), chosen so as to maximize its own utility subject to the constraints discussed below. Having observed the

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\(^4^0\) In practice the status quo payoffs are only achieved if the failed negotiations between the Fund and the potential borrower government are secret. If they are not, the country may incur audience costs, as discussed below.

\(^4^1\) Of course, in reality reforms are not one-dimensional, but including multidimensional reforms significantly complicates the model, and to a large extent we can think about IMF program bargaining as being over more or less adjustment.
outcome $q^*$ of the government's policy choice (which may differ from the government's intended policy $q_0$ due to imperfect implementation), the IMF then decides whether or not to disburse the promised amount of funding to the government. International financial markets then react to the signal of the IMF by either extending additional credit to the government (in the case of IMF approval) or by withdrawing existing credits (in the case of IMF disapproval of a country's policies). In practice, this game is repeated several times during the duration of a program, given that IMF disbursements are generally made on a quarterly basis. This model does not attempt to capture explicitly the repeated-game aspect of IMF programs; however, I will discuss how target fulfillment at a given stage affects the model parameters for the next period, and implicitly the chances of future compliance.

**Actors' Preferences and Utility Functions**

**The Government**

In explaining the trajectories of IMF programs in the developing world we have to focus on three types of potentially conflicting interests of government actors. First, the ideal and material interests of government actors determine a set of economic policies the government would like to implement in the absence of domestic and external constraints. However, the country's financial need and its position in the global economy introduce a set of external constraints on government policies, and set the parameters of the policies the government has to implement in order to address the demands of the country's economic situation in the context of an IMF program. Finally, governments are often constrained domestically in what policies they can implement in their attempts to resolve economic crises. The severity of these constraints depends on the nature and intensity of the political demands of the opposition, as well as on the
ability and willingness of the state apparatus to implement the policies desired by the government. I will start by discussing the utility function of the program country government $U^{gov}$, which is assumed to take the same functional form throughout program initiation and implementation:

$$U^{gov} = E[-c_{gov}(q^* - q_{gov})^2 + \mu F + f(G) + sU^{opp}]$$

where $c_{gov}$ is the cohesion of the government's partisan preferences; $q^*$ stands for the implemented policy; $q_{gov}$ represents the partisan ideal point of the government; $\mu$ is a measure of financial need, which reflects how important IMF funds are for the government; $F$ is the funding obtained in connection with the IMF program, $G$ are rents from being in office, $s$ stands for political influence of the opposition. $E(\cdot)$ indicates that the government bases its decisions on the expected rather than actual utility, since it does not know the actual value of the implemented policy or of the funding disbursed by the IMF, due to the presence of uncertainty in policy implementation, which will be discussed below.

The utility function of the government reveals a number of important factors that contribute to the government's policy choice and ultimately to the initiation and implementation of IMF programs:

1. The first term $-c_{gov}(q^* - q_{gov})^2$ captures the government's partisan policy preferences, i.e. the policies that the government would like to implement in the absence of any external or internal political constraints. Such partisan preferences are best conceptualized as a combination of ideal and material interests of the political party/parties in power. While the range of such interests is obviously broad and multi-dimensional, for the current model we are only concerned about how these interests affect the ideal policy choice in the context of IMF-style economic reforms. The mathematical function of the term indicates a rising disutility as a function of the distance
between the ideal point and the actual implemented policy. Moreover, the intensity of the government’s reaction to policy deviations from its ideal point are mediated by the cohesion of the government's partisan preferences $c_{\text{gov}}$, which in the statistical tests in Chapter 5 is captured by the political fragmentation of the governing coalition.\(^{42}\)

2. The second term $\mu F$ reflects the financial considerations inherent in IMF programs, namely that the benefit of funding is a function of the size of the disbursed amount and of how badly the money is needed. Intuitively, a government with easy outside financing options and high hard currency reserves will be less likely to let the IMF influence its policies than a government at the edge of default. Since the funding associated with IMF programs hinges on the interaction between the IMF, the program country government and international financial markets, the overall funding $F$ varies as a function of the status of IMF programs. Thus, if the country does not enter an IMF agreement, then $F = 0$. If the country enters a program but fails to comply, then $F = S_n < 0$, where $S_n$ is the economic cost of the negative signal sent to outside investors by the IMF's unwillingness to disburse funding. Thus, entering an IMF agreement and not complying is worse than avoiding the Fund altogether, since it signals to investors that the country is in trouble but its government is not willing or capable to address the problem. If the country complies with IMF conditionality, then $F = M_p + S_p$, where $M_p$ is the direct funding provided by the IMF in conjunction with the program, whereas $S_p$ captures the multiplier effect due to the positive signal of the Fund's approval of the country's policies.

3. The third term $f (G)$ reflects another common assumption about the motivations of political actors for seeking government office: the rents accruing to governing individuals and parties as a consequence of their control over the allocation of public resources. We will assume a positive

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\(^{42}\) The intuition is that more fragmented governments are less likely to pursue their ideological preferences, since they are more likely to be preoccupied with intra-coalitional politics.
but decreasing marginal utility of additional rents \( G \) to the government \((f' > 0, f'' < 0)\), which seems a reasonable approximation of reality.\(^{43}\)

4. The government's decision making is influenced by its incomplete control over the outcome of the program. Given the high level of economic and political unpredictability in most IMF program settings, it should come as no surprise that there exist a number of sources of potential uncertainty, including uncertainty about the IMF's ability to detect the extent of policy deviation (due to the high costs of information gathering) and uncertainty about the country's actual level of political importance in the eyes of the West and the IMF. However, arguably the most significant source of uncertainty and program breakdown is the government's limited control over policy outcomes - i.e. the government may attempt to implement a certain policy \( q_0 \) to comply with program conditions, but for a number of reasons (such as external shocks, lack of expertise/coordination) the actual policy may be significantly higher or lower than expected. To formalize this intuition, I assume that the implemented policy \( q^* = q_0 + \theta \), where \( q_0 \) is the government's policy intention and \( \theta \) is a random shock, uniformly distributed around a mean of 0 with a deviation of \( \frac{k}{2} \). Thus, as the degree of policy uncertainty \( k \) increases, the expected magnitude of the policy shock increases and the actual policy is more likely to deviate considerably from the government's target. The implications of this policy uncertainty will be discussed in more detail in a later section.

5. The final term reflects the intuition that other things being equal the government prefers to keep the opposition reasonably content in order to avoid challenges to its rule and to minimize opposition to the policy reforms associated with IMF programs. We can conceive of this

\(^{43}\)Even though examples exist of seemingly insatiable appetites for rents, one would nevertheless expect that Imelda Marcos may have gotten more satisfaction from the first hundred pairs of shoes than from the next hundred.
opposition as being located either in parliament (opposition parties) or in the broader political system (e.g. labor unions and business groups). The potential influence of the opposition's preferences is expected to be stronger when the internal political competition $s$ is more intense.

In the empirical tests in the following chapters, $s$ will be primarily interpreted as the degree of democracy, which determines the extent to which the preferences of the opposition affect economic policy decisions in a given situation. However, even within a democracy, the influence of the opposition can depend on a number of factors, such as the relative parliamentary seat shares of the government and the opposition, and the part of the electoral cycle (since governments are less likely to compromise with political opponents during the post-electoral honeymoon period). Moreover, as I will discuss in more detail in a later section, in addition to this linear effect the model will assume the existence of a minimum threshold $U^{opp}$ in the utility of the opposition, below which the opposition decides to challenge not only individual government policies but the government as such. The challenges implied by this non-revolt condition may take a variety of forms (ranging from parliamentary votes of no-confidence to violent forms of protests including riots and military coups) but it is generally safe to assume that such events would undermine IMF program implementation and deter program initiation in situations where such occurrences seem highly likely.

In order to understand the role of the opposition in the initiation and implementation IMF programs we need to specify the utility function of the opposition:

$$ U^{opp} = -c_{opp} (q' - q_{opp})^2 + f(O) $$  \hspace{1cm} (2)

where $c_{opp}$ is the cohesion of the opposition's partisan preferences; $q'$ stands for the implemented policy; $q_{opp}$ represents the partisan ideal point of the government and $O$ is the opposition's share of total rents. As in the case of the government, the utility of the opposition is inversely related to
the distance between its partisan ideal point $q_{opp}$ and the implemented policy $q^*$, and the strength of this ideological effect depends on the ideological cohesion of the opposition $c_{opp}$.44

Finally, the model allows for the government to share some of the rents with the opposition in an attempt to compensate them for their acquiescence with the government's economic policy. Thus, of the total rents $R$ available to the government, it can redistribute $O$ to the opposition, while keeping $G = R - O$ for its own benefit. This redistribution $O$ can be conceived in the number of different ways depending on who the relevant opposition actor is: if the crucial veto player is an opposition party then such concessions may take the form of government jobs, preferential access to state funding or even straight-out bribes. In the case of threats from the military establishment (particularly true of some Latin American countries in the early democratization period) payoffs came in the form of large military budgets, whereas the Argentine government under Menem “bought” the acquiescence of the unions to the ambitious neoliberal reforms of the early 1990s by giving them blocks of shares in privatized SOEs and control over lucrative health-care plans (Etchemendy 2002). Similarly, Russian reformers in the mid-1990s attempted to get enterprise managers to support the government's ambitious privatization program by selling them large blocks of shares at preferential prices (Shleifer and Treisman 1998). The model could be extended to conceive of the opposition as the median voter (who may be more or less opposed to reforms), in which case the government may choose to use some of the resources at its disposal to win popular support for reforms.45 While the economic efficiency of such second-best reform strategies is uncertain, they clearly help with the short-

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44 Unlike the government, however, I assume that the opposition does not care about the financial implications of IMF programs, since is the government who gets blamed or credited for dealing with financial crises. However, the main results of the model are not substantially affected by this assumption.

45 A prominent example of this strategy was the voucher privatization in many Eastern European countries (including Romania and the Czech Republic), which distributed free or heavily discounted vouchers to citizens who could then exchange them for shares in newly privatized companies.
term political sustainability of economic reforms, which is the key question in the context of an IMF program. At the same time, however, rents can at least in theory be used by antireform governments to placate political actors advocating faster economic and/or political reforms.

The IMF

The IMF faces slightly different utility considerations during program initiation and implementation. During program initiation the IMF’s utility function is as follows:

$$U_{IMF} = -M_p (q^* - q_p)^2 + j_p M_p - \frac{j}{M_{tot} - M_p} \quad (3)$$

where $q_p$ is the program policy target, $M_p$ represents the committed program funding; $M_{tot}$ are the total undisbursed IMF funds available; $p$ stands for the political importance of program country and $j$ is a parameter reflecting the relative “cost” to the IMF of providing funding.

The first term in expression (3) reflects the logic of the IMF’s role as a bank, which cares about being repaid and therefore does not want to lend money to countries whose policies reduce the probability of timely repayment. Therefore, if the IMF does not follow up on its punishment threat (for political reasons), it incurs a cost, which can be interpreted as an expected loss of resources. Since defaults on IMF loans occur very infrequently, we can think of another - more indirect - cost of politically motivated leniency. According to this second interpretation, if the Fund disburses funding to “undisciplined” countries it undermines its credibility as a signaling device for international investors and therefore undermines its ability to leverage additional funding in support of its reform programs. (Stone 2002) This financial multiplier effect is not only important in the context of the limited direct funding at the disposal of the IMF but it also
affects the leverage of the Fund over the program country government since it allows the Fund to play a crucial gatekeeper role for foreign capital. Mirroring this logic, the IMF's disutility increases with the size of the disbursed amount and the extent of the policy deviation from the program targets. Note that in this respect the IMF is better off not disbursing any funds to countries which do not fulfill all the program targets. During program initiation, of course, the IMF cannot observe the policy implemented by the government, even though the signing of an agreement is usually precluded by a number of reform prerequisites meant to signal the government's commitment to reform. Nevertheless, the Fund bases its decision primarily on the expected policy the government will implement under the constraints of the model.

Since the first term only captures the screening aspect of the Fund's banking role (implying that the IMF would be best off never committing any funds), the second term addresses the positive lending incentives of the Fund. Unlike most banks, the primary goal of IMF lending is not financial return (given that the IMF lends at below market rates) but rather the political objectives associated with the role of the IMF as an international lender of last resort. Therefore, the term captures the intuition that the Fund will have stronger incentives to lend to countries facing serious crises (high $\mu$). From the point of view of Western creditors, however, the main reason for Fund lending is to provide the public good of international financial stability. According to the articles of agreement, the IMF's stated mission is to provide financing to countries with balance of payments difficulties in order to minimize the domestic and international fallout of such crises. Since the potential fallout of such crises for the largest IMF shareholders (and implicitly for the IMF) is proportional to the country's political and economic importance, we would expect the IMF to derive higher utility from lending to countries deemed as politically important by the West. The empirical analysis in Chapter 3 will
analyze a range of potential indicators of political importance, based on economic concerns (e.g. overall size of debt and import markets) as well as geopolitical considerations (reflected in the amount of foreign aid or the size of the population).

Finally, there are good theoretical reasons for introducing the budgetary term, given that the IMF has limited funds at its disposal and that its generosity towards a given country could well be determined not just by its political importance but also by how badly those funds are needed elsewhere. However, as we will see below, I only include the budgetary constraint during the initiation phase but not in the implementation phase. This choice is supported by Vreeland & Przeworski (2000), whose statistical tests indicate that budget constraints are only important in explaining program initiation but not program renewal. Intuitively, one can imagine that once the committed funding has been included in the IMF budget, disbursement is not affected by the general availability of funds.

During the implementation phase the IMF observes the policy choice of the government \( q^* \) and decides on this basis whether or not to disburse the committed funds \( M_p \) for that period. As discussed above, at this stage we exclude the budget term, which instead is replaced by the constraint that the disbursed amount \( M^* \) cannot exceed the total funding \( M_p \) committed by the initial letter of agreement \( M^* \leq M_p \):

\[
U^{\text{IMF}} = -M^*(q^* - q_p)^2 + \mu p M^*
\]

where the notation is the same as for expression (3) except for \( M^* \), which represents the disbursed rather than the committed amount of funding.
Solving the model

The IMF's disbursement decision

The model will be solved through backward induction. More formally, there is a unique subgame perfect Nash equilibrium. Therefore, the analysis starts at the last stage of program implementation, in which the IMF decides how much of the committed funding to disburse to the program country. In this part, the actors operate within the constraints of the program parameters $(M_p, q_p)$ set during the program initiation stage. For now I will assume these parameters to be fixed for the duration of the program, even though there are some instances in which program targets are re-negotiated in the middle of a program. Later, when discussing program initiation, we will endogenize $M_p$, in line with the reasonable assumption that the IMF can choose funding levels strategically in order to induce the government to adjust its policies in the desired direction.

The first order condition for the IMF's utility maximization during implementation is:

$$\frac{\partial U_{IMF}}{\partial M^*} = -(q^* - q_p)^2 + \mu p = 0$$

We get two corner solutions, depending on the relationship between the deviation from program targets and the country's political importance:

If $-(q^* - q_p)^2 + \mu p < 0$, then the IMF will not disburse any funds $(M^* = 0)$.

If $-(q^* - q_p)^2 + \mu p \geq 0$, then the IMF will disburse all the committed funds for the period $(M^* = M_p)$. Based on these conditions we can determine the minimum policy level, $q_{min}$, for which the IMF will be willing to disburse the funding:
\[ q_{\text{min}} = q_p - \sqrt{\mu} \]

At the borderline policy level \((q_{\text{min}})\) the IMF is indifferent between withholding and disbursing funding to the government. Notice, however that this borderline policy is lower than the initial policy conditions \(q_p\), indicating that we would expect the IMF to tolerate small deviations from program targets, and that the extent of this tolerance increases with the country's political importance and the severity of its financial crisis.

The government's policy choice during implementation

Next, we turn to the government's maximization task - here the government uses its knowledge of the expected course of action of the IMF to maximize its own utility subject to the constraints of the model. In a determinist world, the government could just choose to either implement \(q_{\text{min}}\) in order to obtain IMF funding at the lowest political cost, or alternatively to avoid IMF conditionality altogether and implement its status-quo policy. However, as discussed above, in reality the government does not have sufficient information/capabilities to be able to set the policy at exactly the \(q_{\text{min}}\) level necessary to just make the IMF indifferent between disbursing and withholding funds. Once we introduce uncertainty about policy implementation the government can no longer simply aim for \(q_{\text{min}}\) to minimize adjustment costs, while still obtaining IMF funding, since it runs the risk of losing IMF support if implementation falls short of expectations. Thus, intuitively it is easy to see the negative effects of uncertainty on the government's expected utility: either implementation falls short \((q^* < q_{\text{min}})\) and receives no IMF funds despite partial reform efforts or the government implements more reforms than absolutely necessary to meet minimum IMF standards \((q^* > q_{\text{min}})\). In this case the government receives IMF funding but at a higher political cost than necessary.
To formalize this intuition, we will analyze the implications of uncertainty under the earlier assumption that the implemented policy $q^*$ is the result of the government's policy intention $q_0$ and a random shock $\theta$, so that $q^* = q_0 + \theta$. Thus, the government can set its target policy $q_0$ and it also knows the value of $k$ (i.e. the extent of implementation uncertainty) but it cannot predict the actual realization of $\theta$, which can be anywhere in the interval $\left(-\frac{k}{2}, \frac{k}{2}\right)$. As long as the realized policy shock is sufficiently favorable $\theta > q_0 - q_{\min} - \sqrt{\mu \rho}$, the government will receive funds from the IMF, since the implemented policy is higher than the minimum required by the Fund $q^* = q_0 + \theta \geq q_{\min}$.46

The uncertainty about policy implementation affects not only the probability of IMF funding disbursement, but also the other components of the government's utility function (partisan and political competition). Thus, the expected utility of the government under uncertainty in an IMF program becomes a function of the expected rather than the implemented policy:

$$U_{gov} = E[-c_{gov} (q^* - q_{gov})^2] + E(\mu F) + E[f(G) + sU_{opp}]$$

After some algebraic manipulation (see appendix) we can rewrite the government's utility function as:

$$U_{gov} = -c_{gov} (q_0 - q_{gov})^2 - \frac{1}{3} c_{gov} k^2 + \mu E(F) + f(G) - sc_{opp} (q_0 - q_{opp})^2 - \frac{1}{3} sc_{opp} k^2 + sf(R - G)$$

46Notice that under uncertainty it may no longer be optimal for the government to aim for the borderline policy satisfying the IMF ($q_{\min}$), since that would entail a significant chance of losing IMF funding in the case of below-average implementation (50% under the uniform distribution assumption used here). However, if the government wants to be absolutely sure of receiving IMF funds, it may have to set an excessively high target policy $q_0 = q_p - \sqrt{\mu \rho} + \frac{k}{2}$, which would be immune to implementation shortfalls. However, such an overshooting strategy would probably entail high political costs and lead to program breakdown at a later stage. Arguably, this is what happened in the early stages of Romania's 1997 IMF program, in which the reformers, eager to comply with IMF conditionality, implemented excessive cuts in domestic credit, thereby deepening the country's recession and ultimately setting the stage for the program's eventual political derailment.
While the IMF's funding disbursement decision is a step-function with an abrupt breaking point at \( q_{\text{min}} = q_p - \sqrt{\Psi} \), for the government the expected value of the funding under implementation uncertainty is a continuous function of the intended policy \( q_0 \). Based on the value of \( q_0 \) we can distinguish three intervals:

1. If \( q_0 < q_p - \sqrt{\Psi} - \frac{k}{2} \), then the government receives no funding and incurs the cost of the negative signal \( S_n \) regardless of the realization of the policy shock \( \theta \) and the choice of \( q_0 \) in this interval. Based on the first-order condition for the government’s utility function,\(^{47}\) we find that the government's ideal policy target in the low-reform status-quo case is \( q_0^{LSQ} = \frac{c_{gov} + c_{opp}}{c_{gov} + c_{opp}} \). In other words, the status-quo policy is a weighted sum between the government's and the opposition's preferences, and depends on the relative strength of their influence on the economic policy making process.

Notice that under the current setup of the model, this situation would never occur because the government, knowing that it will not want to implement the IMF program, would choose not to enter an agreement in the first place, in order to avoid the cost of the negative signal. However, in the context of a multi-stage game, the situation discussed here could occur in the later stages of the program: thus, if during the first stage of the program the government complies with conditionality and receives IMF and third party funding, we would expect that in subsequent stages its financial need would be lower (\( \mu_2 > \mu_1 \)). This lower need would reduce the benefits of IMF funding and may induce the government to ignore IMF conditionality and instead implement the status-quo policy \( q_0^{LSQ} \). A similar effect would occur if the social costs of reforms would radicalize the anti-reform opposition (\( q_{opp2} < q_{opp1} \)), thereby raising the political

\(^{47}\) The f.o.c. is \( \frac{\partial U^{gov}}{\partial \theta} = 0 \) where \( U^{gov}(q_0) = -c_{gov}(q_0 - q_{gov})^2 - \frac{1}{2}(c_{gov} + c_{opp})k^2 + \mu S_n + f(G) + sf(R - G - S_{opp})(q_0 - q_{opp})^2 \)
costs of reforms to the point where they outweigh the benefits of IMF funding. Finally, if a
change in government occurs during an IMF program, and the new government is less reformist
than its predecessor ($q_{gov2} < q_{gov1}$), then it is possible that the new government would be willing
to bear the financial costs of noncompliance in order to fulfill its ideological priorities.

2. If $q_0 > q_p - \sqrt{\mu P} + \frac{k}{2}$, then the government receives funding regardless of the realization of
the policy shock $\theta$ and the choice of $q_0$ in this interval. In this case, the government's
maximization task is very similar to the first case, in that the government sets

$$q_0^{HSQ} = \frac{c_{gov} q_{gov} + sc_{opp} q_{opp}}{c_{gov} + sc_{opp}}.$$ However, while the functional form of $q_0$ is identical to the low-reform
status-quo case, the implemented policy is obviously higher (i.e. more reformist), as is the
government's utility (since it receives the funds associated with the IMF program.)

3. For the purpose of the current analysis, the most interesting scenario occurs when

$$q_p - \sqrt{\mu P} - \frac{k}{2} \leq q_0 \leq q_p - \sqrt{\mu P} + \frac{k}{2}.$$ In this interval the expected probability of funding disbursement
increases with higher levels of the government's intended policy $q_0$. Thus, we can write the
government's utility function as:

$$U^{gov}(q_0) = -c_{gov} (q_0 - q_{gov})^2 - \frac{1}{3} (c_{gov} + sc_{opp}) k^2 + f(G) + sf(R - G) -$$

$$-sc_{opp} (q_0 - q_{opp})^2 + \mu (M_p + S_p - S_n) \left( \frac{-q_p + q_0 + \sqrt{\mu P}}{k} \right) + \frac{1}{2} \left( M_p + S_p + S_n \right)^2.$$ (6)

Setting the first order condition $\frac{\partial U^{gov}}{\partial q_0} = 0$ and solving for $q_0$ we get the optimum value of the
government's policy target $q_0^{unc}$ in the uncertainty range:

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48 More precisely, $U^{gov} = -c_{gov} (q_0 - q_{gov})^2 - \frac{1}{3} (c_{gov} + sc_{opp}) k^2 + \mu (M_p + S_p) + f(G) + sf(R - G) - sc_{opp} (q_0 - q_{opp})^2$. 

61
Based on this expression of the government's optimal policy choice, we can now analyze the factors driving the probability of program success (defined narrowly as the IMF's approval of the country's policies). Using the expression for \( q_0 \) from expression (7), the probability of compliance \( \text{Pr}(\text{comp}) \) can be written as:

\[
\text{Pr}(\text{comp}) = \frac{1}{2} + \frac{-q_p + \sqrt{\mu p}}{k} + \frac{c_{gov} q_{gov} + \frac{1}{2} \mu (M_p + S_p - S_n) \frac{1}{k} + s c_{opp} q_{opp}}{k (c_{gov} + s c_{opp})}
\]  

(8)

The functional form for \( q_0 \) from expression (7) and \( \text{Pr}(\text{comp}) \) from expression (8) reflect the combination of domestic political and economic factors (such as the government's and the opposition's partisan preferences, structural factors like that partisan coherence of the government and the opposition's influence on policy making) and of international considerations (including the country's political importance and the IMF's ability to mobilize other sources of funding.)

The comparative statics of expression (8) above allow us to derive the model's key predictions about the drivers of IMF program compliance. The effects of institutionally driven uncertainty on the probability of compliance depend on the relative value of the government's policy target. Thus, if the government’s target policy is sufficiently ambitious (\( q_o > q_{\text{min}} - \beta \)) then policy uncertainty due to weak institutions undermines compliance with program targets (\( \frac{\partial \text{Pr}(\text{comp})}{\partial k} < 0 \)).

On the other hand, for sufficiently modest reform efforts (\( q_o < q_{\text{min}} - \beta \)) institutionally driven policy uncertainty may actually improve the chances of IMF funding

\[\frac{\partial \text{Pr}(\text{comp})}{\partial k} = \frac{q_o - \sqrt{\mu p} - q_o}{k^2} + \frac{\mu (M_p + S_p - S_n)}{2k^3 (c_{gov} + s c_{opp})}\]
disbursement \( \frac{\partial \text{Pr(comp)}}{\partial k} > 0 \). Since \( \beta > 0 \), the predominant effect of policy uncertainty on compliance with IMF programs is likely to be negative, particularly in situations where the government's financial need is high and promised monetary payoffs from compliance are large.\(^{51}\)

Moreover, from expression (7) above, it is easy to see that under higher levels of policy uncertainty governments choose less ambitious policy targets \( \frac{\partial \text{uncq}}{\partial k} < 0 \). Because in the model poor institutions are associated with higher uncertainty about IMF funding, governments expect to gain less from setting high targets and are therefore less likely to push through reforms.\(^{52}\)

**Hypothesis 1** *Higher institutionally driven policy uncertainty reduces the probability of IMF program implementation at least in situations where the government makes a significant reform effort.*

With respect to the financial incentives of IMF programs, the model supports the intuitive notion that compliance with IMF programs could be improved if the Fund could commit more financial resources to a given program (since \( \frac{\partial \text{Pr(comp)}}{\partial M_p} > 0 \)), and if third-party (official and/or private) lenders would be more responsive to IMF signals and thereby raise the indirect financing function of IMF programs and the costs of non-compliance (since \( \frac{\partial \text{Pr(comp)}}{\partial S_p} > 0 \) and \( \frac{\partial \text{Pr(comp)}}{\partial S_n} < 0 \)).

**Hypothesis 2** *Higher expected levels of direct and indirect IMF funding increase the probability of program compliance.*

Since \( \frac{\partial \text{Pr(comp)}}{\partial p} > 0 \), a higher degree of financial need also raises the chance of compliance, both

\(^{51}\) Even though not explicitly modeled here, the same logic applies to uncertainty about the IMF likelihood/willingness to punish deviations from program targets. If the process is sufficiently unpredictable (due to lack of transparency in IMF conditionality), then the same "fatalism" would set in and undermine the effectiveness of IMF conditionality.

\(^{52}\) Indeed, when policy implementation is completely unpredictable, the government is best off aiming for the status-quo policy and hoping for a positive external shock, which may lead to IMF funding \( q_{0 \text{unc}}^{LSQ} \rightarrow q_{0 \text{SQ}}^{LSQ} \) when \( k \rightarrow \infty \).
because it raises the benefit to the government of IMF funding and because it makes the IMF more lenient, given that \( \frac{\partial \mu}{\partial q} < 0 \). The other driver of IMF lenience – the political importance of a given country - should also contribute to higher IMF program completion rates (\( \frac{\partial \Pr(\text{comp})}{\partial p} > 0 \)), since the IMF has a wider tolerance interval for deviations from the policy targets. Finally, since \( \frac{\partial \Pr(\text{comp})}{\partial q_{gov}} > 0 \), the model also predicts that the effect of financial need should be stronger in politically important countries, and that economic/political importance should matter more in crisis situations, because it is precisely this interaction of size and financial distress that has the greatest potential repercussions for international economic and political stability.

**Hypothesis 3** Higher levels of financial need by the program country raise the probability of IMF program compliance, especially in politically important countries.

The expected impact of financial need on compliance is also mediated by domestic institutional factors. Thus, countries with a high degree of institutionally driven policy uncertainty should react less resolutely to financial need while implementing IMF programs (since \( \frac{\partial \Pr(\text{comp})}{\partial q_{pol}} < 0 \)).

**Hypothesis 4** Higher financial need has a greater positive impact on compliance in countries with low institutionally driven policy uncertainty.

With respect to the domestic political variables, the model predicts higher compliance when the government's partisan policy preference is more reformist (\( \frac{\partial \Pr(\text{comp})}{\partial q_{gov}} > 0 \)). This effect is amplified in situations characterized by low policy uncertainty \( k \) and high levels of cohesion.
within the government $c_{gov}$. Similarly, the prospects of program compliance should improve when IMF conditionality is not strongly opposed by an anti-reformist opposition ($\frac{\partial \Pr(\text{comp})}{\partial q_{opp}} > 0$) $T$

This should be especially true under intense political competition $s$ and with ideologically cohesive opposition forces $c_{opp}$.

**Hypothesis 5** The partisan orientation of the government and the opposition affect compliance with IMF conditionality particularly in settings with low policy uncertainty and high partisan cohesion.

The effects of the degree of political competition ($s$) are more ambiguous. If the opposition is sufficiently pro-reformist compared to the government ($q_{opp} > q_{gov} + \frac{\mu (M_s + S_s - S_g)}{c_{gov}}$), then we expect countries with higher degrees of political competition to have better implementation records ($\frac{\partial \Pr(\text{comp})}{\partial s} > 0$). However, in the opposite partisan scenario ($q_{opp} < q_{gov} + \frac{\mu (M_s + S_s - S_g)}{c_{gov}}$) more political competition undermines implementation ($\frac{\partial \Pr(\text{comp})}{\partial s} < 0$). In other words, when the government is more reformist than the opposition, more intense political competition is expected to reduce the prospects for successful IMF program implementation in line with the expectations of much of the literature about the benefits of insulated and capable technocrats. However, the intuition is that under more intense political competition, the opposition's influence on policy making is stronger. Therefore, if in such an environment the opposition favors more reforms than the government, we would expect to see more reformist policies and, hence, closer compliance with IMF conditionality.
Hypothesis 6 More intense political competition undermines program compliance when governments favor more reforms than the opposition, but facilitates compliance if the opposition is sufficiently more reformist than the government.

A similar prediction emerges from the analysis of the effects of the government's partisan cohesion $c$ on the likelihood of program implementation. As long as $q_{gov} > q_{opp} + \frac{\mu(M_p + S_p - S_n)}{2\delta_{opp}}$ we get $\frac{\partial \text{Pr(compliance)}}{\partial c_{gov}} > 0$ implying that if the government is sufficiently more reformist than the opposition, higher partisan cohesion (e.g. lower fragmentation) will improve the prospects of IMF program implementation. If, however, $q_{gov} < q_{opp} + \frac{\mu(M_p + S_p - S_n)}{2\delta_{opp}}$ then $\frac{\partial \text{Pr(compliance)}}{\partial c_{gov}} < 0$ meaning that more cohesive governments will be less willing to implement IMF programs in this range. 53

Hypothesis 7 Higher levels of partisan cohesion within the government facilitate compliance efforts of sufficiently reformist governments but undermine the prospects of compliance when the government is less reform-oriented than the opposition.

Finally, the analysis turns to the implications of the no-revolt constraint mentioned at the beginning of this chapter particularly with respect to the role of rents in ensuring the political feasibility of economic reforms and IMF programs. Starting from the utility function of the opposition in expression (2) and taking into account that due to uncertainty in policy implementation we have $E[c_{opp}(q^* - q_{opp})^2] = c_{opp}(q_0 - q_{opp})^2 + \frac{1}{3} c_{opp} k^2$, we can write the

53 Notice that as long as the financial incentives are strong enough ($\mu, M_p, S_p$ and $S_n$ have high absolute values) higher government partisan cohesion will hinder implementation even if the government is slightly more reformist than the opposition (but less reformist than the IMF.)
no-revolt constraint as:

\[ U_{opp} = -c_{opp}(q_0 - q_{opp})^2 - \frac{1}{3}c_{opp}k^2 + f(O) \geq U \]

Using implicit differentiation of (9) we can derive an expression for the relationship between the government's optimal economic policy choice \( q_0 \) and the amount of discretionary resources available \( R \):

\[ \frac{\partial q_0}{\partial R} = \frac{f'(O)\frac{\partial O}{\partial R}}{2c_{opp}(q_0 - q_{opp})} \]

Taking into account that \( f'(O) \) and \( \frac{\partial O}{\partial R} > 0 \), we find that the sign of \( \frac{\partial q_0}{\partial R} \) depends on the relationship between the government's constrained policy preference \( q_0 \) (that reflects both its partisan preferences and the financial incentives inherent in IMF conditionality) and the opposition's partisan orientation \( q_{opp} \). Thus, if the government wants to implement more thorough reforms than desired by the opposition \( (q_0 > q_{opp}) \), the model predicts that higher levels of discretionary resources should facilitate higher levels of reforms \( (\frac{\partial q_0}{\partial R} > 0) \) because the government can compensate the opposition with higher rents. On the other hand if the opposition favors more ambitious reforms than the government \( (q_0 < q_{opp}) \), then more resources allow the government to stall reforms \( (\frac{\partial q_0}{\partial R} < 0) \) without risking a challenge from the reformist opposition. The second scenario is less likely to occur in the context of program implementation (since it is unclear why such a government would have entered an IMF program to begin with), but it can be expected to play a more important role when analyzing program initiation, since it

\[ 54 \text{This inequality implies that as overall resources increase the opposition is expected to receive larger rents.} \]

Mathematically, it is easy to see that \( \frac{\partial O}{\partial R} = \frac{f'(R-O)}{f'(R-O)+sf''(O)} > 0 \) given that we know from the functional assumptions of \( f \) that \( f'' > 0 \) and \( f'''' < 0 \) .
would allow anti-reform governments to avoid IMF programs altogether.

**Hypothesis 8** Higher levels of discretionary resources facilitate compliance efforts of reformist governments but undermine the prospects of compliance when used by anti-reform governments to placate a reformist opposition.

Overall, this section has identified a number of testable hypotheses about the influence of domestic and international political and financial factors on the prospects of compliance with IMF conditionality. The model predicts that the partisan preferences of both governing and opposition politicians can affect compliance but that these preferences are filtered through the institutional context of the program country (such as the partisan coherence of the government, the degree of political competition and the discretionary resources available to the government). Moreover, institutions affect not only the agenda of the government's policy making but also its ability to implement these policy targets (and comply with IMF conditionality), given that policy outcomes may differ significantly from the intended policies in the context of high levels of institutionally driven uncertainty. At the same time, however, the model also reflects the importance of the international economic and geopolitical context of IMF programs, by focusing on the role of monetary incentives (both directly from the IMF and from third-party lenders) as well as on potential politically-driven variations in the strictness with which IMF conditionality is enforced in different contexts.

**Program Initiation**

Following the logic of backward induction, we can now use the predicted actions and payoffs from the implementation stage to investigate the conditions under which a government decides to enter an IMF program in the first place. In deciding whether or not to enter an IMF
program the government compares the expected utility in the presence of IMF conditionality to that of its status-quo policies without IMF involvement. Based on the relationship between the government's status-quo policy target \( q_0^{SQ} \) and the minimum level of policy reforms \( q_{min} \) for which the IMF is willing to disburse funding, we can distinguish two broad categories of cases:

1. If \( q_0^{SQ} > q_{min} + \frac{k}{2} \), then the government is strictly better off initiating an IMF program because it can pursue its status-quo policy preference and at the same time is guaranteed to receive the benefits of IMF funding and signaling. The likelihood of such a scenario can increase for several different reasons: first, if the policy preferences of the main domestic political actors (\( q_{gov} \) and \( q_{opp} \)) are sufficiently pro-reform, then the domestic political process would produce policies compatible with IMF prescriptions even in the absence of conditionality. In this case, the IMF provides a bonus to a reformist government but it does not actually have an influence on the policy making process. While one can argue that such cases constitute a waste of scarce IMF resources, which could be employed more effectively in cases where IMF funding can provide the necessary impetus for reforms, such situations do occur in reality (e.g. Poland in 1990, Chile in the 1980s) and allow the IMF to claim at least partial credit for successful reform programs. Beyond providing success stories, IMF funding for such “overdetermined” reform efforts also matters since it can provide important financial help for dealing with external payments (as in Chile during the debt crisis) and send positive signals to other lenders (e.g. the Paris Club for Poland in 1990.) Moreover, a program might be helpful in sustaining the reformist momentum past the initial stages, when political costs may lead to a reversal of reforms in the absence of the financial incentives provided by the IMF program. The other main driver of such “foolproof” IMF programs is a severe financial crisis in a politically important country. Such a crisis creates an international imperative for IMF intervention, and thereby leads to a relaxation of
conditionality (since \(q_{\text{min}} = q_p - \sqrt{\mu_p}\)), which makes the program much more attractive than under normal circumstances. Therefore, we would expect more frequent IMF programs in financially strapped countries, especially when the country question is sufficiently important in economic or political terms.

2. The theoretically more interesting scenario, however, occurs when the government’s status quo policies are less reformist than the Fund’s policy requirements (\(q_0^{sq} < q_{\text{min}} + \frac{k}{T}\)). In this case the government faces a trade-off between the benefits of IMF funding and the political costs of complying with IMF conditionality. Moreover, given the uncertainty about the actually implemented policy, the government also needs to consider the possibility that despite its reform efforts it may fall short of IMF expectations and, therefore, have to bear both the political costs of partial reforms and the negative signal of a failed IMF program. Taking the parameters of the program \((q_p\) and \(M_p\)) as exogenous, the net expected benefit of initiating an IMF program equals the difference between the expected utility of an IMF program and the expected utility of implementing status quo policies \((V = U_{\text{cond}}^{\text{gov}} - U_{\text{sq}}^{\text{gov}})\).

To derive the main theoretical predictions of the model, we can use the expression for \(U_{\text{cond}}^{\text{gov}}\) from (6) and the fact that

\[
U_{\text{sq}}^{\text{gov}} = -c_{\text{gov}}(q_0^{sq} - q_{\text{gov}})^2 - \frac{1}{3}(c_{\text{gov}} + s_{\text{opp}})k^2 + f(G) + sf(R - G) - s_{\text{opp}}(q_0^{sq} - q_{\text{opp}})^2
\]

to write \(V\) as:

\[
V = -c_{\text{gov}}(q_0^{unc} - q_{\text{gov}})(q_0^{unc} + q_0^{sq} - 2q_{\text{gov}}) - s_{\text{opp}}(q_0^{unc} - q_0^{sq})(q_0^{unc} + q_0^{sq} - 2q_{\text{opp}}) + \\
+ \mu \left[ \frac{1}{2} (M_p + S_p - S_n) \left( -q_p + q_0^{unc} + \sqrt{\mu_p} \right) k + \frac{1}{2} (M_p + S_p + S_n) \right]
\]

Given that by definition we know that \(\frac{\partial U_{\text{cond}}^{\text{gov}}}{\partial q_{\text{unc}}^{0}} = 0\) and \(\frac{\partial U_{\text{sq}}^{\text{gov}}}{\partial q_{\text{unc}}^{0}} = 0\), we can apply the envelope theorem to analyze the comparative statics of expression (10). Since we know that
\[ q_0^{unc} > q_p - \sqrt{[W]} - \frac{k}{2}, \] it is easy to see that program initiation is more likely when the direct and indirect financing potential of IMF programs is higher (\( \frac{\partial V}{\partial p} > 0, \frac{\partial V}{\partial S} > 0 \)). However, whereas during program implementation the threat of negative signals can serve as an incentive for higher compliance, in the case of initiation higher non-compliance penalties act as deterrents for IMF programs (since \( \frac{\partial V}{\partial S} > 0 \)).

Hypothesis 9 Program initiation is facilitated by the promise of higher direct and indirect funding but is undermined by the threat of negative IMF signals.

With respect to other model parameters, it is easy to see that higher political importance should encourage governments to apply for IMF support (\( \frac{\partial V}{\partial p} > 0 \)), because the politically motivated leniency makes programs relatively easier to fulfill. However, we would expect the effect of political importance to be more pronounced for countries with high levels of financial need (\( \frac{\partial V}{\partial p\mu} > 0 \)), because Western concerns about the welfare of important countries are likely to be amplified in crisis situations. Thus, countries such as Russia or Mexico may have an easier time securing IMF programs even under normal circumstances but their special status is likely to be elevated during periods of financial distress such as 1982 and 1994 for Mexico, or 1998 for Russia.

Hypothesis 10 Politically important countries are more likely to enter IMF programs, especially

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This is true because \( q_0^{unc} \leq q_p - \sqrt{[W]} + \frac{k}{2} \). The confusing sign of the derivative is due to the fact that \( S_n < 0 \), i.e. stronger signals are more negative and reduce the benefit and the probability of program initiation.
when experiencing significant financial need.

Unlike its consistently positive predicted effect during implementation, more intense financial need does not necessarily increase the likelihood of IMF program initiation.\textsuperscript{56} Thus, the effect of monetary need $\mu$ depends on the parameters of the IMF program $(M_p, q_p)$ and on the relative incentives offered by international financial markets $(S_n, S_p)$. If the costs of non-implementation $(S_n)$ are large in absolute terms compared to the implementation benefits $(M_p+S_p)$, and the probability of failure is relatively high (i.e. the government's optimal policy target $q_0^{unc}$ is significantly below the program target $q_p$), then it is possible that financially desperate governments may be less likely to resort to IMF programs in order to avoid the high non-compliance costs ($\partial \mu \partial < 0$). However, in the more likely scenario, where the financial benefits of IMF programs exceed the potential signaling costs of non-compliance, financial need should act as a catalyst for program initiation ($\partial \mu \partial > 0$), in line with the role of the Fund as an international lender of last resort.

\textbf{Hypothesis 11} Countries experiencing significant financial need are more likely to enter IMF programs unless the likelihood and costs of failure are very high compared to the expected financial benefits.

The degree of policy uncertainty $k$ also affects the likelihood of IMF program initiation in an uneven fashion. Thus, for programs with relatively high success chances ($q_0^{unc} > q_p - \sqrt{\mu_p}$),

\begin{align*}
\text{In mathematical terms, it is easy to see that } &\frac{\partial \mu}{\partial q_p} = \frac{1}{2}(M_p+S_p-S_n)\left(-q_p+\sqrt{q_p^2+4\mu_p}\right) + \frac{1}{2}(M_p+S_p+S_n) \text{ is no longer strictly positive if } S_n < 0 \text{ is sufficiently large in absolute terms or if } q_0^{unc} - q_p < \sqrt{\mu_p}. 
\end{align*}

\textsuperscript{56}
policy uncertainty acts as a deterrent against program initiation \( \frac{\partial V}{\partial k} < 0 \) because it reduces the government's control over program outcomes and thereby reduces the expected benefits of reforms. Moreover, under such circumstances, policy uncertainty reduces the effect of financial need on program initiation: since \( \frac{\partial V}{\partial q} < 0 \), it is easy to see that the catalytic effect of financial crisis is likely to be weakened in countries with limited institutional capacity to enact coherent policies. However, policy uncertainty may actually contribute to the proliferation of IMF programs with low likelihood of success, given that for \( q_{0}^{unc} < q_{p} - \sqrt{\mu p} \) we get \( \frac{\partial V}{\partial k} > 0 \).

**Hypothesis 12** Higher policy uncertainty undermines IMF program initiation at least in situations where the government intends to make a significant reform effort (for ideological or financial reasons).

With respect to the domestic political factors, it is easy to see that \( \frac{\partial V}{\partial q_{gov}} > 0, \frac{\partial V}{\partial q_{opp}} > 0 \) (because \( q_{0}^{unc} - q_{0}^{q} > 0 \)), which means that more reformist governments are more likely to initiate IMF programs, as are government's facing less anti-reformist oppositions. The strength of the government's partisan preferences has a non-linear effect on program initiation, which closely resembles the mechanisms discussed during implementation. Thus, if the government is sufficiently more reformist than the opposition \( q_{gov} > \frac{\mu(M_{p} + S_{x} - S_{k})}{2k_{gov} + q_{opp}} \), strong partisan preferences should promote program initiation \( \frac{\partial V}{\partial q_{gov}} > 0 \) but in the reverse partisan constellation \( q_{gov} < \frac{\mu(M_{p} + S_{x} - S_{k})}{2k_{gov} + q_{opp}} \) more ideological cohesion actually reduces the likelihood of entering a new IMF program \( \frac{\partial V}{\partial q_{gov}} < 0 \).
Hypothesis 13 Partisan cohesion within the government promotes IMF program initiation for reformist governments but undermines the prospects of initiation when the government is less reform-oriented than the opposition.

Along very similar lines, the model predicts that \( \frac{\partial V}{\partial s} < 0 \) if \( q_{opp} < \frac{\mu(M_p + S_p - S_a)}{2k_{gov}} + q_{gov} \), whereas when \( q_{opp} > \frac{\mu(M_p + S_p - S_a)}{2k_{gov}} + q_{gov} \) we get \( \frac{\partial V}{\partial s} > 0 \). In other words, higher levels of political competition are likely to prevent governments from initiating IMF programs unless the opposition is sufficiently more reform-oriented than the government and can use its leverage to push for more reforms.

Hypothesis 14 Intense political competition reduces the likelihood of IMF program initiation unless the opposition favors significantly greater economic reforms than the government.

Finally, turning to the non-revolt constraint, we find that the effects of higher levels of discretionary resources on the likelihood of IMF program initiation is mediated by the domestic political constellation in the program country at the time of decision. If we think of the non-revolt constraint as defining a range of politically feasible economic policy choices (\( q_{min}^*, q_{max}^* \)) then an increase in the resources available to the government would lead to an expansion of this range in both directions (\( \frac{\partial q_{min}^*}{\partial R} < 0 \) and \( \frac{\partial q_{max}^*}{\partial R} > 0 \)). In other words the government’s ability to compensate the opposition by sharing some of the additional resources, allows the government to get away with more extreme policies without the fear of political upheaval. Therefore - as in the
case of program implementation - the question becomes how the government intends to use this economic and political capital. If the government - for ideological and/or financial reasons - wants to initiate IMF-style reforms but faces a reluctant opposition ( \( q_0 > q_{opp} \) ) then additional resources would improve the political feasibility of such reforms and hence increase the probability of IMF program initiation. If, on the other hand, the government's main push for reforms comes from the political pressures of a pro-reform opposition ( \( q_{opp} > q_0 \) ), then the leeway afforded by additional resources would actually reduce the likelihood of an IMF program.

**Hypothesis 15** Discretionary resources promote IMF program initiation for reformist governments but reduce the frequency of new IMF programs among anti-reform governments.

**Conclusion**

This chapter has developed a theoretical framework for analyzing the politics of IMF program initiation and implementation. The framework traced to capture the wide range of domestic and international factors, which affect the preferences and constrain the actions of the two main protagonists – the IMF and the program country government – during their interactions in the context of IMF programs. The second part of the chapter develops a formal model, which incorporates a number of crucial facets of the process of IMF program initiation and implementation. The model yields a series of testable hypotheses about how IMF programs are affected by partisan preferences, the domestic institutional features and the financing need of the program country, and the different priorities of the IMF in the context of international financial
markets. A crucial aspect of the analysis presented in this chapter is that the effects of individual factors are not necessarily additive but emerge from the complex interaction between the intentions of political actors (e.g. the partisan orientations of the government and the opposition), the particular institutional and structural features of the domestic political economy (e.g. the intensity of political competition, the partisan cohesion of key political actors and the availability of discretionary resources) and the country's financial and geopolitical position in the world at a given point in time.

More specifically, the effect of institutional characteristics on the likelihood of compliance depends in crucial ways on the relationship between the policy intentions of the government and the partisan orientation of the opposition. If the government would like to implement more ambitious reforms than desired by the opposition, then IMF program initiation and implementation will be facilitated by more government partisan cohesion, less political competition and higher availability of discretionary resources, all of which contribute to the government's ability to implement tougher reforms. If, on the other hand, the government is opposed to reforms, then the same structural and institutional characteristics should be expected to hinder IMF-style reforms by limiting the ability of the pro-reform opposition to influence the government's economic policy making.

Even with respect to the more conventional explanations of IMF program initiation and compliance (e.g. the importance of economic crisis, the size of funding and the possibility of geopolitically motivated deviations from Fund conditionality), the model provides additional analytical leverage by focusing on the interaction between different factors. Thus, higher levels of financial need are expected to improve the likelihood of compliance but we would expect the
effect to be stronger when the program is backed by substantial financial assistance. Conversely, the positive effects on compliance of high levels of funding (both directly from the IMF and indirectly from other official or private lenders through the multiplier effect) are amplified in situations where the country's financial need is high and administrative institutions function reasonably well. Negative signaling, which occurs when the IMF withholds funding due to inadequate compliance, serves as an incentive for compliance once the government has agreed to a program but should be expected to reduce the likelihood of program initiation since it amplifies the down-side effects of program failure. Weak administrative capacity - the main source of uncertainty in the model - is expected to reduce the success for compliance with IMF program targets but only in cases where the government makes a significant reform effort (for either partisan or financial reasons). Finally, the model predicts that politically important countries should be more likely to initiate programs, should be promised higher levels of direct funding and should be more likely to complete programs but that this political favoritism should be more pronounced in cases where financial need is high and policy uncertainty relatively low.

\[\text{In fact, at the extreme, higher financial need may actually deter governments from initiating IMF programs as long as the negative fallout from non-compliance outweighs the positive incentives provided by direct and indirect funding related to IMF program compliance.}\]

\[\text{Again, at the margin, the model allows for the possibility that unwilling reformers in situations of high administrative uncertainty may comply with IMF conditionality “by mistake”, i.e. by receiving a large positive shock in terms of implementation. A more intuitive interpretation would be to consider uncertainty arising from the ability to collect reliable economic data, in which case high uncertainty may facilitate the distortion of information and, hence, IMF approval despite modest reform efforts.}\]

\[\text{Notice, however, that in the context of the model such success is relative because it is driven by the Fund's more tolerant stance towards deviations from program targets rather than by higher levels of policy reforms.}\]
Chapter 3

Changing Crisis “Recipes”: The International Drivers of IMF Programs

Since IMF programs occur at the intersection between domestic and international politics, the logical starting point for understanding the political dynamics of IMF program initiation and implementation is the broader international political economy context of a given program or cluster of programs. Building on the analytical framework developed in the preceding chapter, this chapter focuses on the international factors, which affect the relative cooperation incentives for the IMF and program country governments. In particular, as illustrated in Figure 3.0, the Fund’s agenda in dealing with a given country is driven by systemic concerns for international financial stability, as well as by Western geopolitical concerns for certain strategically important countries. The analysis in this chapter shows how these economic and political priorities differed in two crucial crisis episodes – the Latin American debt crisis and the post-communist transition – and how these differences affected the nature of IMF involvement in the two regions. At the same time, Figure 3.0 suggests that international financial markets shape the incentives of program initiation and implementation of governments in the developing world. In this respect, too, the chapter identifies significant differences across the two crisis episodes, as the financial boom of the 1990s promised greater potential rewards for IMF compliance than the financial crisis environment of the 1980s.

Insert Figure 3.0 here
Even though a large and well-established academic literature has traced the fundamental
transformation of international financial markets in recent decades,\textsuperscript{60} as well as the
corresponding changes in IMF mission and policy instruments,\textsuperscript{61} the statistical literature on the
drivers and consequences of IMF programs has produced surprisingly little explicitly
comparative work on the consequences of the changing international financial and geopolitical
context for the political dynamics of IMF programs. Existing large-N studies can be broadly
divided into two categories: the most widespread approach\textsuperscript{62} - analyzing cases spanning multiple
regions and time periods - yields larger data sets and lends itself to making broader statements
about the causes and effects of IMF programs but has the disadvantage of ignoring the changing
nature of IMF conditionality and thereby mistakenly assuming causal homogeneity across a
variety of different contexts. An alternative approach has been to focus on a much more
restricted set of empirical cases, usually by analyzing IMF programs in a single region and over a
shorter time period.\textsuperscript{63}

This chapter departs from the existing academic literature by analyzing two temporally
and geographically bounded country clusters - Latin America in the 1980s and the former Soviet
Bloc in the 1990s – to show how the differences in their respective international economic and
political context affected the dynamics of IMF program initiation and implementation. The
systematic comparison of the Latin American and East European IMF programs reveals several
important implications of the changing international context in which individual programs
unfolded: thus, the Latin American programs of the 1980s bore the heavy imprint of the
economic and political imperatives of the debt crisis, with debt service burden emerging as a

\textsuperscript{60} See, for example, Eichengreen and Fishlow (1996), Keohane and Milner (1996).
for Africa.
powerful predictor of program initiation and implementation, and political favoritism reflecting Western concerns about the fallout from a potential default by the region's largest debtors. The East European experience with the Fund was defined to a much greater extent by their low international reserves and limited access to capital markets inherited from the Communist era than by concerns about foreign debt. Therefore, Western concerns and Fund efforts were directed primarily at integrating the ex-communist countries into the world economy and supporting domestic efforts to build market-based economies while maintaining regional political stability.

Despite these contextual differences in the nature of external financial concerns, the evidence from both regions confirms earlier findings (Thacker 2000, Stone 2002) that politically and economically important countries received preferential treatment from the IMF but, unlike previous analyses, this chapter shows that such politically motivated exceptionalism only applies in situations of severe external economic crises. Moreover, the present analysis also demonstrates that the standards of economic and political importance vary as a function of the broader international economic and geopolitical environment, with debt playing a much greater role in Latin America, and market size, population size, and proximity to Western Europe mattering to a greater extent in Eastern Europe.

The analysis in this chapter is based on a series of statistical tests of the drivers of IMF program initiation and implementation during the Latin American debt crisis and the post-communist transition. The first section, which analyzes the economic and political dynamics of IMF program initiation, starts out by confirming the importance of financial need and vulnerability as the most immediate international drivers of IMF programs but also shows that effects were stronger for those aspects of financial need - debt service in Latin America and international reserves in Eastern Europe - which addressed the particular nature of the crisis in
each of the two regions. Next, I analyze the cross-regional differences in how a country’s broader standing in international financial markets affected the political calculus of its relations with the IMF. The findings suggest that countries with intermediate credit ratings were the most likely IMF program candidates in both regions but that creditworthy ex-communist countries were more likely to resort to IMF support than their Latin American counterparts. The final part of the first section, analyzes the interaction between financial need and the economic/political importance of a given country, and finds similar politically motivated deviations from purely technocratic considerations in the application of IMF conditionality with respect to the speed of program initiation. The second section confirms the preferential treatment of economically and politically important countries with respect to other program parameters controlled by the Fund (such as funding and number of conditions) and the strictness with which deviations from program targets are punished.

The third section compares the drivers of compliance with IMF program conditions in Latin America and Eastern Europe. The first part confirms the importance of crisis-specific aspects of financial need – higher interest payment burdens during the Latin American debt crisis and lower international reserve levels in the transition countries – in getting governments to implement IMF programs. The relationship between creditworthiness and program compliance, analyzed in the second part of the section, reveals significant cross-regional differences, which reflect the more cooperative relationship between the Fund and transition countries compared to its interactions with Latin American debtors in the previous decade: thus, in Eastern Europe countries with better credit ratings had consistently higher compliance rates (in line with their superior ability to control their economic policies), whereas in Latin America compliance was the highest among countries with intermediate credit ratings. The two regions also differed with
respect to how economic/political importance affected compliance records: thus, the analysis suggests that in Latin America compliance rates for large debtors were higher than for other countries in intense crisis environments but lower under normal circumstances. Meanwhile, despite benefiting from preferential treatment, important transition economies had consistently lower compliance rates than other countries in the region, which confirms Stone’s (2002) finding that IMF favoritism in the post-communist transition occurred primarily at the initiation rather than the implementation stage. Finally, the last part of the section indicates that once we account for the endogenous nature of the size of IMF loans, there is no statistically conclusive evidence that more generous IMF funding helps promote greater compliance by program countries.

Data and methods

The statistical analysis presented in this chapter relies on quarterly data from two separate episodes of IMF interventions in the developing world: 22 Latin American and Caribbean countries between 1982 and 1989, and 26 ex-communist countries from Eastern Europe and the former Soviet Union between 1990 and 2001. The choice of individual variables used in the tests is discussed in more detail in the relevant empirical sections along with brief comparisons of the two regions in terms of these indicators. For a more detailed overview of the coding, descriptive statistics, and sources for the variables discussed in this chapter (and in chapter 5) see tables 1a-1d in the appendix.

Considering the dichotomous nature of the two main dependent variables - program initiation and compliance – the analysis uses random-effects cross-sectional logit statistical models. Since the observations in the two samples exhibit a high degree of serial autocorrelation, all the statistical models include a non-event duration measure and cubic time splines in
accordance to Beck et al’s (1998) method for dealing with autocorrelation in time-series cross-sectional models with binary dependent variables. Moreover, the models include year dummies to control for temporal variations in IMF conditionality and other potential systemic shocks. However, country dummies were not included in the main regression models because we are interested in both the cross-country and the within-country variations in the factors driving compliance with IMF programs. Nevertheless, the statistical models do include a variable, which should capture quasi-fixed effects: IMF program history measures the proportion of the previous five years (in Eastern Europe) or ten years (in Latin America) for which a given country was involved in an IMF program.

Since, as this chapter clearly demonstrates, countries are not randomly selected into IMF programs but choose to (or have to) initiate programs for a variety of economic and political reasons, the statistical analysis of IMF program compliance has to deal with the problem of selection bias. The present analysis uses the approach pioneered by Heckman (1979), namely including the inverse Mills ratio obtained from the selection equation as an additional control variable in the main model of interest. The selection equations use two possible instruments, which affect selection into a program but not the likelihood of compliance. The rationale for the first instrument, IMF program history, is that countries with a long history of IMF agreements, the threshold for entering another program may be lower but there is no reason to expect that such “eternal clients” would necessarily be more or less likely to comply (and a brief overview of the programs in the two regions reveals no such pattern). The second instrument - the average

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64 Since several of the variables of interest (such as the quality of administrative institutions) vary a lot across countries but to a lesser extent within a given country across time periods, we would expect their effects to be reduced significantly in the fixed effects models.

65 The intuition is that in countries with frequent IMF agreements, the threshold for entering a new agreement should be lower, whereas the underlying structural drivers of such programs (beyond the ones already captured in the model) arguably only change slowly over time.
number of countries covered by an IMF agreement among a given country’s neighbors - captures
the contagion effects inherent in waves of policy reform (Kopstein and Reilly 2002, Elkins and
Simmons 2004), which may explain a government’s decision to enter an IMF program but not
necessarily its willingness (or ability) to follow through with implementation.

II. The drivers of IMF program initiation

1. "Beggars can’t be choosers": financial need and program initiation

   During the eight years between the “official” debut of the debt crisis in 1982 and the end
of the decade, the 22 Latin American and Caribbean countries included in the present analysis
initiated a total of 43 high-conditionality IMF programs and spent an average of 36% of their
time covered by a program. More revealing than these regional aggregates, however, is the large
variation across countries and time periods. Whereas in early 1982, prior to Mexico’s insolvency
announcement, only three of the countries in the region (Costa Rica, Jamaica and Uruguay) were
involved in IMF programs, a year later in early 1983 the number of programs had quadrupled
and by the end of that year 14 of the 22 countries in my sample had committed to an IMF
program. Following this initial “shock treatment” for what was initially regarded as a short term
危机 with short term solutions, the number of programs decreased at first rather slowly (to ten
by late 1985) then declined all the way to four “usual suspects” (Argentina, Chile, Jamaica and
Mexico) in mid-1987 before climbing rapidly again to ten programs by the end of 1989.

   Even by the high standards of the Latin American debt crisis, the Fund’s role in the post
communist transition is remarkable in its ubiquity. Only two of the 26 transition countries
countries - Slovenia and Turkmenistan (interestingly located at the two opposite development
poles among the ex-communist countries) - did not have a single IMF program since the collapse
of Communism in the region. The remaining 24 countries managed to “collect” a remarkable 74 high-conditionality programs between 1990 and 2001, ranging from a single program in Albania, Belarus and Tajikistan to seven programs in Latvia and Romania.

This brief overview of IMF program patterns confirms the intense involvement of the IMF in the political economy of the two regions during their respective crises. So far, the similarity of these broad regional aggregates suggests that rather than focusing on cross-regional differences, the more interesting question is what explains the large cross-country heterogeneity in program initiation within each of the regions. However, as the following discussion shows, the crucial difference between the two country clusters is not the end result of the interactions between the Fund and developing countries – frequent and unevenly distributed programs – but rather the different drivers of these programs and their political implications for how IMF programs came to be viewed by domestic political actors in the countries of the two regions.

Even though at least one prominent recent analysis of the politics of IMF programs argues that one of the main drivers of program initiation is the desire of governments to have conditions imposed from the outside in order to implement domestically unpopular economic reforms (Vreeland 2003), the classic motivation for governments to initiate IMF programs and forfeit a large part of their policymaking freedom is immediate and severe financial distress. In fact, according to the IMF Articles of Agreement, financing need due to unfavorable developments in a country's balance of payments or international reserves position constitutes a necessary condition for the use of Fund resources in the context of a Standby Arrangement (SBA) or similar program. The discussion below shows how three crucial facets of financial need - international reserves, foreign debt burden, and access to capital markets - affected the decisions of Latin American and East European countries to seek IMF assistance.
a. International reserves

The first (and most straightforward) measure of external financial need is the amount of 
international reserves in months of imports. The lower a government’s international reserves 
position as a proportion of its imports of goods and services, the higher the danger that even a 
short-term negative trade shock or capital outflow could result in the inability of the government 
to honor its outside financial obligations. Aside from the long-term damage to the country’s 
international creditworthiness, such insolvency - especially in economically important countries - 
may cause important disruptions international trade and financial stability, and was, therefore, 
one of the principal reasons for the establishment of the IMF as an international lender of last 
resort.

With respect to this first indicator of financial need, the ex-communist countries averaged 
a threateningly low 2.2 months worth of foreign reserves in the 1990s, well below the level of 
three months of imports that is generally regarded as the minimum threshold for a comfortable 
reserve position. This weakness was largely a legacy of the Communist system with its 
continuous shortage of hard currency and was exacerbated in the case of the former Soviet 
republics by an arrangement whereby Russia assumed the bulk of the debt and the foreign 
reserves of the Soviet Union. Hence, the other former Soviet republics emerged at independence 
with practically no hard currency reserves and faced an uphill battle to build up their reserve 
position in the context of a foreign trade oriented primarily towards other ex-communist (and 
equally hard-currency-starved) countries in the early transition period. Even though the average 
reserve position of the countries in the region improved gradually over the course of the twelve 
transition years under analysis (from less than 1 month of imports in early 1993 to about 3.5
months in late 2001), only Hungary, Poland and oil-rich Turkmenistan had international reserves in excess of four months of imports for most of the transition period.

By contrast, during the 1980s the regional average for the Latin American and Caribbean countries in my sample was about four months of imports but declined from a peak of 4.6 months in mid-1986 to around 3 months by late 1989. Sub-regional differences were even larger than among transition economies, with South American countries (particularly Venezuela, Chile and Paraguay) having consistently higher reserves than most Caribbean and Central American countries, whose reserves fell below the critical level of two months of imports for most of the decade. Moreover, the changing domestic and international fortunes countries of Argentina, Peru, Brazil and Colombia were reflected in the large temporal variation in their reserve levels in the 1980s. Nonetheless, reserve shortfalls were less acute in Latin America than in Eastern Europe a decade later, and, therefore, one would expect them to play a less important role as drivers of IMF programs.

The statistical results in Tables 2a&2b confirm the predictions of Hypothesis 11 in the formal model about the importance of financial need for program initiation. The salience of international reserves was greater in cash-strapped Eastern Europe, where according to Models 1&2 in Table 2a, each additional month’s worth of international reserves reduced the odds of program initiation by 45% regardless of whether reserves were lagged by one or two quarters. The substantive effect of higher reserves was considerably smaller (but still statistically significant), for Latin American countries, whose program odds were only reduced by an average of 25% per additional month of reserves (with longer lags producing somewhat stronger results.) The much more powerful implications of low reserves in Eastern Europe become even clearer when comparing the results for a dichotomous specification of \textit{Low international reserves} in
Model 3 of Tables 2a&2b, which uses three months of imports in the preceding quarter as a threshold for identifying instances of financial distress: thus, among ex-communist countries, such crisis cases had ten times higher odds of program initiation than their less troubled counterparts, whereas in Latin America the odds merely doubled (and were only marginally statistically significant.)

The nonlinearity in the effects of international reserve levels on the likelihood of program initiation, which was suggested by the different predictive power of the threshold specification models, becomes even clearer when looking at Figure 1, which presents the predicted probability of initiation based on the inclusion of squared lagged reserves in Model 4 of Tables 2a&2b respectively.

*Insert Figure 1 Here*

The trajectory difference between the two regions is striking: ex-communist countries with very low reserves were highly likely to resort to the IMF but their “zeal” declined quite rapidly as soon as reserves reached relatively comfortable levels of 4-5 months of imports. Meanwhile, in Latin America, the countries most likely to initiate programs were not those with the lowest reserves but rather countries with reserves in the vicinity of the three-month “danger” threshold. Part of this interesting deviation from the expected monotonic relationship between financial need and IMF programs may have to do with the fact that the countries with the lowest reserves (e.g. Haiti, Nicaragua) also had weaker bureaucracies and suffered from greater political instability, which may have prevented them from seeking the needed IMF support. At the same time, however, Figure 1 confirms that in Latin America even countries with relatively healthy reserve levels (of 5-6 months of imports) were not immune to IMF pressures, arguably because,
as we will see below, the large debt repayment commitments of many Latin American debtors could easily wipe out even apparently healthy international reserves.

\[ b. \textit{Foreign debt burden} \]

Despite their healthier international reserves position, Latin American and Caribbean countries experienced a much more precarious than their ex-communist counterparts with respect to a second critical aspect of external financial need: the external debt situation. The regional debt/output ratio in Latin America rose from 38% in late 1981 to 65% in 1987 before declining to 49% in late 1989 with several countries - including Bolivia, Jamaica, Nicaragua, Panama and Costa Rica - weighed down by debts ratios exceeding 100% of GNI. Latin American external debt had risen rapidly during the 1970s as a result of massive and unsustainable lending of recycled oil-money by Western commercial banks,\textsuperscript{66} but the actual debt crisis only started officially with Mexico’s default in August 1982. By comparison, foreign debt accounted for around 15% of output of the former communist bloc at the start of the transition, with only three countries - Bulgaria, Hungary, and Poland - experiencing debt ratios in excess of 30%.

Meanwhile, most of the newly independent states of the former Soviet Union emerged debt-free at independence due to the aforementioned agreement whereby Russia assumed most of the reserves and external obligations of the USSR. Since at the start of the transition the main external challenge was not too much debt, but the extremely low international reserves and the limited access to capital markets, the initial rise of foreign debt in the early 1990s could be considered as somewhat of a success, as it signaled the entry (or re-entry) of ex-communist countries into international financial markets. However, by 1999, East European debt ratios had

\textsuperscript{66}Starting in 1980 much of the Latin American borrowing was channeled into maintaining external liquidity (IADB 1990) until 1982, when the net inflow of international loans was insufficient to cover the spiraling interest payments and resulted in the insolvency of the most indebted nations (Brovedani 1985:24-25).
reached an alarming regional average of 60% of GNI before declining to a more manageble 46% in late 2001.\textsuperscript{67} While several countries – such as Hungary, Bulgaria, and Russia - had inherited substantial foreign debts from the 1980s and struggled with payment crises at various points of the transition,\textsuperscript{68} the region overall was less affected by the specter of massive debt defaults that had haunted Latin America a decade earlier.

While high foreign indebtedness in developing countries should obviously concern both domestic politicians and international financial institutions, the politics of IMF programs usually center more on some of the more immediate consequences, such as fiscal pressures and liquidity concerns related to debt repayment. Even more so than in terms of overall debt, Latin America was in a much more precarious position than Eastern Europe with respect to economic and political costs of servicing the foreign debt accumulated in earlier decades. Thus, in Latin America, interest payments accounted for 4-5.5% of gross national income (GNI) from 1981-88 before declining to around 3% in 1989. In several countries, including Bolivia during its paralyzing crisis in 1982-4 but also in Chile and Jamaica in the mid-1980s, interest payments exceeded 10% of GNI, thereby putting governments in the difficult position of choosing between harsh austerity measures or losing control over inflationary pressures. Meanwhile, the East European regional interest/GNI ratio averaged less than 1% prior to 1996, with only Hungary and Bulgaria experiencing interest burdens in the 4-5% range that was the norm in Latin America in the 1980s. Despite the ex-communist bloc’s rapidly rising debt, only 2% of the region’s GNI was transferred abroad as interest payments by late 2001, though a few countries –

\textsuperscript{67}Even more so than in Latin America, this increase in post-communist relative indebtedness occurred at least in part due to the severe economic contraction of the early 1990s. However, even in absolute terms the overall debt owed by countries in the region more than doubled between 1990-2000.

\textsuperscript{68} Whereas Hungary managed handle the repercussions of the Mexican financial crisis of 1994 at least in part through its healthy privatization revenues, other countries - such as Bulgaria in 1996/7 and Russia in 1998/9 experienced much more severe financial crises and ended up defaulting on some of their external obligations.
most notably Moldova and Kyrgyzstan - had reached interest payment levels of 5% of GNI by 2001, which are alarming given the two countries’ low development levels. The comparison between the two regions yields very similar conclusions when using alternative measures of debt burden: thus, Latin American debt servicing expenses averaged the equivalent of 30 months worth of export earnings, almost five times higher than the regional average for Eastern Europe and the former Soviet Union.

The higher prominence of debt servicing pressures in Latin America is reflected in the statistical evidence on the drivers of program initiation in the two regions. As expected, models 1-3 in the two tables clearly show that the burden of interest payments were a much stronger predictor (in both substantive and statistical terms) of IMF program initiation in the heavily indebted Latin American countries than in their post-communist counterparts. Thus, a one-standard deviation rise in interest/GNI was associated with a statistically significant increase of roughly 55% in the odds of program initiation in Latin America,\textsuperscript{69} whereas in Eastern Europe the corresponding impact was only 10% and was statistically insignificant. Overall, the statistical findings in this section confirm the theoretical predictions of the formal model about the importance of external financial need (Hypothesis 11), but it also reveals some interesting regional variation in the salience of different types of financial need, as reserves mattered more in Eastern Europe while debt burden played a greater role in Latin America.

c. Access to international capital markets

In the volatile relationship between developing countries and international financial markets, the International Monetary Fund fulfills two important functions meant to address two

\textsuperscript{69} The statistical significance is somewhat weaker in Model 4 because the inclusion of squared reserves introduces some multicollinearity.
different types of market failure: the first is related to the Fund’s role as an international lender of last resort and involves the provision of funding to countries which have no (or very limited) access to alternative sources of credit in order to address their balance-of-payment difficulties. The second role of the IMF - as an international judge of the economic policies pursued by developing countries – is meant to facilitate international lending by reducing the informational asymmetries in international financial markets and the information costs for lenders. Ideally these two roles are complementary in the sense that direct IMF lending enhances the credibility of its signals about a given country’s policy record (since its own resources are at stake), whereas the positive signal of IMF funding and supervision is expected to mobilize additional funding from other lenders, thereby leading to a beneficial multiplier effect.

In reality, of course, the mix of these two roles in a given program varies greatly depending on the specific relationship of the country in question with international financial markets. At one extreme there are countries, like Estonia or Latvia in the late 1990s, which had ready access to cheap international financing and therefore enter IMF programs on a purely precautionary basis, i.e. without intending to draw on the resources committed by the Fund but merely to obtain the IMF “seal of approval” for their economic policies. If such precautionary programs predominate, then one would expect a positive relationship between credit-worthiness and IMF program involvement, since countries with better credit ratings should have an easier time to fulfill IMF policy requirements and therefore benefit from the positive signals (rather than suffering the possible repercussions of a negative IMF assessment.) At the other extreme are countries like Moldova in the mid 1990s, whose main source of funding was the IMF and other official multilateral lenders but who had few prospects of accessing international financial markets even with the Fund’s seal of approval. Wherever such need-driven programs
predominate, we would expect to see a negative relationship between financial market access and IMF programs (in line the prediction in Hypothesis 11). Finally, countries with intermediate standing in international finance (such as Romania and Bulgaria for much of the 1990s) stand to benefit from both the direct funding and the potential positive signals due to a successful IMF program, in which case the relationship between credit ratings and the probability of program initiation would be an inverse U-shape.

Before assessing the empirical support for each of the three scenarios, a brief overview of financial market access in the two regions is in order. This overview, as well as the empirical tests below, largely relies on country credit ratings published on a biannual basis by *Institutional Investor*, based on a survey of financial managers from 75-100 top international banks. Figures 2a & 2b illustrate the broad temporal trends based on the regional average in credit ratings during the two crises. Even this rough measure captures the remarkable and abrupt “fall from grace” of Latin American debtors following Mexico’s default in mid-1982, followed by a relative stabilization in 1985-1988 and a renewed decline in 1989 despite the “official” end of the debt crisis heralded by the Brady Plan. However, the decline was not uniform across countries: thus, some of the region’s largest debtors (Brazil, Argentina, Mexico, and even neoliberal poster-child Chile) suffered dramatic declines of 25 or more points on the 100 point IIS scale, whereas less indebted countries (such as Panama, Trinidad-Tobago and Paraguay) held up better. Finally, a group of Caribbean and Central American countries started out from a much lower base and therefore also experienced much smaller declines.

At first glance, judging by Figure 2b, the early transition years also witnessed a substantial decline in credit ratings for the former communist countries, as financial markets became aware of the economic mess left behind by the Communists in countries like Bulgaria.
and Romania. However, much of the decline in the regional average is due to the inclusion starting in 1992 of a large number of newly independent states whose economic and political woes, combined with their short international track record, yielded many low credit ratings and produced a regional average comparable to that of Latin America in the throes of the debt crisis. However, unlike the extended credit malaise that plagued Latin America in the 1980s, the post-communist transition witnessed a gradual but substantial improvement in credit ratings, as increasing numbers of countries managed to gain access to commercial lending in international markets. Much of this growth, however, was driven by a few star performers – especially Poland, Slovenia and the three Baltic states - whereas elsewhere the journey towards global finance was slower and more prone to temporary reversals (e.g. in Russia, Romania and Bulgaria), or had barely even started in the poorer parts of the Balkans and the former Soviet Union.

As this brief overview has shown, both regions consisted of a fairly broad mix of country credit profiles and thereby provide ideal testing grounds for the relationship between credit ratings and IMF program initiation. At the same time, the different direction of the temporal trends during the two crises - downward in Latin America and largely upward in Eastern Europe - raises the question of whether these trends affected the expectations of governments about the likely repercussions of an involvement with the IMF for future access to private capital markets. On the other hand, it is important to remember that the Latin American debt crisis was initially regarded by most experts (including the IMF) as a temporary liquidity crisis which could be addressed through resolute short-term adjustment policies. This optimism – which in hindsight of course was unjustified - may nonetheless have provided significant incentives to Latin American

70 In fact a properly weighted regional average would yield even lower results, since several of the region's worst performers were not even included in the IIS ratings until the late 1990s.
governments to go along with the requirements of IMF conditionality in the hope of a rapid return into the graces of international finance.

How did capital market access affect the politics of IMF program initiation during the two crisis episodes? Figure 3 based on the results in Model 5 of Tables 2a&2b provides strong support for the third scenario, which predicted an inverse quadratic relationship between credit access and the likelihood that a given country enters an IMF program. In both Latin America and Eastern Europe the countries most likely to resort to IMF programs were the borderline cases with intermediate-level credit ratings, for which the immediate monetary incentive of direct IMF funding (in line with Hypothesis 11) was complemented by the longer-term promise of improved access to credit markets in the event of successful compliance with IMF conditionality (following the logic of Hypothesis 9). For both regions the likelihood of initiation declined substantially for countries with comfortable credit ratings and easy access to alternative (and usually cheaper) sources of private credit, which may help explain the ability of countries like Trinidad-Tobago, Colombia and Venezuela to avoid the IMF until the late 1980s, as well as the petering out of the initially intense IMF involvement of countries like Poland, Hungary, and the Czech Republic by the mid to late 1990s. However, this need-based relationship does not hold in the lower range of the credit scale, where the countries with the worst outside options and the greatest dependence on the Fund as a lender of last resort actually exhibited a lower propensity of resorting to IMF programs. Part of this correlation may be due to the fact that the countries with the weakest credit ratings – such as Haiti, Nicaragua, Albania or Georgia – also suffered from weak bureaucratic capacity and political instability which arguably undermined their government’s ability to pursue IMF programs. However, since the results hold even though the statistical models control for bureaucratic quality, these findings support Hypothesis 9 about the
importance of a credible possibility that IMF programs would mobilize additional resources from outside lenders (which was often not the case for the least credit-worthy countries).

While the overall nature of the relationship between credit ratings and IMF program incidence was remarkably similar for the two regions, a closer look at Figure 3 nonetheless reveals some interesting differences. East European countries were significantly more likely to resort to IMF programs at higher levels of international credit ratings than their Latin American counterparts. This finding may be due to the desire of the ex-communist newcomers to international capital markets for the added assurance of precautionary IMF programs but also reflects the more sober reality that in the context of the Latin American debt crisis most governments only resorted to the IMF when they perceived that they had few other alternatives. By contrast, the slightly higher IMF attendance record among Latin American countries at the low end of the credit scale is probably due to the even greater bureaucratic capacity deficit among the former communist countries, which, as will be discussed in more detail in the next chapter, played a more prominent role in the IMF programs in former Soviet Bloc in the 1990s.

2. Political and economic importance and IMF programs

Several scholars have provided systematic evidence supporting the claim that IMF lending is influenced to a significant degree by its largest members, who use their voting rights within the Fund to pursue their geopolitical interests in the developing world. Thus, Stone (2002), using a country’s IMF quota and the size of USAID appropriations as a proxy of political importance, shows that among the transition economies in the 1990s more important countries suffered shorter punishment periods after failing to comply with program conditions.\textsuperscript{71} Using

\textsuperscript{71}In addition to the statistical tests, Stone also provides ample case evidence documenting the importance of U.S. political interventions in shaping the nature of IMF conditionality towards Russia.
patterns of U.N. voting as a measure of ideological proximity to the U.S., Thacker (2000) found that U.S. allies received preferential treatment from the IMF during the period 1975-91.

Since no single measure of political importance is likely to do justice to this multi-faceted concept and many existing measures suffer from validity and reliability problems, the present analysis relies on several different measures of a given country’s economic and political importance to the West: the overall size of the foreign debt, the market size for US exports, the size of the population and foreign aid. Moreover, unlike previous statistical work on the subject, in line with the predictions of the formal model (Hypothesis 10), this section analyzes not only the linear effect of economic and political importance on the political dynamics of IMF programs but also the interaction between political importance and financial need. Specifically, the analysis shows that more important countries of the two regions were more likely to obtain IMF agreements under severe crisis circumstances but that size-based differences disappeared in low-crisis environments.

How do the countries of the two regions compare along the various dimensions of economic and political importance, and which of these dimensions is more likely to have affected the political calculus of IMF conditionality? As discussed earlier, foreign debt was clearly the dominant Western concern in 1980s Latin America, and this concern is justified by the much greater total debt of the region, which amounted to $310bn in late 1981, almost twice as large as the corresponding debt of the ex-communist countries ($156bn) in late 1989. Because

72 For example, the size of the IMF quota suffers from cross-temporal comparability limitations due to the large and irregularly spaced quota increases, which would suggest an illusory increase in importance over time. USAID appropriations and other measures of Western aid are likely to exaggerate the political importance of poor countries due to their relatively high negative correlation with wealth. Finally, U.N. voting patterns were a much weaker indicator of international allegiances in the post-Cold War period and would therefore be of limited use in the case of the former Communist countries (Pop-Eleches 2001).

73 For the statistical tests I also used a variety of additional measures, including the size of the population, the size of GDP and of the IMF quota, the distance from Western Europe (in the case of ex-communist countries) but the results were not sufficiently different from the main measures to warrant separate discussion.
the survival of the highly exposed U.S. and British banks was the crucial concern of Western
governments during the 1980s, the much larger threat to international financial stability posed by
a possible debt repudiation by Latin American debtors becomes even clearer when we compare
the total debt owed to commercial banks, which was three times higher in Latin America
($169bn in 1982) than in the former Soviet bloc ($55bn in 1989). By 2001 the combined debt of
the transition economies had more than doubled to $381bn but only 30% of this debt was owed
to commercial banks, reflecting the diversification of international capital flows during the
1990s. Somewhat surprisingly, after eight years of austerity and stagnation brought about by the
debt crisis, the overall debt of the Latin American and Caribbean countries increased by another
50% to reach $475bn in late 1989, and even commercial bank debt had grown by 30% over the
same time period.

In Latin America the largest debtors throughout the decade were Mexico, Brazil, and
Argentina, which accounted for almost two thirds of the region’s debt and were therefore the
most likely candidates for preferential treatment. Of the other Latin American countries,
arguably the only one whose default could have had serious repercussions for international banks
was Venezuela (with about 5% of regional debt in 1982), but its significant oil revenues and
solid reserve position made a default less likely. In Eastern Europe, the most important debtor
was by far Russia, which had assumed the foreign debt of the Soviet Union and accounted for
roughly 45% of regional debt in 1993, followed by Poland, whose debt made up another third of
post-communist public debt, and even after the country’s successful debt reduction negotiations
in 1989. At the start of the transition, the only other East European countries with significant
foreign debts were Hungary and, to a lesser extent, Bulgaria. Despite the rapid growth of foreign
debt over the course of the 1990s, the top rankings remained unchanged with the exception of
Bulgaria being overtaken by Ukraine and the Czech Republic, none of which, however, amassed sufficient public debt to raise serious concerns among Western creditors.

Developing countries matter to the world economy not only as debtors but also as potential markets – hence their increasingly widespread designation as *emerging markets* in the 1990s. This aspect was particularly important in Eastern Europe, as the dramatic westward trade reorientation of the ex-communist countries created significant opportunities for international businesses to reach tens of millions consumers in previously untapped markets. By comparison, Latin American imports declined for much of the 1980s at least in part due to pressures from the West and the IMF for countries to adjust exchange rates and curb domestic demand in order to raise the foreign currency necessary to honor their high external obligations. Therefore, differences in market size are expected to play a greater role in the politics of IMF programs in Eastern Europe than in Latin America.

When judging the economic importance of a given market, the most straightforward measure is to look at existing import levels, which provide a good sense of the potential disruption to world trade in the event of a serious economic crisis in a given country. In Latin America, the two largest overall markets for foreign goods and services were Brazil and Mexico, followed at some distance by Venezuela, and even further behind by Argentina, Columbia, and Chile. When judging by the more politically salient imports from the US, Mexico emerges as by far the largest market, followed by Brazil and Venezuela at roughly a third of Mexican levels. In Eastern Europe, Russia started out as the far the largest export market, followed by Kazakhstan, Ukraine, and Poland. However, as trade in the former Soviet space declined and East-Central European countries grew at a much faster rate during the 1990s, by the end of the decade Poland had almost tied Russia in market size (around $50bn per year), with Hungary and the Czech
Republic following closely behind (in the $30-35bn range), and Ukraine, Romania, Slovakia, and Slovenia the only other countries over the $10bn mark in 2000. In terms of the imports of US goods and services, Russia’s market share was more than twice the size of next-biggest importers, Poland, Czech Republic and Hungary. On the other hand, the Central European countries were more important as markets for EU countries (especially Germany).

An alternative metric of economic and political importance is the population size of a given country, which matters not only as an indicator of potential future market size but also captures (at least in part) the potential flow of economic and/or political migration in the case of severe economic crisis or political upheaval. Such concerns have certainly affected US policies towards Mexico but on balance immigration concerns have played a much greater role in Western Europe, where large immigrant flows from their poorer and politically unstable East European neighbors (especially following the Yugoslav crisis) served as a vivid reminder of the high regional stakes of the outcomes of the post-communist transition. Therefore, the most obvious candidate for preferential treatment in the post-communist world was Russia, followed by Ukraine and Poland, and, to a lesser extent, Romania. In Latin America, besides Mexico, the possible candidates for preferential treatment for demographic reasons include Brazil, Argentina, and Colombia, though these concerns were probably alleviated by the relative geographical isolation of South America. Distance from the closest Western country played an important strategic role in the ex-communist world, where the welfare of countries in the immediate EU backyard (such as the Central European but also Western Balkan nations) arguably had greater spillover potential to influential IMF shareholders, and may have, therefore, elicited faster and more decisive policy responses by the IMF and other international organizations.
Nonetheless, debt, size, and proximity to the West cannot capture the full political calculus that may lead to preferential treatment in the context of an IMF program. As discussed earlier, geopolitical considerations ranging from nuclear non-proliferation to proximity to international conflict may have contributed to greater political prominence for otherwise marginal countries. However, such considerations are difficult to capture statistically since they are particularly vulnerable to \textit{post hoc} reasoning, along the lines that country X must have been politically important since it received more lenient treatment from the IMF. Therefore, the statistical tests use foreign aid levels as a proxy of political importance. In Eastern Europe, foreign aid levels confirm the political clout of Poland and Russia, but also the growing strategic importance of the Ukraine, as well as the political rewards of Romanian, Albanian and Bulgarian cooperation with the West with respect to the Yugoslav crisis in the late 1990s. In Latin America, besides the “usual suspects” - Mexico, Brazil, and Argentina - bilateral aid flows during the 1980s also signal the strategic importance of two US allies, Panama and El Salvador, and, as will be discussed in more detail below, Bolivia in the second part of the 1980s.

What were the consequences of the significant cross-country differences in economic and political importance? Models 1-3 in Tables 3a&b offer weak systematic evidence that countries with higher debts, larger markets or more generous aid inflows were more likely to enter IMF programs. Even though all the coefficients are positive – indicating that more important countries had better chances of entering IMF agreements - the effects were substantively small and fell short of standard statistical significance levels.\textsuperscript{74}

However, the real test of political neutrality in the Fund’s approach to program initiation is how the IMF reacts to external crises in countries with different economic and political clout.

\textsuperscript{74} The only partial exception was the coefficient for the size of imports from the US in Latin America, which was marginally statistically significant (.1 one-tailed) and suggested that countries with larger markets of US products were somewhat more likely to enter IMF programs.
in the international arena. Judged by this standard, the statistical tests in Tables 3a&b show very clearly that when it comes to IMF program initiation not all countries were created equal: in both regions, symptoms of financial distress were much more likely to trigger IMF programs in large and politically important countries than in their less “significant” neighbors. On the other hand, in non-crisis environments, important countries were just as likely (and maybe more so) to be left to their own devices as other countries, thereby reflecting the idea that in ordinary circumstances the benefits of IMF funding are likely to be outweighed by the loss of sovereignty inherent in IMF conditionality.

Models 4-8 in Tables 3a&3b present a series of specifications using interaction terms between different measures of economic need and political importance. Because interaction terms are often difficult to interpret by simply looking at regression coefficients (Braumoeller 2003), I will present the more important of these results in graph-form, using predicted probabilities based on the actual regression coefficients for the respective models.

Model 4 in Table 3a shows that during the Latin American debt crisis, external vulnerability affected not only the demand for IMF programs on the side of hard-pressed governments, but also the Fund’s incentives to preempt financial crises with potential disruptions for international financial stability and trade. This “supply-side” effect can be seen very clearly in Figure 4a, which illustrates the interaction effects between the size of a country’s foreign debt and its interest payment burden. Thus, whereas for small debtors higher relative interest payment burdens resulted in a substantially modest and statistically insignificant increase in the likelihood of program initiation, the effects were significantly stronger for medium-sized debtors, and for the region's largest debtors (such as Brazil, Mexico, or Argentina) higher debt burdens – and their implicit threat to the country’s ability to honor its external obligations - triggered an
outright “explosion” in the probability that such a country would shortly sign on to a new IMF agreement.\textsuperscript{75}

The implications of Model 4 for how debt size mattered to the politics of Latin American IMF agreements are even more striking: as illustrated by the strong divergence of the initiation probability predictions for different types of debtors in Figure 4a, at high levels of financial distress countries with large absolute debt levels had a significantly higher likelihood of being “drafted” into an IMF agreement than smaller debtors whose possible default would have had more limited implications for international financial stability and Western commercial banks. This finding may explain the quasi-permanent presence of the region’s largest troubled debtors - Mexico, Argentina, Brazil, and Chile – on the IMF program country roster of the 1980s, as well as the Fund’s willingness to endorse heterodox stabilization efforts in Brazil and Argentina, despite the tensions between these policy packages and the standard prescriptions of IMF orthodoxy, whereas smaller countries (like Peru and Bolivia) received significantly fewer concessions in this respect. What is even more striking, however, is the fact that, according to Model 4, at low levels of financial distress larger debtors actually have a significantly lower likelihood of program initiation. This finding implies that whenever larger countries did not pose an immediate threat to international financial stability, they were less likely to be subjected to the rigors of IMF conditionality.

Model 5 in Table 3a confirms that a very similar type of “large country bias” holds with respect to market size for US exports: thus, the IMF program initiation likelihood of minor importers of US goods and services was not affected by higher debt burden levels but the effect became highly statistically significant and substantively large for the region’s largest markets. In

\textsuperscript{75} For example, an increase of interest payments from 4.5% to 5.7% of GNP would have resulted in the probability of signing an IMF agreement more than doubling for that particular quarter.
substantive terms the results were even stronger in Model 6, which suggests that Latin American countries with close ties to Western donors not only received more foreign aid but also had easier access to IMF lending in the event of a financial crisis. On the other hand, Model 7, which uses population size as a proxy for political importance, yielded a smaller and statistically insignificant interaction effect with financial need, which confirms the lower salience of demographic concerns in the Latin American context.

Similar interactions (not reported here) between size and financial need were also obtained by using alternative measures of financial need related to the region's debt crisis, such as debt service as a percentage of exports. However, Model 8 in Table 3a suggests that a different - and somewhat counterintuitive - mechanism is at work with respect to foreign reserve levels. The interaction effect suggests that lower reserves affect small debtors to a greater extent than large debtors, a finding that runs counter to the earlier discussion about the greater IMF responsiveness to financial distress in larger countries. This anomaly may be due to a number of reasons: first, as we have seen, concerns about foreign reserves played a secondary role during the debt crisis and may have, therefore, been less prone to politically motivated exceptions; second, these concerns usually only affected the region's smaller debtors, which generally had weaker reserves positions; and, third, the unusual quadratic relationship between reserves and program initiation (discussed in the previous section) makes interaction effects difficult to interpret.76 Whatever the explanation, the initiation likelihood differences between debtors of different sizes are substantively small and do not approach statistical significance at any reserves level, which means that this result does not directly contradict the earlier findings about the

76 An additional specification (not reported here) suggests the existence of a quadratic interaction effect pointing in the “correct” direction in addition to the simple interaction effect in the “wrong” direction.
differential treatment of politically and economically important countries during the Latin American debt crisis.

For Eastern Europe, the discussion and the statistical models in Table 3b focus primarily on the "primary" external crisis indicator for the post-communist transition - the level of foreign reserves. Model 4 addresses the question of how variations in reserve levels affect IMF program initiation in different-sized markets for US exports and finds that in countries with large markets low reserves had a substantively large and statistically significant positive effect on program initiation, whereas small importers were much less likely to be affected. A similar interaction effect can also be found in Model 5, which uses foreign aid levels as a proxy of political importance. As illustrated in Figure 3b, the model suggests that large aid recipients had a significantly easier time securing IMF agreements at very low reserve levels but as soon as their reserves reached comfortable levels, their predicted initiation likelihood was actually lower than that of their politically less well-connected counterparts.

The results of Model 6 suggest that, unlike in Latin America, demographic concerns played a significant role in the politics of post-communist IMF programs. Thus, lower reserves were more likely to result in IMF programs in more populous countries, a finding which confirms the broader impression of an uneven playing field in the politics of IMF conditionality. Similarly, according to Model 7, countries in closer geographic proximity to Western Europe had better prospects of securing IMF support when facing foreign reserve shortages. Taken together, these two results suggest a “gravity model” of IMF program initiation, which is broadly supportive of the hypothesis that West European concerns for large countries in their vicinity translates into preferential treatment by the IMF.
Finally, Model 8 confirms that the size-financial need interaction also holds when using interest payments as a proxy for financial distress, in the sense that higher interest payments had a stronger catalytic effect on program initiation for larger markets. While the size and statistical significance of this effect was (as expected) somewhat lower than in Latin America, it nevertheless suggests that foreign debt considerations played at least a supporting role in the complicated politics of post-communist IMF program initiation. These findings are in line with similar results by Stone (2002), who found that politically important ex-communist countries - including but not limited to Russia - had an easier time entering IMF agreements due to preferential treatment by the IMF under pressure from Western donor governments.

III. Economic and political drivers of IMF program funding and conditions

The previous section has shown that crisis-specific external financial need played an important role in determining Latin American and East European governments to seek IMF support but that the IMF was significantly more responsive (and even proactive) when faced with serious crises in countries whose economic size or geopolitical importance had significant potential repercussions for international financial and political stability. However, timing is only one of the crucial dimensions driving the economic and political repercussions of IMF programs. As discussed in the formal model in Chapter 2, IMF programs differ along at least three other important parameters: the relative size of the committed funding, the range and depth of the policy conditions attached to the program, and the severity with which conditionality is enforced and deviations are punished. Since, as we have seen, not all countries and crises are created equal, the resulting differences in the bargaining positions of program country governments vis-
à-vis the IMF should also be reflected in cross-country and cross-regional variations in program funding and conditionality.

Even though the centrality of direct funding to the success of IMF programs continues to be the subject of considerable debates, most governments do approach the Fund at least partly for the traditional purpose of obtaining temporary support for balance of payments difficulties. For such governments a larger monetary commitment from the IMF can provide much needed relief from international and domestic financial pressures, and in extreme cases can provide a political life-raft for governments facing severe crises. Since countries are not obliged to draw on an existing loan commitment, larger loans should be preferable even for governments, whose primary reason for program initiation is to have policy conditions imposed from the outside, since larger loans provide a more credible “alibi” with respect to domestic political audiences. Unlike program initiation, which is a joint decision of the IMF and the government, the amount of funding committed to a given program is largely a decision of the Fund, and therefore reflects the economic and political priorities of the IMF (and its largest shareholders).

Since the amount of IMF funding available to a given program is based on the country's IMF quota, the most straightforward indicator of the Fund’s financial largesse towards a country is the annualized share of the quota committed in support of an SBA or EFF program. Judged by this standard, the average IMF program during the Latin American debt crisis was allotted 76% of the country’s IMF quota, significantly more than the 43% committed for the typical East European program in the 1990s. This difference may reflect the greater demands

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77 Vreeland (2003) argues that some governments seek IMF conditionality in order to weaken domestic political opposition to economic reforms, which the government wanted to pursue anyway.
78 Except under extraordinary circumstances, members can only borrow up to 100% of the quota annually and up to 300% of the quota cumulatively.
79 This cross-regional disparity also holds for alternative measures for the size of funding (as a % of GDP or as a % of annual imports).
on IMF resources in the 1990s due to the rapid rise in the number of worldwide IMF programs. However, these higher funding levels probably produced few real benefits to Latin American citizens, since most of the funds left the country almost immediately in the form of debt service payments.

Table 4 here

In terms of cross-country funding differences, the large and statistically significant funding boost for large debtors in Model 1 confirms the earlier findings about the Fund’s preferential treatment of large countries. The results in Model 2 reveal a similar (but substantively smaller) favoritism towards large countries during the post-communist transition. It appears, therefore, that important countries also get a better financial deal in the context of IMF programs. The larger relative loans extended to big countries can be justified within the framework of the Fund's responsibility for international financial stability, since the insolvency and potential economic collapse of “heavyweights” such as Brazil, Mexico or Russia is likely to have negative repercussions at the regional and possibly at the global level, which explains the substantial financial packages assembled by Western nations in the IFIs in response to crises such as Mexico in 1994 and Russia in 1998. On the other hand, the use of generous IMF funding in large countries even in the absence of imminent financial crises – such as in Russia in 1995-6 prior to the presidential elections – suggests that IMF exceptionalism goes beyond such systemic concerns, and is used to pursue broader Western political objectives.

Beyond the salience of economic and political importance, Models 1 and 2 in Table 4 suggest that democracies may have benefited from slightly more generous financial terms, though the positive coefficient for regime type is relatively small and only marginally significant.

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80 Similar results (not reported) are also obtained when using alternative measures of size, such as GDP, population, or total imports.
in Latin America. On the other hand, the results do not point towards an ideological bias when it comes to the size of the loan: thus, in both regions the ideological orientation of the government was not associated with systematic variations in funding size. Moreover, the results suggest that IMF generosity during the Latin American debt crisis and the post-communist transition was at least partially need-based, in that countries with low international reserves received significantly larger amounts of IMF funding. In addition, higher pre-program inflation was associated with significantly more funding in Eastern Europe but not in Latin America, a finding which confirms the greater domestic focus of post-communist IMF programs. Finally, the amount of unused IMF reserves at the time of program initiation was a positive but statistically insignificant predictor of loan size. Therefore, it appears that the effect of tighter budget constraints during periods of heavy reliance on Fund resources, may be counterbalanced by the greater financial need of program countries during such crisis periods.

Unlike the relative size of IMF loans, the other two key parameters of IMF programs – the toughness of program conditions and the severity with which deviations are punished - are much harder to compare consistently across countries. Even if program targets were publicly available for all programs, it would be virtually impossible to establish how tough a given target (or combination of targets) is in a given economic situation. Therefore, Models 3-4 in Table 4 focus on a more easily comparable aspect of IMF conditionality: the number of structural conditions and total conditions contained in a given East European IMF program from 1993-1998. To the extent that the number of structural and total conditions is indicative of how demanding a given program is, the results of the Poisson regressions in Models 3-4 do not reveal systematic differences, which would hint at conditionality biases on the basis of size, regime type.

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81 The data, which draws on the Fund’s internal program monitoring database (MONA) as published in Ivanova et al (2002), is unfortunately not available prior to 1993, which means that the current analysis cannot be extended Latin American programs of the 1980s.
or ideology. The highly statistically significant negative coefficient for quality of governance confirms that the proliferation of structural conditions and the overall rise in the number of conditions in a typical IMF program during the 1990s was at least in part a response to the weak bureaucratic capacity of many program countries. Finally, according to Model 4, countries with high interest payment burdens generally had fewer conditions attached to their IMF programs, probably due to the more “classical” external roots of their economic crisis and IMF involvement, which required fewer domestic conditions and benchmarks.

Turning to the third parameter of program design – the enforcement of conditionality - Model 5 analyzes the determinants of the number of program waivers given to individual countries within a given IMF program. The Fund can waive one or more program conditions in situations where circumstances beyond the government's control make it difficult to fulfill the original program targets. While such waivers are important for program flexibility in an unpredictable international environment, they can also be used to allow certain countries to get away with deviations from IMF conditionality without having to pay the price of noncompliance. Model 5 suggests that countries with weak bureaucracies and a high number of program conditions received more waivers, whereas countries that high external interest burdens benefited from fewer such concessions. Along with the findings in Models 3&4, these findings illustrate the differences between the traditional “external crisis” conditionality of the 1970s and 1980s, which had focused on a small number of rigidly enforced criteria, and the broader but also more flexible approach to conditionality brought about by the increasing IMF focus on domestic reforms in the 1990s.

Finally, Model 5 also shows that large debtors received significantly more waivers than other countries. Similar results were obtained when using alternative indicators of country size,
such as GDP, imports, and population. Therefore, it appears that the Fund’s preferential treatment of larger countries includes a laxer enforcement of conditionality in addition to faster program initiation and larger relative financial packages that were discussed earlier in this chapter. While such IMF exceptionalism may be a politically expedient and economically attractive alternative to bilateral aid for large IMF shareholders in their pursuit of economic and geopolitical interests, the practice undermines the technocratic legitimacy and ultimately the effectiveness of IMF conditionality in the developing world.

IV. Program implementation

The preceding two sections have shown that Latin American and East European IMF programs were initiated at least in response to government responses to external financial crises, but that the timing and the funding and conditionality details of IMF programs also reflected the reality is large differences in the political and economic importance of the countries of the two regions. Despite its important signaling role, however, IMF program initiation only represents an initial step towards domestic and international adjustment. The most important political challenges - especially for the government of the program country - occur at the implementation phase during which the policy blueprint laid out in the letter of agreement has to be translated into actual policies. Somewhat surprisingly, this crucial aspect of IMF programs has received relatively scant attention in most cross-national analyses of IMF lending, which have instead focused primarily on the socioeconomic consequences of these programs. This section

82 For example, the Clinton administration’s support for Yeltsin’s Russia through the IMF had the double advantage over bilateral aid of bypassing a potentially hostile Congress and of leveraging US funds (since other IMF members essentially footed 82% of the bill.)
contributes to a small but growing set of studies concerned with program implementation, by focusing on the comparative international drivers of compliance with IMF conditionality during the Latin American debt crisis and the post-communist transition.

In the statistical tests in this section (as well as in Chapters 5 and 7) implementation is coded dichotomously on the basis of whether a given program was active (i.e. the government had access to IMF funding) in a given time period. This measure of compliance does not capture the extent to which a given country fulfilled the specific policy targets of the IMF agreement, only whether or not the IMF considered the overall policies to have been sufficiently compliant to warrant the stamp of IMF approval. However, this potential bias in favor of politically privileged countries should be mitigated by the inclusion of controls for the sources of such exceptionalism, which were discussed in the previous section. Moreover, the measure is consistent with the approach to conditionality proposed by the formal model, which specifically incorporates the role of politically driven “softness” in the enforcement of IMF conditionality.

The overall compliance record of the two regions was fairly similar in that the Latin American and East European countries covered by IMF programs can be considered as “in compliance” about two-thirds of the time. For the former communist countries slightly less than half of the IMF programs were completed in more or less their entirety, about one fifth went off track early in the program and around a third either slipped in the later stages of the program or

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84 Since IMF funding disbursements are closely tied to the fulfillment of IMF conditionality countries eligible for IMF funding through an SBA or EFF agreement were coded compliant with IMF conditionality. Because for precautionary programs, non-disbursement does not automatically imply non-compliance, this data was supplemented by country-specific information from the IMF country desks, EIU Country Reports and from Ivanova et al (2003).
85 Unfortunately, there is not enough publicly available data to allow for a cross-country comparison of target fulfillment. Moreover, even if such data were available, it would still be extremely difficult to control for potential variations in the toughness of the program conditions across countries.
recovered after suffering some temporary setbacks. For Latin America the corresponding compliance record was slightly worse, with around two fifth of programs completed, about a quarter significantly but not fully completed, while a third of programs went off-track during their early stages. What were the international political drivers of this mixed compliance record by Latin American and East European program countries?

*Financial need*

According to the predictions of the formal model, external financial need should be a predictor of program compliance in addition to initiation, since countries in more precarious external financial situations should be more dependent on the funding and signaling benefits associated with implementing IMF conditionality. However, as the findings at the program initiation stage have indicated, the precise nature of external need depends on the specific context of the crisis, with foreign debt burden playing a central role in Latin America, while scarce international reserves mattered more in the cash-strapped post-communist countries.

*Tables 5a&5b here*

The statistical results in Tables 5a&5b confirm that external financial need played an important role in explaining cross-country differences in IMF program implementation but that the effects of financial need were not uniform across time and space but reflected the different economic priorities of the two crises. Thus, in line with the exigencies of the debt crisis, higher interest payment burdens emerged as by far the strongest predictor of IMF program compliance in Latin America: according to Models 1&2 in Table 5a, a one standard deviation increase in the interest rate burden would predict four times higher odds of compliance in a given quarter. Meanwhile, in Eastern Europe the effect of higher interest payments was much weaker and actually pointed
in the “wrong” direction (significantly so in Models 3&4 in Table 5b), which suggests that rather than acting as external financial incentives for IMF compliance higher foreign debt obligations may have actually undermined program implementation. One possible explanation for this finding is suggested by the Bulgarian experience of the mid 1990s, where the fiscal burden of debt service payments undermined the government's stabilization efforts and thereby contributed to the derailment of IMF programs. Latin American countries also suffered from the fiscal repercussions of debt payments, but these effects were outweighed by the critical role of debt repayments in the political dynamics of IMF programs, compared to the greater domestic focus in Eastern Europe.

Post-communist governments were nonetheless significantly affected by external financial considerations in their IMF program implementation “calculus”: thus, Model 1 in Table 5b reveals a highly significant negative effect on implementation in countries with higher lagged reserves, with each additional month worth of reserves in the preceding quarter reducing the odds of compliance by about 40%. The longer lag specification used in Model 2 produced substantively smaller and statistically weaker (but still significant) results, which suggests that East European governments reacted very quickly to changes in international reserves positions and confirms the paramount importance of international liquidity in post-communist IMF programs. However, the short memory of external crises revealed by these findings produces a certain self-defeating dynamic of successful IMF programs, since the increase in international reserves that should accompany compliance (due to direct IMF funding and better access to outside finance) ultimately undermines the financial incentives, which drove the government's desire to initiate and comply with IMF programs. By comparison, Models 1&2 in Table 5a suggest that international reserves played a more modest role during the implementation of Latin
American IMF programs, a finding that echoes the results at the initiation stage. Furthermore, the greater size and statistical significance of the longer lag in Model 2 suggests that Latin American governments responded more cautiously to changes in reserves than their East European counterparts. In addition to the lower salience of reserves during the debt crisis, this difference may reflect the fact that short-term increases in international liquidity were probably weaker predictors of financial health in Latin America, in the context of the much greater long-term shadow cast by the burden of foreign debt.

The implementation dynamics of IMF programs in the two regions also differed significantly in terms of the implications of varying degrees of credit-worthiness and capital market access. While at the initiation stage the most likely IMF candidates in both regions had been countries with intermediate credit scores, the results in Figure 5 (based on Model 4 in Tables 5a&5b) reveal an interesting divergence at the implementation stage.

*Figure 5 here*

Thus, in Latin America compliance was highest among middle range countries, which had greater capabilities and better prospects for future access to capital markets than the basket cases at the low end of the IIS rating scale, but at the same time were more dependent on IMF funding than the countries with high credit ratings. Meanwhile, the likelihood of compliance increased significantly and uniformly with better credit ratings among the transition economies, which suggests that the importance of greater capabilities and concerns about the signaling consequences of noncompliance to international capital markets outweighed the role of direct funding, which presumably was more important in countries with poor credit ratings and few outside financing options.
What accounts for these different compliance dynamics for the two regions in the upper range of credit-worthiness? One answer is suggested by the greater propensity of transition countries to enter IMF programs even in circumstances of comfortable access to international capital markets, which was discussed in an earlier section (see Figure 3). Thus, Eastern Europe had a higher prevalence of precautionary programs than Latin America, which explains the divergence in compliance levels, since governments would only enter precautionary IMF programs if they are reasonably confident that they can complete them (and hence reap the signaling benefits associated with compliance). A second (related) answer has to do with the different temporal trends in financial market access during the two crises: whereas the gradual expansion of foreign credit to the ex-communist world under IMF supervision created powerful incentives to play by the rules of a game with significant rewards, in Latin America credit ratings and market access declined precipitously for most of the region after 1982, which meant that compliance with IMF conditionality offered significantly fewer long-term rewards in return for the considerable short-term costs. Once more, the different international dynamics of the two crises are reflected in the different patterns of IMF program implementation and emphasize the importance of studying cross-national patterns of economic adjustment in an explicitly comparative setting.

Size matters (2): Economic and Political Importance during Implementation

The analysis so far has identified evidence of preferential treatment for large and politically important countries with respect to the timing and funding size of IMF programs in both Latin America and Eastern Europe, as well as greater tolerance for deviations from program
targets in transition economies. Therefore, one might reasonably expect similar patterns at the implementation stage, as political pressures on the IMF to extend funding to economically and politically important countries may supersede concerns about the long-term credibility of conditionality. On the other hand, as discussed in the formal model, countries with greater political leverage are likely to be aware of their special status, and may, therefore, pursue economic policies that deviate significantly from program targets, thereby triggering the suspension of the program despite the Fund’s politically motivated leniency. In the post-communist context, Stone (2002) found that large countries (especially Russia) were at least as likely to be punished for IMF noncompliance as their smaller counterparts, but that the punishment duration for such special cases was shorter, thereby allowing a faster return into the fold of the IMF.

The empirical evidence presented in Models 5-7 in Tables 5a&5b once again reveals significant and theoretically interesting variations in the political dynamics of IMF programs in the two regions. Thus, Figure 6a (based on the interaction effect in Model 5 in Table 5a) shows that at low interest burden levels smaller countries had a significantly better compliance record than their economically more important counterparts but the latter responded much more dramatically to higher interest burdens, as indicated by the much larger size and statistical significance of Interest/GNP for countries with larger overall debt in Model 5. Indeed, at extremely high levels of interest payments (above 10% of GNP) large countries actually had a statistically significant compliance advantage over smaller countries but the difference was relatively small in substantive terms because at under such financial duress predicted compliance probabilities were above 98% for all types of countries.

Model 6 reveals a similar if somewhat weaker relationship between reserves and foreign
aid, in that declining reserves provided a greater compliance boost to larger recipients of development aid, but overall compliance was generally lower in such politically privileged countries. These interaction effects suggest that economically and politically important countries did not receive preferential treatment in low-crisis environments, and were in fact more likely to get “punished” by having credit tranches withheld. However, in serious crisis situations compliance levels in large countries “caught up” and even exceeded those of their smaller counterparts, which suggests that under such circumstances concerns about the regional and global consequences of an economic collapse superseded the competing concerns about maintaining the credibility of IMF conditionality.

Among the transition countries, Models 5&6 in Table 5b reveal similar interactions between reserve levels on one hand and indicators of economic and political importance (market size and foreign aid) on the other: thus, according to Model 5 lower reserves had a greater positive impact on compliance in large markets but size was not a significant predictor of compliance at any reserve level. Model 6 reveals a similar but somewhat stronger interaction between reserves and foreign aid: as illustrated by Figure 6b, compliance rates in large aid recipients responded much more strongly to changes in foreign reserves than in countries with lower aid inflows. As a consequence, in crisis situations marked by extremely low reserves, we notice a convergence in the predicted probability of IMF programs from countries of different

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86 The effect of lower reserves was not statistically significant for program countries in the lowest 20 percentiles of aid funds, and the size of the coefficient increased by more than 50% between the 5th and 95th percentile of aid recipients.

87 However, this size effect was only marginally significant (at .2 two-tailed) for the medium range of foreign reserves (between 3-5 months of imports).

88 Since the regression controls for a variety of domestic factors (such as regime type, partisan orientation, and the quality of governance) it is reasonable to assume that these interactions indeed capture the political dynamics of economic/political importance in the context of program implementation.

89 For example, for a large market (e.g. the size of Ukraine in the late 1990s) each additional month of reserves corresponds to a 38% change (significant at 5%) in the odds of compliance, whereas in a small market like Moldova the coefficient is 50% lower and statistically insignificant.
economic and political weight being given the Fund’s stamp of approval. However, Figure 6b also shows that – unlike in Latin America - larger aid recipients had worse compliance record across-the-board.\textsuperscript{90} Finally – in marked contrast to Latin America – there is no statistical evidence of an interaction effect between financial need and economic importance during post-communist IMF program implementation when using debt-related indicators such as interest/GDP or total foreign debt, which confirms the context-specific nature of the political dynamics of financial crises and IMF programs.

The consistent compliance deficit of large transition countries is even more striking considering the earlier findings about the larger loans and the higher frequency of waivers granted to privileged countries. Therefore, the greater IMF flexibility towards politically important countries does not imply impunity from punishment for deviations from program targets. However, the costs of such punishments are mitigated by the prompter initiation of IMF programs in response to financial distress, a conclusion that is broadly compatible with Stone’s (2002) findings that larger countries are more likely to get punished but suffer shorter punishment spells than their smaller counterparts. Moreover - and this aspect adds an important nuance to Stone’s argument - the greater punishment incidence for larger countries applies primarily to low-crisis situations, characterized by comfortable reserve levels in Eastern Europe and manageable interest burdens in Latin America. In instances of serious financial distress, however, this compliance deficit is greatly reduced in Eastern Europe and even reversed in Latin America, thereby reflecting the Fund’s concern for the broader implications of a possible economic and political collapse in a pivotal country.

\textsuperscript{90} The negative effect of higher aid levels is substantively relatively large (between 40-60\% lower compliance odds for each standard deviation change in aid) and marginally significant (between .13 and .2 two-tailed) at medium/high reserve levels but the effect becomes insignificant at very low reserve levels.
“Money can't buy me love”: Funding and IMF Program Implementation

The question about the relative importance of the amount of direct IMF funding to the success of Fund programs has been the subject of heated debates among academics and policymakers, particularly during the periodic negotiations about increasing IMF quotas in order to make more financial resources available for Fund lending. While larger loans can obviously affect a wide range of economic outcomes in the program countries and beyond, for the purpose of the present analysis the key empirical question is whether more funding promotes more compliance with IMF conditionality. As reflected in government’s utility function in the formal model in Chapter 2, we should expect the greater financial incentives associated with more generous loans to determine governments to make greater policy concessions in order to secure the “prize” of IMF funding. What were the implications of the significant variation in the relative size of committed IMF funds (discussed in section 4.3), for the compliance patterns in the two regions?

Table 6 here

When using the most straight-forward measure of IMF financial generosity, Models 1&3 reveal moderately significant positive funding effects on compliance in both regions even controlling for other domestic and international explanations: thus, in Latin America a one standard deviation rise in the size of the loan (as a % of the IMF quota) was associated with a statistically significant 53% rise in the odds of compliance, while in Eastern Europe the corresponding compliance boost of larger loans was 45% (and marginally significant). While these findings confirm that programs with larger relative loans have better chances of being completed, the other regressions in Table 6 raise significant questions about the extent to which
these results can be interpreted as evidence of a causal connection between larger loans and compliance.

The main problem with the results in Models 1&3 is that they ignore the endogeneity of the size of the loan. As the analysis in Table 4 has demonstrated, countries experiencing severe economic crises (characterized by low reserves, and high inflation and interest payment burdens) were likely to get larger relative loans, as were as were economically large and politically privileged countries. Therefore, loan size cannot be treated as an endogenous variable, which means that its effects have to be analyzed through two-stage regressions. Model 4 in Table 6 presents the second-stage results of such a regression, which uses the predicted values for loan size for the post-communist cases from Model 4 in Table 4. Even though the coefficient for loan size continues to be positive, to substantive effect was reduced by one third and the results were no longer statistically significant, which suggests that the evidence for an independent effect of financial incentives in the ex-communist countries is rather weak.

The second problem with interpreting the results in Models 1&3 as evidence of the beneficial effects of higher funding is that loan size as a proportion of IMF quota is a better predictor of IMF generosity (i.e. how much the Fund is willing to commit given its institutional constraints) than of the relative financial importance of the loan for a given country. Therefore, Models 2&5 in Table 6 use an alternative measure of loan size, which measures the committed IMF funds as a proportion of the country's imports in the preceding year and thereby captures the relative “buying power” of a given IMF loan. The substantively small and statistically

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91 The instrument used to identify the regression was the amount of uncommitted IMF resources divided by the size of a given country's quota. The justification for using this instrument is that budget constraints are likely to affect the size of the loan but once a loan is budgeted it should not affect the likelihood of funding disbursement by the IMF.

92 Unfortunately, as Model 2 in Table 4 indicates, budget constraints were a much too weak predictor of loan size to be used as an instrument in the Latin American cases, and therefore rendered the two-stage model estimates unusable.

93 Since IMF quotas are only adjusted once every 5-10 years, they are limited in their ability to capture the changing economic size and economic needs of a country over time.
insignificant effects of loan size in these two models provide further suggestive evidence that the positive relationship between funding and compliance in Models 1&3 primarily reflects the IMF's goodwill towards certain countries (which benefit from more generous funding and laxer enforcement of conditionality) than of the greater incentives for program country governments to adjust their policies in order to secure IMF funds. Overall, the statistical evidence presented in this section indicates that higher amounts of direct funding had little independent influence on IMF program implementation in Latin America and Eastern Europe. Given the relatively modest size of even the more generous IMF financial packages, these findings do not preclude the possibility that a significant increase in direct IMF funding could contribute to better compliance in the future. However, within the current institutional and budgetary constraints, differences in funding levels have at best a modest effect on the complex and politically charged process of IMF program implementation.

Conclusion

This chapter has emphasized the importance of understanding the politics of IMF programs in their broader global economic and geopolitical context. In response to the pressing Western concerns with international financial stability and the survival of leading commercial banks, the IMF interventions in Latin America were primarily targeted at avoiding the outright default of the Latin American countries, and especially of the region's largest debtors. The emphasis on debt repayment is reflected by the clear statistical evidence in this chapter about the crucial role of the debt service burden as a driver of the IMF program initiation and implementation. These priorities left little space for "adjustment with a human face" (IADB
1990) and may explain the strong partisan reactions to IMF-style reforms, which will be discussed in greater detail in chapter 6.

The lower salience of foreign debt in the post-communist transition reduced the inherent tradeoff between international and domestic policy imperatives, which had defined IMF conditionality during the Latin American debt crisis. Even though external financial need continued to be one of the key drivers of IMF programs, the main concern of East European governments was not debt repayment but gaining access to hard-currency credits to overcome the critically low foreign reserve levels inherited from the communist period. Therefore, the IMF had the opportunity to play a much less controversial role, as a provider of much-needed funds and as a reform “coach” for countries eager to (re)gain access to international financial markets. Even though IMF programs in Eastern Europe were neither universally welcomed nor uniformly implemented, the politics of post-communist IMF-style reforms were less contentious than in Latin America, which set the stage for the lower profile of ideological disagreements during the domestic political process of IMF program initiation and implementation, which will be discussed in more detail in chapters 6 and 7.

Despite the changing nature and political dynamics of IMF programs in the last two decades, the statistical evidence for both program episodes, which were discussed in this chapter, confirms that when it comes to IMF programs not all countries were created equal. In both regions, economically and politically more important countries (especially large debtors in Latin America and countries with large populations and potential export markets in Eastern Europe) were shown to have had an easier time securing an IMF agreement when facing economic crises but were more likely to be left alone otherwise. While the Fund’s greater concern with large markets and debtors is compatible with its mandate as a guardian of international trade and
financial stability, this chapter’s statistical evidence about the apparent lack of IMF responsiveness to financial distress in small countries raises more troubling questions about the way the IMF is serving its constituents.
Chapter 4
Navigating External Crises: Case Study Evidence from Latin America and Eastern Europe

To complement the statistical findings about the international drivers of IMF programs, this chapter provides a more detailed account of the role of external financial need and economic/geopolitical importance in shaping the interactions between the IMF and individual Latin American and East European countries. Among the Latin American countries, the chapter traces the trajectories of Argentina, Peru, Bolivia, and Chile, four cases, which illustrate a variety of IMF interactions, ranging from showcase cooperation in Chile and post-1985 Bolivia, to frequent involvement and patchy compliance in Argentina, and outright rebellion in post-1985 Peru. In Eastern Europe, the surprisingly close IMF relations of Moldova illustrate the powerful draw of IMF funding and legitimacy for economically and politically vulnerable countries, while the more conflictual relationship between the Meciar government in Slovakia and the Fund demonstrates that even extreme financial need is not a sufficient condition for IMF program initiation and implementation, especially in the context of the tight constraints on acceptable economic policies imposed by IMF conditionality in the mid-1990s.

These brief case studies, whose domestic aspects will be analyzed in more detail in Chapter 6, serve two main purposes: first, they illustrate how financial need affected the initiation and implementation of IMF programs across a broad range of situations, whose international contexts differed with respect to the size and importance of the country, as well as regional and temporal variations of IMF conditionality. Thus, the chapter contrasts the trajectory of Argentina, one of the region’s largest debtors, to that of more marginal countries like Bolivia or Peru, and confirms the more active involvement of the IMF in countries considered pivotal to international financial stability. The contrast between Meciar’s Slovakia and Garcia’s Peru on
one hand, and Alfonsin’s Argentina on the other, suggests that size also mattered with respect to the severity with which anti-Western rhetoric and deviations from economic orthodoxy were punished by the Fund.

Second, the cases contribute to a richer understanding of the complex international dynamics of IMF programs by discussing country-specific factors, which cannot be properly captured by cross-national statistical tests but which are nevertheless theoretically interesting and empirically important. For example, issues such as the war on drugs in Bolivia or Moldova’s precarious geopolitical position are important for understanding the trajectories of IMF programs in individual countries. However, the case studies can also identify mechanisms of broader theoretical relevance for understanding the relations between the Fund and developing countries: thus, the ability of certain countries (such as Moldova, Chile, and post-1985 Bolivia) to enhance their political importance by playing the role showcase reform examples, suggests an interesting deviation from the determinism implied by the statistical results about the uphill battle facing economically marginal countries trying to obtain preferential treatment from the IMF.

**Bolivia: The Costs and Benefits of Geopolitical Marginality**

At the outset of the 1980s the Bolivian economy had all the ingredients for economic disaster even when compared to the low regional standards, and during the first half of the decade the situation continued to decline precipitously. Like many of its neighbors, Bolivia had contracted a sizable foreign debt under the military regimes in the context of the boom mentality of the 1970s. Unfortunately, despite being accompanied by commodity-driven solid economic growth until the late 1970s, only a small proportion of these capital inflows resulted in productive capital investments, nor did they lead to significant improvements in the living
standards of Bolivia's impoverished population but instead resulted in massive capital flight that by 1980-81 exceeded 10 percent of GNP (Sachs 1986). Therefore, when capital flows reversed in 1982 the Bolivian economy was singularly ill-prepared to weather the external and internal adjustment process required by the exigencies of the debt crisis.

_Crisis at the periphery: Bolivia under Siles_

By the time the democratic government of Siles Zuazo assumed power in late 1982, Bolivia's foreign debt had become a crushing burden on its economy and society. The relative indebtedness was very high (amounting to 114% of the country's annual GNP), thereby placing the country on par with an unenviable group of highly indebted sub-Saharan African countries hardest hit by the debt crisis. The costs of servicing this debt were exacerbated when the economic slowdown of the late 1970s turned to full-blown recession in 1982-83 (with an annual decline of 4.5% of GDP) and the international price for Bolivia's primary commodities (tin and fuels) declined sharply after 1979 (Klein 1992:271), thereby leading to a sharp decline in exports and foreign currency inflows. Thus, at the beginning of the debt crisis Bolivia's interest payments accounted for a staggering 44.8% of export earnings and 14.2% of GNP, whereas total debt service amounted to 59% of exports, one of the highest debt burdens in the region. The situation improved only after the quasi-collapse of the economy in 1985, first due to the temporary suspension of debt payments in conjunction with the aggressive stabilization program of the new Paz government and later as a result of the substantial debt reductions approved by Western donors after 1987. Nevertheless, despite a significant reduction in the level of interest payments (from more than 14% of GNP in 1984 to around 2.8% in 1988-89), overall indebtedness remained high by the end of the decade (92% of GNP in 1989 down from a peak of 171% in
1984) and debt service was still above the regional average in the second half of the 1980s. Meanwhile, the country's foreign reserves, which were mostly below the regional average and declined to critically low levels between mid-1987 and 1988, hardly provided the necessary buffer against short-term capital flow fluctuations.

Considering Bolivia's extremely fragile external position throughout the decade and the Fund's role as an international lender of last resort, Bolivia should have been a prime candidate for IMF programs in the 1980s. Nonetheless, Bolivia did not secure its first IMF standby agreement until June 1986, almost four years after the debut of the debt crisis. While part of this surprising delay was due to the reluctance and inability of Bolivia's leftist government to implement the tough adjustment measures required by IMF conditionality between 1982-5, the relations between Bolivia and the Fund cannot be simply blamed on ideological conflict. Unlike the more confrontational approach of Garcia in Peru and even Alfonsin in Argentina, President Siles, whose track record with IMF program implementation went back to his first stint as a president in 1957, tried to maintain good relations with the West and the IMF. This conciliatory approach is best reflected by the continuation of debt service payments until May 1984 even though these payments exacted a steep price from the crumbling Bolivian economy without being rewarded access to financing from either private or multilateral lenders. Even after the center-right reformist government of Paz came to power in mid-1985, it another year for the first IMF program to materialize.

What explains this remarkably hands-off approach of the IMF in Bolivia, especially in the context of its intense involvement in other highly indebted Latin American countries during the same time period? The statistical results in the previous chapter have suggested that higher levels of financial distress were less likely to result in IMF program initiation in smaller

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94 The role of partisan politics on economic policies in Bolivia is discussed in more detail in Chapter 6.
countries, such as Bolivia, since they represented lower threats to regional and international financial stability and were, therefore, lower on the very busy agenda of the Fund. Therefore, the discussion below analyzes the Bolivian experience with IMF conditionality in the 1980s from the perspective of the country’s marginal international position in the context of the debt crisis.

Unlike its larger and more developed neighbors (Argentina, Brazil and Chile), Bolivia's high level of relative indebtedness did not create serious political concerns among Western lenders. Despite its high relative indebtedness, the overall size of the debt was relatively low by regional and global standards ($3.3bn), and therefore presented no threat to the stability of Western commercial banks. Thus, the exposure of the top nine Western commercial banks to Bolivian debt was only $44m by mid-1987, compared to $15.8bn for Brazil at the same time point. (Sachs 1987). The country's marginal international status did not change substantially after the return to democracy in late 1982, even though it somewhat alleviated international isolation of the country compared to the final two years of the military regime, particularly during the violent rule of Garcia Mesa in 1980-81.

In an international context in which debt service moratoriums were not yet widespread and therefore carried high political costs, the Siles government continued to honor its debt service obligations until mid-1984 in an effort to avoid a renewed international pariah status. However, these payments exacted a heavy toll on the Bolivian economy and exacerbated fiscal imbalances and inflationary pressures. Despite an external burden compared by some observers to the war reparations in interwar Germany (Pastor 1992:69), Bolivia was unable to secure an IMF program to reduce the short-term consequences of its government's continuation debt service payments. While the economic consequences of this hands-off approach were hardly ideal (since they delayed the access to much-needed funds), the less intense political pressure of
IMF conditionality allowed the Siles government a slightly wider maneuvering space, and may have prevented the further escalation of social tensions and thereby reduced the likelihood of democratic breakdown. Nevertheless, Bolivia’s experience with international financial markets in the early years of the debt crisis epitomizes the “all pain no gain” nature of economic adjustment in Latin America in the early 1980s.

*The Paz Government and its Unexpected Allies: Jeffrey Sachs, the IMF, and the U.S. Government*

Compared to the grim picture of the first part of the decade, after 1985 Bolivia stands out for the unusually cordial tone of its government’s relations with international financial institutions, as well as for the relative flexibility of IMF conditionality and the generous terms of the country's debt renegotiation process. Since Latin America during the debt crisis is quite possibly the last place to look for evidence of benevolent Western interventions in developing countries, how can we explain this remarkable turnaround in the country’s fortunes? I will argue that this unexpected external boost for the Bolivian reformers can be explained by a fortuitous combination of a number of factors - its marginal importance in the context of the debt crisis, its symbolic role as a poster child for neoliberal reforms and the political priorities of the U.S. war on drugs - which will be discussed in more detail below.

By 1985 Bolivia's relatively low overall debt was of minimal concern to Western financial interests, the more so since the secondary market value of the countries debt had already been reduced to a fraction of its initial value\(^9\), since repayment looked increasingly unrealistic considering the country's poverty and disastrous economic crisis. Ironically,

\(^9\)Thus, by mid 1987 Bolivian debt was trading at 10 cents to the dollar in the secondary market for developing country debt (Sachs and Huizinga 1987).
however, the very marginality which contributed to the failure of the Siles government to secure an IMF agreement prior to 1984, allowed the Paz government more flexibility in the design of its economic program, which was not backed by an IMF program during its first ten crucial months. By avoiding the strict constraints of IMF conditionality, the Paz government was able to delay the resumption of debt service payments, whose burden could have easily undermined the fragile emerging economic and political stability of the country by providing a rallying point for the losers of the painful adjustment process. The costs of this delay in debt service resumption were relatively low for both sides: for Bolivia, the sanctions triggered by the moratorium were largely irrelevant, since the country was already excluded from any significant external financing sources after its default in May 1984. Meanwhile, Western lenders (and the IMF) were less concerned with the economic fallout of a temporary moratorium in a small debtor like Bolivia, whereas a similar action may have triggered a stronger reaction in the case of one of the large debtors. Nonetheless, the normalization of relations with the international financial institutions, particularly the IMF, was high on the agenda of the Paz government, since it constituted an important precondition for the resumption of official lending without which the long-term economic recovery of Bolivia seemed highly unlikely.

The answer to Bolivia's international financial dilemma - the tension between the need for IMF approval and the pursuit of economic and political stabilization, which was potentially undermined by standard IMF program requirements such as the reduction of debt arrears and currency devaluations - came in the person of Jeffrey Sachs, the Harvard economist who had advised Banzer during the 1985 presidential campaign, and who became the official economic adviser of the Paz government in January 1986. Sachs not only supported the Bolivian government's decision to delay debt payments and to defend the currency during the inflationary
spike following the collapse of tin prices in December 1985, but he became an influential lobbyist for Bolivia in its negotiations with the IMF and conferred a crucial sense of credibility and expertise to the policy decisions of the Paz government. The success of this approach became clear in June 1986, when, after expressing reservations for several months, the IMF agreed to a standby agreement in June 1986 without requiring any changes to the existing framework of the NEP (Conaghan and Malloy 1994:196). Within the context of the formal model, Sachs' role in facilitating initiation of the IMF agreement can be interpreted as either a credible signal about the reform commitment of the Bolivian government or as a reduction of institutional uncertainty through his contribution to the formulation of a coherent economic reform program.

Following the initiation of the IMF standby agreement in June 1986, the Bolivian government's commitment to orthodox economic reform was finally rewarded not only through the direct IMF disbursements of SDR 114.9 million in the second half of 1986\(^{96}\), but more importantly a rescheduling of Paris Club debt (to official lenders) in June 1986, as well as the initiation of a debt renegotiation process with the commercial banks, which was concluded in 1987 with an agreement whereby Bolivia was allowed to repurchase half its debt in the secondary market at 11 cents to the dollar and to reschedule the rest of the outstanding debt. The remarkable leniency of the IMF and other Western lenders during this period - manifested not only in the surprisingly generous terms of the debt renegotiations\(^{97}\) but also in the ability of the Bolivian government to obtain new official loans even as it continued to default on its foreign debts.

\(^{96}\) Is funding consisted of SDR 32 million through regular standby disbursements, SDR 64 million in compensatory financing for export shortfalls and SDR 18 million through the lower conditionality Structural Adjustment Facility (SAF) initiated in December 1986.

\(^{97}\) As Pastor (1992:91) points out, developing countries are usually prohibited from entering the secondary market for their own debt obligations because such an option would give them the perverse incentive to restrict their debt service intentionally in order to be able to repurchase their own debt at a lower price.
debt service - suggests that Bolivia became the beneficiary of a politically motivated deviation from the usual strict constraints of IMF conditionality.

The relative leniency of IMF conditionality in Bolivia, however, only applied to the external requirements of IMF programs but not to deviations from domestic reform measures. Thus, the IMF withheld funding for much of 1987 in response to the rising budget deficit incurred by the Bolivian government in its effort to fuel economic growth by raising public investment. Aware that the country's macroeconomic stability depended to a large extent on the continuation of amicable relationships with the IMF and foreign creditors, the Paz government reversed its expansionary policies, which may have contributed to its electoral defeat in 1989 but was successful in restoring Bolivia's status as a showcase for neo-liberal reforms and was rewarded in July 1988 with the signing of a multi-year Enhanced Structural Adjustment Facility (ESAF) program, whose benefits were supplemented by additional compensatory financing for export shortfalls. Bolivia's successful orthodox reforms in a reasonably democratic context placed it in an ideal position to reap the financial benefits of becoming a showcase example for Western promoters neoliberal economic policies in a regional context characterized by heterodox deviations from IMF conditionality in the mid-to-late 1980s (e.g. in Argentina, Brazil and Peru). However, unlike the exceptional status arising from economic or military importance, Bolivia's preferential status was contingent on the strict adherence to the economic tenets of neoliberalism, which drastically restricted the policy maneuvering space of the Paz government.

A similarly mixed blessing underlies the second source of political exceptionalism that influenced Bolivia's interaction with the West, and by extension the IMF: the participation of the Paz government in the U.S. led war on drugs, meant to reduce the supply of cocaine to Western markets. On one hand the willingness of the Bolivian government to cooperate with the United
States' campaign against coca leaf production in the Andean countries played an important role not only in bringing about U.S. political pressures on the IMF and Western commercial banks for favorable treatment of Bolivia, but was also an important driver in the rapid increase of Western foreign aid inflows into Bolivia, which rose from $117m in 1984 to $396m in 1987 and became an important source of foreign currency for the Bolivian government. At the same time, however, the economic costs of the crackdown against coca leaf producers had a serious negative impact on the Bolivian economy, not only because the revenues from illegal coca exports accounted for half the country's total export earnings and for an important portion of deposits in the Bolivian banking system, but also because it exacerbated the poverty of some of the country's least developed rural regions, where the livelihood of more than a quarter million farmers depended on the crop. In addition to these real economic costs, the expectation of export revenue shortfalls associated with the war on drugs fueled speculations about the inevitability of a currency devaluation in the summer of 1986, thereby contributing to the maintenance of high interest rates, which in turn hurt economic recovery (Sachs 1986:33-34).

Overall, the international dynamics of Bolivian reforms in the second part of the 1980s were rather unique by regional standards, in that the country’s role as a neoliberal showcase example, combined with its low overall debt and its costly participation in the U.S. war on drugs, resulted in an unusually generous treatment by the IMF and Western creditors. Through its close relationship with Jeffrey Sachs, Bolivia managed to square the circle between gaining international backing for its adjustment efforts and implementing a reform package, whose components were tailored to the specific political and economic needs of the country. Thus, in a sense Bolivia represents the ideal case orthodox adjustment scenario for a highly indebted developing country during the Latin American debt crisis, and as such the limitations of its
success (with respect to growth, redistribution, and democracy) illustrate the narrow confines of the maneuvering space available to Latin American governments during this period.

**Adjustment in the Spotlight: Argentina and the Debt Crisis**

While Bolivia was learning to cope with the challenges of economic and political marginality, Argentina’s troubles were of a different nature. As one of the world's three largest developing country debtors (behind Brazil and Mexico), with more than $43 billion in foreign debt by the end of 1982, Argentina had a prominent position on the balance sheets of many Western commercial banks and, therefore, played a central role in the political and economic agenda of Western creditors and the Fund’s mission in the region. Even though in relative terms the public debt was not excessive by regional standards (accounting for 55% of GNP in 1982), debt service placed a significant and increasingly worrisome burden on public finances, given that interest payments alone amounted to 4.5% of GNP and total debt service used up half the country’s export earnings at the outset of the debt crisis and almost 70% by 1983. Even though international reserves were initially relatively solid (around $3 billion or 6.6 months of imports by mid 1982), they only covered the equivalent of one year of debt service payments, hardly a comfortable cushion considering the abrupt halt to foreign capital inflows into the region after Mexico's insolvency announcement in August 1982. As such, Argentina certainly fit the profile of an economically important country in financial distress, which according to the predictions of the formal model and the findings of the statistical tests made it an obvious target for IMF conditionality. Indeed, between 1982 and the end of 1989, Argentina entered four IMF standby agreements, one of which was renegotiated and extended in mid 1985 in conjunction with the launching of the Austral Plan. Nevertheless, the relationship between the Fund and Argentina,
while never degenerating into open confrontation as in the case of Alan Garcia's Peru, remained uneasy throughout the decade, as reflected in the patchy compliance record of the programs and the occasionally defiant public statements of Argentine officials.

The underlying tone of the relationship between Argentina under Alfonsin and the IMF (as the representative of Western creditors) was set by what large sections of the country's population and civilian elite viewed as the illegitimate nature of Argentina's foreign debt. This sentiment, present to varying degrees in many Latin American countries, was justified by the fact that the bulk of the country's external debt had been accumulated under the brutal and thoroughly discredited military dictatorship (Damill and Frenkel 1996:81), which had “succeeded” to oversee a dramatic increase in public debt (from $8.3 billion in 1976 to $45 billion in 198398) through a combination of costly infrastructure projects and defense spending. This resentment was exacerbated by the Reagan government's ideological support for the military dictatorship prior to the Falklands war99 and the nationalization of private foreign debt by the outgoing military regime in late 1982, as part of its rapprochement with the West in response to the outbreak of the debt crisis. Moreover, the unusual willingness of the IMF to sign a standby agreement with the lame-duck military government of General Bignone in the context of the extreme domestic economic and political instability reinforced the Argentines' distrust of the Western motives in their dealings with developing country debtors.

Elected after a campaign in which both major parties had emphasized their anti-imperialist foreign policy stance, the new Alfonsin government initially sought a political solution to the debt crisis. Emboldened by the domestic and international legitimacy derived

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99Thus, Reagan decried the Carter administration's human rights sanctions as having made "a mess of our relations with the planet's seventh-largest country, Argentina, a nation with which we should be close friends," and praised the military dictatorship for its actions against the terrorist threat." (Sklar 1988:61 cited it Vaes 1989:33)
from its democratic credentials, and reassured by the country's relative economic self-sufficiency\textsuperscript{100}, Argentina emerged as the key promoter of a debtors' cartel, meant to create a unified response of developing countries in their debt negotiations with Western creditors under the banner of the IMF. After several months of intense lobbying from all sides, which culminated in the ironically misnamed “Cartagena Consensus” of June 1984, Argentina only managed to get the endorsement of several of the smaller countries, whereas Mexico, Brazil, Venezuela, and Colombia favored a more conciliatory approach that eventually resulted in the preferred Western formula of case-by-case negotiations and weakened the bargaining position of the debtors\textsuperscript{101}.

Unlike the post-1985 Peruvian government, the Argentine government decided to avoid the risky strategy of unilateral defection and, “rewarded” at least in part by a relatively advantageous initial debt rescheduling, agreed to negotiations with the IMF. Following several months of tense negotiations, punctuated occasionally by intense rhetorical and personal clashes\textsuperscript{102}, the Argentine economy minister Bernardo Grinspun eventually signed a letter of intent for an IMF standby agreement in September 1984, which was approved by the IMF Executive Board in late December 1984. However, the Argentine government almost immediately broke some of the program conditions, which, despite an initial funding disbursement in January 1985 and the resignation in February of Grinspun and the equally populist central bank governor Garcia

\textsuperscript{100}Thus, Alfonsin argued explicitly - and at least to some extent justifiedly - that Argentina with "its own beef, grain, industry and energy resources...could go it alone" (cited in Watkins 1985:43).

\textsuperscript{101}While a more detailed analysis of this crucial breakdown of debtor cooperation is beyond the scope of the current discussion, the four “defectors” were motivated by different considerations: Mexico was more dependent than other countries on its close financial and trade ties with the United States (Kahler 1985:379), Brazil was more vulnerable due to its dependence on energy imports (ibid), whereas Venezuela and Colombia were facing a more manageable debt situation and in fact managed to avoid IMF conditionality until at least 1989.

\textsuperscript{102}Aside from the obvious tensions about the relative degree of internal adjustment an external support, the negotiations suffered from increasingly acrimonious relations between the two negotiating teams, which were shouting terms for a while (Stiles 1991:186). Moreover, the Argentine government chose to publicize its defiant stance by flouting standard IMF procedures and submitting a unilateral home-made letter of intent, which clearly prioritized domestic growth over debt repayment (ibid:185).
Vasquez in protest against the stringent monetary measures advocated by the IMF\textsuperscript{103}, resulted in the breakdown of the program by March 1985 and the end of Argentina's first attempt at orthodox adjustment under the democratic regime.

The eagerness of the Western creditors to continue to engage the Argentine government despite the breakdown of the program and the acceleration of inflation in the second quarter of 1985 was emphasized by the continuation of (albeit fruitless) negotiations during this period between the IMF mission and the new economic team of Juan Sourrouille, Grinspun's successor as economic minister of the Alfonsin government. The politically motivated flexibility of the Fund's relationship with Argentina during this period became even more obvious in July 1985, when the IMF staff agreed to accept the heterodox \textit{Plan Austral}, announced by Alfonsin in a public speech on June 14th without prior consultation with the IMF, as the basis for a renewal and extension of the standby agreement suspended earlier in the year\textsuperscript{104}. In doing so, the IMF leadership not only chose to play along with the Argentine government's ostentatious display of economic policymaking independence (whose political importance was particularly salient in the context of the imminent congressional elections), but it also tolerated the program's significant deviations from standard IMF orthodoxy, particularly with respect to the wage and price freeze measures instituted by the plan.

The IMF's remarkable tolerance for Argentina's heterodox stabilization approach was reiterated in early/mid 1987, when it extended its seal of approval to the new attempt of the Alfonsin government to cope with the renewed fiscal crisis and inflationary pressures, even though the \textit{Australito}, like its considerably more successful predecessor contained important


\textsuperscript{104}It was hardly a coincidence that the IMF approval came shortly after Federal Reserve Chairman Paul Volcker praised the plan and promised direct U.S. support for Argentina's negotiations with the commercial banks and the international financial institutions (Vacs 1989:41).
wage and price freeze components. This leniency, promoted by the U.S. government on number
of occasions (such as a program waiver and a $500 million bridge loan negotiated with U.S.
support in September 1987), only applied to domestic policies and debt restructuring
negotiations but - significantly - not to debt forgiveness, as indicated by U.S. Secretary of the
Treasury James Baker dismissal of an Argentine request for 30% debt reduction in 1988 as
“fantasy” (Vacs 1989:43). When the U.S. government finally agreed to significant debt
reductions for developing countries as part of the Brady Plan in 1989, the help came too late for
the Alfonsin government, which had already completely lost control over the Argentine economy
during the first months of that year.

Even a brief comparison of the different experiences of the Argentine and Bolivian
governments in their interactions with the IMF during the 1980s provide some interesting
insights into the role of Western political and economic considerations in shaping the nature of
IMF conditionality during the debt crisis. Thus, whereas the Siles government in Bolivia had
failed to secure an IMF agreement during its three-year tenure despite taking a more conciliatory
approach towards debt payments and Western conditionality than the Argentine government
during the same period, Bolivia's marginality within the broader international context of the debt
crisis facilitated a much more generous treatment with respect to debt forgiveness, once the
successful orthodox economic reforms of the Paz government after 1985 had elevated the
country to the privileged status of a showcase for neo-liberal policies. This relative financial
generosity, which had the significant advantage of being quite cheap for Western investors
(given Bolivia's small overall debt and extremely low likelihood of repayment by 1985), came at
the price of strictly enforced domestic conditionality. Meanwhile, Argentina was allowed to “get
away” with significant deviations from IMF orthodoxy as long as its policies were broadly
consistent with the Western goal of financial stability and timely debt payments but the price for this relative freedom was the persistence of the high debt service burden, which played an important role in derailing the country's adjustment efforts under Alfonsin. While - as will be discussed in more detail in the following section - it is questionable whether Alfonsin would have been willing or capable to implement an orthodox reform program along the lines of the Bolivian NEP, Argentina could have hardly hoped for a similarly generous financial treatment given the significantly higher costs of such a concession to Western creditors. These differences suggest that the menu of options available to Latin American governments during the 1980s was shaped in important ways by their relative economic and political importance to the West, thereby creating different sets of incentives to policymakers and ultimately producing different adjustment paths.

Peru: The Art of Mistimed Compliance and Defiance

Peru, like neighboring Bolivia, experienced two radically different phases during its relationship with the IMF in the 1980s: a valiant attempt at compliance under the Belaunde government until 1985, and an equally brave confrontation attempt under Alan Garcia after 1985. But unlike their luckier neighbors, Peruvian politicians picked the “wrong” timing for both of these approaches the IMF conditionality, and the result ended up producing the worst of both worlds for political leaders and citizens alike.

Even though the Belaunde government certainly had its share of the blame for the failure of its economic reform agenda after 1982, its task was considerably complicated by the unfavorable international economic environment and inflexible initial approach of the IMF to the Latin American debt crisis. Besides Chile, Peru was one of the few committed neoliberal

105 See chapter 6 for a more detailed discussion of some these political and economic miscalculations.
reformers in Latin America prior to 1982 and the Belaunde government's solid neoliberal track record between 1980 and 1982 initially resulted in close cooperation with the IMF during the first year of the debt crisis: in fact, the Belaunde government signed a three-year $650m Extended Fund Facility agreement with the IMF in early June 1982, two months before the official outbreak of the debt crisis. Moreover, despite its heavy debt service burden, which accounted for almost 50% of the country's exports in 1982, the government adhered rather closely with the restrictive terms of the program despite the increasing unpopularity of the austerity measures. However, by mid-1983 the deep recession, combined with increased military expenditures due to the rising threat of the *Shining Path* insurgency, as well as political pressures in conjunction with the municipal elections in late 1983, contributed to larger-than-expected fiscal deficit and inflation levels, and eventually resulted in the breakdown of the IMF program by November 1983.

Given the Peruvian government's traditionally close relationship with the IMF, Belaunde's Finance Minister, Rodriguez Pastor, attempted to extract concessions with respect to the depth of the austerity measures required as part of the negotiations for the renewal of the IMF agreement in late 1983/early 1984 (*Wall Street Journal* 1/4/1984). However, despite the country's precarious economic situation and the increasing likelihood of a leftist or populist victory in the rapidly approaching general elections scheduled for July 1985, the IMF maintained a tough bargaining position, which delayed the approval of the program and further complicated Peru's difficult negotiations with the commercial banks. Eventually, following a last-minute intervention from Fund Managing Director de Larosiere, the IMF negotiating team agreed in late April 1984 to sign a somewhat “softer” 18-month-program to accommodate the electoral concerns of the Belaunde government.
The course of these negotiations surrounding the 1984 Peruvian IMF program, nicely illustrate the predictions of the formal model and the statistical finding of the previous chapter. Thus, as a country of medium size and economic importance,\textsuperscript{106} we would expect Peru’s experience with IMF program initiation in the early 1980s to occupy the middle ground between Bolivia’s futile efforts to secure IMF funding and the much prompter response of the Fund to Argentina’s economic woes. In this sense the substantial initiation delays and the initial intransigence of Fund negotiators are balanced by the eventual political intervention which led to the signing of the program. However, as it turned out, this middle ground was hardly a comfortable one for the Peruvian government. During the four-month delay in the approval of the program, the Fund's inflexible approach to Peru's difficult economic and political situation had contributed decisively to the political defeat of the neoliberal reform project in Peru. Under increasing political pressure from his own party and an increasingly impatient population, President Belaunde fired Rodriguez Pastor for his willingness to accept the stringent austerity measures promoted by the IMF in mid-March 1984. The move was followed by the \textit{en masse} resignation of the neoliberal technocrats and marked a decisive break in the government's economic policy, which shifted towards a more “reactivationist” stance (Wall Street Journal, 3/21/1984). The expansionary policies pursued in mid-1984 led to a ballooning fiscal deficit (6.1\% for the year) and resulted in the breakdown of the IMF agreement by mid-September. Moreover, despite its moderate success in reactivating the economy (which grew at 4.8\% in 1984), the policy change failed to reverse the political decline of the Belaunde government and set the stage for the victory of Alan Garcia in the general elections of mid-1985.

\textsuperscript{106} For example Peru’s foreign debt in 1983 ($10.7bn) was three times larger than Bolivia’s but less than a quarter the size of Argentina’s.
A Costly, Mistimed Rebellion: Peru under Alan Garcia

Immediately after his convincing electoral victory in July 1985, the new Peruvian president, Alan Garcia, signaled a decisive departure from the accommodationist relationship with the IMF pursued by the Belaunde government for most of its tenure. Having thoroughly internalized the political lessons of his predecessor's disappointing experiences with IMF conditionality, Garcia wasted no time to spell out his confrontational approach to relations with the Fund. Already in his inaugural speech on July 28th 1985, Garcia announced his nonnegotiable opposition to IMF demands, which he regarded as tantamount to giving up the country's political sovereignty (*Wall Street Journal*, 7/29/1985). The populist tone of his rhetoric was matched in policy terms by an official announcement of the government's intention to limit debt service payments to no more than 10% of export earnings in an effort to give the Peru the breathing space necessary for economic recovery.

The Fund’s reaction to the Peruvian “rebellion” was swift, and in August 1986 the IMF's announced that Peru was ineligible for additional IMF loans. Thus relegated to the bottom of the international financial hierarchy alongside a “select” group of IMF delinquents (including Liberia, Vietnam Guyana and Sudan), the Peruvian government found itself cut off not only from IMF and World Bank lending but increasingly also from trade credits. This credit shortage was exacerbated by the failure of Garcia's export promotion policies and ultimately contributed decisively to the spectacular collapse of the Peruvian economy starting in 1988. Despite the drastic decline in foreign reserves and international credit-worthiness combined with the rapidly increasing inflation during this period, Peru was not able to secure an IMF agreement until after the inauguration of the Fujimori government in 1990. Thus, the international political gamble of the Peruvian government ended in a decisive defeat that illustrated the dangers of open
confrontation with the IMF in a period of worldwide neoliberal ascendancy.

While Peru’s international isolation was triggered intentionally by the Garcia government, most individual elements of Garcia's political approach were not unique in the context of the often tense relationship between the Fund and Latin American governments in this period. Thus, Garcia’s nationalist rhetoric about the skewed priorities of debt repayment were not all that different from some of the statements by members of Alfonsin’s government in 1983-4. Similarly, while Garcia’s economic program included a number heterodox deviations from IMF policy prescriptions, the same was true of the Argentine Plan Austral, which the IMF tolerated and even supported during the same time period. Furthermore, the Fund also backed the economic program of the Bolivian reformers despite their reliance on fixed exchange rates and their refusal to resume commercial debt payments until late 1986. Moreover, despite his inflammatory rhetoric, Garcia actually adopted a fairly pragmatic approach to debt service in an attempt to preserve crucial sources of private credit for the country.107

Even though none of the individual elements that led to Peru’s international isolation were uniquely Peruvian, the Garcia government miscalculated in three important ways. First, Garcia misjudged the gravity of combined effect of his strategy's economic, political, ideological, and rhetorical challenges to Western neoliberalism inherent in his frontal attack on the IMF. By comparison, Argentina’s confrontational rhetoric in 1983-4 was balanced by a more timely debt service performance, whereas Bolivia’s debt moratorium in 1985-6 was accompanied by an ambitious neoliberal domestic reform agenda. Second, perhaps under the spell of his own nationalist rhetoric, Garcia had overestimated his country's importance to Western economic interests and had thus unleashed an uneven conflict from which Peru could only emerge as a

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107 In fact, as Pastor (1992:122) points out, Peruvian debt service payments actually exceeded the 10% ceiling between 1985-87, and the decline in 1988 was due primarily to the incapacity rather than the unwillingness of the Garcia government to pay.
loser. Whereas Argentina’s potential default would have seriously rattled Western banks, Peru’s
debt was a much smaller concern, and, therefore – in line with the statistical findings in the
previous chapter - triggered a much less forgiving reaction from the IMF. Ironically, Peru’s
higher overall debt and economic importance compared to neighboring Bolivia, may have also
contributed to the more serious consequences of its partial debt moratorium, since its
consequences were significantly costlier to Western creditors than for the much smaller Bolivian
debt. Finally, Garcia’s challenge to the West was undermined not only by the country’s modest
size but also because it arguably came too late in the debt crisis. Thus, by 1986 the threat of an
international debtor’s cartel, which had been a major concern for the West in 1983-4, had
practically disappeared. At the same time, Western commercial banks had gradually managed to
reduce their exposure to Latin American debt, and were therefore in a much less vulnerable
position than at the outset of the debt crisis. These systemic factors further exacerbated the power
imbalance between the Peruvian government and Western creditors, and thereby sealed the fate
of Garcia’s quixotic rebellion against the IMF and the West.

Overall, the relationship between successive Peruvian governments and the IMF during
the 1980s illustrate the difficult trade-offs faced by middle-sized countries during the debt crisis.
Peru’s negative experience with both orthodoxy and heterodoxy is primarily the consequence of
the unfortunate timing and interaction between the country's domestic policies and international
economic developments during the 1980s. Thus, the cooperative stance of the Belaunde
government in the early months of the debt crisis was not rewarded by more flexibility in the
Fund’s approach to conditionality and ultimately undermined the political feasibility of orthodox
economic adjustment in a democratic context. However, the diametrically opposite approach to
IMF relations chosen by the Garcia government after 1985 did not produce better outcomes. The
severity of the West's punishment of the Garcia government's political “heresy” emphasizes not only the crucial importance of the IMF in the overall international economic context of the debt crisis but also the significant context-dependence of developing-country strategies for dealing with the IMF: even though Garcia’s approach combined a number of elements from the relatively successful Argentine and Bolivian strategies in the mid-1980s, the ultimate economic and political repercussions of his approach were radically different because of its unfavorable timing and its incongruence with Peru’s more modest economic importance.

A Strained Alliance - Chile and the IMF in the Mid-1980s

By most standards, Pinochet’s Chile in the 1980s was the ideal candidate IMF programs. Beside a regionally unique track record of home-grown and ideologically committed economic orthodoxy, Chile also exhibited some of the classic external financial crisis symptoms: thus, in 1982 Chile had not only the second highest interest payment burden in the region (amounting to 10.7% of GNP) but its $17.3 billion overall debt was the fifth highest in Latin America and, therefore, created more significant concerns about a possible default than in a smaller debtor like Bolivia. This combination of financial need and size, which was the strongest predictor of IMF program initiation and implementation in the statistical analysis in the preceding chapter, made Chile into an obvious candidate for IMF programs. These theoretical predictions were borne out with remarkable consistency if we analyze the broad patterns of the country’s initiation and implementation of IMF programs during the 1980s. The first agreement was approved in early January 1983 and over a two-year period provided $500 million in direct loans, which were fully disbursed by the end of the program after a partial renegotiation of program targets in early 1984. Only six months after the expiration of the first program, Chile and the IMF signed a second
agreement in August 1985, this time for $750 million over three-year period, which was in turn extended for an extra year in 1988, also fully implemented. Finally, in early November 1989, just over a month before the country's first democratic elections in two decades, the IMF approved one last $82 million program with the outgoing Pinochet government, which, in a curious departure from standard program procedures, was disbursed immediately in one tranche. Overall, then, since the debut of the debt crisis in August 1982 the Chilean military government had spent less than 18 months without an IMF supported program, in what undoubtedly ranks as the closest cooperation between the Fund and any Latin American country during the 1980s.

Nevertheless, a closer look at the interaction between the IMF and the Chilean government reveals a much more complicated picture than suggested by this broad overview. Thus, between 1983-85 Chile underwent a difficult transition from the Chicago-style monetarism of the 1970s to the post-1985 pragmatic neoliberalism, in the process, the relationship between the Pinochet regime and the IMF went through a rough patch. Even though the Chilean government initially responded to the debt crisis with an IMF-supported classical orthodox adjustment strategy, the economic and political costs of this approach became increasingly obvious to the Pinochet regime during 1983, and Chile suddenly found itself in the unfamiliar position of having to struggle to fulfill the requirements of the IMF agreement it had signed in January 1983. In less than two years the burden of adjusting to its threateningly high foreign debt had transformed Chile from a poster child of neoliberalism to just another Latin American problem child of the debt crisis.

These problems came to a head in the fall of 1983, when it became clear that Pinochet's political survival hinged on the initiation of economic reactivation measures, whose expansionary fiscal implications conflicted with the program targets agreed upon in the IMF
standby agreement earlier that year. At the same time, however, the Chilean government could hardly afford to simply abandon the program, given that its foreign reserves had declined from $3 billion in early 1982 to around $1.3 billion by late 1983, and that the IMF agreement was important not only because of its direct funding but also because the Fund acted as an effective gatekeeper for the country's much-needed debt renegotiations with its commercial creditors. Nevertheless, Chile had two important advantages compared to Peru or Bolivia in its negotiations with the IMF in late 1983/early 1984: first, its larger overall debt raised its economic importance to Western banks and therefore raised the stakes of a possible default. Second, and more important, the ideological and educational value of a successful neoliberal adjustment example was important in the charged political context of Argentina's attempts to assemble a debtors' cartel in early 1984, and Chile was one of the few promising candidates.

As a consequence of the high stakes on both sides, the lengthy negotiations during the winter and spring of 1984 proceeded very discreetly, avoiding the drawn-out rhetorical exchanges and public statements that plagued the Fund's relationship with Argentina and Peru. By mid-February the IMF agreed to grant the Chilean government a waiver that would allow the expansion of the government deficit to almost 5%, which seems relatively generous, considering the Fund's refusal to let Peru get away with a 4% deficit in the same time period. Moreover, following Pinochet's strategic replacement of Finance Minister Carlos Caceres with Luis Escobar, who just happened to be the country's former representative at the World Bank and the IMF, in late April the IMF agreed to raise the fiscal deficit target 5.6% for the year. The relative generosity of this target, not only compared to the 4.1% final offer made to Peru that a month, but also when judged by Chile's actual deficit in 1984 (4.8%), suggests that Chile did receive preferential treatment in its negotiations with the IMF. The sad irony of the Fund's treatment of
Chile and Peru in the spring of 1984 is that the IMF appears to have been more concerned with political feasibility in the case of Pinochet's military dictatorship than for Peru's fledgling democracy.

As will be discussed in more detail in Chapter 7, starting in mid-1985, the consolidation of a pragmatic neoliberal political coalition, combined with the country's rapid export-led economic growth in the second half of the 1980s, restored Chile to its “rightful” place as a role model for aspiring neoliberal reformers. However, the severity of the economic and political crisis provoked by the initial orthodox adjustment effort, underscores the narrow constraints of politically sustainable neoliberal economic reforms during the 1980s debt crisis even for an “ideal case candidate” such as Chile. Therefore, it should come as no surprise that during the early part of the debt crisis, failed economic adjustment was the rule rather than the exception in Latin America.

**Moldova: The Making of an Unlikely IMF “Regular”**

In the mid to late 1990s Moldova became a somewhat unexpected poster child for IMF style reforms in the non-Baltic former Soviet Union. From December 1993 until May 2000, Moldova was virtually continuously engaged in IMF programs with only a brief two-month hiatus in 1996. The frequent and fairly consistently implemented Moldovan IMF programs are even more remarkable considering the country’s unpromising domestic context, characterized by weak institutions and a government dominated by former Communists. Therefore, Moldova’s close cooperation with the International Monetary Fund represents the perfect example of the crucial importance of external constraints as drivers of the whole intensive involvement of ex-communist countries with the IMF during the first decade of the transition. In particular, I argue
that this unlikely alliance has to be analyzed from the perspective of the country’s high financial
dependence on multilateral funding, combined with the need for international legitimacy of the
fledgling Moldovan state, caught in a tense geopolitical situation between two potential patron
states (Romania and Russia). This extraordinary dependence was at least partially balanced by
the Fund’s need for a “showcase” example of successful IMF conditionality in the former Soviet
Union, which contributed to a more forgiving IMF reaction to temporary policy slippage, and
suggests a broader applicability of the post-1985 Bolivian strategy for overcoming the
disadvantages of marginality.

Large carrots for a hungry man

Moldova's post-communist experience can be regarded as a textbook case for situations
in which extreme financial need drives desperate governments into the arms of the IMF.
Following the breakup of the Soviet Union, the drastic rise in the country's energy costs
combined with quasi-collapse of its traditional export markets in the former Soviet Union led to
high dependence on external funding to cover the country's basic import needs. Like most former
Soviet republics, Moldova emerged at independence with virtually no foreign reserves, and the
situation improved only slowly inconsistently over the course of the decade: thus, Moldova's
international reserves rose from 1.6 months of imports in late 1993 to around 3 months in 1994-7,
before declining again to 1.4 in 1998 due to the fallout of the Russian crisis. Moreover, with the
exception of a brief period in 1997, Moldova had essentially no access to international financial
markets, which meant that the government's only realistic source of funding were official donors,
particularly Western governments and international financial organizations.\textsuperscript{108} In view of

\textsuperscript{108}The only non-Western alternatives would have been direct assistance from either the Russian or the Romanian
government, both of which were in a dire financial position themselves and could have hardly afforded the finance
Moldova's extremely limited geopolitical importance to the West, the only hope for gaining access to Western funding was a close cooperation with the IMF, which has been widely regarded as the gate-keeper for official credits in the former communist bloc.

The extent of Moldova's dependence on IMF approval is illustrated by the fact that during the 1993-5 period official credits from bilateral and multilateral donors accounted for more than 96% of the country's total foreign debt, with about a third of the total funding coming directly from the IMF. The relatively large flows of official funding into Moldova during the mid-1990s were intended not just as policy incentives for the Moldovan government but as part of a Western strategy to illustrate the benefits of courageous economic reforms in the former Soviet republics. Moreover, the Fund's assessment of Moldovan economic policy played a remarkably clear signaling role in mobilizing/suspending lending by other official donors: thus, the STF and SB programs in late 1993 were “rewarded” with additional funding from the World Bank, the EU and the EBRD, as well as by bilateral assistance pledges from Western governments. Similarly, the IMF's decision to withhold payment on the third tranche of the EFF program in late 1996 also prompted the suspension of a World Bank Structural Adjustment loan.

Thus, the Moldovan case confirms the predictions of the formal model that as long as IMF programs are associated with sufficiently high levels of direct and indirect funding to a sufficiently desperate government, we may get instances of IMF program implementation even under adverse political and institutional conditions.

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109 These figures are based on data from the EIU Country Data statistics, and do not include Moldova's unpaid energy bills to the Russian gas company Gazprom.

Choosing patrons: IMF conditionality and Moldovan sovereignty

The second major reason for the Moldovan government's surprisingly close adherence to IMF conditionality goes beyond the economic considerations captured by the formal model and the statistical tests, and has to do with the peculiar nature of Moldova's geopolitical position in the early post-independence period. After gaining its official independence during the chaotic days of the August 1991 coup in Moscow, Moldova had to confront a series of threats not only to its territorial integrity but also to its very existence as a sovereign state. In this context, IMF conditionality, while reducing the government's maneuvering space in determining economic policy, played an important role in promoting the international legitimacy of a state, whose viability was (and still is) questionable.

The first and arguably most fundamental threat to Moldovan independence came from the reformist Popular Front of Moldova, which had won the first free elections in 1990 and which actively pursued reunification with Romania. Though many outside observers had anticipated this reunification as an inevitable consequence of the close ethnic and cultural similarities between the two countries, the reunification movement lost momentum starting in early 1992 and has steadily declined ever since. From an internal perspective, popular support for reunification suffered due to mixed memories of Bucharest's inter-war rule of the region, fears of ethnic unrest from Moldova's large and vocal ethnic minorities, and to a certain degree as a result of 40 years of intense Soviet indoctrination. Moldova's largely russified elite had good reasons to believe that joining Romania would prove to be a bad career move and deprive them of prestigious posts in the new state. (Kolsto, 1996:123) From an external perspective, the separatist crisis in Transdniestr constituted a clear signal that Russia was willing to defend its regional interests through the use of force, and that neither Romania nor the West would be able or willing to
intervene. As Moldova has increasingly rejected the possibility of re-unification, its leaders have made sustained efforts to popularize the doctrine of Moldovanism, which emphasizes the distinctiveness of Moldova's cultural and historic heritage.¹¹¹

By avoiding reunification with Romania, the Moldovan government ensured the survival of Moldova as a state. But this survival only marked the beginning of a difficult struggle to define the country's position in the international arena in the context of formidable internal and external constraints. The most difficult trial for Moldova was the Transdniestra crisis, which has undermined Moldova's territorial integrity and played a decisive role in shaping both Moldova's internal politics and its foreign policy. While ostensibly an internal ethnic conflict, the Transdniestra crisis was the core of the heated debate about Moldova's international status and Russia's role in the region. The importance of the Transdniestra conflict in the wider context of the debate about Moldova's international status and Russia's role in the region was probably best summarized by Nicolae Nau, Moldova's ambassador to the UN, during a speech in front of the UN General Assembly. Nau emphasized that the crisis was not - as Russia had claimed - inter-ethnic but rather a political conflict used by Russia as an excuse to justify the continued presence of its armed forces on Moldova's territory. He furthermore accused Russia of ultimately pursuing the goal of “restoring the old imperial structures with the blessing of the international community.” (Moldova Suverana, 10/14/1993) Nau's strong claims are supported by General Lebed, the Commander of the 14th Russian army, who called Transdniestra “Russia's key to the Balkans” and emphasized that if Russia left this strategic crossroads between the Ukraine, Romania and the Black Sea, it would lose its influence on the entire region (quoted in Gabanyi, __________
⁴¹¹While this unexpectedly successful effort constitutes a fascinating and original approach to the identity crisis facing Moldovan society, its details are beyond the scope of the current discussion. For an interesting analysis of this topic, see Igor Munteanu's article 'Moldovanism' as a Political Weapon (Transition, 10/4/96)
Russia explicitly acknowledged that the importance of its armed presence in the region extended beyond the scope of the Transdniestrian conflict and that the timing and order of the troop withdrawal was contingent on Russian-Moldovan relations. (Cojocaru 1996:4)

In addition to playing the “Transdniestrian card”, Russia used Moldova's economic dependence to influence the domestic and foreign policy of the Moldovan government. For example, during the 1996 presidential elections, which pitted the independent-minded acting President Mircea Snegur against the more pro-Russian Petru Lucinschi, the Russian CIS Minister Aman Tuleev, told Pravda that Russia should give no more credits to Moldova if Snegur was reelected president (Transitions, 11/16/96) Along similar lines, Moldova's resistance against becoming a buffer state as a consequence of NATO enlargement, was rewarded by Moscow by agreeing to reschedule Moldova’s gas debts and to exempt the Moldovan government from the debts contracted by the Transdniestrian authorities. (Negru 1997:8) Other potentially important economic threats included the introduction of visas for Moldovans looking for work in Russia and the imposition of import tariffs, which would further cripple Moldova's export-dependent economy.

The external pressures from Bucharest and Moscow were also reflected in Moldova's domestic political landscape, with the independence-minded PDAM government facing challenges from the pro-Romanian Popular Front and its successors, as well as from the pro-Russian Socialist Party/Edinstvo bloc. In this context the decision of the Moldovan government to cooperate closely with international organizations represented an astute political maneuver meant to find an alternative patron, which could counter-balance the Russian and Romanian claims to influence. The most obvious example in this respect was the close cooperation between the Moldovan government and the CSCE mission in Moldova in trying to solve the Transdniestrian
crisis. Moldova followed CSCE recommendations on minority policies and language rights, and thereby not only gained the approval of the West, but also weakened the position of Russia and Transdniestra, who found it much harder to blame Moldova for the continuation of the crisis. Moldova's strengthened international position resulting from this rapprochement to the West was illustrated by Moldova's threat to vote against the admission of Russia to the Council of Europe unless Russia withdrew its troops from Transdniestra. (Gabanyi 1996:29)

Seen from this balance-of-power perspective, Moldova's interaction with the IMF went beyond the traditional tradeoff between funding and sovereignty inherent in IMF conditionality. Some of the Western support received as a consequence of the “green light” from the IMF was specifically targeted to reduce Moldova's dependence on Russia: thus, the country received support from EBRD to build an oil terminal on the Danube in an effort to reduce its dependence on Russian oil (Interfax, 11/29/1994). Also, Moldova received a $250m loan from the World Bank to repay Russian oil debts after Russia had temporarily shut off oil supplies in late 1994. (Journal of Commerce, 12/8/1994)

Therefore, while IMF conditionality arguably induced the Moldovan government to implement economic policies, which contradicted both its partisan and its electoral interests, and which ultimately failed to reverse the country’s precipitous economic decline, the funding and “legitimizing” function of IMF cooperation may have actually contributed not only to the survival of the PDAM government but also to the stability of the fledgling Moldovan state. The continuing importance of the IMF in the country’s international “equation” was emphasized by the decision of the unreformed Communists to “forget” their electoral tirades against Western imperialism and to continue to implement the IMF Poverty Reduction and Growth Facility (PRGF) arrangement initiated by the previous government. Such cooperation is likely to
continue for at least as long as the basic economic and political parameters of Moldova’s precarious international position remain unchanged.

*The Perils of Heresy: Slovakia under Meciar*

When Slovakia obtained its independence on January 1, 1993 the prospects for the new republic were hardly promising. Even though it was not facing security threats comparable to those of Moldova (discussed above), Slovakia’s international position was extremely fragile, with Western observers worrying about “the creation of a state (...) with unclear ties to its allies and an uncertain future.” (*Washington Times*, 12/15/92). Such worries were exacerbated by the recent memory of the Yugoslav ethnic conflicts in the context of significant pre-independence tensions between the nationalist Slovak government of Vladimir Meciar and the country's large Hungarian minority, which had also affected diplomatic relations with neighboring Hungary.112

Slovakia’s economic situation did not look much more promising either. Even though relatively prosperous and favorably located by East European standards, from a structural standpoint Slovakia's economy was burdened by the preponderance of an antiquated heavy industry with a large military component. This industry relied heavily on energy and raw material imports from the former Soviet Union, and produced relatively uncompetitive semi-finished products directed primarily at former CMEA markets. (Janos 1997:19) To make matters worse, Slovakia had an unusually high concentration of arms manufacturers, who saw their traditional markets in the Eastern bloc and the Third World decline following the end of the Cold War. Thus, between 1988-1992 the Slovak arms industry shrunk by almost 90%, resulting in layoffs of 42,000 out of 52,000 workers employed in the industry, and adding to Slovakia's high

112 These tensions were exacerbated by a drawn-out international dispute between the Slovak and the Hungarian government about the building of the Gabcikovo dam on the Danube.
unemployment rates (Fisher 1993). Therefore, there could be few doubts about the economic necessity for structural reforms of these Stalinist dinosaurs, an objective agenda that featured high on the list of IMF priorities. Moreover, Slovakia's international reserves were extremely low in the first 18 months of independence, during which they hovered below the critical value of one month worth of imports, thereby placing the country at an acute risk of insolvency given that its access to international capital markets was uncertain due to the political instability following independence.

Under such circumstances one would have expected that Slovakia would rush to secure IMF support of its economic policies by subjecting itself to the rigors of an IMF agreement. This logic of this prediction is supported not only by the statistical results from the previous chapter about the strong incentives of low international reserves but also by the fact that the Czech Republic entered an IMF standby agreement in June 1993, despite its incomparably more stable external position and its higher credibility in the West. Nevertheless, in the almost six years between independence and Meciar’s electoral defeat in late 1998, Slovakia experienced only one IMF program, which – tellingly – was initiated by Meciar’s political opponents during the brief six-month power alternation in 1994, and was almost immediately abandoned upon Meciar’s return to power in October 1994. What explains this glaring absence in a region characterized by almost ubiquitous IMF programs? While the domestic political explanations of this puzzle are addressed in more detail in Chapter 7, the following discussion focuses on the international implications of the convoluted relationship between the Meciar government and the IMF (and the West more broadly) and reveals the tight ideological constraints on the acceptable economic policies and political rhetoric during the post-communist transition.

113 According to Prime Minister Meciar, reserves fell as low as $25m in the second quarter of 1993 (EIU Country Report, 2nd quarter 1993).
The Politics of an Unlikely Standoff: Failed Negotiations in 1993-4

Even though at first Slovakia appeared to conform to expectations in that negotiations for an IMF standby agreement started almost immediately after independence, the process was abruptly discontinued on February 20, 1993, when the IMF delegation left Bratislava after the Slovak government refused to comply with several key IMF conditions. The official reactions of the Slovak leadership to this conflict are telling: Prime Minister Meciar argued that the IMF recommendations for a 30% currency devaluation were based on data “of a catastrophic character” from former Czechoslovakian federal sources and lamented that IMF fiscal austerity measures would “affect 50% of all children in the Slovak Republic.” The populist-nationalist undertones of the reaction were even clearer in the declarations of the Slovak minister of agriculture, Peter Baco, who claimed that the IMF pressures for agricultural subsidy cuts were aimed to increase food prices in order to allow Western companies to penetrate the Slovak market. (EIU Country Report, 2nd quarter 1993).

Even though the Slovak government was careful to avoid a complete breakdown of its relations with the IMF, the relationship between the two negotiating sides continued to be tense until the fall of the Meciar government in March 1994. Even though Meciar repeatedly emphasized that the IMF looked at Slovakia with “respect and admiration” (cited in CTK, 8/2/1993) and the country managed to secure a $180m credit line from the IMF in June 1993, the two sides continued to disagree about a series of policy conditions. Thus, the June agreement

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116 Meciar recognized the high stakes of such a break and admitted that some sort of IMF seal of approval was necessary to avoid “the threat of being in dispute with the banking world and in isolation(...) We could have managed even in the future [without the IMF], but with a considerably slower rate of development” (Slovak Radio 6/18/1993 cited in BBC Summary of World Broadcasts 6/21/1993).
was not a regular standby program, but was part of the lower conditionality structural transformation facility (STF) intended to support transition economies. Therefore, the Slovak government continued its emphasis on selective implementation of IMF policies, such as the 10% currency devaluation in July 1993, which was instituted with a five-month delay and was well below the 20-30% level envisioned by the IMF. Instead, the government instituted an unorthodox policy alternative for dealing with trade and balance-of-payments deficits by imposing a 10% surcharge on imports, which became one of the key stumbling blocks in IMF negotiations in subsequent years.

Even though ideologically motivated policy disagreements undoubtedly played an important role in the tense relationship between the Fund and Slovakia during this period, the magnitude of these disagreements was undoubtedly exaggerated by Meciar's penchant for rhetorical bravado. Thus, when Slovakia eventually caved in to international pressure and devaluated its currency in July 1993, Meciar could have used the opportunity to emphasize his government’s flexibility and readiness to find a compromise with international financial institutions. Instead, he chose to spin the decision as yet another instance of Slovak resistance to IMF demands, and as a national victory: “I was told that no one has ever resisted the IMF for five months. The Swedes tried this, they stood fast for two and a half years, but then they had to apologize. So is this [10% devaluation] a loss or a victory?”117 The result was a cat-and-mouse relationship with the IMF, which alternated between promises to start negotiating a standby agreement for 1994 to accusations that the World Bank and the IMF were responsible for delaying work on the 1994 budget. Such confrontational tactics intensified after Meciar’s return to power in late 1994, in part because by then the country’s foreign reserves had reached more...

comfortable levels and the country’s improving economic performance contributed to better access to international capital markets and thereby reduced the need for direct IMF funding. Therefore, despite some promises to the contrary in mid 1995 and intense pressures from the IMF, the WTO and the EU, the Slovak government repeatedly postponed the reduction and elimination of the 10% import surcharge instituted in 1993.

Ironically, the most of the actual economic policies pursued by the Meciar government were generally compatible with the main priorities of IMF-style economic reforms: thus, the 23% inflation rate in 1993 was on par with reform frontrunners such as Hungary and the Czech Republic, while most countries in the region (including many engaged in IMF programs) were still struggling with triple digit inflation. Similarly, fiscal and monetary policies during 1995-1996 were in line with IMF conditionality as part of the July 1994 standby agreement, with the budget surplus in 1995 and a very small 1.3% deficit in 1996, while inflation declined even further from 13% in 1994 to 10% in 1995 and an impressive 5.7% in 1996. At the same time, Slovakia privatized and restructured a large part of its economy, and even its main policy disagreements with the IMF – the delayed currency devaluation and the 10% import surcharge – were not particularly severe when compared to the Fund’s tolerance for unorthodox stabilization measures in Latin America a decade earlier.

The tense relationship with the IMF had a number of negative repercussions. First, the standoff deprived Slovakia of significant funding opportunities, not only from the IMF but also from other multilateral and bilateral lenders, for whom the IMF acted as a gatekeeper. Such

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118 While foreign reserves increased from $472m at the end of 1993 to around $3.5bn in 1995-6 (with much of this increase occurring during the short tenure of the Moravcik government in 1994), Slovakia's reserves barely exceeded four months of imports even at their peak in late 1995, and then declined to 2.3 months of imports around the 1998 elections. Thus, Slovakia's foreign position was hardly so solid as to take it out of the potential sphere of influence of the IMF.

119 The share of the private sector in overall GDP jumped from 30% in 1992 to 55% in 1994 (according to EBRD estimates).
funding would have been particularly important during the early post-independence period (1993-4) when Slovakia struggled with low reserves and a precarious economy. Even after this a critical phase, the defiant and occasionally belligerent tone of the Slovak official discourse towards the IMF and the West in general, contributed to the significant and costly delays of Slovakia's Western integration, particularly the EU. Finally, the failure to comply with IMF-style neoliberal policy prescriptions probably played an important role in discouraging foreign direct investment, which was surprisingly low compared to Slovakia's neighbors, especially given the country's solid economic performance in the mid 1990s. This point was emphasized by a World Bank official in early 1995, who warned that “Slovakia cannot get by in its development without foreign investment ... and Bratislava has to realize that without the removal of legal, economic and trade barriers there will not be any interest in the Slovak market on the part of foreign capital.” As a consequence Slovakia found itself in the unenviable position of having to cope with painful economic reforms with minimal international assistance, a situation which exacerbated the short-term costs of economic reforms in the early post independence period.

As suggested above (and will be discussed in more detail in Chapter 7) Meciar’s insistence on nationalist and confrontational rhetoric undoubtedly deserves much of the blame for Slovakia’s costly international isolation. However, the Slovak experience also illustrates the narrow range of policy options available to post-communist countries during the heyday of the Washington Consensus. When Slovakia finally managed to secure an IMF program in July 1994 during the short tenure of the Moravcik government, it was - despite complaints by a prominent

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120 Of course, Slovakia's patchy democratic record and its disputed minority policies towards Hungarians and Romas also played an important role in these decisions (but these factors can also be considered as part of the broader populist “package” of Meciarism.)
122 In 1993 Slovakia suffered the fourth consecutive year of economic contraction (by 3.7%) and unemployment, which averaged more than 14% in 1993-4, was one of the highest in the region.
HZDS politician about the softer IMF approach towards the new government – due to the much more accommodating stance of the Slovak reformers, who agreed to the same basic conditions, which had been rejected by the Meciar government earlier in the year.

Summing up, the Slovak case illustrates the high political and economic costs of nationalist-populist deviations from the prescriptions of the Washington consensus in post-communist Eastern Europe. The Slovak government's repeated resistance against IMF conditionality throughout the mid-1990s is particularly striking, given that at least in the early period (1993-4) the newly created Slovak state needed both the funding and the stamp of Fund's approval of its economic policies, in view of its precarious international position. Thus, Slovakia's experience serves as a reminder that IMF conditionality and the Washington Consensus are not automatically imposed by external pressures even in small, vulnerable countries. At the same time, the consistency with which the IMF punished Slovakia’s relatively minor deviations from economic orthodoxy suggests that at least for small countries without the benefits of political favoritism, the range of acceptable economic policies had narrowed considerably by the mid-1990s, at least compared to the “ends-over-means” approach to economic adjustment during the debt crisis in the 1980s.

Conclusion

The interactions between the International Monetary Fund and the four Latin American and two East European countries discussed in this chapter, have confirmed the centrality of financial need in the politics of program initiation and implementation. Thus, concerns about debt servicing in Argentina and low international reserves in Moldova were arguably the main reasons for their repeated involvement in IMF programs despite the fact that their governments
were a priori reluctant to engage in IMF style economic reforms. Among more willing reformers, such as Chile under Pinochet and Peru under Belaunde, financial considerations not only complemented domestic reform drives but also contributed to the continuation of reforms at critical junctures when the high economic and political costs of adjustment undermined the original domestic commitment to reforms. Still, despite the steep economic costs of avoiding IMF programs in crisis situations, the experiences of Slovakia under Meciar, Bolivia under Siles, and Peru under Garcia show that even extreme financial need is no guarantee of successful IMF engagements. Even among these outliers, however, financial considerations were not completely irrelevant. Thus, the Siles government in Bolivia repeatedly tried to secure an IMF agreement in response to its crushing debt service burden but failed to do so due to a combination of domestic political paralysis and IMF intransigence. Meanwhile, despite its combative rhetorical stance, the Meciar government in Slovakia was careful not to trigger a complete breakdown of its tense relationship with the Fund during the early post-independence period, when the country was most financially vulnerable due to its extremely low reserves. Slovakia’s more consistent rejection of IMF conditionality after 1995 coincided with an improving external position, which reduced the country’s financial dependence on IMF funding and signaling. The only government to make a decisive break with the IMF under conditions of severe financial duress was that of Alan Garcia in the late 1980s but the high costs of the resulting international isolation served as a stark reminder for developing countries tempted by similar “rebellions.”

The cases discussed in this chapter also reveal the different political dynamics and trade-offs of IMF conditionality in countries of different economic and political importance: the Argentine case confirms that large Latin American debtors had fast-track access to IMF funding and were treated more leniently when deviating from economic orthodoxy. On the other hand,
the generous financial terms secured by Bolivia in the mid-to-late 1980s and Moldova in the mid-1990s suggest one possible strategy through which “minor” countries can “play the system,” namely by fulfilling the role of showcase reformer, which is necessary for the Fund’s international credibility and may temporarily elevate even small countries to relative political importance. However, the broader applicability of such strategy for other small developing countries is likely to be limited, since the political value of showcase status is likely to be diminished as soon as more countries follow suit. Finally, if the Peruvian experience of the 1980s is any guide, medium-size countries may have actually received the worst of both worlds, in that even exemplary compliance with IMF conditionality was unlikely to be rewarded as generously in financial terms as for small countries like Bolivia (since concessions would have been more expensive in absolute terms) but at the same time, any deviations from orthodoxy were punished more severely than for economically more important countries such as Argentina.

While one should be cautious about drawing broad cross-regional generalizations on the basis of six cases, the comparative empirical evidence presented in this chapter suggests a few interesting conclusions about the role of conditionality in the two crises. The experiences of Moldova, Slovakia under Moravcik, Peru under Belaunde and even Chile under Pinochet show that close cooperation with the IMF often carried significant political costs for governments in both regions. With the partial exception of economically more important countries (such as Argentina and to some extent Chile), the Fund appears to have subordinated such political concerns to the consistent enforcement of IMF conditionality. Moreover, the serious repercussions of Slovakia’s 10% import surcharge, a measure which had raised few eyebrows in earlier decades,\textsuperscript{123} suggests an over-time reduction in the Fund’s tolerance for policy deviations.

\textsuperscript{123} For example, Uruguay in 1982 and the Nixon administration in 1971 instituted similar measure without triggering similar responses.
from economic orthodoxy. On the other hand, in purely financial terms, IMF cooperation was more attractive for the ex-communist countries in the 1990s, since (as in the case of Moldova) it unlocked significant direct and indirect funding, whereas in Latin America such funds usually left the country almost immediately in the form of debt service payments. While compliance was no guarantee of economic and political success, outright rebellion against the IMF and the West more broadly was hardly an attractive alternative, when considering the steep costs of international isolation triggered by the combative stance of the Meciar government in Slovakia and especially by the Garcia administration in Peru. Overall, then, financially vulnerable developing countries in both regions had to walk a fine line between domestic priorities and the requirements of IMF conditionality. This tradeoff, which in the context of the Latin American debt crisis was exacerbated by the imbalance between the pain of adjustment and the gains of compliance, created difficult political dilemmas for the governments of the two regions in their attempts to address the roots and consequences of the serious economic crisis confronting their countries. These domestic political struggles are the subject of the next two chapters of this book.
Chapter 5: Domestic Political Responses to Economic Crises

The preceding two chapters have illustrated the importance of international political and economic considerations in driving the initiation and implementation of IMF programs in the developing world. Despite the significant and growing external influence on domestic economic policy making in a globalizing world, however, IMF programs cannot be simply viewed as outside impositions on powerless and compliant Third World governments. As the cases of Bolivia (1982-85), Peru (1985-89) and Slovakia (1993-95) have shown, even extremely vulnerable countries do not automatically subject themselves to IMF conditionality in response to external crises. Moreover, the uneven program implementation record of East European and Latin American countries underscores the limited ability of the Fund to impose its policies on program countries. On the other hand, governments will occasionally sign and implement IMF agreements even though their international finances hardly require IMF support.\(^\text{124}\) In order to understand these important deviations from the traditional logic of IMF program initiation and implementation, the following two chapters focus on the domestic economic and political dynamics of IMF-style reforms.

Even though the broad parameters of IMF conditionality were defined by the economic and political imperatives of the international context in which the two crisis episodes occurred, the actual economic policies stipulated by IMF agreements had to be implemented domestically. Therefore, the political dynamics of these programs have to be analyzed in the broader context of domestic economic crises, political interests, and institutional constraints, which are illustrated in Figure 5.0. According to the logic of the formal model in Chapter 2, international financial markets and the Fund’s approach to conditionality at a given time point can set the constraints

\(^{124}\) See for example Vreeland’s discussion of Uruguay’s 1990 IMF program (2003:39-51).
for what a government *has to do* in order to address its international and domestic economic problems within the context of an IMF program, and such constraints are more likely to be binding the greater the intensity of the preceding economic crisis. However, when making their policy choices, governments are also guided by what governing parties and politicians *want to do* for ideological reasons. Finally, governments differ in terms of what they *can do* in policy terms in a given situation, depending on the political influence and policy preferences of the domestic opposition and the reliability of the country's bureaucratic apparatus. The next two chapters show that the successful implementation of IMF-style economic reforms requires a difficult and often volatile combination between these three crucial elements: thus, governments have to strike a delicate balance between their own economic and ideological agenda, the demands of IMF conditionality, and the domestic political and institutional feasibility of neoliberal reform blueprints.

The analysis presented in this chapter confirms the importance of all three types of factors – economic crises, ideological preferences, and political/institutional constraints - for IMF program initiation and implementation. In both regions countries were more likely to resort to IMF programs when facing inflationary crises, rightist governments were generally more favorably disposed towards IMF-style reforms, and such reforms had better odds of success when initiated by governments with low fragmentation, stable political support, and well-functioning bureaucratic institutions. In line with the formal model predictions, however, few of these factors worked uniformly across the two regions, or even across different countries within the same region. Instead, the effects of individual factors (such as economic crises) were usually mediated by other variables (such as ideology), and, moreover, the nature of these interactions was different during the Latin American debt crisis than in the post-communist transition. Thus,
ideological differences played an important role in shaping the reactions of Latin American
governments to inflationary crises, with rightist governments much more likely to respond by
initiating economic reforms than leftist governments. Meanwhile, in the transition countries,
nationalists and ex-communists were less likely to initiate IMF programs in low-inflation
environments, but domestic economic crises led to policy convergence between reformers and
ex-communists and erased ideologically based policy differences.

The more acrimonious and ideologically charged nature of Latin American IMF
programs is also reflected in the lower compliance rates of democratic regimes and fragmented
governments, whereas in the transition countries democracy actually promoted program
implementation because IMF-style reforms had greater popular legitimacy than in Latin
America. On the other hand, in Eastern Europe differences in the quality of bureaucratic
institutions played a more important role in reform initiation and implementation than in Latin
America, which suggests that reform failures were primarily due to institutional rather than
ideological reasons. The comparison of the political dynamics of these two crisis episodes
suggests that the different international contexts of the two program clusters (discussed in the
preceding chapters), combined with differences in institutional legacies between the countries of
the two regions, shaped the nature of the link between economic crises and reforms by triggering
different interpretations of the roots of domestic imbalances and, hence, different policy
responses as governments attempted to address these economic challenges.

*Domestic economic crises as drivers of program initiation*

Even though the primary mission of the IMF is to address the external imbalances of
program countries, domestic economic crises nevertheless figure prominently among the reasons
for which countries resort to IMF support. In fact, the link between economic crises and reform initiation and implementation constitutes one of the classical explanations of neoliberal economic reforms.\textsuperscript{125} The underlying reason for this link is that deep crises can help create a societal consensus in favor of reforms, while at the same time weakening the economic and political benefits of previous rent-seeking activities (Williamson 1993). For all the political and scholarly preoccupation with the roots and consequences of economic crises, however, there has been surprisingly little work on how to conceptualize and diagnose such crises. For the most part the crisis has been taken as a given - along the lines that you know an economic crisis when you see one - and the debate focuses on explaining its roots or finding the policy solutions for dealing with the crisis.

The most widespread indicator of domestic economic crisis as a driver of economic reforms and IMF interventions has been the level of consumer price inflation (Santaella 1986, Remmer 1996, Stone 2002). Compared to other potential crisis indicators,\textsuperscript{126} inflation has a number of theoretical and practical advantages: First, inflation is one of the most visible and politically salient aspects of economic crisis because it affects most people and most aspects of economic activity in a very immediate sense. Second, inflation is easier to measure consistently across countries and time periods than other indicators of economic crises, such as budget deficits or unemployment levels,\textsuperscript{127} and, therefore, a more reliable measure to be used in cross-country tests. A closer look at the literature, however, suggests that even with respect to inflation, there is little consensus as to what constitutes a crisis. Thus, Bruno and Easterly (1995)


\textsuperscript{126} For example, Vreeland (2003) uses budget deficit, whereas Tornell (1998) and Milner and Kubota (2005) use GDP change (in addition to inflation).

\textsuperscript{127} Some governments use quasi-fiscal deficits to achieve better official budget statistics, growth rates have a hard time accounting for large unofficial sectors, and unemployment statistics are notoriously unreliable due to country-specific differences in accounting procedures and reporting incentives.
identify inflation levels above 40% as harmful for growth - a threshold also used by Milner and Kubota (2005) - while Ghosh and Stevens (1998) have set this threshold much lower. Meanwhile, other analysts have emphasized the crucial role of hyperinflation (Weyland 1998), while much of the literature (e.g. Stone 2002) treats inflation as a continuous variable. The present analysis relies primarily on logged inflation levels but it also illustrates the effects of different time lags and threshold specifications.

The inflationary record of Latin American and Caribbean countries during the 1980s was highly heterogeneous: at one extreme - represented primarily by Argentina and Brazil and to some extent by Peru - triple-digit inflation was the norm rather than the exception for most of the decade and the dismal record was rounded out by hyperinflationary episodes toward the end of the decade. At the low end of the inflation spectrum we find not only Pinochet’s Chile, Colombia and (at least until 1989) Venezuela but also several Central American and Caribbean countries. While the ex-communist countries also experienced high and variable inflation levels, their trajectory nevertheless stands out in several ways. First, with the exception of Hungary and Czechoslovakia, all the ex-communist countries experienced at least one episode of triple-digit inflation after the collapse of Communism, and almost two thirds of them - including not only troubled economies like Georgia and Ukraine, but also advanced reformers like Poland or Estonia - reached hyperinflationary levels (above 500%) at least once in the 1990s. Second, in contrast to Latin America, post-communist inflation appears to have been more of a transitional phenomenon, with only one country (Belarus) stuck above 50% inflation by late 2001.

The statistical results in Tables 5.1a&5.1b confirm the crucial role of domestic economic crises as drivers of IMF program initiation, as predicted by Hypothesis 11 in the formal model. According to models 1-4 in the two tables, governments of both regions were significantly more
likely to turn to the IMF when experiencing high inflation. In both regions, a one-unit increase in logged inflation (roughly equivalent to a rise in inflation from 10% to 50%) was on average associated with a 30-40% rise in the odds of a new IMF agreement in both Latin America and Eastern Europe, though the results were more statistically significant for the latter. While on average responses to inflationary crisis were remarkably similar, the temporal patterns differed across the two regions: whereas in Latin America the size and significance of the different inflation lags indicators was very similar, in the transition countries the results were significantly stronger when inflation was lagged by two or three quarters compared to the quarter immediately preceding program initiation. These results suggest that responses to inflationary crises were initially slower in ex-communist countries (possibly due to their weaker bureaucratic expertise) but once this initial handicap was overcome, the policy reaction was more decisive than in Latin America judging by the larger size of the coefficient for inflation in Model 3 in Table 5.1b compared to the Model 3 in Table 5.1a.

The statistical results presented so far suggest a significant increase in the likelihood of IMF program initiation in response to higher inflation levels in the two regions. However, it is conceivable that the reform incentives inherent in domestic economic crises are not simply linear functions of economic performance (such as inflation) but that crisis perception is triggered relatively abruptly once certain crisis thresholds are reached. Therefore, Model 5 Table 5.1a&5.1b uses a dichotomous inflation measure with 40% as the threshold for high inflation, whereas Model 6 uses a threshold of 1000%, intended to capture hyperinflationary episodes. Even though the coefficients for the two measures are positive and at least marginally statistically significant in both regions, the results were generally weaker than for the continuous inflation measures, suggesting that the effects of inflation on program initiation are better
conceptualized as continuous rather than step-functions. Finally, Model 7 in the two tables reveals a moderate negative quadratic effect of inflation, which suggests that increases in logged inflation have a greater effect at low levels of inflation. Nonetheless, the effects of inflation increases continue to be positive and statistically significant even at high inflation, which means that the link between domestic economic crisis and reform initiation is consistently positive across the entire range of initial economic conditions.

Finally, Model 8 of Tables 5.1a&5.1b addresses the interplay between domestic and external economic crises in the process of IMF program initiation. In both regions, the interaction term between inflation and international reserves was positive: thus, inflation played a more important catalytic role in reform initiation for countries with a comfortable reserve position, largely because – as discussed in Chapter 4 - countries with low reserves had a much higher baseline probability of approaching the IMF. Similarly, lower reserves were strong drivers of program initiation at low inflation levels, but the effect disappeared in both regions in cases of extremely high inflation. Therefore, it appears that rather than reinforcing each other, domestic and external economic crises acted as substitute drivers of IMF programs in both Latin America and Eastern Europe. In other words, countries resorted to IMF support for both domestic and international economic reasons, but having a crisis simultaneously on both fronts did not provide an additional reform impetus.

Partisan policy responses to economic crises

Despite the strong link between economic crises and IMF program initiation, the empirical record also reveals a range of deviations from the straightforward crisis-reform link
implicitly assumed by much of the statistical literature. Some governments respond rapidly and drastically to economic crises (Poland in 1990, Bolivia in 1985-6) while others either ignore similarly serious crises (Peru in 1987-9) or seem unable to cope with the political challenges of reform implementation (Bolivia in 1982-4, Romania 1998-9). Why does economic crisis result in political action in some settings but not in others? More broadly - what is the process through which certain economic indicators (and the realities they purport to measure) become catalysts of sustained political action to transform - often dramatically - established economic policy patterns, institutions and social relations?

To answer these questions, the analysis moves beyond purely economic crisis indicators to incorporate the insight that - like beauty - economic crisis is often in the eye of the beholder. Psychologists have argued that objective economic conditions are fairly limited predictors of personal economic satisfaction (Kahneman 1992) and more recent work in political science finds that economic conditions are weakly correlated with perceived government performance at the level of Russian regions (Herrera 2004). However, there is little systematic evidence about why economic crisis indicators do or do not trigger concerted political efforts to institute economic reforms.

As suggested by the formal model predictions, a logical starting point for explaining different responses to economic crises is to look at the ideological preferences of domestic political actors, especially those of top decision-makers who play a crucial role in the initiation of neoliberal reforms and IMF programs. As will be discussed in more detail in the following chapter, the reform trajectories of individual Latin American and East European countries (such as Bolivia, Peru and Slovakia) were significantly shaped by the ideological preferences of their leaders. In this sense, the two regions offer an ideal testing ground for the importance of
ideology, since the ideological orientations of the different governments varied along three key dimensions. First, both regions had a broad cross-country spectrum of ideological orientations, ranging from unrepentant Communists (in Cuba and Uzbekistan) to ideologically committed neoliberals (e.g. in Chile in the 1980s and Poland in 1990). Second, both regions offer a number of interesting instances of significant within-country ideological reversals (such as in Bolivia, Peru, Slovakia and Bulgaria) which facilitate a better understanding of the effects overtime ideological change in a given institutional context. Finally, the cross-regional differences in the nature of the economic crisis and the role of political parties allows for a useful test of the generalizability of the relationship between economic crisis, partisan politics, and reforms in the developing world.

Ideology-based explanations have featured prominently in case-study based accounts of economic reforms, either by invoking leftist or populist leanings of political leaders as reasons for reform delays or by ascribing the nature and timing of reforms to the ideological zeal of neoliberals. However, ideological leanings have played a surprisingly marginal role in cross-national (and particularly statistical) work on economic reforms. The few exceptions in this respect, such as Williamson (1993), Biglaiser and DeRouen (2004) for Latin America, and Stone (2002) for post-communist IMF programs, report no systematic economic policy differences between governments of different ideological persuasions. The main problem with the findings of the statistical literature on the politics of economic reforms is the implicit assumption that economic crises affect the likelihood of reform initiation in uniform ways irrespective of the ideological and institutional context in which the crisis unfolds. To the extent that ideological preferences are considered, the omission of interaction terms between ideology and crisis

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\[128\] See e.g. Appel (2000), Ffrench-Davis (2002).
indicators essentially implies that ideology provides similar reform “shocks” regardless of the economic situation.

This chapter argues that in order to understand the politics of economic reforms we need to take a closer look at the interplay between “objective” economic crisis indicators and the ideological preferences of political leaders who are in power at the time of the crisis. A priori there are a number of different possible interactions between economic crisis and ideology: under the first scenario, crisis-driven policy convergence, low-crisis environments are characterized by significant ideology-driven policy differences but these differences decline under the pressure of severe economic crises. In such a universe, ideological deviations from economic orthodoxy are “luxuries”, which have to be abandoned in the face of severe economic crises. A second possibility, crisis-driven policy divergence, is that ideology matters more in explaining how different governments react to economic crisis than with respect to their non-crisis baseline policies. Here, right-wing governments seize the crisis as an opportunity to implement reforms they would have favored anyway, whereas leftists parties (and their constituencies) are likely to be more sensitive to the costs of market reforms and are therefore less eager to embrace them even under extreme duress. The third scenario, crisis-independent ideological differentiation, predicts that ideology should matter uniformly regardless of the economic context of policy making. Under such circumstances, IMF-style reforms are always more likely in countries with neoliberal governments and economic crises encourage reforms fairly evenly for all types of governments. The final configuration, ideological irrelevance, implies that ideological effects on policy-making will be minimal across a variety of economic environments and economic crises promote reforms uniformly across the ideological spectrum.
Which of the four scenarios described above provide a more accurate description of how domestic economic crises affected the decisions of developing country governments during the Latin American debt crisis and the post-communist transition? The question is addressed by the statistical tests in Tables 5.2a&5.2b, which analyze the interaction between the government’s partisan preferences and different crisis indicators. Since measures of ideological orientations do not travel well across regions and time periods the analysis uses different measures of partisan orientation for the two regions: for Latin America, I build on Coppedge’s (2001) well-documented left-right classification scheme, which scores parties from 0 (Right) to 4 (Left).  

To determine the overall partisan orientation of a multiparty governing coalition, I use the average partisan orientation scores of the individual parties weighted by their relative seat share. By contrast, in the fluid political environment of the post-communist transition, the traditional left-right divide is less useful analytically (Tismaneanu 1996, Tucker 2006). Therefore, I have coded political parties along one of the key fault lines of post-communist politics - whether a given party is a successor to the Communist parties, which dominated the political scenes of Soviet bloc countries for more than four decades. Moreover, I also captured a peculiar type of party (in countries like Slovakia, Croatia and Belarus), whose leaders, while not necessarily former top communist officials, have pursued a nationalist/populist rhetoric and governing style. Finally, I created a composite category – *ex-communist/nationalist parties* – which combines the two categories.

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129 In coding the political parties for the ten countries in my sample that are not included in Coppedge’s analysis, I have relied primarily on data from the World Bank’s *Database of Political Institutions* and supplemented them where necessary with data from other sources (especially Nohlen 1993).

130 I also differentiated between reformed and unreformed Communist successor parties but their behavior did not differ systematically, so they were lumped together in the present analysis.

131 Data for this variable is based on the classification in the World Bank Database of Political Institutions. (Keefer et al 2000)
Model 1 in Tables 5.2a&5.2b reveals some important cross-regional differences in the interaction between economic crisis and ideology. In Eastern Europe, ex-communist/nationalist governments were only half as likely as other governments to initiate IMF programs at low levels of inflation but their response to inflationary crisis was twice as strong. The implications of this interaction, illustrated in Figure 5.1b, are that at high inflation levels (around 200%) governments of different ideological persuasions were equally likely to initiate IMF-style reforms and in hyperinflationary situations ex-communists even exceeded the reformers in their reformist zeal (though the difference was not statistically significant). Meanwhile, judging by Model 1 in Table 5.2a, in Latin America higher inflation greatly increased the odds of program initiation for right governments (more than double for each unit-change in logged inflation), but the effect disappeared for center governments and turned negative for left governments. As Figure 5.1a illustrates, what seems to set leftist and rightist governments apart is not their baseline attitude towards the IMF at low levels of inflation but their different reactions to high inflation, which prompted the Right to initiate IMF style reforms whereas the Left tried to avoid the high social costs of anti-inflationary measures.

These results suggest an important difference between the two regions in the political dynamics of crisis-driven reforms: whereas among post-communist countries inflation produced policy convergence among governments of different ideological persuasions, in Latin America of the 1980s such crises provoked divergent policies depending on the partisan orientation of the government. The two regions also differed in the intensity of ideological effects on economic

132 Because interaction terms are often difficult to interpret by simply looking at regression coefficients (Braumoeller 2003), I will present the more important of these results in graph-form, using predicted probabilities based on the actual regression coefficients for the two regions.

133 According to model 5 in Table 2b, a one-unit increase in logged inflation in the preceding quarter raised the odds of program initiation for ex-communists by 44%, whereas for more reformist governments the corresponding increase was only 21%.
policy making, as illustrated by the much greater substantive and statistical significance of the
government orientation measure in Latin America compared to Eastern Europe.\footnote{In the former, a one-unit change on the 0-4 scale of government orientation led to a statistically significant 25% reduction in the odds of program initiation (in models 1-4 of Table 2a), while in the latter the odds difference between ex-communists and non-communists averaged 15% and failed to reach statistical significance.} Overall, in line with theoretical expectations, partisan political differences played a more important role in IMF program initiation during the ideologically charged Latin American debt crisis than in the post-communist transition.

The reasons for the different ideological influences on policy reactions to inflationary crisis in the two regions can be traced to the different origins of the two crises, which were discussed in Chapter 4. Thus, in Latin America the most visible crisis aspect was the high external indebtedness of most countries in the region. The actual debt crisis started officially with Mexico’s default in August 1982 and since both the trigger of the crisis and several aggravating circumstances were of an external nature,\footnote{Factors included the global recession after 1979, the rise of interest rates, the lower lending willingness of commercial banks, and deteriorating terms of trade. (Eichengreen & Fishlow 1996:22)} many domestic political actors and analysts initially interpreted the debt crisis primarily as a temporary external payments crisis, which did not require a fundamental revision of the region’s developmental strategy (Jorge 1985:11). This view was supported by the rapid economic growth experienced by much of the region in the 1970s and the fact that the wide availability of low-conditionality loans had enabled the Latin American countries to finance their massive fiscal deficits in largely non-inflationary ways. On the other hand, the growth slow-down and the rising inflation starting in the late 1970s could also be interpreted as signs of the exhaustion of Latin America’s ISI development model. The resulting ambiguity about the nature and the roots of the region’s economic crisis contributed to the contentious politics of IMF programs and economic reforms in the 1980s. Broadly speaking, right-leaning governments tended to be more sympathetic to the IMF-
advocated austerity measures as necessary policy responses to correct for earlier fiscal
ingenuity, whereas leftist and populist parties (and their social constituencies) were more likely
to argue against having the popular sector bear the brunt of the adjustment costs in order to repay
Western commercial banks for loans, which had in many cases been contracted by military
regimes and had primarily benefited the economic elites.

These ideological differences in the interpretation of the debt crisis are also reflected in
the interaction between partisan orientation and interest payment burden in Model 2 of Table
5.2a, which suggests that higher interest payments determined right and (and to a lesser extent)
centrist governments to seek out the IMF support but the effect vanished for left governments
which were more likely to blame the West for the severity of the crisis. Thus, the policy
differences between left and right governments were exacerbated in situations of extreme
external economic need in much the same way as in the case of inflationary crises. However, it is
worth noting that, according to Model 3, for the second indicator of external financial need -
international reserves - dire economic straits actually led to policy convergence among
governments of different ideological persuasions, whereas ideological differences manifested
themselves more clearly in low-crisis environments characterized by comfortable international
reserves. Therefore, it appears that crisis-driven ideological policy divergence in Latin America
only applied to aspects of economic crises, which were open to divergent political
interpretations. Meanwhile, the more classical indicator of external financial need, which was
connected directly with the Fund's traditional role as an international lender of last resort, did not
trigger similarly divisive responses and was, therefore, more likely to persuade otherwise
reluctant governments to initiate IMF programs.
Despite the dramatic international westward reorientation of most ex-communist countries following the fall of the Iron Curtain, the primary economic challenge of the post-communist transition was unquestionably of a domestic nature and entailed the wholesale structural transformation of their economies at a historically unprecedented scale and speed. While a crisis of such depth could have been expected to lead to ideological clashes, the abysmal economic performance in the last years of Communism meant that post-communist economic reform debates focused primarily on questions of timing, sequencing and speed rather than disagreements about the roots and severity of the economic crisis. Despite occasional rhetorical flourishes and a few instances of actual policy "rebellion", mainstream post-communist political actors rarely questioned that the roots of the crisis lay primarily in Communist-era domestic institutional and structural legacies.\footnote{However, see Sachs (1994) for a provocative alternative explanation of Russia’s inflationary troubles.} Therefore, despite the high economic and political costs of IMF-style reforms,\footnote{Even compared to the "lost decade" of the 1980s in Latin America, the post-communist output fall in the early to mid 1990s was unprecedented in its depth, with most countries experiencing output declines of over 35% and as high as 65% in some cases.} the political dynamics of these reforms were not as ideologically charged as in Latin America a decade earlier, which may explain why ex-communists were generally quick to abandon their anti-reform inclinations once they were faced with serious inflationary crises. The weakness of partisan considerations in the face of economic crises is also reflected in Model 3 of Table 5.2b, which indicates that the strongest external crisis predictor in Eastern Europe - the level of international reserves - also played a greater role in the case of ex-communist/nationalist governments, though the effects were large and statistically significant for all government regardless of ideological orientation.\footnote{For the sake of comparability with Latin America, Model 2 presents the interaction between interest payments and ideology. In line with the discussion of the lower salience of debt in Eastern Europe, interest payments were not significant predictors of program initiation for any type of government, though the effects appeared to be somewhat stronger for reformist governments.}
Bureaucratic quality and program initiation

Ideological or crisis-driven government policy intentions are not sufficient, however, to ensure the initiation and implementation of IMF-style reforms. Governments also need to be able to translate these policy designs into political reality, and one of the crucial factors affecting this process is the effectiveness of bureaucratic institutions. In this respect, East European countries faced particular difficulties, since post-communist reforms occurred in the context of extremely underdeveloped markets and political institutions. Especially in the early transition years, most ex-communist countries were plagued by weak legislative and regulatory frameworks, a dysfunctional banking sector, and rudimentary financial markets prone to scandals and speculation. By comparison, despite the importance of the state sector and the distortions created by the large capital inflows of the 1970s, most Latin American countries could at least depend upon the basic legal and institutional framework necessary for the functioning of a market economy. Therefore, we would expect that the variation in the functioning of state institutions to matter more for the success of economic reforms in expertise-scarce Eastern Europe than in Latin America.

Aside from the cross-regional differences, the bureaucratic capacity of governments to get things done also varied to a significant extent within the two regions. Thus, in Latin America, judging by the ICRG bureaucratic quality scores,139 Chile, Colombia, Venezuela and Brazil had significantly better performing bureaucracies than the regional average, whereas impoverished countries like Bolivia, Paraguay, and Haiti ranked at the bottom of the hierarchy, with relatively few significant overtime changes during the 1980s. Meanwhile, among the transition economies, there was a large and temporally persistent gap between the relatively functional bureaucratic

139 Published on an annual basis by the International Country Risk Guide (ICRG), these bureaucratic quality scores rate countries on a scale of 0-5, where higher scores indicate better functioning bureaucracies.
institutions in East-Central Europe and the Baltics, and the abysmal state apparatus inherited by most former Soviet republics, particularly in Central Asia. Several Balkan countries - such as Romania, Bulgaria, and Macedonia - started out with fairly modest institutions but improved gradually over the course of the transition, even though they have yet to close the gap that separates them from the transition “pioneers.”

The statistical patterns of IMF program initiation confirm the predictions of Hypothesis 12 in the formal model, in the sense that the policy responses to post-communist economic crises were shaped by the ability of governments to respond to crises in a coherent fashion. The quality of governance indicator had a large and statistically significant positive effect on program initiation according to Models 1-6 in Table 1b: thus, for each one-standard-deviation increase in the quality of governance index, the odds of program initiation increased by 122%. Moreover, the weak interaction between governance and inflation reflected in Figure 5.2b (based on Model 4 in Table 5.1b) suggests that irrespective of the intensity of the domestic economic crisis, policy responses of post-communist governments depended crucially on the sheer capacity to get things done, undoubtedly a legacy of the expertise deficit inherited by many transition countries. On the other hand, Model 5 reveals a negative interaction effect between international reserves and quality of governance, whose effects are illustrated in Figure 5.3b. This finding suggests that countries with better institutions reacted much more decisively to external crises, as illustrated by the much steeper slope of the probability curve for countries with good governance in Figure 5.3b.

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140 Since ICRG data coverage was patchy for the ex-communist countries, I used the governance and public administration score from several editions of Nations in Transit, covering all the transition countries in my sample (with the partial exception of Mongolia) from 1993 to 2001 and extended the dataset back to 1990 using the NIT coding criteria. The variable is scored on a scale from 0-7 (with higher scores indicating better institutions) but the highest actual score was 5.25.

141 Such an increase was equivalent to the reduction of foreign reserves by three months of imports, which implies a strong effect, considering the sensitivity of post-communist countries to changes in reserves.
Conversely, better bureaucracies mattered the most in low-reserve environments, where they led to a much higher propensity of program initiation, whereas in countries with comfortable reserves institutional differences mattered less (even though they were still statistically significant).

Even in Latin America, the policy reactions to economic crises were not just ideological affairs but were mediated by the different abilities of governments to pursue their objectives. Thus, in Table 5.1a the bureaucratic quality indicator emerged as a strong positive predictor of program initiation, even though its explanatory power was lower in both substantive and statistical terms than in Eastern Europe. Model 4 of Table 5.1a reveals an interesting positive interaction effect between inflation in the preceding quarter and the quality of bureaucracy in Latin America. As illustrated in Figure 5.2a, governments presiding over more capable bureaucracies were much more likely to respond to inflationary crises by rapidly initiating IMF-style reforms. However, in Model 5, which uses inflation lagged by a full year, the interaction effect disappears, which suggests that even less capable governments eventually responded to inflationary pressures but that they did so more slowly.

The strong positive interaction between interest payments and bureaucratic quality in Model 6 indicates that better bureaucratic institutions also improved the ability of Latin American governments to secure IMF programs to deal with the rising foreign interest payments: thus, as illustrated in Figure 5.3a, higher interest payments had no statistically discernible effect on program initiation in countries with very poor bureaucratic institutions, whereas for the region's most efficient bureaucracies the effect was substantively large and highly statistically significant.\(^{142}\) In substantive terms, the effect of each additional month of imports worth of reserves was twice as large for countries at the top of the governance hierarchy than for those at the bottom. Furthermore, the effect was highly statistically significant for the former (.001) but was only marginally significant for the latter (.1 one-tailed).
significant. Conversely, bureaucratic quality had a large and statistically significant positive effect on the likelihood of program initiation in countries with high interest payment burdens but the coefficient turned negative (and borderline significant) among countries with the lowest interest payments - a finding, which confirms the somewhat counterintuitive prediction of the formal model about the uneven effects of institutionally driven policy uncertainty on the proliferation of IMF programs.

Buying Consensus: Discretionary resources and program initiation

The political economy literature has identified several additional domestic political factors that may affect the ability of reformers to build viable pro-reform coalitions and overcome organized political opposition to key aspects of neoliberal policies. One strategy for building such coalitions is through the use of discretionary resources, which governments intent on embarking on potentially costly economic reforms, can use to pay off political opponents (or even their own constituents.) However, as discussed in the formal model, like most political assets, discretionary resources merely provide those controlling them with more leeway to pursue their preferred policies. Therefore, according to Hypothesis 15, we should expect discretionary resources to facilitate the initiation of IMF programs for governments that are intent on pursuing economic reforms (and facing political opposition to this strategy), whereas the same resources could be used by other governments to avoid IMF style reforms and cushion the political consequences of such delays.

The current analysis uses the share of the state sector in overall GDP as a proxy for

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143 Thus, at the highest value of the bureaucratic quality index (e.g. the case of Chile), a one-standard-deviation increase in interest payments was associated with more than a fourfold increase in the odds of program initiation.
144 See Etchemendy (2002) and Shleifer and Treisman’s (1998).
discretionary resources, since it captures the relative size of the economy under more direct government influence, and which can be used for buying off reform opponents. As one would expect, this variable highlights one of the most striking differences between the two regions. With the notable exception of Cuba (where the state accounted for roughly 95% of economic activity throughout the decade), the share of the state sector in overall GDP was less than a quarter for all the Latin American and Caribbean countries in my sample, with only Bolivia, Chile, Honduras, Jamaica and Venezuela in the 15-20% range during the 1980s. Moreover, given that with the partial exception of Chile, privatization did not start until the 1990s, the share of the state sector did not change substantially between 1982 and 1989, thereby relegating most of the variation in this variable to cross-country rather than cross-temporal differences. By contrast, at the outset of the post-communist transition, the state controlled the vast majority of economic activity in the former command economies, ranging from roughly 70% in Poland and Hungary (where reforms had started earlier than elsewhere in the region) to over 90% in Albania, Bulgaria and most former Soviet republics. Even after more than a decade of what was undoubtedly the most sweeping privatization episode in modern history, the former communist states still controlled at least 25% of the economy everywhere except for Hungary, the Czech Republic and Slovakia by 2001. Thus, on one hand the transition economies faced a much deeper structural transformation than their Latin American counterparts, but at the same time their governments controlled a much larger set of economic assets, which could be used in discretionary ways to facilitate the political feasibility of otherwise costly and potentially destabilizing economic reforms.

145 Persson and Tabellini (2000), have used corruption as a proxy for office rents; however, as they note, the main source of cross-country corruption data (Transparency International's Corruption Perception Index) only starts coverage in the mid 1990s, and, therefore, does not provide sufficient data for time-series cross-sectional tests (particularly for the Latin American cases in the 1980s).
The empirical evidence confirms the interaction between ideology and discretionarily resources during program initiation, as predicted by Hypothesis 15 the formal model. Thus, in Latin America the size of the state sector played a modest role in predicting program initiation judging by the results in Table 1a and in Models 1-5 in Table 5.1a. However, Model 7 indicates that this null-finding is the result of two opposing effects of discretionary resources as a function of the ideological constellation of a given country. As illustrated in Figure 5.4a, higher discretionary resources at the disposal of right governments facing left oppositions increased the likelihood of program initiation in Latin America, \(^{146}\) arguably because it allowed the government to build stronger reform coalitions and to soften some of the political opposition to the generally unpopular IMF-style reforms through the use of side payments. On the other hand, in situations where a left government was facing a right opposition, greater discretionary resources actually reduced the likelihood of the government entering a new IMF program.\(^{147}\)

In Eastern Europe, where partisan differences in policy responses to economic crises were weaker, the interaction between ideology and discretionary resources was also less pronounced. Nevertheless, as illustrated in Figure 5.4b (based on the results in Model 6 in Table 5.1b), having a larger state sector at their disposal appears to have facilitated IMF program initiation for reformist governments facing nationalist/ex-communist oppositions.\(^{148}\) Unlike in Latin America, however, higher discretionary resources do not seem to have been used by ex-communists to avoid IMF conditionality, given that the coefficient of the State sector/GDP variable was still positive (though insignificant) for ex-communist governments facing reformist governments facing left oppositions.\(^{146}\) Thus, for a center-right government facing a left opposition, a one-standard-deviation increase in the size of the state sector was associated with a 70% increase in the odds of program initiation (significant at .1 one-tailed). \(^{147}\) Thus, for a center-left government facing a right opposition, a one-standard-deviation increase in the size of the state sector was associated with a 60% reduction in the odds of program initiation (significant at .05 one-tailed). \(^{148}\) Thus, for a non-communist government facing a nationalist/ex-communist opposition, a one-standard-deviation increase in the size of the state sector was associated with a 68% increase in the odds of program initiation (marginally significant at .1 one-tailed). These results were significantly stronger in both substantive and statistical terms when the year dummies were omitted from the model specification.
oppositions. As a consequence, discretionary resources had a positive overall effect on the likelihood of program initiation, as indicated by the moderately large coefficients of the State sector/GDP variable in Table 5.1b.  

Taken together, these findings suggest that even though discretionary resources were helpful in allowing governments to reduce the political costs of the austerity measures inherent in IMF-style adjustment policies, the process was of a technocratic rather than an ideological nature, which stands in marked contrast to the Latin American experience of the 1980s. This conclusion is farther supported by the strong interaction between discretionary resources and international reserves in Model 7 in Table 5.1b: thus, discretionary resources were irrelevant to program initiation in situations of acute external crisis (e.g. reserve levels of less than one month of imports) but as soon as reserves reached more comfortable levels, the larger state sectors played a substantively large and statistically significant role in driving IMF program initiation. In other words, as long as the external financial need was sufficiently clear and immediate, East European governments did not have to use discretionary resources as political side payments in order to convince domestic audiences of the necessity of IMF programs. When such immediate crisis threats were not present, however, governments of all political stripes had better chances of securing IMF programs if they had sufficient discretionary resources to buy off the domestic opposition to such economic reforms.

Political power balance

The history of IMF programs in the developing world abounds with examples of the

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149 A one-standard-deviation increase in the size of the state sector was on average associated with a 50% increase in the odds of program initiation, though the statistical significance was a relatively modest (between .2-.25 two-tailed).
150 For example, for a country with four months of imports worth of foreign reserves, a one-standard-deviation increase in the size of the state sector was associated with a 170% increase in the odds of program initiation.
intense domestic political struggles provoked by the high stakes of the economic adjustment policies required by IMF conditionality. As such, the politics of IMF programs are part of the broader debate about the relationship between economic reforms and several closely related aspects of political competition. The question about the effect of regime type on the viability of economic reforms has received different answers for the two regions and time periods analyzed in this book. Even though few studies have focused explicitly on regime type as an explanatory variable, most political economy analyses of Latin America in the 1980s have hinted at the tension between economic reforms and open political competition. Thus, several prominent studies (Nelson 1990; Haggard & Kaufman 1992; Haggard & Webb 1994) have emphasized the importance of the concentration of authority in the state leadership and the insulation of the executive branch from societal interests in ensuring the success of neo-liberal reforms. Along similar lines Haggard & Kaufman (1995: 370) have noted that fragmented and polarized party systems are one of the most serious obstacles to successful reforms. Therefore, one would expect to find significant tensions between democratic politics (and political competition more broadly) and IMF programs during the Latin American debt crisis. By contrast, democracy and economic reforms have been remarkably compatible in the post-communist context (Bunce 1998, Fish 1998), where the rejection of communist totalitarianism was closely intertwined with the embrace of market institutions. This (albeit imperfect) affinity between economic and political liberalism predicts a greater compatibility between democratic politics and IMF-style reforms in Eastern Europe. Moreover, in line with the predictions of the formal model, the present analysis adds an important new dimension to the study of the relationship between political competition

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151 One notable exception in this respect is Kaufman and Stallings’ (1989) analysis, which concluded that authoritarian regimes in Latin America had generally chosen more orthodox economic adjustment strategies than either new or established democracies. On the other hand, Remmer (1998) found no regime effect on the success of economic reforms in South American countries from 1980-94.
and neoliberal economic reforms by focusing on the crucial interaction between democratic politics, economic crises, and ideological differences.

Even a brief comparison of the two regions with respect to their democratic trajectory during the time periods discussed in this analysis reveals some striking similarities. First, there was a rapid increase of the total share of democracies during the first three years of the democratization progress: using the score of 16 on the Polity regime scale as the democracy cutoff point, the former communist world went from having no democracies in 1989 to more than half of its ever-expanding number of countries by the end of 1992 (15 of the 26 countries in my sample were democratic at that point). Similarly, though slightly less dramatically, whereas in 1982 democracies accounted for only eight of the 22 Latin American countries in my sample, by 1985 the tally had risen to 13, an almost identical proportion as in the former Communist countries by 1992. However, following this initial surge of democratization, both regions experienced a democratic plateau for the rest of the decade with the share of democracies virtually unchanged until 1989 in Latin America and 2001 in the transition countries. In the case of the ex-Communist countries the mid and late 1990s included some important reversals of early democratic progress particularly in Belarus and Kyrgyzstan, whereas in Latin America the remarkable regime stability suggested by these numbers masks the important political struggles in several countries, which by the turn of the decade resulted in the negotiated transitions in Chile and Paraguay but also in the erosion of several democracies, most notably Venezuela and Peru.

Despite their similar democratization trajectories and their shared challenge of coping with painful economic reforms while undergoing complicated political transitions, the countries

152 The results are not changed significantly by choosing a slightly higher or lower cutoff point and are therefore not discussed here.
of the two regions displayed different relationships between political competition and IMF program initiation. Thus, judging by the results in Tables 5.3a&5.3b, IMF programs in Latin America were affected to a much greater extent by the domestic political power balance between the government and the opposition than was the case in Eastern Europe. This comparison reinforces the earlier discussion about the more politicized nature of IMF programs in the context of the debt crisis, and illustrates the domestic political implications of the changing international dynamics of IMF conditionality.

While the effect of Polity regime scores\textsuperscript{153} in Tables 5.1a&5.2a was positive but relatively modest in statistical terms, Model 1 in Table 5.3a reveals an interesting and significant interaction effect between regime and domestic political power balance: thus, as predicted by predicted by Hypothesis 14 in the formal model, higher degrees of democracy were associated with a greater likelihood of program initiation when the government was less reformist than the opposition, but the regime effect disappeared when right governments were facing leftist political opponents. Conversely, ideological differences in the propensity of program initiation were most pronounced for authoritarian governments, whereas for democratic regimes the policies of left governments started to converge (albeit not completely) with those of the center and the right. It appears, therefore, that left governments in Latin America had a harder time resisting IMF reform pressures when these pressures were compounded by domestic political pressures from a reformist opposition in a democratic context.

The politically charged nature of Latin American IMF programs is further emphasized by several other results in Table 5.3a: thus, according to Model 2, program initiation was

\textsuperscript{153} The use of Polity regime scores instead of Freedom House political and civil liberties is justified by Polity’s emphasis on structural characteristics of political regimes (such as constraints on executive power and openness and regulation of political participation), which are more relevant for analyzing the politics of IMF-style economic reforms than Freedom House’s emphasis on liberties. However, the results presented below were not affected by the use of alternative democracy measures.
significantly more likely when the government controlled a larger seat share in parliament, and Model 3 shows that this effect was stronger for pro-reform governments (as predicted by Hypothesis 15). Both of these results suggest that countries were most likely to enter IMF programs when powerful governments could impose their preferences on a relatively weak opposition, through a process that mirrored the international imposition of IMF programs on vulnerable Latin American debtors.

This adversarial approach to program initiation may explain the sharp electoral reversals in the patterns of Latin American involvement with the Fund: thus, according to Model 4, in the year following an election, Latin American governments were significantly less likely to enter a new IMF program if the country had previously been heavily involved with the Fund, but if the country's earlier IMF involvement had been marginal, then a new government was significantly more likely to initiate an IMF agreement. Similarly, the interaction effect in Model 5 indicates that past inflation was a much stronger driver of program initiation in post-electoral periods than during other parts of the electoral cycle, which suggests that economic crises were best tackled by governments benefiting from a post-electoral legitimacy and power advantage over the opposition.

Meanwhile, in Eastern Europe, the decision to enter IMF programs appears to have been largely unrelated to a variety of different dimensions of domestic political competition. Thus, the coefficients for the Polity regime indicator was small and statistically insignificant across the different models in Tables 5.1b&5.2b, and judging by Model 1 in Table 5.3b, there was no significant interaction between regime and ideology in post-communist program initiation. Moreover, according to Models 2&3, government fragmentation and the government’s share of

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154 For example, the odds of program initiation for a new government in a country, which had spent 75% of the preceding decade covered by an IMF program were five times lower than would have otherwise been the case.
parliamentary seats did not affect a given country’s prospects of entering a new IMF agreement. These findings are in line with the lower salience of partisan convictions in policy responses to crises, which was discussed earlier.

The only noticeable influence of political competition on program initiation has to do with the actions of governments following elections, which replicate the patterns seen earlier in the Latin American cases: thus, according to Model 4 in Table 5.3b, East European governments were less likely to initiate a new IMF program in the aftermath of an election if the country had been previously involved extensively with the Fund, whereas post-electoral periods were more likely to witness a new IMF program if prior to the election the country’s IMF involvement had been minimal. Similarly, Model 5 indicates that the catalytic effects of past inflation on program initiation were twice as large (and more statistically significant) following elections as in other parts of the electoral cycle, which suggests that the post-electoral political honeymoon period was a more promising time to tackle inflationary problems. Therefore, it appears that ex-communist countries were not immune to electoral policy cycles, but the effects were smaller in substantive terms than in Latin America, which further confirms the less politicized nature of IMF program initiation during the post-communist transition compared to the Latin American debt crisis.

**II. Reform implementation**

Despite its bureaucratic demands and its occasionally contentious politics, IMF program initiation constitutes only the first – and arguably easiest – step of the long and difficult process

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155 For example, the odds of program initiation for a new government in a country, which had spent 75% of the preceding five years covered by an IMF program were roughly half than would have otherwise been the case (marginally significant at .13 two-tailed). Note, however, that these effects were substantially weaker than in Latin America.
of reform implementation. While the preceding section has shown that economic crises, mediated by partisan interests and domestic political institutions, have played a crucial role in spurring the onset of reforms in the two regions, what determines whether this initial reform impetus is sufficiently resilient to ensure implementation? Does the intensity of the preceding crisis matter? Or does the answer once again lie in the interaction between economic crisis and the partisan convictions and bureaucratic capacity of the governments in charge?

**Economic crises, ideology and program implementation**

To answer these questions, the chapter now turns to the statistical results of the IMF program implementation models presented in Tables 4a&4b. Judging the effects of inflationary crises on the implementation of IMF programs is somewhat more complicated than for initiation because the coefficient for lagged inflation can be interpreted in two ways: higher inflation may continue to push governments to implement reforms but it can also be seen as a failure of earlier reform efforts, which could lead to the interruption of the IMF program and of economic reforms. To address this problem, I introduced an additional version of the inflation measure, *pre-program inflation*, which uses the inflation level in the quarter prior to program initiation for the entire duration of the program and thereby avoids the danger of conflating the two effects by capturing only the pre-program inflation. The slightly larger and more statistically significant coefficient of lagged inflation (Model 1) compared to pre-program inflation (Model 2) in Table 5.2a suggests that “inflation memory” was fairly short in Latin America and that – ironically – reforms may have a higher long-term survival potential if they are not too expedient in reducing inflation.156 By contrast, in Eastern Europe pre-program inflation was a stronger predictor than

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156 As will be discussed in more detail in the following chapter, one prominent example of such self-defeating success was the Argentine *Plan Austral* in 1985-6.
lagged inflation but both coefficients were substantively smaller and statistically less significant than in Latin America, which suggests that inflationary crises affected primarily post-communist reform initiation, whereas in Latin America the effects were noticeable during both initiation and implementation.

Given the powerful role of ideology as a filter during IMF program initiation in Latin America, one might expect its influence to be lower during implementation because governments opposed to the tenets of IMF-style reforms should be highly unlikely to have entered a program in the first place. Indeed, these expectations were borne out with respect to inflationary crises since Model 3 in Table 4a shows that higher preprogram inflation had a greater positive impact on implementation for left governments.\textsuperscript{157} On the other hand, judging by the large negative interaction effect between interest payments and ideology in Model 4, that ideologically informed interpretation differences about the nature of the debt crisis continued to affect policies even at the implementation stage. However, unlike during initiation, right-leaning Latin American governments no longer differed systematically from their leftist counterparts in their propensity to go along with IMF conditionality, as indicated by the small and statistically insignificant effect of ideology in models 1&2, as well as by the mixed evidence about the crisis-ideology interactions in Models 3&4.\textsuperscript{158}

Meanwhile, in Eastern Europe the effects of inflation on implementation were similar to the initiation phase, in that higher pre-program inflation only served as a reform catalyst for ex-communist/nationalist governments according to the interaction effects in Model 3. Furthermore,

\textsuperscript{157} Thus, the size of the preprogram inflation effect was twice as large for left as for center-right governments (but the statistical significance was highest for centrist governments.) However, the government's ideological orientation was not significant predictor of compliance at any inflation level.

\textsuperscript{158} For example, according to Model 4, right governments were significantly more likely to comply at extremely high interest burdens levels (significant at .05 one-tailed), but at very low levels of interest payments, leftist governments actually had a higher predicted probability of compliance (slightly less significant at .15 two-tailed), while for most of the intermediate interest burden levels the impact of ideology was negligible.
as illustrated by Figure 5.5b, the effects of the government's partisan orientation depended in crucial ways on the severity of the domestic crisis: thus, at low preprogram inflation levels, nationalist/ex-communist governments behaved as predicted by the formal model in that they had a worse compliance record than their more reformist counterparts. At high inflation levels, however, nominally anti-reform governments actually had a noticeable compliance advantage over their more reformist counterparts, which suggests a Nixon-goes-to-China scenario, in which reforms in crisis situations were more effectively handled by politicians whose prior partisan inclinations were less favorable towards these reforms. With respect to external crises, however, ideological differences played a negligible role: thus, according to Model 4, the effects of lower reserves on compliance were large and statistically significant irrespective of the ideological orientation of the government.

**Bureaucratic quality and program implementation**

Whereas the preliminary steps required for the initiation of an IMF program can generally be accomplished by a small team of reasonably competent technocrats, the more complex and far-reaching policy tasks required by program implementation places much greater demands on the state’s bureaucratic capacity, which should therefore be an even stronger predictor of reforms during the implementation phase. This expectation is confirmed for Latin America, where the results in Table 5.4a indicate that (in line with Hypothesis 1) program countries with better bureaucracies received a substantively and statistically significant implementation boost (compared to a more modest role during initiation.) Moreover, as Figure

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159 For extremely low inflation levels (below 5%) compliance for nationalist/ex-communist governments was less than half as high as for other government (marginally significant at .1 one-tailed).

160 For programs whose initial inflation levels exceeded 1000%, the odds of compliance for ex-communist governments was more than six times higher than for reformers (though the results were only marginally significant, hovering around .1 two-tailed).
5.6a (based on the interaction effect in Model 5) illustrates, the effect of inflationary crises on reform durability in Latin America was significantly mediated by the quality of bureaucratic institutions, in that high inflation elicited decisive reforms in countries with capable bureaucracies but had a negligible impact on the compliance of low-quality bureaucracies (even once they had managed to initiate IMF-style reforms). As predicted by Hypothesis 4, more capable governments also complied more successfully when faced with external financial crises, judging by the positive interaction effect between interest burden and bureaucratic quality in Model 6.161

In Eastern Europe, countries with higher governance and public administration scores were also significantly more likely to comply with IMF conditionality, with each one-unit increase in the governance score associated with a doubling of the odds of successful implementation. While countries with better institutions had better compliance records in both regions, the nature of the interaction between quality of governance and inflation ran in the opposite direction in Eastern Europe compared to Latin America. According to Figure 5.6b, the quality of governance had a large and significant positive impact on implementation at low levels of pre-program inflation but weak bureaucracies responded more strongly to inflation and as a consequence the good-governance compliance boost vanished in high-inflation environments. Similarly, Model 5 indicates that more responsive bureaucracies were a strong predictor of compliance in countries with comfortable foreign reserves positions, but that this governance differential mattered much less in situations of extreme financial hardship. This finding suggests that sufficiently desperate post-communist governments chose more ambitious reform targets to ensure IMF approval even in the event of policy slippage during implementation. As discussed in the context of the formal model, however, such an “overshooting” can be economically costly for

161 Model 7 suggests that there was no significant interaction effect between reserves and bureaucratic quality.
the program country and politically costly for its government (as the Moldovan reformers found out…)

Finally, the interaction between bureaucratic capacity and ideology in Model 7 of Tables 5.4a&5.4b confirms the greater salience of ideology during Latin American IMF programs. Thus, in line with the predictions of the formal model, in Latin America higher quality bureaucratic institutions provided a substantively large and statistically significant compliance boost for right and center-right governments but were largely irrelevant for left and center-left governments. Meanwhile, in line with the more technocratic nature of post-communist IMF programs, in Eastern Europe the effects of better governance had virtually identical positive effects on compliance irrespective of the ideological orientation of the government.

Taken together, these findings about the interaction between bureaucratic capacity and economic crises provide some interesting insights into the comparative dynamics of economic reforms in Eastern Europe and Latin America. The Latin American cases confirm the Hypothesis 1 in the formal model, whereby bureaucratic capacity should matter most for pro-reform governments, and in situations of intense economic crisis, such as high inflation and crushing interest payment burdens. Nevertheless, this relatively successful mobilization among the region's more capable governments appears to have occurred only in response to severe external or domestic crises, which further underlines the unwilling nature economic reforms throughout much of the region during the debt crisis and explains the stop-go policy cycles in countries with reasonably functional bureaucracies such as Brazil and Argentina. By contrast, during the post-communist transition, bureaucratic capacity made a greater difference in low-crisis environments, which suggests that the region's more functional states implemented reforms even

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162 Thus, a one-standard deviation increase in the bureaucratic quality index roughly doubled the odds of compliance for right and center-right governments (significant at .05 one-tailed).
without immediate economic crisis threats. Meanwhile, countries with weaker institutional capabilities only implemented reforms when facing extreme domestic or international economic pressures. Once they were faced with such immediate economic threats, however, governments in poor-governance countries appear to have been able to make up (at least partially) in political will what they were lacking in institutional capabilities. While such a “mobilizational” approach to economic reforms may help tackle short-term crises in the context of an IMF program, its economic and political sustainability are likely to be questionable in the long run, as illustrated by the Moldovan experience discussed in the following chapter.

Discretionary resources

Since IMF programs usually involve economic policies, which provoke significant short-term costs for some political actors, successful program implementation requires careful coalition building on behalf of the government. One of the more effective strategies for building such coalitions is to use selective benefits to buy off politically influent losers from IMF-style policies, and as discussed during program initiation, such strategies are more likely to succeed when reform-minded governments control significant discretionary resources, which can be used as side payments. However, the statistical evidence from the program initiation stage also suggested that discretionary resources only facilitated reforms when used by reformist governments in the two regions, whereas for leftist/ex-communist governments, the availability of greater state resources was either irrelevant (in Eastern Europe) or obstructive (in Latin America) to reform initiation. Even though one would expect to observe a similar logic at play during implementation - namely that discretionary resources simply allow governments to pursue their preferred policy interests with fewer domestic constraints - the net effect of resources on
implementation is harder to predict for leftist/ex-communist governments. On one hand, having initiated an IMF program, even a leftist government presumably had sufficient financial/political incentives to overcome its ideological aversion to IMF-style reforms, in which case one would expect it to use the discretionary resources at its disposal to implement the program and reap its financial/political benefits. Under such a scenario, IMF program implementation should benefit from higher discretionary resources regardless of the ideological identity of the government. If, on the other hand, a leftist government inherited an IMF program from its predecessor, or if it only initiated the IMF program unwillingly in response to financial or political pressures, then it is conceivable that as soon as these pressures abate, the government would switch strategies and use the political capital provided by discretionary resources to slow or reverse economic reforms.

The statistical evidence about the role of discretionary resources in IMF program implementation reveals some telling differences between the political dynamics of reforms in the two regions. In Latin America discretionary resources affected implementation in much the same way as initiation, and as predicted by Hypothesis 8: thus, according to Figure 5.7a (based on Model 8 of Table 5.4a), higher discretionary resources facilitated compliance efforts by right governments but made leftist governments less likely to comply.163 These findings provide further evidence for the ideologically charged nature of Latin American IMF programs, and suggest that even once they entered IMF programs, leftist Latin American governments were likely to use their political capital to avoid the implementation of programs, despite the costs inherent in non-compliance. It appears, therefore, that for leftist (and to a lesser extent for centrist) governments, IMF programs during the debt crisis were merely short-term compromises

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163 Thus, for a right-wing government, the odds of implementation doubled for each standard deviation increase in the GDP share of SOEs (marginally significant at .1 one-tailed), whereas for a center-left government an equivalent change in discretionary resources triggered a 60% reduction in the odds of compliance (also marginally significant at .1 one-tailed).
in response to economic and political pressures, which were likely to be abandoned as soon as permitted by political circumstances.

By contrast, Figure 5.7b (based on Model 8 of Table 5.4b) reveals that in Eastern Europe greater discretionary resources had an unexpected effect on compliance, in that they contributed to a significantly improved implementation record among nationalist/ex-communist governments\textsuperscript{164} but were largely irrelevant for other governments. This counterintuitive result, which is also at odds with the predictions of the formal model, has two interesting implications for our understanding of post-communist reforms: first, it appears that, unlike Latin American leftists during the debt crisis, East European ex-communists were willing to use their political capital to ensure reform implementation (at least in the short term) once an economic crisis had impelled them to enter IMF agreements. Second, the fact that despite their stronger \textit{a priori} ideological commitment to IMF-style economic policies, reformist governments were not able to benefit from having larger state sectors at their disposal, suggests that non-communists had a harder time using state assets for political purposes than ex-communist parties. Meanwhile, former Communists were better able to leverage their closer ties to SOE managers and the communist-era state administration to facilitate the implementation of neoliberal reforms once pressing economic crises had convinced them of the necessity of such reforms.

\textit{Squaring the circle: Democratic politics and program implementation}

How was the difficult process of economic adjustment under IMF auspices affected by democratic politics in the two regions? As discussed earlier, IMF program initiation in Eastern Europe was primarily driven by financial considerations and bureaucratic capacity but was only

\textsuperscript{164} A one-standard-deviation increase in the size of the state sector, was associated with an almost fivefold increase in the odds of compliance among nationalist/ex-communist governments (significant at .05 two-tailed).
minimally affected by the relative political power balance between government and opposition. Meanwhile, in Latin America the more divisive interpretations of the roots of the economic crisis contributed to a more charged political process of program initiation, in which new IMF programs largely reflected the relative political influence of reform proponents and opponents. To what extent were these broad regional trends continued during implementation?

The most striking difference between the political dynamics of program implementation in two regions is with respect to the role of democracy. Thus, judging by the negative and substantively large effects of Polity regime scores in Table 5.4a, IMF program implementation was clearly at odds with democratic politics during the Latin American debt crisis. The widespread unpopularity of IMF-style economic adjustment measures created significant barriers for democratic governments attempting to implement the policy commitments agreed to in their debt negotiations with the Fund and Western lenders. These findings confirm case-based evidence about the greater success of economic orthodoxy in authoritarian regimes like Chile and Mexico (Kaufman 1992), as well as about the tensions between democratic politics and IMF-style reforms in Bolivia, Peru, and Argentina, which will be discussed in the following chapter. However, Model 1 in Table 5a suggests that democratic politics did not affect the prospects of program implementation uniformly across different political contexts: thus, as illustrated in Figure 5.8, if right-leaning governments faced leftist oppositions, then greater degrees of democracy significantly undermined the prospects of successful program completion, but the negative effects of democracy were negligible when the government was

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165 These tests are based on a measure of partisan difference between the government and the opposition, calculated by subtracting the partisan orientation score of the opposition from that of the government, thereby yielding a scale from -4 (a right-wing government facing a left-wing opposition) to +4 (for cases with the opposite political constellation.)

166 For example, for a right government facing a center-left opposition, each standard deviation increase in democracy (seven points on the 20-point Polity regime scale) reduced the odds of compliance by half.
less reformist than the opposition. These results confirm the predictions of the formal model (Hypothesis 6) that democracy is more likely to undermine program implementation in environments where it gives greater political influence to an opposition which favors less ambitious economic adjustment policies than the government. Given the high costs and the low legitimacy of IMF-style economic reforms during the Latin American debt crisis, however, political opposition to IMF conditionality was fairly common, which meant that many Latin American governments faced a difficult tradeoff between fulfilling IMF program conditions and respecting the democratic political process.

Post-communist governments were not confronted with a similarly difficult trade-off between economic reforms and democracy. Even though democracy had played a marginal role during program initiation, at the implementation stage post-communist democracies appear to have had a clear advantage over their authoritarian counterparts, as illustrated by the positive and substantively large effects of Polity regime scores in Table 5.4b. The weak interaction effect revealed by Model 1 in Table 5b suggests that the democratic compliance boost was relatively independent of the ideological configuration of the domestic political scene: thus, the odds of compliance with IMF conditionality roughly doubled for each one-standard-deviation (five-point) increase in democracy, regardless of whether nationalists/ex-communists were in

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167 For example, based on the results in Model 1 of Table 5.4b, a one-standard deviation increase the regime score (five points on the 20-point Polity scale) was associated with a 115% increase in the odds of compliance. However, the statistical significance of the results was somewhat sensitive to model specifications, largely because of the fairly high correlation between Regime and Quality of governance.

168 For the former communist countries, partisan difference takes a value of 1 if the government is less reformist than the opposition, 0 if their partisan positions are similar (either both the government and the opposition are pro-reform, or both are anti-reform), and -1 if the opposition is more pro-reform than the government. While such an approach may obscure significant differences between parties in the same category, the nature of the data does not justify the construction of a continuous variable based on gradations of reformism.
These findings underscore the weaker ideological bent of post-communist IMF programs and suggest that despite the considerable hardships resulting from the market reforms of the last decade and a half, Eastern Europe did not witness the type of popular backlash against neoliberal economic policies, which had shaped the political economy of the Latin American debt crisis. Therefore, in Eastern Europe, democratic politics did not pose as many obstacles to economic reforms as in Latin America, and it even appears that the legitimacy conferred by democratic governance strengthened the ability of post-communist governments to implement IMF programs.

Beyond broad systemic characteristics such as regime type, the politics of IMF program implementation are also affected by other aspects of domestic political competition. Due to the potentially high political costs of IMF-style economic adjustment policies, one of the key challenges for successful program implementation hinges is the ability of the government to maintain unity and discipline within its own ranks. According to Hypothesis 7 from the formal model, the importance of government cohesion should be particularly high in situations where the government favors reforms for partisan reasons, because under such circumstances any weakness within the governing coalition could undermine the reform momentum. Meanwhile, the model predicted that cohesion would undermine implementation if the government is ideologically opposed to reforms since it makes the government less susceptible to reform pressures from the IMF and (possibly) the domestic opposition. To capture cohesion, the tests use an indicator of fragmentation within the governing coalition.

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169 The only difference was that the results were statistically significant (at .05 one-tailed) when the government was either more reformist or equally reformist as the opposition, but statistical significance was much lower (.28 two-tailed) when a non-communist government faced a nationalist/ex-communist opposition.

170 Government fragmentation is measured as the Herfindahl index of the parliamentary seat shares of the governing parties as a proportion of the total number of seats controlled by the government. Fragmentation ranges from 0 (in cases where the government is formed by one party) to a theoretical maximum of 1 (when the government is supported by a large number of independents.) The methodology and the data (for 1990-1997) are based on the
results in Model 2 in Table 5b, the patterns of compliance in East European IMF programs closely conformed to these theoretical predictions: thus, as illustrated in Figure 5.9, higher government fragmentation undermined the implementation efforts of reformist governments facing nationalist/ex-communist oppositions,\textsuperscript{171} but in the reverse ideological constellation, fragmentation appeared to promote program compliance by governments dominated by nationalists and former communists.\textsuperscript{172} These statistical findings are illustrated in more detail by the comparison between the Bulgarian and Romanian IMF programs in the following chapter. Meanwhile, according to Model 2 in Table 5a, government fragmentation undermined compliance in Latin America, and the weakness of the interaction effect between fragmentation and ideological balance (results omitted) suggests that such lack of internal coherence hurt the reform efforts of governments across the ideological spectrum. Thus, given the narrow maneuvering space between IMF economic adjustment requirements and the widespread domestic political opposition to the hardship, Latin American could ill afford internal dissent in their attempts to fulfill IMF program targets.

The last two models in Tables 5a&5b explore the relationship between elections and program compliance in the two regions and confirm the much more politically charged nature of IMF conditionality in Latin America compared to Eastern Europe. Thus, according to Model 3 in Table 5a, Latin American governments – in particular those at the center and on the left of the political spectrum – were significantly less likely to comply with IMF conditionality in the

\textsuperscript{171} The odds of compliance were reduced by 58\% for each one-standard-deviation increase in government fragmentation (significant at .01 one-tailed).

\textsuperscript{172} The odds of compliance increased by 158\% for each one-standard-deviation increase in government fragmentation (significant at .01 one-tailed).
aftermath of elections. This finding suggests that Latin American governments were unwilling to use the political legitimacy conferred by electoral victories to implement unpopular reforms, which underscores the low popularity of IMF-style reforms among all but the most committed neoliberals among Latin American political elites. Model 4 in Table 5a nicely complements this picture by indicating that Latin American governments were also less eager to implement IMF programs prior to elections. Since the negative electoral campaign effect was significantly stronger for right and center-right governments, this finding confirms the low popularity of IMF programs among the Latin American masses, and suggests a Downsian policy convergence among Latin American political parties intent on securing electoral support from voters, who were by-and-large unenthusiastic about neoliberal economic reforms. By contrast, Models 3&4 in Table 5b reveal extremely weak overall pre- and post-electoral effects on IMF program implementation. Combined with the weakness of the interaction effects in the two models, these findings provide further evidence for the less antagonistic view of IMF programs held by both elites and citizens in post-communist Eastern Europe and the former Soviet Union.

Conclusion

The comparative statistical evidence about the domestic political dynamics of IMF program initiation and implementation in Latin America and the former Soviet bloc has a number of important implications for our understanding of economic reforms in the developing world. While the analysis confirms the importance of inflationary crises as reform catalysts, it

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173 For example, a centrist government had two thirds lower odds of compliance following an election than at other points in the electoral cycle (significant at .05 two-tailed). However, as one would expect, the results were much weaker in both substantive and statistical terms (but still negative) for right governments, which presumably did not share the antipathy of their centrist than leftist counterparts for IMF-style reforms.
also illustrates quite clearly that economic crises are at least to some extent “in the eye of the beholder.” Economic crises are defined not only with reference to more or less objective economic indicators but are significantly shaped by the way key political actors interpret and react to these economic challenges. Domestic economic crises did not have a uniform effect on the decision to initiate or implement IMF programs but instead were filtered through the partisan preferences of the governing parties in the countries of the two regions. In Latin America left and right parties had similar reform inclinations at low inflation levels but experienced policy divergence in reaction to inflationary crises, which made right-leaning governments more likely to initiate reforms but actually further discouraged reforms by the left. A similar crisis-driven ideological divergence of economic policy trajectories also occurred in response to higher foreign debt service payments, which had been identified as the main external driver of IMF programs in the preceding chapters. Once reforms were initiated, however, ideological differences ceased to affect governments’ policy responses to domestic crises, and implementation was driven primarily by the severity of the initial crisis and the bureaucratic capacity of the state. However, the ideological rift persisted with respect to interest payments, which promoted IMF program implementation for right governments but undermined it for the left, thereby underscoring the divisive nature of externally induced economic adjustment during the Latin American debt crisis.

By contrast, in Eastern Europe inflation acted as a stronger reform catalyst for ex-communist/nationalist governments, which were less likely to initiate and implement IMF program in low-inflation environments but appeared to be more capable of mobilizing in the face of inflationary crises than their reformist counterparts. The former communist countries also experienced policy convergence with respect to the key external indicator of economic crises –
low foreign reserve levels – which acted as a stronger reform catalyst for nationalist/ex-communist governments during the program initiation phase. In the context of post-communist institutional uncertainty, the quality of governance and public administration played an even more important role than in Latin America in that it significantly affected both the initiation and implementation of IMF-style reforms. Moreover, whereas economic crises exacerbated implementation differences between Latin American governments with different levels of bureaucratic expertise, in Eastern Europe the quality of governance mattered less in crisis situations, as desperate governments appeared to make up in short-term political determination what they lacked in bureaucratic capabilities.

The different partisan responses to economic crises can be traced back to the different nature of IMF and Western involvement in the two regions, which were discussed in earlier chapters. Since IMF interventions in Latin America were primarily targeted at ensuring the continuation of debt payments by debtor governments, they were likely to elicit stronger partisan reactions than in post-communist Eastern Europe, where the IMF played a less controversial advisory role to governments who largely agreed with the Fund’s economic crisis “diagnosis.” On the other hand, the two regions also differed along potentially important domestic dimensions, such as party system institutionalization and the strength of organized interests (especially labor and business), which played a more active role in Latin America and may explain the greater ideological discipline of Latin American parties compared to their post-communist counterparts. These questions will be addressed in more detail in the case studies in the following chapter, as well as through comparison with the political dynamics of IMF programs in Latin America during the 1990s in the final chapter of the book.
The greater rigidity of partisan fault lines in Latin America compared to Eastern Europe, also affected other domestic political mechanisms of IMF program initiation and implementation in the two regions. Thus, the political capital inherent in greater discretionary resources was used strictly along ideological lines in Latin America, where it promoted program initiation and implementation for right governments but undermined it for the left. Meanwhile, in the post-communist context, discretionary sources played a greater role in program initiation for non-communist reformers, but at the implementation stage ex-communist governments were better able to leverage their ties to the state sector, and therefore received an unexpected reform boost in situations with abundant discretionary resources. The cross-regional differences in partisan salience were also responsible for the stronger post-electoral reversals of program initiation trends in Latin America, where newly elected governments were more likely to avoid the IMF if previous governments had engaged in frequent programs, but were more likely to seek Fund support if the country had previously avoided IMF engagements. Meanwhile, in Eastern Europe such electoral policy reversals were much smaller in both substantive and statistical terms despite the remarkable regularity of power alternation between different ideological camps, thereby confirming the more technocratic nature of post-communist economic decision-making.

Finally, the domestic political dynamics of IMF programs were significantly shaped by the overall legitimacy of Western objectives and IMF conditionality in the two regions. In Latin America of the 1980s, the widespread perception of IMF programs as external impositions created significant tensions between the popular sovereignty which underlies democratic governance and the political imperatives of IMF-style economic adjustment policies. This tension is reflected in the negative relationship between democracy and program compliance in Latin America, which suggests that democratic politics were hard to reconcile with IMF
cooperation in the inhospitable international economic environment of the debt crisis. Meanwhile, post-communist compliance with IMF conditionality was actually reinforced by democratic politics, a finding which confirms the more cooperative tone of the relationship between the Fund and many transition economies in the 1990s. The electoral dynamics of IMF program initiation and implementation suggest that the cross-regional popularity differential of IMF interventions applied to both political elites and ordinary citizens in the two regions: thus, in the aftermath of elections, when politicians have greater freedom to pursue their preferred policy agenda, Latin American governments (especially those in the center and on the left of the political spectrum) were significantly less likely to comply with IMF programs, whereas in Eastern Europe no such trends were noticeable. Similarly, the greater reluctance of Latin American right and center-right governments to implement IMF programs prior to elections, combined with the greater likelihood of ex-communist governments to initiate IMF programs during electoral campaigns, confirms that Latin American voters had much more negative views of IMF-style adjustment policies than their East European counterparts.

The overall picture, which emerges from the analysis in this chapter, questions the utility of sweeping theoretical claims about the drivers of IMF programs and of economic reforms more broadly. Even though certain regularities exist – in both Latin America and Eastern Europe IMF programs were more likely to be initiated and implemented by governments in countries with more capable bureaucracies, and which were facing severe economic crises – the particular nature of the complicated interactions between economic crisis, ideology and political institutions differed substantially across the two regions. These different political dynamics were not random, however, but were an outgrowth of the systematic differences in the international economic and political environment of the two crises, which were discussed in chapters 3 and 4.
Thus, in Latin America, the overarching Western concerns with minimizing the international economic fallout of the debt crisis set the stage for the tense and ideologically divisive domestic politics, which characterized the initiation and implementation of IMF programs in the region. As a consequence, Latin American countries experienced an ideology-driven policy divergence in response to economic crises, and the implementation of IMF-style reforms was frequently at odds with democratic politics. Meanwhile, in the ex-communist countries the IMF was seen primarily as an important source of funding and an (albeit occasionally harsh) tutor of neoliberal economic reforms. Therefore, post-communist IMF programs were the result of crisis-driven convergence among the policy choices of governments from different ideological backgrounds, and their successful implementation was actually facilitated by democratic politics.
Chapter 6

Domestic Politics and IMF programs: Case Evidence from Latin America and Eastern Europe

The preceding chapter revealed several crucial cross-regional differences in the domestic political dynamics of IMF programs during the Latin American debt crisis and the post-communist transition in Eastern Europe and the former Soviet Union. This chapter revisits the economic reform trajectories of the four Latin American and two East European countries discussed in Chapter 4 (Argentina, Bolivia, Chile, Peru, Moldova and Slovakia) and introduces two additional post-communist cases (Bulgaria and Romania) to illustrate some of the main formal model predictions and cross-national statistical findings about the domestic politics of economic crises in the context of IMF conditionality. In addition, these brief case studies attempt to capture certain aspects of domestic political dynamics with greater nuance than allowed by the cross-national statistical indicators used in the previous chapter.

In line with the statistical findings about the crisis-driven ideological divergence of economic policies in Latin America, this chapter traces two of the most dramatic policy reversals of the Latin American debt crisis: Bolivia's remarkable transformation from hyperinflationary paralysis under the leftist Siles government (1982-85) to one of the region's showcase orthodox reformers under the right Paz government in the second half of the decade; and Peru's dramatic rejection of IMF conditionality under President Alan Garcia after 1985 following its earlier costly cooperation with the IMF under the center-right Belaunde government. A closer look at the political dynamics of this two important economic policy U-turns should facilitate a better understanding of the complicated interaction of ideology and economic crises in the tense
political environment of the Latin American debt crisis.

While avoiding Bolivia's and Peru's abrupt policy reversals, the centrist Alfonsin administration in Argentina nevertheless failed to address its country’s pressing economic problems. The analysis in this chapter tries to identify the domestic political roots of this failure and focuses on Alfonsin’s conflictual relationship with labor and business organizations, as well as on the missed opportunities to leverage post-electoral legitimacy in the context of severe economic crises in order to find a long-term political compromise to the social tensions that fueled inflation throughout the 1980s. Whereas the experiences of Bolivia, Peru, and Argentina illustrate the tension between democratic politics and IMF-style reforms in the context of the pervasive popular resistance to painful austerity measures, this chapter shows that even an ideologically committed, highly authoritarian regime like Pinochet's Chile was not immune to critical political challenges in its attempt to execute an orthodox economic adjustment strategy in the difficult context of the debt crisis. In addition to discussing the implications of the parliamentary power balance between the government and the opposition (in the three democratic cases), the Latin American case studies also analyze the important role of the government's ties to influential organized societal interests, particularly labor unions and business organizations, whose cooperation (or at least acquiescence) played an important role in facilitating the success of IMF-style reforms in Latin America.

Judging by the statistical findings in Chapter 5, post-communist IMF programs triggered different domestic political dynamics than had been the norm during the Latin American debt crisis. Thus, the broad cross-national patterns of IMF program initiation and implementation in Eastern Europe suggested that economic crises were more likely to trigger policy convergence among governments of different ideological persuasions. The four East European cases discussed
in this chapter illustrate these statistical findings by analyzing the effects of a wide range of ideology/crisis constellations on IMF programs in the post-communist context: thus, the Slovak case, characterized by relative macroeconomic stability but initially low foreign reserves, provides an interesting contrast between the reluctance of the Meciar government and the eagerness of the Moravcik government to cooperate with the IMF. Meanwhile, the ex-communist governments of Moldova, Bulgaria, and Romania had mixed compliance records but unlike their Latin American leftist counterparts tended to react to economic crises by seeking closer ties to the IMF. By contrast, the track record of East European pro-reform governments in the four countries suggests a high propensity to seek out IMF conditionality in support of their domestic reform goals but the weak implementation record of the Moldovan and Romanian reformers suggests that ideological commitment was not sufficient for the success of IMF style reforms in situations where the government's zeal was undermined by political fragmentation and weak bureaucratic institutions. Finally, while domestic political constraints clearly mattered to the trajectories of IMF programs in the four East European countries, the cases nonetheless suggest that, unlike in Latin America, democratic politics were not inherently incompatible with IMF conditionality, and under certain circumstances more inclusionary democratic politics even appeared to facilitate compliance with IMF programs.

*From Basket-Case to Showcase: Bolivia's Reform Path in the 1980s*

From the point of view of its economic reform trajectory, Bolivia offers an interesting contrast between the economic and political chaos of the first part of the decade (first under a rapid succession of unstable military governments and later under the equally unstable
democratic rule of Hernan Siles Zuazo) and the remarkable recovery of macroeconomic stability and governability in the second part of the 1980s, during which Bolivia became a showcase example of successful orthodox reforms under the leadership of Victor Paz Estenssoro. The country's relationship with the IMF closely parallels the dramatic reversal of its economic policy path: whereas the Siles government had failed to secure an IMF agreement despite several attempts at stabilization packages between 1982-84, the Paz government, despite its initial decision to adopt the stabilization program proposed by Jeffrey Sachs instead of the policy proposals of the IMF, quickly became the darling of the international financial institutions, with the initial standby agreement of 1986/87 being followed by a lower conditionality structural adjustment fund (SAF) program in 1988 in conjunction with active support from the World Bank and bilateral donors. It should be noted, however, that the absence of IMF programs in the context of the severe crisis of 1982-84 was not the result of a confrontational approach towards Fund conditionality (as in Peru under Alan Garcia) but - as will be discussed below - an expression of the political paralysis of the Siles government for most of its three-year tenure.

Since the country's main structural characteristics - its marginal geopolitical position, high indebtedness, weak bureaucracy, extreme poverty and lack of export diversity - did not change during the 1980s, this sharp inter-temporal contrast offers the analytical advantage of allowing us to isolate the domestic political mechanisms that drove this remarkable and unexpected changes in economic policy. The Bolivian experience clearly illustrates the prediction of the former model and the statistical finding that the effects of similar levels of external and domestic economic crisis on the likelihood of program initiation depended on the partisan preferences of the governing parties. Thus, the center-left UDP government of Siles Zuazo was incapable of overcoming the opposition to IMF-style reforms from the labor unions
and from within the governing coalition despite the high economic and political costs of this policy paralysis. By contrast, the center-right MNR-ADN government under Paz Estenssoro used the crisis as a political catalyst for an economic reform program whose orthodoxy was rivaled at the time only by Chile and gradually became a classic success story in the eyes neoliberal reform proponents.

**Domestic Economic Stagnation**

The domestic economic situation in Bolivia at the time of its “democratization by default” in October 1982 was critical. Tax revenues had declined from already low levels (8.3%) in 1980 to 4.2% of GDP in 1982, inflation had reached almost 300% for the year and the economy contracted by 4.4% in the context of an almost complete halt to private investment (2.8% of GDP).\(^{174}\) To make matters worse from a political point of view, the relative prosperity of the 1970s had not resulted in significant gains in real wages and government services, thereby limiting the scope and political feasibility of classical demand-side austerity measures. The Bolivian economy continued to deteriorate rapidly under the democratic government of Siles Zuazo: thus, by late 1984/early 1985 the Bolivian government had virtually ceased to collect taxes (accounting for less than 1% of GDP) and had lost control over the budget (with the deficit for 1984 reaching 22.9%). In the absence of external financing options, this fiscal imbalance was financed almost exclusively by domestic money creation and resulted in one of the most spectacular episodes of hyperinflation in the postwar period with a yearly inflation rate well above 10,000% between late 1984 and mid 1985. Even though, as discussed in Chapter 4, this catastrophic domestic economic crisis was complemented by an equally critical external debt

\(^{174}\) Data based on Pastor (1992:70-71, 79)
service burden, the Siles government failed to mount a policy response capable of tackling the crisis and securing IMF support for its economic adjustment efforts. How can we explain this remarkable failure to respond to a crisis, whose staggering economic costs affected most of Bolivian society and, therefore, exacted a heavy political price for the government? To answer this question, the following section takes a closer look at Bolivia party politics and its implications for economic reforms.

The Difficult Legacy of the Unfinished Bolivian Revolution

The social and political roots of the conflicts over economic policy making during the 1980s cannot be properly understood without reference to the legacies of the Bolivian revolution of 1952 and the succession of civilian and military regimes that ruled (or at least attempted to rule) the country in the three decades prior to the debt crisis. This historical background is important both because several of the key political personalities of the 1980s played a major role since the 1952 revolution (such as Hernan Siles Zuazo and Victor Paz Estenssoro) or at least during the various authoritarian regimes of the 1960s and '70s (e.g. the ex military dictator Hugo Banzer), and because the key conflict lines of Bolivian society remained remarkably consistent from the mid-1950s to 1985.

Despite the sometimes important differences in the ideological platforms and democratic commitment of successive 20th-century Bolivian governments, political patronage remained a constant and often the most important element in the power struggle between different factions and interest groups. This pattern goes back at least as far as the late 19th and early 20th-century rivalry between the traditional Conservative and Liberal parties, which were primarily
personalistic cliques competing for the spoils of power rather than coherent ideological platforms. While this thinly veiled caudillismo was a widespread political phenomenon in Latin America at the time (and has shown remarkable persistence in countries like Colombia, Uruguay and Paraguay), Bolivia's dependence on primary exports (first silver, later tin and then oil/gas) combined with the weakness of the domestic manufacturing sector, created strong incentives for the Bolivian middle-class and elite to rely on state patronage as a significant source of income. Since the structural roots of this widespread middle-class economic dependence on the state did not change significantly in the second half of the 20th century, the central importance of patronage to party politics remained unchanged even after the popular revolution of 1952. The high stakes of the conflicts over the distribution of patronage are illustrated by the fact that the 1964 coup led by General Barrientos against the first Paz Estenssoro's government was supported by important factions within the ruling Movimiento Nacionalista Revolucionario (MNR) after Paz had broken the underlying patronage sharing bargain of the 1961 Constitution by inserting a clause allowing for his reelection.

The second salient characteristic that differentiated the Bolivian political scene from most of its neighbors was also an outgrowth of the revolutionary struggle of 1952: the strength and the semi-independent position of the labor unions, the Central Obrera Boliviana (COB). Unlike the Mexican PRI and Argentine Peronists, the populist Bolivian MNR did not succeed in coopting and subordinating the popular sectors mobilized by the revolution, in particular the militant labor unions concentrated in the country's strategic mining sector. The tensions between the state capitalist development project of the MNR and the often intransigent wage demands of the unions surfaced after a brief honeymoon period in the context of the fiscal austerity dictated by

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175 The Bolivian saying that “La industria mayor de este pais es la politica” (This country's biggest business is politics) is indicative in this respect. (Malloy 1970 cited in Gamarra and Malloy 1995:401).
Bolivia's first IMF agreement in 1956 (Gamarra and Malloy 1995:403). To make matters worse, the MNR was equally incapable of controlling the armed forces, which had been strengthened with U.S. support in order to control popular revolts but ended up adding to the cycle of political instability and bad governance during its almost 18 years in power starting in 1964.

Thus, the dominant pattern of political competition in pre-1985 Bolivia was one of gridlock between a fractionalized, patronage dependent middle-class and elite on one hand, and a labor movement strong enough to block most attempts at painful economic reforms but too weak to gain power and rule by itself. Despite repeated violent attempts to crush the labor movement during the 1970s, successive military regimes proved incapable of replicating Pinochet's successful repression of the powerful Chilean union movement. This resilience of organized labor, combined with a gradual loss of political support from the middle-class, eventually weakened Hugo Banzer's military regime to the point where it agreed to democratic elections in 1978. As three rounds of inconclusive elections in three consecutive years (1978-80) made abundantly clear, democratization in Bolivia did not occur as a result of pressures from a strong, coherent democratic opposition but rather because of the obvious inability of a weak military government to manage the country's increasingly critical economic situation.

The Return of Democracy and the Road to Hyperinflation

Following the shameful final salida of the military after an increasingly chaotic and violent succession of short-lived governments during the transition period between 1978-1982, in October 1982 Bolivia returned to democracy under the presidency Hernan Siles Zuazo, who had received the largest share votes in the presidential elections of 1980 but was prevented from
assuming power by the military coup of General Garcia Mesa. The return to democracy did not, however, coincide with a return to governability, since Siles could only count on the support of a plurality of congressional votes (36%) and faced a strong opposition from both the center-right MNR under the leadership of Paz Estenssoro (one of the veterans of the 1952 revolution) and the right-wing Accion Democratica y Nacionalista (ADN), which served as the electoral vehicle for one of the more unlikely democratic candidates, former longtime dictator Hugo Banzer Suarez. Moreover, the governing Unidad Democratica y Popular (UDP) was plagued by internal splits between center-left parties such as Movimiento Nacionalista Revolucionario de Izquierda (MNRI)\(^\text{176}\) and the Movimiento de Izquierda Revolucionaria (MIR)\(^\text{177}\), and the more radical Marxist Partido Comunista Boliviano (PCB). In a sense, at least from the point of view of the center-right and right opposition, this political situation could be dubbed “ungovernability by design,” given that they opposed new elections in 1982 for fear that they might result in a strong mandate for the left, which had already achieved significant gains in 1980 compared to 1979 and benefited from its more resolute opposition to the discredited military regime.

The government's uneasy middle ground between a militant and mobilized left and an entrenched right with strong ties to the country's military and economic elite was also reflected at the societal level. Despite its initially strong support from organized labor, the Siles government obtained at best the conditional acquiescence but never the full support of the labor movement, after turning down the COB's claims for co-governance at both the political and the public enterprise level during the first months of the administration. (Malloy and Gamarra 1987:115) At the same time, the government was on even shakier ground in its relations with the business

\(^{176}\)The MNRI was formed in the early 1970s by Siles Zuazo and several other members of the leftist faction of the original MNR and became one of the major political forces during the three chaotic elections of the democratic transition period (1978-80).

\(^{177}\)The MIR's history also goes back to the early 1970s, when it had formed around a group of young leftist intellectuals, including the future president Jaime Paz Zamora.
sector, represented for the first time in a more unitary fashion by the Confederation of Private Entrepreneurs, which distrusted the leftist-populist electoral discourse of the UDP and grew increasingly frustrated with the government's inability to control the economy.

This political gridlock, which had undermined the emergence of a coherent developmental strategy during the economic boom of the 1960s and 1970s, had even more troubling economic consequences in the context of economic slowdown that started in 1978 and was exacerbated by the reversal of capital flows after 1981. The inflationary crisis, which started amid the political chaos of the final months of the military regime in 1982 and culminated in the hyperinflation of early 1985, was precipitated by the unfortunate interaction of two factors. The first factor - a large and growing primary fiscal deficit - was rooted in the inability of successive Bolivian governments to impose the cost of economic adjustment on either the business sector (tax revenues declined rapidly from 8.3% in 1980 to 4.2% in 1982 until they bottomed out at 1.6% in 1984\textsuperscript{178}) or the popular sector, given that the already low social expenditures were difficult to reduce any further and that unions successfully resisted additional wage cuts in 1982-83 and managed to obtain a clearly unsustainable doubling of real wages in mid 1984. Moreover, the frequent indexation of wages added an important inertial component to inflation, even though the magnitude of this effect remains a debated subject among analysts (Morales 1987, Pastor 1991). The second factor, which explains the relative timing of the increase in inflationary pressures starting in 1982, is connected to the evolution of capital flows during this period. Whereas the wide availability of foreign credits had facilitated the noninflationary financing of the budget deficit until the late 1970s, by the turn of the decade the increasingly large burden of servicing this foreign debt became an important driver of the ballooning fiscal deficit, which grew from 7.5% in 1981 to 14.2% in 1982. The inflationary effect of the rising debt service

\textsuperscript{178}Data based on Pastor (1992:79)
expenditures was exacerbated by the abrupt drying up of foreign credit lines following the official debut of the debt crisis in the months preceding the inauguration of the Siles administration, because it forced the government to finance this deficit through inflationary domestic monetary emissions.

In the context of the severely constrained access to domestic and international sources of credit and the rapidly mounting inflationary crisis, the Siles government should have been an obvious candidate for an IMF program in the 1982-85 period. While the more radical left parties of the governing coalition (particularly the PCB) were opposed to IMF conditionality on ideological grounds, the same cannot be said about President Siles Zuazo, whose track record with the IMF program implementation went back to his first stint as a president in 1957. The concern of the Bolivian government with maintaining good relations with the West and the IMF is best reflected by the continuation of debt service payments until May 1984 even though these payments exacted a steep price from the crumbling Bolivian economy without being rewarded access to financing from either private lenders or the IMF and the World Bank.

As a consequence, the failure of the Siles government to secure an IMF agreement during its three years in office can be explained neither by the lack of financial incentives (given Bolivia dire financial situation) nor by an ideologically motivated confrontational rhetoric as in the case of Peru under Alan Garcia. In fact, after a first unsuccessful attempt at heterodox stabilization in late 1982, the Siles government made a series of attempts to introduce economic packages designed with the intention of gaining IMF support, but these technocratically designed *paquetes* invariably failed after being first watered down by debates within the governing coalition, later sabotaged by an increasingly assertive congressional opposition and finally hindered in their implementation by frequent and sometimes violent labor protests (Malloy and Gamarra
The conflicts triggered by these timid reform efforts reached a peak in April 1984, when the COB called a general strike in response to the government's new stabilization package following an IMF delegation visit to La Paz earlier that month. After the general strike, lacking significant support in both Congress and broader society, the Siles government essentially renounced all efforts to control the country's rapidly deteriorating economic situation. After stopping debt service payments in May 1984 and making important wage concessions to the unions during the summer, the window of opportunity for addressing Bolivia's crisis within the parameters of IMF conditionality had permanently closed for the Siles Zuazo administration. For the remainder of Siles' tenure, which was cut short after he agreed to early elections in the face of a constitutional coup mounted by the opposition with wide civil and military support, the Bolivian government watched helplessly as the economy drifted towards hyperinflation and the country became virtually ungovernable. Thus, the economic reform efforts of Bolivia's first democratically elected government in two decades were thwarted by a combination of internal ideological conflicts, a strong parliamentary opposition, and an unresolved legacy of class conflict which resulted in a zero-sum logic in the interactions of organized labor and business. These political difficulties were undoubtedly exacerbated by the sheer magnitude of the economic adjustment task confronting the Bolivian government in an extraordinarily inauspicious international economic environment but, as we will see in the following section, such obstacles could be overcome with the right political strategy.

The Path to Economic and Political Stability: The Paz Government (1985-89)
Rather than retelling the fascinating story of the “Bolivian miracle” in the second half of the 1980s, this section will attempt to identify the political mechanisms, which help explain the divergent outcomes in terms of economic reforms and IMF relations between the governments of the two former revolutionary comrades, Hernan Siles Zuazo and Victor Paz Estenssoro. The analysis illustrates a number of key statistical finding from the previous chapter, particularly about the interaction between ideology and economic crisis in triggering reforms, as well as about the important role of a discretionary resources in ensuring the political feasibility of economic reform efforts by right and center-right governments.

At the outset, the newly elected Paz government hardly seemed to have much better economic or political prospects than its predecessor. The economy was in its fourth year of recession, inflation was raging at a monthly rate of 66% in July 1985 (the month of the election), unemployment was around 18%, and the country had defaulted on its foreign debt and had no access to new loans from either private or official creditors. Politically, the situation was equally unpromising, with the only real achievement of the Siles administration - the preservation of the country's nascent democracy - threatened by the weak commitment of major political actors to formal democracy. Thus, during the 1985 electoral campaign, the COB had openly tried to provoke a coup to preempt the inevitable victory of the right at the polls, and democracy arguably only survived because the recent memory of its catastrophic governments between 1978-82 made the military reluctant to intervene openly in the political process (Malloy and Gamarra 1987:115). Despite the decisive defeat of the left, which had split into several factions and whose combined vote share barely exceeded 20%, the 1985 elections failed to produce a decisive majority in Congress, where the center-right MNR of Victor Paz Estenssoro and the right-wing ADN of the former military dictator, Hugo Banzer, were virtually tied with about a
third of parliamentary seats. To make matters worse, Paz was elected president after a congressional vote, given that in the first round of the presidential elections he had not only failed to achieve an absolute majority that had actually been a close second with a mere 26.4% of the popular vote. Moreover, Paz hardly fit the profile of a dynamic young politician who would revolutionize Bolivian politics, given that, like his predecessor Siles, he was one of the old caudillos of the 1952 revolution and had played an important role in creating the foundations of Bolivian state capitalism during his first two presidential terms between 1952-56 and 1960-64.

Against all these odds, Paz presided over one of the region's most ambitious and successful stabilization programs of the 1980s. The basic ingredients of Paz’s economic policy have been discussed in great detail elsewhere (Sachs 1987, Pastor 1992) and will only be summarized briefly here. The New Economic Policy (NEP), launched by decree on August 29th 1985, included (1) a unified exchange rate without capital or exchange controls; (2) improved fiscal discipline through a combination of a public sector wage freeze and employment cuts, a public sector price liberalization (especially energy prices) and spending cuts in public investment; (3) trade liberalization which effectively limited the ability of local producers to raise prices; (4) tax reform based on a regressive value-added tax structure and (5) a conscious effort to improve relations and credibility with official creditors, including the IMF, in order to obtain new credits and renegotiate existing loans. It should be noted, however, that this rapprochement with the IMF did not translate into the wholesale adoption of the Fund's adjustment recipe during the first year of reforms. Thus, Bolivia did not resume its debt service payments during the first months of reforms, and, when the peso came under pressure following a temporary inflation spike in December 1985-January 1986, the Bolivian government did not follow the Fund's advice to evaluate the currency but instead followed Jeffrey Sachs' strategy of
defending the national currency by selling off foreign reserves in the (ultimately justified) hope that a stable exchange rate would reduce inflationary pressures and thereby restore financial market confidence in Bolivia (Pastor 1992:88). Despite its modest effect on growth for the duration of the Paz government and the uneven distribution of adjustment costs to the detriment of labor (as reflected by the initial drop and slow recovery of real wages and the persistence of unemployment levels in the 20% range), the NEP's economic results were remarkable, particularly with respect to inflation and fiscal discipline.

In addition to its successful fight against inflation, the Paz government achieved a fundamental transformation of Bolivian political dynamics based on an unexpected political consensus (at least at the elite level) around a neoliberal economic policy, which has proven remarkably resilient during the following decade. How can we explain this remarkable turnaround and what are its theoretical implications for our understanding of the politics of economic reforms and IMF program initiation and implementation? Below I will argue that this success can be explained through a combination of Paz's skillful mix of political alliances and repression in a domestic environment unsettled by the trauma of hyperinflation.

One of the classic explanations for the initiation of economic reforms (and IMF programs) is the catalytic effect of economic crisis, which can help overcome resistance to reforms by influential social actors or interest groups. In the Bolivian case the depth of the crisis - particularly with respect to inflation levels - clearly played an important role in convincing significant segments of the Bolivian elite and population that the status quo economic policies and their political foundations were exceedingly costly to maintain. In this context, the event of hyperinflation, despite its high short-term economic costs and political risks, can be regarded as an important (and possibly necessary) intermediate step for overcoming long-term fiscal
imbalances in inflationary pressures. On the other hand, inflation in Bolivia had been extremely
high on several occasions in the three years preceding the enactment of the NEP - reaching
annual rates 757% in the third quarter of 1982, 826% in the fourth quarter of 1983 and 3735% in
the second quarter of 1984 - but none of these inflationary episodes had resulted in a political
consensus for decisive stabilization program under the Siles government.

By contrast, Victor Paz Estenssoro proved remarkably adept at using the traumatic social
and economic consequences of the crisis to create political support for and undermine opposition
to his ambitious economic reform plans. In a landmark speech immediately following his
election, Paz claimed that the country was dying and the economy was in a coma, whereas the
U.S.-educated head of Paz's economic team, Gonzalo Sanchez de Losada, concluded that “the
state is practically destroyed,” and therefore, “the first political goal consists of reestablishing the
authority of the state or society.” 179 Aware that the effectiveness of such crisis rhetoric declines
rapidly after a brief post-election honeymoon period, the Paz government moved quickly to take
advantage of the brief window of opportunity provided by the gravity of the economic crisis and
the legitimacy of their recent electoral success. As will be discussed in more detail below, the
domestic political strategy aimed at restoring the country's governability included a patronage-
based parliamentary alliance with Banzer's ADN, a tough stance towards organized labor, and
the creation of a pro-business economic environment while at the same time minimizing the
influence of particularistic business demands on economic policy. Thus, the Bolivian case
provides further evidence in for the formal model prediction that the effects of domestic
economic crisis on the initiation and implementation of economic reforms (and IMF programs)
are mediated by the partisan political preferences of the government and that similar degrees of
crisis can lead to divergent policy responses for right and left governments.

A closer look at the political developments in the immediate aftermath of the launching by decree of the *New Economic Policy* on Aug. 29th 1985 reveals the serious nature of the political challenges faced by the proponents of reforms, as well as the difficult economic and moral trade-offs inherent in political strategies aimed at ensuring the sustainability of these reforms. Less than a week after the official launching of the reforms, the Paz government already faced its first challenge from the COB, which continued its confrontational tactics from the previous government and launched a national strike that triggered a series of hunger strikes, roadblocks and building occupations throughout the country. Recalling the paralyzing effects of labor unrest on its predecessor's reform attempts, the Paz government moved decisively against the COB by declaring a state of siege on Sept. 19th 1985 and arresting more than 200 labor leaders, many of whom were sent to internment camps in remote parts of the country until the COB agreed to suspend the strike and negotiate with the government two weeks later (Conaghan and Malloy 1994:149). While such repressive measures (repeated on a smaller scale during the miners' march on La Paz in August 1986) represented significant deviations from standard democratic practices, they did not seriously undermine political support for the Paz government, partly because the unions had limited popular backing given the marginal role of the industrial proletariat in the Bolivian economy and the fact many Bolivians held the unions at least partially responsible for the country's economic and political crisis. Moreover, the government gradually managed to erode union power by significantly reducing employment in the union stronghold of the state-owned tin mines, which had become increasingly unprofitable following the collapse of tin prices in late 1985 (Klein 1992:276). At the same time, however, the Bolivian government minimized protests over the layoffs through severance payments and

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180 These tactics provoked unease going to more democratically minded members of the Paz cabinet, one of whom later admitted that the government had “behaved like authoritarian pigs.” (cited in Conaghan and Malloy 1994:149).
the creation in 1987 of a *Fondo Social de Emergencia (FSE)*, designed to provide temporary public sector jobs for lower-class workers. This last set of measures illustrates the importance of discretionary resources for governments attempting to buy political support (or at least acquiescence) from key social actors for the implementation of the economic reform agenda.

The importance of the selective use of discretionary resources to ensure the political feasibility of economic reforms was even more striking in the case of the *Pacto por la Democracia*, the parliamentary alliance between Paz Estenssoro's ruling center-right MNR and the largest opposition party, the right-wing ADN of the ex-dictator Hugo Banzer. Initiated by Paz at the height of the government's confrontation with organized labor and signed on Oct. 16 1985, the unlikely alliance with the ADN not only ensured parliamentary backing for the state of siege but ensured a working majority of congressional votes, which facilitated the passage of crucial reform legislation through Congress and allowed Paz to avoid the two-front political battle (in Congress and society) that had brought the Siles government to its knees. In exchange for its political support, Banzer's ADN was granted an important share of state patronage in the form of public employment and control over a number of state corporations (Gamarra and Malloy 1995:414). While this pact, driven largely by the two parties respective leaders (at times against the wishes of important actions within their own parties), undermined the government's ability to reduce public sector employment and reduced Congress to the symbolic role of rubber-stamping executive initiatives, it nevertheless contributed decisively to the restoration of governability in Bolivia, and to the creation of a elite consensus in favor of neoliberal economic reforms.

The third important domestic political aspect of the Paz administration's reform strategy was its relationship with the business sector. On one hand, business had benefited from the restoration of political order following the 1985 elections, especially given that the costs of
macroeconomic stabilization and fiscal discipline had fallen disproportionately on the shoulders of labor. On the other hand, domestic private business lobbied against the reduction of tariffs and private sector credits, which were part of the NEP economic package, but their demands were largely ignored by the technocrats in charge of the Paz government's economic policy. This relative autonomy of the government from business demands was crucial not only in controlling inflation (by limiting the local producers' ability to raise prices) but also in reducing the social tensions inherent in its tough policies against organized labor and the social costs of fiscal austerity measures.

Idiosyncrasy or Blueprint: Some Tentative Conclusions Based on the Bolivian Experience

As the preceding analysis has illustrated, the sharp contrast in Bolivia's domestic economic reform trajectory and its relationship with the IMF and Western lenders before and after 1985 can be traced to the profound political transformation initiated by the Paz government upon coming to power at the peak of a profound economic and governability crisis it inherited from Bolivia's first democratically elected government in almost two decades. While the traumatic experience of hyperinflation was certainly conducive to breaking the social and political stalemate that had paralyzed economic policymaking in the preceding years, it by no means guaranteed the sharp turnaround the country experienced beginning in mid 1985. The decisive component was the emergence of a stable pro-reform coalition between the ruling center-right MNR and the largest opposition party, the right-wing ADN. The coalition, largely a product of the acute political instincts of the two parties' leaders, Victor Paz Estenssoro and Hugo Banzer, was cemented by elaborate patronage and power-sharing agreements and ensured the political stability necessary for the initiation and implementation of a coherent economic
In this respect, the Paz government differed sharply from the Siles administration, which was paralyzed not only by internal infighting but also by a hostile and powerful parliamentary opposition. Thus, the Bolivian case confirms the statistical findings about the importance of stable pro-reform coalitions at the parliamentary level for the successful implementation of IMF-style reforms, and it highlights the important role of individual leaders in bringing about such coalitions.

At the same time, however, Bolivia's political trajectory emphasizes the importance of looking beyond parliament in analyzing the sources of political support and opposition to economic reforms. In particular, the resolute resistance of a powerful organized labor sector played a more important role in the failure of successive stabilization attempts under the Siles government than the ideological opposition within the center-left governing coalition. In this context, one of the crucial manifestations of the partisan differences between the two successive Bolivian governments was the way they dealt with the challenge of union opposition to economic reforms: whereas the Siles government repeatedly gave in to union pressures (despite the fact that it received only qualified political support from organized labor), the Paz administration took a much more confrontational approach based on a combination of repressive measures and material inducements, which succeeded in significantly reducing the political influence of labor unions and thereby paved the way for the implementation of socially costly economic reforms. These different approaches also illustrate the difficult tradeoffs between governability and democratic norms in the context of the painful economic adjustment required by the unfortunate intersection of domestic economic crisis and an extremely unfavorable international environment during the 1980s.

Bolivia's trajectory after 1985 compares favorably to most of its peers - not only in terms
of inflation\textsuperscript{181} but also in terms of political stability – a conclusion which is all the more remarkable given the country's extreme poverty, history of class conflict and state weakness. Seen from this perspective, Bolivia can be regarded as an example how a group of political leaders, motivated by little more than desire for patronage and political survival succeeded in creating a political coalition, which not only achieved the long-elusive macroeconomic stabilization but created the foundations for the consolidation of its political and economic reforms over the next two decades. Bolivia under Paz nevertheless remains one of the few examples from the 1980s of highly indebted developing countries that have managed to square the circle between Western pressures, domestic demands and tight economic constraints in the context of a relatively democratic political system.

At the same time, however, the peculiar mix of political pacts, repressive labor practices and patronage politics reveals the difficult tradeoffs between democracy and economic adjustment inherent in an economic environment whose parameters were set by the primacy of Western concerns with international financial stability in the context of the debt crisis. These inherent tensions were further emphasized by the electoral defeat of the MNR in the 1989 elections: thus, despite the notable economic and political achievements of the Paz government, the slow pace of economic recovery\textsuperscript{182} put a damper on the initial popular support for economic reforms. Even though successive democratically elected Bolivian governments continued the broad parameters of Paz’s neoliberal economic policies, the country’s fragile economy\textsuperscript{183} and

\textsuperscript{181} With a brief exception in early 1986, inflation in Bolivia after the initial stabilization in late 1985 was kept at annual levels below 25% in the second half of the decade, a resounding success not only by historical standards but also compared to the performance of its Latin American peers (most notably Argentina and Brazil) who continued to battle chronically high levels of inflation until the early 1990s.

\textsuperscript{182} Despite the macro-economic stability, the country's real economy recovered only slowly starting in 1987, with economic growth between 2.6-3% in 1987-89, unemployment levels of about 20% throughout the late 1980s and real wages whose 1989 levels were still lower than at the outset of the debt crisis.

\textsuperscript{183} The continuing decline of the tin industry and the country's growing dependence on two potentially conflicting sources of foreign currency - foreign aid on one hand and the export earnings from the illegal sale of coca leaves on
widespread poverty ensured that economic policy making in Bolivia remained a game of delicate political brinkmanship long after the 1985 crisis had abated. The political upheaval of recent years suggests that despite ushering in almost two decades of relative economic and political stability, these reforms ultimately failed to reverse Bolivia’s deep-seated legacies of poverty, inequality and social polarization.

Failed Orthodoxy and Heterodoxy: Peru under Belaunde and Garcia

In July 1985, while the newly elected Bolivian government was preparing to embark on the road to the economic orthodoxy, in neighboring Peru, the president-elect, Alan Garcia, initiated a dramatic reversal of the Belaunde government's earlier path of neoliberal economic management under close IMF supervision. As in Bolivia, this sharp policy reversal occurred in the unstable political environment of an impoverished fledgling democracy, and was the result of fundamentally different ideological interpretations of how to tackle the severe economic imbalances of the Latin American debt crisis. However, unlike Bolivia’s relative success after 1985, Peru’s two democratic governments of the 1980s failed in their attempts to tackle the country’s severe economic crisis, and when Alberto Fujimori, a little-known agronomist of Japanese descent, won the second round of presidential elections in early 1990, the very existence of democratic elections was quite possibly the only real achievement of a decade of democratic rule in Peru.

What explains Peru's remarkable economic debacle under its two democratically elected
governments of the 1980s? Structural legacies cannot provide a satisfactory answer, given that in most respects Peru's economic and political background at the start of the debt crisis was quite typical of the rest of the region: in 1982 foreign debt accounted for 45% of GDP (slightly below the regional average for that year), inflation ran at 65%, which was higher than in most Latin American countries but not unmanageable, particularly since the fiscal deficit of 3.2% was well below most of its peers, and the economy was reasonably diversified, especially by comparison to Bolivia. Politically, despite the prevalence of personalism and patronage politics, at the time of the 1980 elections, the Peruvian party system showed considerable promise of consolidation (Cotler 1995:335) and the far-left guerrilla movements (such as Sendero Luminoso and Tupac Amaru) did not yet pose a significant challenge to the country's governability. If structural legacies cannot account for the Peruvian debacle, the obvious alternative would be to look at the policies of the country's two governments during this period.

Orthodoxy Punished: The Failure of Economic Adjustment under Belaunde

From 1980-85, under the presidency of Fernando Belaunde, the Peruvian government pursued one of the region's most ideologically committed neoliberal reform strategies of the period. The genesis of this strategy, intended to adopt the basic economic tenets of the Chilean model in Peru's democratic context, is unique in Latin America of the early 1980s in the sense that it was adopted by a democratically elected government prior to the debut of the debt crisis and in the absence of immediate pressures from the IMF. In part, this unexpected democratic neoliberalism can be interpreted as a political reaction against another “original” Peruvian
political phenomenon - the leftist military regime of general Velasco - whose economic failures not only prepared the way for the transition to democracy but also discredited the statist ISI model promoted by Velasco. Moreover, the positive economic results of an IMF-supported orthodox stabilization program under the transitional government of General Morales Bermudez in 1978-79, combined with the widely publicized success of the Chilean free market strategy in the late 1970s, convinced important sectors of the Peruvian elite to throw their support behind a small group of Western-trained technocrats who became the core of Belaunde's economic team (Pastor 1992:110-111).

Initially, the political prospects for the Belaunde government and its economic reform agenda looked rather promising. Belaunde had won the 1980 presidential elections with a comfortable 45% to 27% margin over the second-ranked candidate, and his party, the center-right Accion Popular (AP), had secured an absolute majority of 54.4% in the Lower House of Parliament. Belaunde's power in Parliament was further strengthened by the alliance with the rightist Partido Popular Cristiano (PPC), as well as by the infighting in the (misnamed) leftist Izquierda Unida (IU) and the willingness of the AP's traditional rival and largest parliamentary opposition party - the center-left APRA - to take on the role of “loyal opposition” while overcoming significant internal strife after the death of its founding leader, Haya de la Torre (Cotler 1995:340). At the societal level, the AP government also benefited from a favorable situation, given that it could count on business support for its neoliberal economic agenda and because the political power of labor unions had been weakened by their confrontations with the military regime during the Morales Bermudez governing period.

During the Belaunde government's first two years in power, the country's solid growth rates of 4.5% in 1980 and 1981 seemed to confirm the optimistic expectations of the neoliberal
reformers and initially strengthened their political power. However, these early economic successes, driven to a large extent by healthy capital inflows and a temporary rise in the country's commodity export prices, may have ultimately contributed to the political defeat of the neoliberals, who witnessed their political support evaporate overnight as the economy took a turn for the worse in mid-1982 with the debut of the debt crisis. While it is unclear whether any kind of democratic neoliberal coalition could have survived the depth of Peru's 1983 economic crisis\(^{184}\) - especially because the initial reforms were launched in a relatively low-crisis environment and therefore lacked the “redemptive” quality of the post-1985 Bolivian reforms - the Belaunde government undoubtedly undermined its initial political capital through its exclusionary governing style. Buying into the neoliberal assumptions about the benefits of insulated technocratic decision-making, the Belaunde government ruled primarily by executive decree, without even the pretense of soliciting the input of parliament or business and labor organizations. As a consequence, when the deterioration of the country's external position and a string of natural disasters undermined the effectiveness of the monetarist model after mid-1982 and deflated the expertise-based legitimacy of the technocrats, the Belaunde government suddenly found itself cut off from political support not only at the societal level but even within the governing AP. The increasing political weakness of the Peruvian government starting in mid-1983 eventually created important tensions within the core economic team, which resulted in increasingly incoherent economic policies and ultimately in the abandonment of orthodox adjustment, as reflected in the government's repeated failure to comply with IMF conditionality after late 1983.

In a sense, the failure of orthodoxy under Belaunde, combined with the setbacks suffered

\(^{184}\)After stagnating in 1982, the Bolivian economy plunged by almost 13% in 1983 while inflation reached 125% in the same year despite the government's desperate stabilization efforts.
by neoliberal reform efforts in Chile and Mexico during the same period, illustrates the important limitations of the IMF economic adjustment recipe in the first part of the debt crisis. The significant tradeoffs between the IMF’s debt repayment agenda and the domestic economic growth objectives of Latin American countries created a political environment that made the task of successful economic adjustment in a democratic context exceedingly difficult. Whereas Chile's military government and Mexico's one-party dominant regime weathered the crisis through a combination of deviations from orthodoxy, Western support, and exclusionary politics, the Belaunde government essentially collapsed under the weight of the crisis. While it is difficult to know whether Peru, if it had continued its pursuit of economic orthodoxy, would have experienced a similar economic recovery as Chile in the second part of the 1980s, the circumstances of Belaunde's political defeat confirm the inherent tension between democracy and consistent neoliberal reforms, particularly since most of the ruling party withdrew its support for the president's sinking neoliberal ship in anticipation of the voters' harsh judgment of the government's economic record in the 1985 elections.

**Heterodoxy and International Isolation: Peru under Garcia**

Having won the July 1985 elections by riding a wave of popular discontent with his predecessor's IMF-style economic policies, Peru’s newly elected president, Alan Garcia, almost immediately set out to fulfill his electoral promises of reversing the country’s domestic and international economic strategy. In addition to its widely publicized break with the IMF and its decision to limit debt service payments to no more than 10% of export earnings, the Garcia
government instituted a heterodox economic policy program based on a combination of fixed exchange rates and price controls to reduce inertial inflation, as well as by a series of growth stimulating measures, including lower interest rates, reduced taxes, increased subsidies and higher wages (Pastor 1992:122-123). The short-term results of this strategy were remarkably positive: relieved of the heavy burden of the payments, the Peruvian economy grew by an impressive 9.5% in 1986 and by 7.8% in 1987, while inflation fell from almost 160% in 1985 to 63% in 1986.\textsuperscript{185} Therefore, Garcia's populism resonated not only with the economic frustrations and resentments of large segments of the Peruvian population against the neoliberal agenda of the previous government and the IMF, but its early economic achievements reinforced the credibility of Garcia's interpretation of the country's initial economic crisis as stemming from the inopportune application of IMF-style policies.

Despite these early successes, the Peruvian government's risky strategy started to unravel by mid-1987, as inflation started to pick up again (rising to 114% for the year) and the costs of the country's international economic isolation started to affect economic growth. The following two years witnessed an economic crisis that looked bleak even by the low regional standards at the end of Latin America's lost decade: inflation grew steadily and reached crippling levels from mid-1988 until early 1990,\textsuperscript{186} and the economy was affected by a deep two-year recession, leading to declines in real wages and living standards, which wiped out the gains of the temporary recovery between 1985-87.\textsuperscript{187} While Chilean and Bolivian orthodoxy, and the Argentine “middle-of-the-road” approach were not without their costs and drawbacks, Peru's

\textsuperscript{185} Data from Pastor (1992:116).
\textsuperscript{186} Starting in mid-1988 inflation never fell below 20% per month (equivalent to an annual rate of almost 1000%) and reached alarming levels (as high as 114% in September 1988) on several occasions prior to the 1990 elections (data from Pastor 1992:128-129).
\textsuperscript{187} The economy declined by 8.8% in 1988 and 10.4% in 1989, thereby contributing to the 3.1% average annual decline in per capita GDP during the 1980s. The real minimum wage in 1989 was less than a quarter of 1980 levels, and had even declined by more than half since 1985, despite an initial improvement in the first two years of the Garcia administration (data from Pastor 1992 and ECLAC 1990).
dramatic failure in the late 1980s arguably did more to discredit heterodox adjustment policies in Latin America than the combined theoretical arguments of neoliberals in the region and elsewhere. While some have argued that Peru's failure does not necessarily prove that a “well conceived and well-implemented heterodox program cannot work,” (Paus 1991:427), it nevertheless illustrates the magnitude of the difficulties encountered by such programs in the increasingly orthodox international economic environment of the emerging Washington Consensus.

Given these staggering economic costs and their inevitable repercussions on Garcia's political support among the poor, the traditional crisis-reform paradigm would predict a reformist turn in the policy approach of the Garcia government as the failure of heterodox adjustment was becoming increasingly obvious. Instead, for the remainder of its increasingly chaotic term in office, the Garcia government chose to “muddle through” with a series of half-hearted heterodox policy packages, which failed to arrest the country's economic freefall. In this sense, Peru's post-1985 trajectory confirms the statistical findings in the previous chapter about the crucial interaction between economic crisis and the government's partisan orientation in driving the initiation and implementation of IMF-style reforms. Of course, by late 1987 the status-quo bias in the economic policies of the Peruvian government was largely overdetermined: first, having been the most vocal proponent of heterodoxy during its first two years in office, the Garcia government could have hardly afforded to abandon its ideological position on which much of its initial legitimacy and popularity were based. Second, the Garcia government was ill-equipped politically to implement the painful adjustment measures inherent in IMF-style reforms, given that much of APRA’s rank-and-file would have feared the negative repercussions of austerity and possible labor unrest, whereas the business sector deeply distrusted Garcia and could
therefore hardly form the backbone of an APRA-led reform coalition.\textsuperscript{188} Finally, even in the unlikely event that the domestic political will to initiate neoliberal reforms had existed, Peru under Garcia would have faced a costly uphill battle to reverse the damage of the acrimonious confrontation with the Fund and Western lenders after 1985. This strong status-quo bias on both the domestic and the international front helps explain the statistical finding in Chapter 5 that higher inflation levels only promote IMF program initiation in the aftermath of elections, when governments have not yet burned bridges with a variety of potential domestic and international allies.

\textit{The Uncomfortable Middle Ground: Argentina under Alfonsin}

Argentina's economic reform trajectory during the lost decade of the 1980s, closely paralleled by its relationship with International Monetary Fund, represents a microcosm that contains an impressive array of the many economic experiments and political struggles experienced by Latin American countries in their attempt to come to terms with the debt crisis in the delicate political context of democratic transitions. Between 1982 and 1989 Argentina experienced in rapid succession (1) the breakdown of its military regime following the disastrous defeat in the Falklands war and increasing economic paralysis (1982-83); (2) a brief flirtation with Keynesian experiments and a short-lived attempt to create a debtor's cartel to counter Western adjustment pressures (late 1983 to mid-1984); (3) an unsuccessful attempt at IMF style orthodox liberalization and a gradual slide towards hyperinflation (late 1984-mid 1985); (4) an unorthodox stabilization program with IMF support (mid 1985 to early 1986), whose remarkable

\textsuperscript{188} After some initial attempts at cooperation with local capitalists, Garcia’s relationship with the business sector deteriorated sharply following his heavy-handed attempt to nationalize domestic banks in July 1987 (Pastor and Wise 1991:23).
early success prompted premature policy relaxation and a return to inflation that proved increasingly unresponsive to successive heterodox stabilization attempts (early 1986-mid 1987); (5) a renewed turn to orthodoxy and a failed attempt at structural reforms in the context of growing domestic opposition and reluctant Western support (mid 1987 to mid 1988) and finally (6) one last stabilization attempt - the Primavera plan initiated August 1988 - whose failure in February 1989 resulted in the decisive electoral defeat of Alfonsin's Radical Party amid political chaos and hyperinflation. Thus, while one can hardly accuse the Argentine government of not having tried a variety of economic strategies to deal with the country's predicament, by the end of the decade its careful game of political brinkmanship between the competing claims of domestic and international interests had reaped very modest economic achievements and succeeded in alienating many of the government's erstwhile supporters. While the Alfonsin government succeeded in what it viewed as its most important task - providing sufficient breathing space for Argentina's fragile democracy in the context of a deep economic crisis - the ultimate failure of its economic policy reinforces the conclusions drawn from the Bolivian and Peruvian cases about the narrow maneuvering space of democratic governments between the political demands of labor and business in an inhospitable international economic environment.

**Economic Crisis, Political Parties and Organized Interests**

To an even greater extent than in its international political initiatives, the Alfonsin government made a concerted effort to find a middle-ground compromise solution between the conflicting claims of domestic social and political actors in devising its domestic political
approach to the implementation of economic reforms. As mentioned before, in the context of the country's costly external adjustment and the zero-sum political conflict mentality that dominated Argentina during this period, this quintessentially democratic approach to economic policy making ended with complete economic and extensive political failure by the end of Alfonsin's six-year tenure. When placed in comparative context, the failure of Argentine economic policy during this period illustrates a number of crucial mechanisms that can further our theoretical understanding of the political economy of successful economic reforms under democracy. Structured to a large extent as an (at least implicit) comparison to the successful economic reforms in Bolivia after 1985, this subsection emphasizes the crucial elements that undermined the emergence of a durable political coalition in support of reforms and hence the implementation of a coherent economic reform policy in Argentina during the 1980s. The timing, nature and initial perception of the economic and political crisis at the outset of the debt crisis prevented the emergence of a stable political coalition at both the congressional and societal level during the early period of exceptional politics. This pattern of “fair-weather” coalitions between an increasingly isolated government and powerful independent business and organized labor interests was reinforced by the initial success of heterodox stabilization and thereby undermined the government's ability to impose the considerable costs of adjustment on any particular group. From this perspective, the inflationary spiral Argentina experienced in 1989, much like Bolivia's hyperinflation four years earlier, was symptomatic of the extreme difficulty of finding a democratic solution to the long-standing social conflicts in the highly polarized Latin American societies in the extremely unfavorable international economic environment of the debt crisis.
The economic situation inherited by the Alfonsin government from its military predecessors displayed crisis symptoms that were very similar to the economic legacy of the collapsing military regime in Bolivia a year earlier: high inflation levels of almost 350% in 1983, a contracting economy, whose modest recovery in 1983 hardly balanced out the recession of the preceding four years, a large and growing budget deficit (approaching 8% in 1983 up from 5% in 1982) and an unsustainable foreign debt situation that raised serious questions about the prospects for long-term economic recovery. Even though the 1983 Argentine crisis fell short of the dramatic economic and political ungovernability that characterized the hyperinflationary episodes of Bolivia in 1985 or Peru in 1988-9, its deep historical roots at both the domestic and international levels arguably required a profound transformation of the country's political economy trajectory.\textsuperscript{189} From this perspective, the democratic transition of 1983 could have provided a unique opportunity to initiate such a transformation, not only because the power of the Argentine military was at an all-time low following its military defeat in the Falklands and its disastrous governance record between 1976-83, but also because of the relative disarticulation of labor and business organizations during the repressive military rule (Acuna 1992:7-9).

Despite its unquestionable democratic legitimacy following its clear 1983 electoral victory, the Alfonsin administration failed to take advantage of the initial opportunity to use Argentina's political and economic crisis as a rallying point for creating a powerful and stable

\textsuperscript{189}Thus, the failed stabilization effort under Martinez de Hoz after 1978 was only the most recent of long succession of military and civilian governments that had proven incapable of resolving the zero-sum economic conflict between organized labor and various competing sectoral business interests. Moreover, at the international level, the state capitalist development model of the preceding two decades had done little to reverse the country's dependence on traditional exports and in a sense exacerbated Argentina's foreign dependence through the accumulation of a sizable foreign debt, particularly starting in the mid-1970s.
reform coalition to support the government's economic policy agenda. Part of the reason for this failure was the Alfonsin government's lack of a clear ideological position on economic matters. On one hand the Radical Party leadership distrusted orthodox economic prescriptions, largely because they were associated in the minds of many Argentines with the discredited military regime and the equally distrusted IMF pressures. On the other hand the vaguely populist themes that had dominated the electoral campaign hardly provided an alternative ideological blueprint for domestic economic policy making, and, as a consequence the Alfonsin government reinforced the unfounded popular optimism democracy would almost automatically solve the country's economic crisis. Therefore, Alfonsin committed the classical mistake - which was to be repeated over and over by equally well-meaning democratic reformers in Eastern Europe - of equating democracy with economic prosperity when he claimed that “with democracy you eat, you get educated, and you get cured” (cited in Canitrot 1994:81). This conflation of democracy and economic well-being had the double disadvantage of denying the short-term importance of political solidarity and economic sacrifices by key social actors, and to provide the basis for the longer-term delegitimation of democracy by tying it directly to Argentina's uncertain economic prospects.

The government's second opportunity to use economic crisis as a catalyst for changing the political power balance in its favor came in the spring of 1985, due to the rising inflationary pressures resulting from the powerful sectoral demands and the interruption of IMF support. Faced with the alarming specter of hyperinflation, Alfonsin gave a memorable speech on April 26 in front of 200,000 supporters, which marked an important reversal in the government early optimistic rhetoric by acknowledging the severity of the economic crisis, the necessity of economic sacrifices prior to any recovery and even claimed that the country was in the midst of a
“war economy”. This dramatic crisis rhetoric was followed six weeks later by the announcement of the *Plan Austral*, which despite its important heterodox elements, was considered by many observers as “more IMF than the IMF” because of its ambitious fiscal and monetary targets. Emboldened by the remarkably fast anti-inflationary success of the *Austral* and the Radical victory in the September 1985 parliamentary elections, Alfonsin called for a new consensus in support of his government's economic reform program in his famous *Parque Norte* speech in November 1985 (Smith 1990: 12). Ironically, however, the surprisingly painless success of the stabilization package of arguably undermined the long-term prospects for economic reforms for at least two reasons. First, it led to a retrospective “deflation” of the severity of the crisis and thereby contributed to the self-defeating success of heterodox stabilization due to the rapid resumption of societal pressures for inflationary economic stimulus measures (Manzetti and Dell'Aquila 1988:2). Second, it reinforced the government's penchant for relying on insulated executive initiatives as the basis for economic policy instead of forging a broader political coalition for reforms, particularly in the context of the heightened importance of political coordination in the difficult task of the structural reforms that constituted the crucial second step of the *Austral* plan.

*The (Un)making of a Fair-Weather Coalition*

Alfonsin and his Radical Party (UCR) came to power following the October 1983 elections, after a surprising victory over the Peronists (PJ) who suffered their first defeat in a freely contested democratic election. Given that the UCR obtained only a razor-thin majority in the House of Representatives (with 129 of 254 seats) and actually trailed behind the PJ in the
Senate (with 18 of 46 seats), Alfonsin hardly commanded the parliamentary support required for potentially painful economic reforms, especially given that the Argentine electoral system schedules lower-house parliamentary elections every two years. At least in retrospect the obvious solution to the problem would have been the initiation of a formal “national unity” pact at the congressional level between the UCR and the PJ, which could have delivered reliable political support and shared responsibility for the government's economic policy in return for some form of power-sharing agreement. Such a cooptation of the Peronist leadership would have been important not only with respect to the political legitimacy derived from congressional support but also because it could have facilitated the government's difficult negotiations with organized labor, a close ally of the Peronists. Furthermore, the period immediately following the 1983 elections provided a real window of opportunity for such a grand alliance, given that the two parties had come a long way in reconciling their better historical rivalry due to their shared suffering under the military regime, and that - unlike in 1989 - the two parties differed only minimally in their ideological platforms (McGuire 1995:222-223).

However, for a number of reasons, the newly democratic Argentina did not witness the emergence of a political pact at the party level along the lines of the Bolivian Pacto por la Democracia of 1985. First, many Radicals erroneously interpreted their electoral victory and the PJ's subsequent internal conflicts as a sign of the decisive decline of Peronism and, therefore, underestimated its considerable residual political power. This sense of confidence reduced the Radicals' willingness to seek political concertation with the Peronists, who in turn proceeded to rebuild their party unity in opposition to the Alfonsin government, thereby further complicating any attempts at political cooperation (Torre 1993: 76-77). Second, the quasi-complete loss of legitimacy by the military reduced the short-term probability of a coup, and thus diminished the
importance of a broad civilian alliance against a common authoritarian threat. Third, the government's focus on the external dimension of the crisis, combined with the aforementioned optimism about the domestic economic prospects, relegated the task of domestic coalition building to the margins of the political agenda during the first months of the Alfonsin government. As a consequence Alfonsin missed the opportunity to forge a political coalition from a position of strength in late 1983, and then again after the initial success of the Austral plan and the renewed UCR victory in the 1985 parliamentary elections. Instead, the first major concession to the Peronists occurred from a position of weakness in mid 1987 with the appointment of Carlos Alderete, one of the leaders of the anti-reform wing of the Peronist labor movement, as minister of labor. This concession failed to produce the political benefits expected by the Radical leadership, given that Alderete's presence in the cabinet merely provided the opposition with a “Trojan horse” in the government, as evidenced by his vocal opposition to Sourrouille on monetary policy in his support for labor in the debates over the collective bargaining laws (Smith 1990:21). Therefore, it hardly came as a surprise that following the 1987 elections, the new Peronist-dominated Congress actively tried to sabotage most of the government's economic policy initiatives, especially with respect to the structural reform efforts at the core of the IMF-supported orthodox stabilization program in late 1987/early 1988. The resulting policy paralysis was an important contributing factor to the rising inflation, which increasingly affected the Argentine economy after mid-1988, and eventually degenerated into hyperinflation in the second half of 1989. These parliamentary roadblocks to Argentine reforms illustrate statistical findings in Chapter 5 about the importance of comfortable parliamentary majorities for governments intent on initiating IMF-style reforms in the tense political context of the Latin American debt crisis.
As in the Bolivian case, however, any account of the politics underlying Argentina's reform path in the 1980s has to focus on the partisan preferences and relative political power of not only political parties but also key social actors, particularly the interests of labor unions and the business organizations of key economic sectors. While this brief analysis can hardly do justice to this complex and important aspect of Argentine economic reforms,¹⁹⁰ I will nevertheless point out the crucial factors shaping the temporary achievements and ultimate failure of Alfonsin's economic policy efforts.

From the outset the Alfonsin government faced a number of handicaps in its political relationship with organized interests. Unlike the Peronists, the Radicals appealed to voters as individual citizens rather than as members of corporate groups, which deprived them of the corporate structures of political support available to their opponents. This unease with Argentina's organized corporate interests was reflected by the official rhetoric coming from the Radical party leadership at various key political junctures, starting with the 1983 electoral campaign, continuing during the inflationary crisis in the spring of 1985, and culminating during the government's late turn towards orthodoxy, when Sourrouille echoed the standard neoliberal complaint about the resistance of powerful sectoral interests to “the transformations demanded by Argentine society.”¹⁹¹

The political consequences of this mutual distrust were exacerbated by the relative strength of labor and business groups during the 1980s. Since Argentina's industrial sector was fairly large and diversified by Latin American standards (certainly compared to Bolivia and Peru), industrial workers represented a more significant (though declining) proportion of the population, which translated into higher popular support for the labor movement and would have significantly

¹⁹⁰ For more detailed analytical accounts of these relations, see Carlos Acuna (1992), Marcelo Luis Acuna (1995), William Smith (1990).
raised the political costs of coercive actions by the government against labor unrest (along the lines pursued by the Paz government in Bolivia). Moreover, despite its aggressive anti-labor policies, the Argentine military government had been significantly less effective than its Chilean counterpart in dismantling the organizational structures of organized labor. Argentina's various business organizations (representing the often conflicting interests of different sectors) had also weathered the military repression reasonably well, and looked upon democracy as a political opportunity to pursue its economic interests.

Aware of the close political ties between the labor unions and the opposition Peronists, and anticipating the rise of union demands in a democratic context, the Radicals started their confrontational approach against organized labor already during the electoral campaign. However, unlike the Bolivian MNR, the Alfonsin government limited its attacks on union power to strictly democratic procedures throughout its tenure, despite the unions' active - and frequently obstructive - opposition to most of the government's economic initiatives, as indicated by the remarkable frequency and extensiveness of strikes and labor protests between 1983 and 1989. The first - and arguably most important - government attempt to curb the power of the Peronist unions occurred in February 1984, when the so-called Mucci Law, intended to democratize internal union elections and thereby reduce the political power of old-style Peronist union leaders, failed in the Senate after an extremely close (24-22) vote. This narrow defeat not only deprived the government of gaining more influence in the politics of Argentina's labor unions but it also enforced an atmosphere of political distrust that permeated all subsequent negotiations between the two sides. During the following years, despite a number of occasional cooperation attempts, the bargaining positions of the two sides hardened and drifted apart even farther as the government moved away from its early populism under Grinspun to an increasingly orthodox
approach to economic adjustment by the end of the decade. As discussed earlier, relations barely improved even after the Alfonsin government's conciliatory move to designate a prominent union leader, Carlos Alderete, as labor minister in 1987, given that the unions refused to moderate their economic demands to the increasingly isolated administration during this period.

Compared to the Peronist loyalties of the labor movement, the business sector emerged from the dictatorship with uncertain political loyalties, considering its increasingly conflictual relationship with the military government, its traditional distrust of the Peronists and the absence of a credible pro-business party on the Argentine political spectrum in 1983. However, even though the government's relations with business were generally less conflictual than with organized labor, the business sector organizations did not emerge as a key political support basis for the Radical government. In part, the reason for this outcome was the government's initial failure to involve corporate interests in the design of economic policy, which contributed to an unexpected anti-government alliance between key labor and business interests in the months leading up to the launching of the Austral Plan. This so-called “production front” brought together the General Confederation of Labor (CGT) and leading business organizations (including the representatives of manufacturing interests and agro-exporters) and resulted in higher wages, whose costs were then passed on the producers in the form of higher prices due to the semi-closed nature of the Argentine economy.

Following the success of the Austral Plan, business confidence in the government increased, which allowed the Alfonsin administration to dissolve the “production front” and replace it with the government-overseen Economic and Social Conference (CES). The CES, however, proved to be little more than lip service to the notion of a social pact between government, labor and business because corporate interests any real input into policymaking, and
completely excluded the important agricultural and banking sectors from the process (Smith 1990:12-13). Moreover, when in July 1986, following a thirty--three-day strike by the metal workers, the government pressured the Metallurgical Industry Association (ADIMRA) to accede to the wage demands of the unions, the compromise not only fueled inflation by encouraging similar deals in other industries but it also dealt a severe blow to the business sector's confidence in the government (Acuna 1991:17). This downward trend continued during 1987-88 in line with the government's increasing inability to control fiscal and inflationary pressures. As a consequence, despite Alfonsin's announcement of an “alliance between production and democracy”\textsuperscript{192} in mid-1988, business support for the government's increasingly neoliberal economic policies was at best mixed, and vanished almost completely as the economy started its inevitable drift towards hyperinflation by late 1988.

\textit{Conclusion: Liberal Democracy and Economic Adjustment in the 1980s - Pick One?}

The Argentine case illustrates the significant trade-offs between the democratic agenda pursued by the Alfonsin government between 1983 and 1989 and the difficult economic adjustment tasks facing Argentina during this period. The Alfonsin government tried to steer a careful middle course between the various conflicting domestic and international demands, a strategy that yielded some temporary gains but ended in hyperinflation and complete political defeat. Unwilling to resort to the labor repression strategies employed by the Chilean and to a lesser extent by the Bolivian government, and incapable of coopting crucial business and labor organizations under the banner of its economic reforms, the Argentine government was unable to find a political solution for distributing economic burden of adjustment. As in Bolivia prior to 1985, the economic manifestation of this political deadlock was the recurring problem of high

inflation, which by the 1989 had degenerated to hyperinflation levels.

Keeping in mind these important economic and political constraints, the preceding analysis nevertheless suggests that the Alfonsin government shares at least part of the blame for these unfortunate results. Thus, the government failed to take advantage on two occasions (in late 1983 and in mid-to-late 1985) of the unique political opportunity provided by the combination of a fairly severe economic crisis and the political legitimacy of recent electoral victories to forge political pacts at the parliamentary and the societal level in support of the economic reform agenda. Instead, Alfonsin relied primarily on a small team of technocrats in the design of economic reforms and, as a consequence, was only able to muster political support when it was least necessary, namely during the successful first stage of the Austral Plan between the summer of 1985 in the spring of 1986. Once the immediate crisis had abated, Argentine organized interests renewed their redistributive pressures and showed little interest in supporting the government's structural reform agenda, which was needed to complement the initial heterodox stabilization program. Realizing its increasing isolation, the Alfonsin government belatedly tried to forge an alliance first with the Peronist unions and later with the business organizations but its concessions were rightly interpreted as a sign of weakness and, therefore, failed to produce the expected results. Ironically, the political lessons of Alfonsin's failure seem to have been thoroughly internalized by his political successor - the Peronist Carlos Menem - who in the early 1990s managed to assemble precisely the neoliberal labor-business coalition that had eluded Alfonsin in the 1980s.
Compared to the tense and reversal-prone IMF relations of most Latin American debtors, Chile’s close and consistent involvement with the Fund during the debt crisis of the 1980s appears as little more than a theoretically overdetermined case. After all, Chile had a solid track record of orthodox economic policies for several years prior to the debut of the debt crisis. After almost three decades of sustained scrutiny from academic and policy circles the broad parameters of the Chilean model are rather well-established: a highly centralized military regime under the leadership of Gen. Augusto Pinochet, which, through the suppression of leftist parties and labor unions and the selective cooptation of business interests, insulated a coherent team of Chicago-educated neoliberal technocrats from the political pressures of special interests and as a result created a model of neoliberal social and economic transformation, hailed by the neoliberals and decried by many critics for its consequent policy application of neoclassical economic principles. Given that by mid-1982 Chile also suffered from one of the heaviest debt burdens in the region - with debt service payments using up more than 70% of export revenues and interest payments alone accounting for 10% of GNP - the Pinochet regime had the partisan and financial motives, as well as the political and administrative means that made it the ideal candidate for IMF conditionality.

These theoretical predictions were borne out with remarkable consistency judging by the repeated patterns of timely program initiation and solid implementation of IMF programs during the 1980s, which were described in Chapter 4. Beneath the surface of this neat high-level correlation, however, one finds a much more complicated and contradictory sets of political processes at the domestic level. Despite its initial strength and ultimate political survival until the
end of the decade, between 1983 and 1985 the Pinochet government experienced the most significant political crisis of its 17-year rule. Despite its undeniable status as a darling of international finance during the 1970s, Chile was not spared the politically difficult trade-off between honoring its external debt obligations and promoting domestic economic recovery. The political solutions to this tension entailed a combination of political repression and policy concessions, which entailed significant pragmatic deviations from the tenets of the strict economic orthodoxy advocated by both the Chilean government and the IMF at the outset of the debt crisis.

The Rise of Neoliberal Pragmatism: Redefining the Chilean Model

Whereas as late as mid-1981 Milton Freedman had sung the praises of the unfolding neoliberal Chilean boom, barely 18 months later the economic miracle had come to an abrupt end. The Chicago Boys' insistence on a monetarist response to the external shock of the debt crisis had disastrous effects on the economy, which contracted by an unprecedented 14.5% during 1982, while inflation doubled compared to 1981 and reached 20%. In addition, private consumption decreased by 16% and unemployment reached the catastrophic level of 30% by the end of 1982. To add ideological insult to economic injury, the Chilean government was forced to preempt the imminent failure of several large and medium banks by nationalizing more than a third of the country's banking system, which increased both the size of the state sector and the government's foreign debt. Just as ironically, considering the Chicago Boys's emphatic rejection of the populist public spending projects that had mushroomed in other parts of Latin America during the credit boom of the 1970s, the rapid expansion of private sector consumption and

\[193\text{Data from Borzutsky (1987:78) and Silva (1996:180).}\]
private sector foreign debt after 1976 created very similar balance of payment difficulties for Chile when capital flows reversed in mid-1982.

As predicted by the formal model and confirmed by the statistical findings, the initial reaction of Chile's technocratic government to the eruption of the crisis in 1982 was driven by its ideological convictions about the appropriate economic policy response to financial crises. As a consequence the Chilean government initially ignored the growing pressures from business organizations and popular sector groups for a softening of the austerity measures agreed with the IMF in January 1983. Gradually, however, Pinochet became concerned by the increasingly energetic demands of the broad center-left umbrella organization *Alianza Democratica* (AD), which organized monthly large-scale national protests and demanded rapid transition to democratic rule, reactivating economic measures and a tougher negotiating stance towards the IMF (Silva 1992:86). The situation became positively threatening to the survival of the Pinochet regime, when in August 1983 the country's top business organizations, united under the umbrella of the Federation of Production and Commerce (CPC) started to signal the possibility of an alliance with the AD, which would have amounted to a radical loss of political support from one of the pillars of the Pinochet government since the 1973 coup. This surprising estrangement between the military regime and its erstwhile loyal supporters in the business sector emphasizes the tensions between the IMF's emphasis on austerity and debt repayment, and the political viability of domestic neoliberal coalitions, in the context in which Latin American governments were forced to choose between the conflicting demands of foreign banks and domestic producers.

Pinochet's reaction to this unprecedented political challenge to the survival of the military regime was based on a two-pronged approach. First, he refused to enter a dialogue with the AD
and began to use massive military repression against the pro-democracy protesters, which in August 1983 resulted in the deployment of 18000 troops in Santiago and left at least 30 dead, and continued with varying degrees of intensity until early 1985 (Borzutzky 1987:83). At the same time, however, Pinochet pursued a number of economic measures meant to defuse some of the economic discontent of the population by promoting some social protection and public work projects. In this sense the government’s control over significant discretionary economic resources facilitated the political viability of neoliberal policies, in line with the statistical findings in the previous chapter. Second, Pinochet moved quickly to regain the confidence of the business sector through a combination of policy changes designed to reactivate economic growth, and a comprehensive cabinet change, which drastically reduced the policy influence of the Chicago Boys and paved the way for the “pragmatic neoliberalism” political pact between the military government and the CPC during the second half of the 1980s. One of the most prominent victims of this reshuffle was the finance minister Carlos Caceres, who was fired in mid-April 1984 in the midst of the country's efforts to clinch a more flexible deal in its renegotiation of the 1983 standby agreement with the IMF. Pinochet's dismissal of Caceres, whose commitment to austerity had made him equally unpopular with labor and business, closely parallels the forced resignation of Belaunde's neoliberal finance minister Rodriguez-Pastor during the Peruvian IMF renegotiation process in the previous month. If, in addition, we recount the resignation in February 1985 of Bernardo Grinspun in the heat of the conflict over the country's failing IMF program, the remarkable connection between the pressures of IMF conditionality and domestic political instability in Latin America becomes a pattern that is difficult to ignore. On the other hand, the radically different responses of the three governments - political paralysis in Peru, pragmatic neoliberalism in Chile, and heterodox adjustment in
Argentina - emphasize that external pressures were refracted in very different ways by the domestic political constellations of the program countries.

Slovakia - conditionality vs. populism

From its unpromising birth into nationhood in January 1993 until the parliamentary elections in late 1998, Slovakia under its nationalist-populist Prime Minister Vladimir Mečiar represents one of the most intriguing cases in the political economy of post-communist reforms in Eastern Europe. Unlike its East-Central European neighbors, Slovakia's attitude towards Western integration and conditionality was lukewarm, controversial and often contradictory. The country's rocky relationship with the IMF during Mečiar’s rule, which was discussed in more detail in Chapter 4, was emblematic of the peculiar reform approach of the Mečiar government, which combined a fairly prudent fiscal and monetary policy with a mixture of nationalist-populist rhetoric and policies. In line with the statistical findings in the previous chapter, the contrast between Mečiar’s defiance of IMF policy prescriptions and the country’s eager embrace of the same prescriptions during the brief interlude of the reformist Moravčík government in mid-1994 illustrates that partisan differences also mattered in the post-communist transition, as long as the domestic economic crisis was not too severe.

The Domestic Political Roots of Mečiar’s Anti-IMF Stance

As discussed in Chapter 4, Slovakia under Mečiar repeatedly resisted the demands of IMF conditionality despite its very fragile initial external position. While Chapter 4 explored the
international political dynamics and consequences of this conflict, the present discussion focuses on the domestic political dimension of Slovakia's peculiar approach to economic reforms under the leadership of Vladimir Mečiar. In particular, it is important to understand why Mečiar decided to forego the potentially important benefits of funding and outside validation associated with successful IMF involvement despite the fact that - as mentioned in Chapter 4 - the actual policy disagreements between the Fund and the Mečiar government were hardly insurmountable.

One possible answer suggested by the statistical findings, is that the Slovak government may not have had the bureaucratic capacity and expertise necessary to implement the demanding structural reforms required by IMF conditionality. Indeed, Slovakia had to tackle its structural economic distortions inherited from communism in the chaotic institutional environment of the early post-independence period, when the daunting task of setting up state institutions and formulating economic policy was complicated by the serious shortage of qualified specialists. Nonetheless, despite a large fiscal deficit of 6.8% in 1993, monetary policy was surprisingly successful, resulting in an inflation rate of 23% for the year, which was remarkably low by regional standards. While Mečiar's claims about IMF's appreciation for the exceptional effectiveness of the Slovak government (Slovak Radio, 6/4/1993) were likely exaggerated, the better-than-expected economic results during Slovakia's first year of independence suggest a fairly rapid improvement in the institutional capacity of the fledgling state. Moreover, even though lagging behind the Czech Republic and Hungary in terms of its quality of governance, Slovakia was nevertheless well ahead of countries with much more consistent IMF track records, such as Moldova and Azerbaijan. Therefore, the Mečiar government’s failure to initiate and implement IMF programs can hardly be blamed on institutional weakness. Instead, Mečiar’s

194The problem was particularly acute in terms of financial expertise, given that most of the senior staff in the financial institutions of the former Czechoslovakia had been Czechs. (Montreal Gazette 3/26/1993)
“rebellion” has to be analyzed in the context of the implications of IMF conditionality for the
domestic political power balance in Slovakia.

While the tension between program conditions and national self-determination is an
integral part of IMF conditionality, for the Mečiar government this dilemma was further
complicated by the role of Western economic and political influence on the domestic political
power balance of Slovakia. Even though Mečiar’s Movement for a Democratic Slovakia (HZDS)
was an outgrowth of the anti-communist Public Against Violence (VPN), Mečiar’s prominent
role in the breakup of Czechoslovakia, combined with his nationalist rhetoric against Slovakia’s
Hungarian minority, his intolerance to internal dissent and his populist tendencies of blaming the
hardship of the economic transition on the West, set Mečiar at odds with the Western
establishment even prior to the country’s independence. As a consequence, Mečiar’s policies
were frequently subjected to outspoken criticism in Western media and diplomatic circles, and
the domestic opposition invoked its closer ties to the West its increasingly bitter political struggle
against Mečiar.

Against this domestic political background, Mečiar’s decision about the optimal strategy
vis-à-vis the IMF entailed a significant trade-off. On one hand, a close cooperation with the IMF
may have allowed Mečiar to improve his image in the West and to challenge the opposition’s
claims of being the only real hope for the country’s Western integration efforts. On the other
hand, acquiescence to IMF demands would have meant playing on the reformist opposition’s
policy home-turf, while at the same time weakening Mečiar’s political support among reform
losers, who would have probably defected to other more outspokenly anti-reform parties.
Moreover, bowing to IMF pressures would have undermined Mečiar's populist image as the
“father of the people,” on which much of his electoral appeal rested. Finally, Mečiar was
probably aware that even in the event of a close relationship with the IMF, his government still faced an uphill battle in securing Western approval, given the country’s other outstanding problem areas, such as minority rights and corruption. Therefore, Mečiar opted for a more confrontational approach to IMF negotiations, a strategy which came at an economic cost but allowed him to play a much more familiar and electorally successful domestic role as a political maverick who defends Slovakia’s interests against a variety of outside threats. The resulting siege mentality had the added advantage of allowing Mečiar to paint his opponents as unpatriotic, and of justifying his semi-authoritarian governing style, which may explain the statistical findings about the positive relationship between democracy and IMF-style reforms in the post-communist context.

While some of Mečiar's public statements may be dismissed as inconsequential populist rhetoric,195 the actions of the Slovak government in late 1993 and early 1994 were largely consistent with this rhetoric. Even though Mečiar's ruling HZDS suffered a number of political defections and lost its political majority in mid-1993, the fragmented pro-reform opposition proved incapable of mounting a serious political challenge, which may have forced Mečiar to adopt more reformist policies. The situations further deteriorated when Mečiar managed to forge an alliance with the extreme nationalist Slovak National Party (SNS) in October 1993, which contributed to a further radicalization of the government's nationalist-populist stance. As a consequence the Slovak government dragged its feet in its IMF negotiations, resisting a number of unpopular conditions such as the increase in value added taxes (VAT) and the regulation of salaries.

Overall, Slovakia's failure to initiate a standby agreement with the IMF in the early post

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195 For example, Mečiar downplayed the Fund’s influence on Slovak economic policy making by claiming that the IFIs were expected “to fill just a consultancy role and make recommendations, which the government often does not observe, as the situation forces us to do something else” (cited in CTK, 11/24/1993).
independence period is consistent with the findings of the statistical model about the relationship between domestic economic crisis and ideology, which had indicated that at low inflation levels nationalist/populist and ex-communist governments were less likely to initiate IMF programs. Considering Slovakia's low inflation in 1993-4, Meciar’s ideologically motivated defiance of the IMF is consistent with the notion that in the post-communist context, anti-reform governments were likely to pursue their ideological leanings as long as they managed to avoid severe domestic crises. Since post-independence Slovakia never experienced triple-digit inflation, let alone hyperinflation, we can only speculate about whether Meciar would have relented to IMF pressures if his “original” reform recipe had produced a more severe and visible domestic economic crisis. What we do know, however, based on the discussion in Chapter 4, is that Meciar’s ideologically based disagreements with the Fund precluded an IMF agreement at a time when Slovakia's fragile external reserves would have predicted a more conciliatory approach by the Slovak government.

**IMF cooperation during the 1994 neo-liberal intermezzo**

The importance of partisan politics in driving Slovakia's relations with the IMF was further emphasized by the radical change of tone following the fall of the Mečiar government after a vote of no-confidence in March 1994. Immediately upon assuming office, the caretaker coalition government of Prime Minister Jozef Moravčík announced the resumption of negotiations with the IMF to obtain the second tranche of the June 1993 STF program and to sign a new standby agreement. Despite complaints by a prominent HZDS politician about the
softer IMF approach towards the new government, the new standby agreement signed in July 1994 by the Moravčík government included the same basic conditions, which had been rejected by the Mečiar government earlier in the year.\textsuperscript{196} Sergej Kozlik, one of Mečiar's deputies, described this process in amusingly rustic terms, comparing the IMF agreement to a cowpat in a field: “One person stops before it, the other treads in it. Whose boots are going to stink now? The Moravčík government's!”\textsuperscript{197}

Somewhat surprisingly, the inexperienced and highly fragmented coalition government managed to comply with IMF conditionality in the months preceding the September/October 1994 elections, and was rewarded by high praise and significant loan disbursements by the IMF and the World Bank. Nevertheless, Kozlik’s prediction was ultimately accurate, since the Slovak reformers paid the political costs of the austerity measures implemented as part of the IMF program by losing the elections in late 1994. While this electoral outcome was obviously driven not only by the politics of IMF conditionality but by the superior organizational capacity of Mečiar's HZDS and the fragmentation of the reformist camp, the situation nevertheless illustrates the difficult trade-offs between domestic political imperatives and external pressures in the context of IMF programs.

\textit{Back to confrontation - Mečiar's return to power}

Following his return to power, Mečiar formed a coalition with the right-wing Slovak National Party (SNP) and the extreme-left Association of Slovak Workers (ZRS). Given that the

\textsuperscript{196} (cited in \textit{CTK}, 6/20/1994)
\textsuperscript{197} \textit{CTK}, 6/20/1994.
former protested against “national impoverishment by international capital”, while the latter professed to be “basically against the EU, NATO and the IMF” (cited in The Economist 11/12/1994), this coalition exacerbated Mečiar's populist tendencies. Moreover, Mečiar's authoritarian governing style, which included attempts to control the mass media and the harassment of political opponents, limited the influence of the reformist opposition. The problem was exacerbated by the deep personal rivalries between Mečiar and many opposition leaders (Peter Weiss, Milan Knazko, Ján Čarnogurský), which precluded the formation of a more moderate governing coalition, as well as by the political infighting between the various opposition parties, who failed to pose a serious political challenge until the 1998 elections.

The country’s prudent fiscal and monetary policies during 1995-1996 led to a further decline in inflation (to single digits), which combined with the equally impressive economic growth (exceeding 6% per annum from 1995-1997) confirms the ability of the Mečiar government to manage the economy. Therefore, the failure to comply with IMF conditionality after the 1994 elections - as reflected by the fact that Slovakia did not receive any funding from the IMF during this period - cannot be blamed on institutional weakness but rather on the unwillingness to comply with “politically inconvenient” IMF conditions. Thus, the Slovak government’s repeated resistance against the reduction and elimination of the 10% import surcharge instituted in 1993 was in line with the nationalist and protectionist stance promoted by the Slovak finance minister Sergei Kozlik, who also resisted the sale of state assets to foreigners, based on his conviction that Slovakia “should prosper on the basis of its own resources.”

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198 Possibly the most prominent example of these tactics was in Mečiar's long-standing conflict with the Slovak President Michal Kovac, who played an important role in the non-confidence vote against the Mečiar government in March 1994. Thus, in August 1995 the Slovak Intelligence Service (SIS) allegedly kidnapped Kovac's son and handed him over to Austrian police, which was investigating him on a series of criminal charges. Other tactics included the publication by the SIS of forged documents according to which President Kovac was supposed to have stolen and illegally exported large sums of money (ERWI, April 1997).

Moreover, while privatization continued despite initial warnings about a complete moratorium and a possible reversal of privatization deals initiated by the Moravčík government, the privatization strategy favored direct sales over voucher privatization, and attracted intense criticisms about preferential treatments for Mečiar's political allies. Nevertheless, despite the somewhat bizarre situation in which the privatization minister Peter Bisak (a member of the extreme-left ZRS) opposed privatization of any kind, Slovakia emerged as one of the countries with the highest private sector shares (83% in 1998 according to EBRD estimates). Other politically motivated disagreements with the IMF during this period included welfare spending (raising the retirement age and reducing family benefits by 40%) and energy price controls.

_Implications and conclusions_

The country's surprisingly solid macro-economic stability and economic growth during this period suggests that the failure to comply with IMF conditionality cannot be traced to the pervasive institutional weakness, which has hindered economic reforms elsewhere in the region. Instead, the country's strained relationship with the IMF should be seen primarily as the result between the incompatibility between the strict prescriptions of IMF conditionality and the nationalist-populist agenda of Slovakia's leader Vladimir Mečiar in the context of the country's polarized domestic political scene. The importance of ideology in the Slovak case is further reinforced by the dramatic reversal of the country’s relationship with the IMF during the brief tenure of the reformist government of Jozef Moravčík. Thus, Slovakia's experience serves as a reminder that IMF conditionality and the Washington Consensus are not automatically imposed by external pressures even in small, vulnerable countries at the expense of interests and/or
convictions of domestic political actors.

**Moldova - the politics of an unlikely cooperation**

Whereas Slovakia under Mečiar illustrates the importance of partisan convictions and domestic political considerations as filters of IMF conditionality, Moldova's experience in the post-communist period may constitute the best example of a situation in which severe domestic and external economic crises contributed to a surprisingly successful and consistent implementation of IMF programs, despite an unfavorable domestic political situation and a weak institutional framework. Despite the dominance of former communists in both the governing and the main opposition party, and the high social and economic costs of reforms, the relationship between the Fund and the Moldovan government during the mid-1990s was remarkably close and cooperative (especially compared to the non-Baltic former Soviet republics). Thus, the Moldovan case illustrates the extent to which the political will arising from economic crisis helped governments overcome (at least in part) their ideological reservations about neoliberal reforms and the limited bureaucratic capacity to implement these reforms.

**The background: economic free-fall and political turmoil**

At the time of its independence declaration from the Soviet Union in August 1991 Moldova's economy displayed all the ingredients for disaster: a large, unreformed agricultural sector, an outdated, energy-intensive industry and an almost complete dependence on external energy. Since trade accounted for more than 50% of Moldova's GDP before the collapse of the Soviet Union, and the vast majority of this trade was directed to other Soviet republics
(Crowther 1996:128), the collapse of these markets in 1991-2 was fatal for large sectors of the Moldovan industry. The effects of this quasi-disappearance of traditional markets for Moldovan products were exacerbated by the *de facto* secession of the Transdniestra region in Eastern Moldova, where 40% of Moldova's industry and more than 80% of the country's energy generation capacity was located. The extreme dependence on external energy sources was not substantially reduced after independence (Bercu 1997:5), and generated high economic costs, given that starting in 1992 Moldova ceased to benefit from massively subsidized Russian energy prices, and as a consequence experience 40-fold rises in gas and petrol prices and a 100-fold increase in the price of coal (*World Bank* 1994:5-6).

The economic consequences of these structural difficulties were drastic even by post-communist standards. Thus, by the end of 2000, Moldovan real GDP (in constant prices) was at 34% of the 1990 level, making Moldova the poorest country in Europe with a GDP per capita of around $300 per year. Moreover - unlike other countries in the region, which have experienced sharp initial economic contractions - the Moldovan economy only started to show clear signs of recovery in 2001. The human costs of this economic crisis were equally drastic: real wages declined to about a quarter of their 1990 levels by the end of the decade, the access to healthcare and education was severely reduced particularly in rural areas, and the consumption of basic foods (meat, milk, eggs) declined by 50% by 1996, to levels which were less than half of those in Belarus (a country hardly renown for its prosperity...)200

While the structural weakness of the Moldovan economy and the high social costs of economic reforms hardly boded well for the prospects of compliance with IMF conditionality, the situation looked equally unpromising from an institutional perspective. Even though the Moldovan Central Bank has played an important and consistent role in promoting monetary

200For an in-depth analysis of the crippling social costs of Moldova's transition, see Orlova & Ronnas (1999).
stability (particularly after it achieved a higher degree of independence in 1995), other parts of the state apparatus have been notoriously weak. Thus, tax evasion has been consistently high due to the large size of the unofficial economy, the predominance of barter trade and the inability to enforce tax penalties on companies with significant tax arrears. Moreover, given the failure of the government to provide even basic services such as law enforcement, healthcare and education in many rural areas, the reach of state authority was drastically diminished throughout the country, not only in the regions with ethnic autonomy claims (Transdniestra and Gagauzia).

Another important obstacle to the design and implementation of coherent reforms was Moldova's lack of experts with relevant exposure to Western political and economic models. These problems were exacerbated by the massive braindrain in the post-communist period, during which as many as 600,000 of Moldova's 4.2 million citizens went abroad in search of better-paying jobs (Economist, 7/15/2000). Moreover, at least in the 1990-1992 period, Moldova had very limited access to Western economic advice, and was largely left to deal with its staggering economic and political problems on its own (Socor 1994, Orlova & Ronnas 1999). Arguably, this early isolation was due to the West's concern for stabilizing the geo-political situation in the disintegrating Soviet Union by preventing a possible unification between Moldova and Romania, and by encouraging Moldova first to stay in the Soviet Union and later to join the Commonwealth of Independent States.201

Finally, Moldova's post-communist transition has been significantly complicated by the repercussions of the ethnic conflict in Transdniestra, where a group of hard-line Communists under the leadership of Igor Smirnov have set up a quasi-independent break-away republic with

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201 According to Alexandru Mosanu, the head of the Moldovan parliament “we were pushed into CIS by several large Western powers. They have counseled us in this direction and even reproached us because we, as democrats, do not want to join the CIS.” (quoted in Gabanyi 1996:28)
direct and indirect support from Moscow. While the still-unresolved status of Transdniestr has played a crucial role in shaping Moldova's domestic politics and foreign policy during the 1990s, it has also negatively affected the country's economy in a number of ways: first, through the direct costs of the military confrontations in 1992; second, through the Moldovan government's inability to control and tax a large part of the country's industrial base; third, via the loss in potential foreign investments in the context of high political instability; and finally - and most ironically - through the accumulation of debts by the Transdniestr authorities, for which the Moldovan government was held responsible.

The politics of an unlikely cooperation

Moldova's economic policy during the early post-independence period was roughly in line with the dire predictions of its difficult structural legacy. Burdened by the disruptive effects of the Transdniestr conflict and the intense parliamentary debates about a possible unification with Romania, the Moldovan government pursued a largely ad-hoc economic policy. However, starting with the structural transformation facility (STF) program in mid 1993, Moldova embarked on one of the most ambitious economic reform programs in the region with the support of the IMF and other international financial institutions. Moldova's economic policy has

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202 Moscow did not just arm the separatist rebels, but units of the Russian 14th Army actually joined the Dniestr forces in their open battles with the Moldovan forces. (Crowther 1996:345)
203 For example, during the 1996 presidential elections, one of the key campaign promises of the former Communist Party Secretary Petru Lucinschi was that his close connections to the Russian would help him solve the Transdniestr problem. (RFE/RL, 12/30/1996)
204 In a remarkable display of cynicism, the Russian gas company Gazprom claimed that Moldova was fully responsible for the $300m debt owed by the Transdniestr authorities, given that Russia does not recognize Transdniestr as a sovereign state. (Central European, 9/1998)
been under quasi-permanent IMF supervision for the entire decade: after the first standby agreement of December 1993, Moldova almost immediately entered a second agreement in March 1995, which was followed in March 1996 by a three year Extended Fund Facility (EFF) program (extended later until May 2000) and finally by another three year Poverty Reduction and Growth Facility (PRGF) program signed in December 2000.

While far from perfect, the implementation record of successive Moldovan governments has been remarkably consistent, particularly compared to other countries of the region (Russia, the Ukraine, Belarus, Romania). Thus, the first stand-by agreement was fully implemented, and even though the IMF disbursed only three of the five planned tranches of the 1995 stand-by program, there was no conflict between the Fund and the government, as indicated by the quick agreement on the terms for the 1996 EFF agreement and the continuation of funding by the World Bank and the EBRD. Similarly, while the IMF postponed the disbursement of funding at several points during the 1996-2000 EFF program, these tactical delays were primarily targeted at specific conditions (e.g. land reform and the privatization of the wine and tobacco industry), while the Fund was careful to commend the Moldovan government for its progress with respect to the broader reform process. Moreover, the program never went completely off-track, as indicated by the resumption of lending after such delays in both 1997 and 1999.

Moldova's status as a model of harmonious IMF cooperation among the non-Baltic former Soviet republics is particularly striking, given that at least until 1998 its domestic political scene was dominated by parties and politicians with close ties to the Communist regime. Thus, the ruling Democratic Agrarian Party (PDAM) appealed primarily to a reform-shy rural electorate and relied on a network of collective farm chairmen, agronomists, rural mayors and district-level executive officials (Socor 1994:8). Moreover, the country's leading politicians -
President Mircea Snegur, Prime Minister Andrei Sangheli and the Parliament Speaker Petru Lucinschi - were all former high-ranking Communist officials, who, although relatively reformist, never officially broke with the Communist party (ibid:9). The prospects for reforms were further complicated by the prominent role of hardline Communists in Parliament, with the Socialist Party-Edinstvo claiming a quarter of the seats in the 1994 elections and the re-legalized Moldovan Communist Party winning almost 40% of the seats in the post-1998 parliament. The extreme Left not only rejected the “colonialism” inherent in Moldova's market reforms and accused the government of allowing the IMF to rule the country, but they even rejected Gorbachev-style reform Communism in favor of the “golden age” of the Soviet period (Munteanu 1997). Given that many of the extreme left's anti-reform ideas resonated with an impoverished and disillusioned Moldovan electorate, how can we explain the perseverance of the Moldovan government in pursuing IMF-style economic reforms, which seemed to contradict the ruling party's partisan and electoral interests?

The answer to this question actually conforms rather closely to the statistical findings about the importance of bureaucratic capacity and about the penchant of ex-communist parties to abandon their reform reluctance only in the face of extreme economic crisis. Thus, in the immediate post-independence period, Moldova’s economic policy was largely in line with its leaders' statist convictions205 and its extremely underdeveloped state institutions. However, after two years of dramatic economic decline, low international reserves and rising inflation (which exceeded 1000% by late 1992), Moldova's sharp policy turn towards IMF-style reforms confirms that sufficiently desperate ex-communist governments can overcome their ideological reluctance to neoliberal reforms and bridge even sizable governance gaps in order to preempt a complete economic breakdown. Similarly, the overtime decline in Moldova’s compliance record

205 According to Moldova's President Mircea Snegur cited in EIU (2nd quarter 1993).
illustrates the importance of severe domestic economic crisis as an impetus for IMF-style reforms, particularly in the case of ex-communist governments: thus, the close adherence to the targets of the first standby agreement of 1993 occurred in the aftermath of the raging inflation of late 1992/early 1993. Meanwhile, the more extended implementation lapse starting in late 1997 occurred in the context of single-digit inflation and a much more comfortable foreign reserve position, which suggests that as soon as the most immediate economic threats subsided, partisan concerns and bureaucratic capacity limitations once again played a more prominent role.

The economic and political repercussions of this unexpectedly close IMF cooperation by the reformed Moldovan ex-communists were decidedly mixed. On the economic front, the successes of bringing inflation under control and improving foreign reserves were counterbalanced by the poor growth performance and the rapid growth of foreign debt. Judged by the outcomes of the 1998 parliamentary elections, the political implications were even more intriguing: thus, on one hand, the ruling PDAM suffered a resounding electoral defeat, with many of its voters defecting to the re-legalized Communist Party (PCM), which gained almost 40% of the parliamentary seats on an outspokenly anti-reform and anti-Western electoral platform. On the other hand, the 1998 Moldovan elections did not replicate the dynamics of the 1985 Peruvian elections by catapulting anti-Western populists into power as a backlash against IMF-style austerity measures. Instead, Moldovan voters placed their trust in a broad reformist coalition, the Democratic Convention of Moldova (CDM), which had campaigned on a platform of accelerated economic reforms and Western integration. This remarkable outcome further confirms the greater patience of East European voters for reform-related economic hardships, and explains the positive relationship between democracy and program implementation revealed by the statistical results Chapter 5.
The story of Moldova’s unlikely neoliberal reforms in the 1990s, however, does not have a happy ending characterized by a virtuous cycle economic and political liberalism. Thus, the CDM’s efforts to accelerate economic reforms under IMF guidance were at best partially successful, as reflected in the government’s patchy compliance record with the EFF program it had inherited from its predecessor. The main political reason for this failure to live up to its electoral promises was the crippling internal conflicts between the different members of the governing coalition. Formed in opposition to the growing popularity of the hard-line Communists in the run-up to the 1998 elections, once in power the CDM spent too much time and energy on political infighting to be able to devise and implement a coherent economic reform program. As such, the succession of CDM governments between 1998 and 2001 provides a perfect illustration of the statistical findings about nefarious consequences of government fragmentation on the ability of reformist post-communist governments to implement the intended neoliberal reforms. This political stagnation was exacerbated by the absence of an immediate inflationary or external payments crisis, which could have rallied the supporters of more ambitious reforms; such an interpretation is supported by the fact that the most successful compliance episode of this period occurred in 1999, when inflation rose from single digits to over 50% during the course of the year, while foreign reserves fell once again below 2 months of imports. Finally, Moldova’s weak bureaucratic capacity became even more of a liability in the absence of an immediate crisis, especially in the context in which further reform progress had to include much more institutionally demanding structural reforms. This recognition arguably triggered the shift in late December 2000 to a lower-conditionality PRGF program, designed for developing countries for which standard IMF programs are too demanding.

After almost eight years of painful and inconclusive economic reforms under IMF
supervision, in the early elections of February 2001 the Moldovan voters finally handed a decisive electoral victory to the hard-line PCM, which won 70% of seats on a 50% vote share.\textsuperscript{206} Despite their electoral promises to reverse the country’s market-oriented economic policies, following their accession to power the Communists did not initiate a dramatic redirection of Moldova’s domestic or international trajectory along the lines of the Garcia government in Peru. In fact, the PCM government of Vasile Tarlev initially retained a number of technocrats from the outgoing reformist government of Dumitru Braghis, and continued to comply to a sufficient degree with the conditions of the PRGF government to ensure a positive Fund evaluation of the country’s monetary and fiscal policies and a disbursement of funding in July 2002. Even though the PCM government subsequently failed to secure further disbursements or to renew the program after it expired in 2003, it nevertheless continue to pursue a prudent fiscal and economic policy and attempted a renewed rapprochement to the West and the international financial institutions in 2005. Overall, even though it signaled the limits of popular patience with painful economic reforms, the return to power of the unreformed Moldovan Communists nevertheless confirmed that in the post-communist context the economic policy reverberations of electoral changes are likely to be relatively modest, at least for economically vulnerable countries like Moldova.

\textit{Bulgaria and Romania - the fragile political balance of IMF-style reforms}

Whereas the cases of Slovakia and Moldova were situated at opposite ends of the IMF interaction spectrum and illustrate how specific factors (nationalism/populism in Slovakia and

\textsuperscript{206} As in the case of the Romanian center-right a few months earlier, Moldova’s reformist incumbents managed to further deteriorate their precarious electoral standing by failing to unite forces and thus wasting almost 17% of votes due to the inability of various parties to cross the electoral threshold.
extreme economic vulnerability in Moldova) may “overpower” the effects of other political and economic considerations, Romania and Bulgaria can be considered more mainstream candidates for IMF programs. The reason for devoting this section to a comparison of the IMF programs of the two countries is that, despite after a remarkably similar political and economic trajectory prior to 1996, Bulgaria became the showcase example of IMF conditionality in the former Soviet bloc, whereas Romania experienced four years of inconclusive reforms in the context of a checkered IMF track record. This unexpected disjunction can be explained by the deeper preceding crisis in Bulgaria and the higher political cohesion of the Bulgarian reformers, as well as by a certain degree of path dependency in the evolution of reforms in the two countries. Therefore, I emphasize the fragility of the political balance underlying IMF-style reform efforts and the importance of context specific approaches to the design of IMF programs.

Common legacies (and some differences)

Among the former communist countries, Romania and Bulgaria are probably more similar to each other in terms of economic and political legacies than to any other country in the region. They share not only a somewhat marginal geographic position on the southeastern fringe of Europe, a long history of imperial domination (first under the Ottomans and later by the Soviet Union) and a border on the former Yugoslavia, which imposed significant economic and political costs at various points during the 1990s. Predominantly agrarian before World War II, both countries experienced a rapid industrialization process under Communism, and as a consequence, both Romania and Bulgaria inherited industrial sectors, which were inefficient and
energy-intensive even by Eastern European standards. These structural problems were exacerbated by the fact that, unlike Poland and Hungary, the two countries were ruled by hard-line Stalinists (Ceausescu and Zhivkov), who resisted the economic reforms and the political opening initiated under Gorbachev in the Soviet Union. As a consequence, compared to their former “comrades” on the Western fringe of the Soviet bloc, Romania and Bulgaria embarked on the difficult path of democratization and marketization with less developed civil societies and political parties, fewer Western-trained specialists and less hope of Western assistance, poorer populations and more distorted economies. In light of these difficult legacies, it should come as no big surprise that the politics of post-communist reforms in Bulgaria and Romania turned out to be more contorted than in the more advanced Central European reformers. As a consequence, whereas Hungary, Poland and the Czech Republic had successfully “graduated” from the IMF by the mid 1990s, Romania and Bulgaria became quasi-permanent IMF “pupils” with mixed and often unpredictable “grades” for most of the 1990s and beyond.

At the same time, however, Bulgaria's and Romania's legacies and post-communist prospects were not nearly as bleak as those of Moldova and other former Soviet republics (with the exception of the Baltics, and, to a certain extent, Russia). Even though both countries had significant and vocal ethnic minorities, they did not face the ethnic strife and territorial integrity threats of many former Soviet and Yugoslav republics. Moreover, being among the few independent states whose borders did not change after 1989, Bulgaria and Romania were spared the additional burden of creating state institutions from scratch, while at the same time pursuing

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207 These differences are summarized in a characteristically outspoken passage from *The Economist* (10/19/1996): “True Romania and Bulgaria were laggards even before Soviet power collapsed. Their North-Western neighbors, notably the then Czechoslovakia, had inherited more literacy, more education, more industry, more wealth and - even in Poland and Hungary - stronger traditions of democracy. Romania and Bulgaria remained predominantly rural, more brutal, more - to be candid - Balkan.”

208 The Hungarian minority in Romania accounts for 7.1% of the population, whereas in Bulgaria, Turks represent 9.4% of the population. Both countries also have large Roma (Gypsy) minorities, with estimates ranging from 2-10%, but so far the Roma have played a minor political role, due to the lack of effective ethnic Roma parties.
deep-reaching economic and political reforms. As a consequence, the quality of their administrative institutions, while significantly below Central European levels, was nevertheless noticeably better than in the non-Baltic former Soviet republics. Moreover, despite their second tier status among former communist aspirants to Western integration, both countries were closer to the Western than the Soviet orbit, and both gained at least some geo-strategic importance during the Yugoslav crisis (particularly Kosovo).

The most important difference legacy difference between the two countries was the evolution of their foreign debt during the 1980s. Even though the two countries had comparable indebtedness levels in the early 1980s, Romania under Ceausescu pursued an aggressive debt repayment strategy for most of the final decade of Communist rule, and as a consequence the country emerged essentially debt-free at the outset of the transition in December 1989. Thus, total external debt in late 1989 stood at only $1.1bn (or about 2.5% of real GDP) and was more than outweighed by the country's solid foreign and gold reserves, totaling $2.7bn. By contrast, in late 1989 Bulgaria had a crushing $10.1bn foreign debt (net of reserves) in an economy with an annual real GDP of just above $15bn. As a consequence, Bulgaria's debt service accounted for 63% of the country's export earnings in 1989, and put significant pressures on government finances throughout the 1990s. On the other hand, Romania's comparatively advantageous external position came at a substantial economic and political cost, given the draconian austerity measures instituted as part of the debt repayment efforts. Ceausescu's shock therapy of the 1980s not only ruined the economy (which contracted by almost 11% in 1988-1989), but the drastic reduction in consumption and social services during that period created an understandable aversion of large portions of the Romanian population towards economic policies requiring further living standard sacrifices. (Daianu 1997) These differences in indebtedness and popular
attitudes towards austerity measures may explain why reformers came to power in Bulgaria in late 1991 (though their government collapsed after less than a year), whereas in Romania, the reformist opposition had to wait until 1996 to assume power.

The politics of partial reforms in the early transition period

Prior to the watershed elections of late 1996 in Romania and early 1997 in Bulgaria, the two countries' economic and political trajectories were remarkably similar. Following the collapse of their respective hard-line communist regimes, both Romania and Bulgaria witnessed the return to power of only marginally reformed communist successor parties - the National Salvation Front (FSN) in Romania and the Bulgarian Socialist Party (BSP) in Bulgaria - following free but not entirely fair elections in 1990. As a consequence, no real reform efforts were made during the first year of post-communism, but the rapidly rising economic imbalances eventually led to the collapse of the BSP government in Bulgaria in November 1990 and to the strengthening of the reformers (under the leadership of Prime Minister Petre Roman) within the ruling FSN in Romania. Both countries turned to the IMF in early 1991 and made a first attempt at liberalization and stabilization for the remainder of the year. Even though both reform programs made some significant progress and were rewarded by several IMF disbursements, stabilization was ultimately unsuccessful, largely due to high levels of political instability. In Bulgaria, the interim government of Dimitar Popov struggled with its lack of a clear political mandate and was eventually replaced following the parliamentary elections of October 1991, in which the pro-reform Union of Democratic Forces (SDS) emerged victorious but without an
absolute parliamentary majority. In Romania, in September 1991, bands of miners, protesting against the government's reformist economic policies, rioted through Bucharest and even occupied Parliament in an eventually successful attempt to overthrow the government of Petre Roman. Even though Roman's successor, Theodor Stolojan, was a politically unaffiliated, reform-minded technocrat, the riots had longer-term reverberations on the political prospects of Romanian economic reforms, since they eventually precipitated a split in the ruling FSN between a more reformist camp around former Prime Minister Roman and a more hard-line leftist group loyal to President Ion Iliescu.

Despite a number of country-specific variations, the same pattern of stop-go reforms, punctuated by IMF pressures, popular resistance and political instability continued throughout the early transition period in both countries. Thus, during 1992 the newly instated SDS government of Filip Dimitrov pursued an ambitious economic reform strategy in conjunction with a stand-by agreement with the IMF signed in April, and with the longer-term goal of deepening structural reforms by entering an Extended Fund Facility later in the year. However, the austerity measures led to widespread popular protests and contributed to the dissolution of the fragile alliance between the ruling SDS and the predominantly Turkish Movement for Rights and Freedom (DPS), on whose tacit support the survival of the Dimitrov government depended. As a consequence, the Dimitrov government resigned, leading to a protracted political crisis and the suspension of IMF support in October 1992. The new government, headed by the independent Lyuben Berov, with the tacit support of the BSP and the DPS, as well as a breakaway faction of the SDS, tried to balance the conflicting imperatives of Bulgaria's increasingly pressing debt burden, whose resolution required IMF support and, hence, an acceleration of economic reforms, and the debilitating political constraints of a government
without a clear power base in either parliament and society. Even though the Berov government, pressed by increasingly urgent debt rescheduling negotiations with the London Club, initiated a new IMF agreement in April 1994 and attempted to implement an austere budget for the year, the rising political costs of the austerity measures yet again undermined the reform program, leading to the fall of the Berov government in October 1994 and the suspension of IMF credits shortly thereafter. The ensuing parliamentary elections in December 1994 produced a narrow majority for the leftist BSP, which captured 125 of the 240 seats in parliament and was able to form a government under a young reform-Communist, Zhan Videnov. However, after a brief period of relative political stability in 1994 and the first half of 1995, Bulgaria's increasingly weak external position and economic performance during 1996 precipitated a renewed political crisis at the end of 1996, leading to the resignation of the Videnov government in February 1997, following several weeks of severe economic crisis and massive anti-government demonstrations.

During the same time period, political instability was slightly lower in Romania but the underlying conflict between reformers and reform opponents in the context of economic crisis and external conditionality yielded a very similar stop-go pattern of economic reforms. Thus, in the spring of 1992 the caretaker government of Theodor Stolojan negotiated a new standby agreement and managed to comply with IMF conditionality long enough to obtain three tranches of the standby loan between June and November 1992. However, inflation for the year still ran at more than 200%, partially because the Romanian economy reacted poorly to the demand restraint measures and contracted by almost 10% for the year, creating stagflationary pressures. Also, the political pressures of the electoral campaign for the October 1992 general elections interfered with the reform program of the Stolojan government, and the victory of the leftist Party of Social Democracy (PDSR) resulted in a renewed slowdown of the reform momentum.
and in the suspension of IMF support. The political environment of economic reforms was further undermined by the failure of the victorious PDSR to forge an alliance with the pro-reform opposition clustered around a heterogeneous center-right coalition, the Democratic Convention (CDR). As a consequence, the PDSR formed a minority government led by a nominally independent technocrat, Nicolae Vacaroiu, with the tacit support of four small extremist parties: the nationalist, Transylvania-based Party of National Unity (PUNR), the ultranationalist/xenophobic Greater Romania Party (PRM), the barely reformed Communist-leaning Socialist Work Party (PSM) and the somewhat more moderate Democratic Agrarian Party (PDAR). Even though, despite predictions to the contrary and a number of serious governmental crises, the Vacaroiu government managed to hold on to power for the four years of its mandate, it did so by pursuing an uneven and often inconsistent reform policy, characterized by alternating episodes of orthodox reforms and populist measures meant to buy political support either from its anti-reform, anti-Western parliamentary allies or from its equally anti-reformist electorate. Predictably, the Romanian government's relationship with the IMF was equally mixed during this period: after almost a year of avoiding IMF conditionality in the aftermath of the 1992 elections, the Vacaroiu government eventually responded to the rising inflation, which exceeded 300% by late 1993, and, in line with the statistical findings in Chapter 5, initiated and implemented a relatively successful stabilization under IMF guidance in mid 1994. Ironically – but once again in line with the region-wide statistical patterns – this rapid success undermined the longer-term macroeconomic stability prospects, since they gave the PDSR government the opportunity to pursue a Mečiar-style eclectic approach to reforms and IMF cooperation in 1995-6 in the context rapid growth, moderately successful fiscal and monetary policies and populist/nationalist tendencies resulting from the alliance with the red-brown satellite parties and
the electoral challenges in the months prior to the 1996 elections.

*The prelude to political change: partial reforms and crisis in 1995-6*

Despite the stop-go approach to reforms during their tenure, the leftist governments of Romania and Bulgaria scored some initial successes in terms of controlling inflation and promoting economic growth, particularly during late 1994 and 1995. Thus, under the Vacaroiu government recorded four years of continuous economic growth between 1993 and 1996, including a 7% rise in GDP in 1995 and 4% increases in 1994 and 1996. Moreover, inflation slowed in mid 1994 and averaged less than 40% during 1995 and 1996, despite an electorally driven acceleration of inflation at the end of 1996. Even the less successful Videnov government in Bulgaria recorded positive growth 2.8% in 1995, in conjunction with a reduction of inflation to just above 60% in the same year. While hardly spectacular in absolute terms, these achievements were remarkable considering the two governments' poor reform records, and led to somewhat of a puzzle among foreign observers, given that Romania and Bulgaria were the only two transition economies to have experienced a return to growth prior to achieving successful stabilization. (Fisher et al 1996, Gerloff 2000)

*Bulgaria in free-fall*

However, the sustainability of these “half-way reform miracles” turned out to be limited, particularly in the Bulgarian case. In line with the theoretical expectations of a relatively stable anti-reform government facing only moderate financial pressures and with weak institutional capabilities, the Videnov government failed to comply with the conditions of the 1994 standby agreement, which led to the IMF’s suspension of credits. For most of 1995, the Videnov
government, while not rejecting IMF negotiations altogether, resisted IMF pressures for an acceleration of structural reforms, particularly with respect to loss-making SOEs and the struggling banking sector. Instead the Bulgarian government tried to live up to its contradictory campaign promises of reducing inflation, while at the same time stimulating employment. It did so, with some initial success, by pursuing an expansionary credit policy, while counteracting inflationary pressures through price controls. Predictably, the high quasi-fiscal deficits due to the extension of easy credits to loss-making SOEs further weakened Bulgaria's fragile banking sector, as illustrated by the high ratio of non-performing assets on the commercial banks' balance sheets and the failure of the Vitosha Bank for Agricultural Credit in early 1996, followed by two other banks later in the year.

The domestic economic problems were exacerbated by Bulgaria's increasingly vulnerable external position due to the rapid decline of foreign reserves from $1.5bn in August 1995 to below $700m in April 1996 and the large projected debt service amounting to $1.25bn in 1996 and 1.6bn in 1997 (EIU Country Report 2nd quarter 1996). Despite Bulgaria's positive trade and current account balance in the previous year, it became increasingly clear that the country would not make it through the following months without the support of the IMF and the World Bank. Facing the immediate danger of default, in July 1996 the BSP government acquiesced to IMF conditionality and signed a stand-by agreement, which included austere fiscal and monetary policies, drastic energy price increases, as well as a commitment to deepening structural reforms (including a enterprise closures leading to the loss of at least 40,000 jobs, as well as a program to recapitalize the struggling commercial banks). However, facing opposition from labor unions and from within the ruling BSP, and hampered by the inherent difficulties of rapid structural reforms in a weak institutional environment, the Videnov government soon fell behind in its
commitments to industrial and financial sector restructuring, which prompted the IMF to stop the disbursement of funding in August 1996.

The developments during the following six months precipitated an economic and political crisis of major proportions, which led Bulgaria to the brink of chaos. Thus, as currency reserves continued to drop in the absence of multilateral funding, the Bulgarian National Bank was increasingly limited in its ability to intervene in foreign exchange markets. The resulting rapid devaluation of the Bulgarian lev further fueled inflation, which reached an annual rate of more than 250% by the end of the year, and degenerated into hyperinflation in the first two months of 1997. At the same time, in its attempts to control inflation, the government raised interest rates drastically in late 1996, which contributed to the further weakening of the banking sector209 and to a deep recession, with the economy contracting by more than 10% compared to 1995. In November 1996 the IMF started to insist that the only solution to Bulgaria's economic woes was the introduction of a currency board, which would have pegged the Bulgarian currency to a foreign currency (the German D-Mark or the US Dollar) under the supervision of an independent Currency Board replacing the Bulgarian Central Bank as the country's supreme monetary authority. Even though the appropriateness of currency board as a solution for countries with chronic financial instability was debated even within the IMF and was certainly at odds with the BSP's policy preferences (since it essentially abolished the government's ability to influence monetary policy), Prime Minister Videnov appeared willing to accept it as an inevitable measure necessary for IMF support and the avoidance of debt default and complete economic chaos.

Videnov's sudden willingness to accommodate drastic IMF reform conditions illustrates

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209 In addition to the five banks (including a major state bank) involved in bankruptcy proceedings since June 1996, nine other banks were placed under close government supervision in September and the Bulgarian minister for economic development, Rumen Gechev, admitted in late October that only 14 of the country's 44 banks could be considered stable. (cited in EIU Country Report, 4th quarter 1996).
the importance of IMF influence and the relative weakness of ideological convictions in situations of extreme financial crisis during the post-communist transition. However, as things turned out, Bulgaria did not emerge as a second Moldova, with former Communists in the unlikely role of orthodox neoliberal reformers under the close guidance of the IMF. Part of the explanation may have been the IMF's reluctance to trust the BSP government with the implementation of the Currency Board, not only given the BSP's mixed track record in implementing painful reforms but also due to the low likelihood that the compromised BSP leadership could achieve the broad political and societal consensus necessary for such a fundamental economic decision. (EIU Country Profile, 4th quarter 1996). The extent to which the IMF has tried to actively affect Bulgarian domestic politics is difficult to assess. However, several facts suggest at least an indirect influence of the IMF stance on the domestic power balance in Bulgaria. Thus, the head of the Bulgarian opposition, Ivan Kostov, met with high-ranking IMF officials in Washington shortly before the signing of the July 1996 standby agreement, and declared that the West did not see the Bulgarian government as a suitable negotiation partner (cited in Sofia Kontinent, 7/3/1996). Seen from this perspective, the IMF's tough approach to conditionality, with respect to both structural reforms and the currency board, seems to confirm that by late 1996 the Fund was not willing to give the embattled Videnov government much breathing space.

On the other hand, even in the context of a more flexible IMF conditionality stance, it is unclear whether the Videnov government (or any other BSP successor government) could have exercised sufficient political authority to bring the country's economic free-fall under control. Thus, following the sound defeat of the BSP candidate, Ivan Marazov, in the presidential elections of November 1996, Videnov's position within his own party became increasingly
vulnerable, and he resigned at the Party Congress on December 19, after weeks of internal conflicts between different factions within the BSP. Following Videnov's resignation, the BSP tried to form a new government under the former Interior Minister Nikolai Dobrev, which included more than half of the ministers of the outgoing Videnov government. This decision prompted not only vehement protests from the opposition but also several weeks of violent street protests throughout the country. In the face of a virtually ungovernable country and an imminent economic disaster (with inflation in January exceeding 40%), the BSP finally agreed to the creation of a non-partisan interim government under the leadership of Stefan Sofianski, the mayor of Sofia. The parliamentary elections in April 1997 reflected the dramatic decline of the BSP, which obtained less than a quarter of votes and parliamentary seats, whereas the center-right coalition between the SDS and two minor coalition partners received 52.3% of the vote, and thus obtained 137 of the 240 parliamentary seats. Given that the BSP has yet to recover from this blow more than four years later - their vote share dropped to 17% in the 2001 elections - the crisis of 1996/97 seems to have marked the end of Bulgaria's experiment with “selective” stop-go reforms and emphasizes the narrow maneuvering room for such policies in an economy with Bulgaria's debt burden and external vulnerability. As I will argue below, the severity of the 1996-7 crisis emphasized (in the eyes of both the elite and the electorate) the utter failure of the BSP's approach to solving Bulgaria's economic problems, thereby paving the way for the thorough reforms of the following four years.

Romania's inconclusive crisis

Unlike the catastrophic economic performance of the Bulgarian economy in the last year
of the Videnov government, Romania's evolution prior to the 1996 elections is much harder to evaluate. As mentioned earlier, for most of the 1994-6 period Romania performed remarkably well in terms of both its growth performance (with cumulative growth of 15.7% for the three years) and with relative macroeconomic stability starting in mid-1994, even though inflation started to rise to more than 50% towards the end of 1996, largely due to the expansionary policy pursued by the PDSR government prior to the October 1996 elections. As a consequence the degree to which Romania was headed down the same road of growth reversal and financial turmoil as its Southern neighbor remains an unresolved question, given that the PDSR's loss of the 1996 elections led to a drastic change in economic policy, meaning that the country's post-1997 performance cannot be considered as a “natural” outcome of the PDSR's earlier economic policies. Rather than engaging in a full-blown analysis of the sustainability of Romania's partial reform trajectory in the unrealized scenario of a continuation of PDSR rule after the 1996 elections, this subsection will attempt to identify some of the structural problems confronting the Romanian years during the final years of the Vacaroiu government. This analysis will proceed within the broader context of the country's relationship with the IMF and international financial markets, and it will identify the economic and political implications of the PDSR legacy for the prospects of reforms under the new center-right CDR government after the 1996 elections.

Following the successful stabilization of mid-1994 and a rather comfortable external reserve position at the end of 1994 (with international reserves in excess of $3bn, corresponding to 3.1 months of imports), the PDSR government faced relatively low external pressures for most of 1995, especially since the country managed to gain access to international capital markets by securing a loan from Citibank in March 1995. This relatively low financial dependence on the IMF, combined with the Fund's tough negotiating stance on structural reforms and fiscal
discipline and the PDSR's efforts to pacify its nationalist coalition partners contributed to a relatively strained relation between the Romanian government and the IMF during 1995. When the IMF postponed the disbursement of an outstanding Structural Transformation Facility (STF) tranche in March 1995 due to the slow progress with structural reforms, the Romanian minister for economic reform, Mircea Cosea complained that the IMF and the World Bank had insufficient understanding of the Romanian situation and that their imposition of unnecessarily harsh measures risked pushing the East European countries back to Communism. (cited in EIU Country Report, 2nd quarter 1995) However, towards the end of the year, the rapidly rising current account deficit put serious pressures on the Romanian currency and led to a significant reduction in the country's foreign reserves (with international reserves of 2.6bn or 2.8 months of imports), prompting a temporary rapprochement with the IMF, which resulted in the extension of the 1994 standby agreement and the disbursement of a funding tranche in December 1995.

The parallels between the Romanian and the Bulgarian governments' relationships with the IMF during 1995-6 go beyond the pattern of initial resistance to conditionality due to relatively strong external positions and economic performance, followed by rapprochement with the Fund in the face of external and internal economic imbalances. Despite a number of important differences (which will be discussed below), the evolution of the PDSR's interaction with the Fund in 1996 mirrors several important elements of its Bulgarian counterpart's efforts to balance external needs and political constraints in the context of IMF conditionality. Even though Romania's smaller foreign debt and its better access to private capital markets made it somewhat less dependent on IMF approval than Bulgaria, the Romanian government nevertheless had few hopes of financing its large current account deficit without securing IMF approval, given that more than half of Romania's debt was owed to multilateral institutions
(including the IMF) and that even the access to private capital was likely to suffer significantly in the case of an open conflict with the IMF. Therefore, like in the Bulgarian case, the IMF used its high leverage over the Romanian government to impose tough conditions for the December 1995 standby agreement, including a 2.2% budget deficit, a reduction in bank credits and wage increases, substantial financial sector reforms and the elimination of foreign exchange restrictions.

Like in the Bulgarian case, the Vacaroiu government initially tried to fulfill the requirements of the IMF program, and scored some early successes by reducing inflation to a monthly average of 1.6% for the first three months of 1996. This relative financial discipline, resulting at least in part from the breakdown of the governing coalition of the PDSR with its nationalist/communist satellite parties, proved short-lived and was soon undermined by the governing party's political considerations in the context of the approaching general elections. In an increasingly desperate effort to pacify the Romanian electorate, the Vacaroiu government tried to maintain the subsidies to troubled state-owned enterprises in both industry and agriculture, and tried to boost living standards by allowing nominal wages to grow at a higher rate than inflation. To control the inflationary pressures of these expansionary fiscal policies, the Romanian authorities delayed the elimination of foreign exchange restrictions and accelerated the build-up quasi-fiscal deficits by ordering state banks to give generous credits to SOEs. Predictably, these policies drew harsh criticisms from the IMF on a number of occasions and eventually led to the suspension of the stand-by agreement in July 1996. However, the costs of these IMF sanctions were mitigated by the unexpected decision of the World Bank continue to disburse substantial funding to Romania even after the IMF's criticism of Romanian economic policies, as well as by Romania's successful international bond issues amounting to more than a
billion dollars in 1996. Therefore, the 1995-6 standby agreement illustrates the importance of effective signaling mechanisms in ensuring compliance with IMF programs, particularly in situations where the government's policy preferences diverge significantly from those of the IMF.

The slowdown of reforms mirrored the domestic political developments during 1996. Until March 1996, the PDSR and its presidential candidate, Ion Iliescu, seemed well positioned to win the upcoming elections and appeared inclined towards forming a possible governing alliance with the center-right opposition instead of its traditional extremist allies. Such an alliance would have facilitated a smoother Western integration, while at the same time avoiding a sharp break with the PDSR's gradualist reform strategy. However, during the final weeks of the electoral campaign, the PDSR adopted an extreme nationalist/populist rhetoric, which included warnings about the danger of secessionist movements by the Hungarian minority in Transylvania and the traditional claims about the need for reform with a human face. The motivations for the surprisingly drastic left-turn of the PDSR illustrate the complex interaction between IMF conditionality and domestic politics in program countries. Arguably, the tough and uncompromising stand of the IMF towards the Vacaroiu government played an important role in the PDSR's decision to pursue the nationalist/populist strategy during the 1996 elections instead of its original centrist approach in the spring of 1996. In order to succeed electorally as a centrist party, the PDSR needed a positive “report card” from the West, which was particularly important in the context of the overwhelming popular support for Western integration. At the same time, however, the PDSR could not afford to veer too far to the right in its attempts to win Western approval, given its traditional voter base among the reform losers and employees in the struggling state sector. However, the IMF's demanding conditions left very little maneuvering
room for the PDSR government, particularly because the 20% inflation target was difficult to
achieve in conjunction with some of the other program conditions, such as price and foreign
exchange liberalization. Moreover, the IMF's decision to suspend funding in March, barely three
months into the program, combined with the timing of a strongly worded condemnation of
Romania's economic policies on June 19 (between two rounds of local elections), made it
increasingly difficult to claim Western recognition of the PDSR government's achievements.210

While domestic factors, such as the centrist opposition's repeatedly emphasized refusal to
consider a coalition government with the PDSR after the 1996 election, obviously contributed to
the PDSR's policy shift, Romania's relationship with the IMF during 1996 illustrate how
excessively tough IMF conditionality may be counterproductive, since it raises the political costs
of reforms to the point, where the government prefers to implement its status quo policy. On the
other hand, IMF conditionality may have played an important role in the narrow victory of the
center-right opposition in November 1996, thereby paving the way for a more decisive break
with the gradualist reform strategy of the PDSR in the 1993-6 period.

The economic legacy of the PDSR rule is somewhat difficult to assess, and the resulting
ambiguity had important repercussions for the prospects of subsequent economic reforms in
Romania. On one hand, there is little question that the policies pursued in the pre-election
months would have been unsustainable in the long run, given the country's declining foreign
reserves and the need for IMF approval to continue accessing private capital markets (from
which Romania had borrowed more than $1.5bn in 1996). Moreover, the delay of banking
reform211 and the widespread use of preferential credits to subsidize loss making sectors, led to

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210 These problems were exacerbated by the increasing realization that Romania was relegated to the second tier of
NATO and EU expansion, which the Romanian opposition exploited during the electoral campaign.
211 By the end of 1996 privatization in the banking system had basically not started, as illustrated by the fact that
Romania's state banks still accounted for 78% of total banking sector assets.
massive non-performing loans in the portfolios of many state banks. The bulk of the bad loans in Romania's banking sector were due to two banks, Bancorex and Banca Agricola, which together accumulated by early 1997 a total of US $2.25 billion of bad loans - an equivalent of about 6% of GDP. On the other hand, it is unlikely that Romania would have experienced a crisis of Bulgarian dimensions, and – more importantly – the full repercussions of the PDSR’s partial reforms were not nearly as apparent by the time the 1996 elections transferred the responsibility of governing and cleaning up the mess to the center-right opposition.

*Explaining the post-1997 disjunction*

Following their accession to power in late 1996/early 1997, the pro-reform coalitions of Romania and Bulgaria initiated immediate and ambitious economic reform programs in close coordination with the IMF. However, whereas the Bulgarian government successfully implemented its 1997 standby agreement and then continued to be the IMF “poster child” for exemplary program implementation by initiating and carrying through a three-year Extended Fund Facility (EFF) program between 1998-2001, Romania's reform trajectory during the same period was marked by a series of costly and ineffective partial reform efforts, which resulted in an equally lukewarm response on behalf of the IMF. Thus, following the failure of the initial standby agreement in the fall of 1997, the Romanian government failed to secure a new agreement until mid-1999, when the country faced severe balance-of-payments difficulties. However, even under strong external pressures, the government's implementation record was

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212 Romania was helped by the fact that its relative debt burden was still low by late 1996 and that its banking crisis was not as serious as in Bulgaria (*EIU Country Report*, 3rd quarter 1996).
unimpressive, resulting in the disbursement of only two more tranches of IMF funding in August 1999 and June 2000 prior to the government's decisive defeat in the elections of November 2000. What accounts for this remarkable disjunction, given that the two countries' trajectories had been so similar until 1996, and given that the two countries resembled each other in terms of both economic structure and in terms of the political objectives of their respective governments? Below, I will argue that the disjunction can be explained by a set of political and institutional constraints, which were reinforced by the nature of IMF conditionality, and which can be largely traced back to the variations in the extent of the economic and political crisis preceding the initiation of reforms.

*The initial reform wave - coping with shock to get to therapy*

For most of 1997 both the Bulgarian and the Romanian government attempted to work through the vast reform backlog left behind by their Socialist predecessors, and they did so by replicating the shock therapy approach the Balcerowicz government had implemented in Poland in 1990. Thus, the Ciorbea government in Romania, in close cooperation with the IMF, launched a reform program, whose sweep was more radical than any of the previous shock therapy initiatives tried elsewhere in the region (*EIU Country Report*, 1st quarter 1997) and included the standard policy package of monetary and fiscal austerity, trade, exchange rate and price liberalization, combined with ambitious privatization and restructuring measures. The Bulgarian program also included the setup of a Currency Board, whose details were finalized in June 1997, thereby creating a powerful commitment mechanism for Bulgarian policy makers. As expected, the short term effects of these programs were drastic, with sharp declines in output (of about 7%
in 1997 for both countries), lower real wages and consumption levels, and rising poverty and unemployment. However, by mid-year both countries seemed to have achieved their stabilization goal, with monthly inflation declining to below 4% in July 1997.

Starting in the fall of 1997, however, the reform trajectory of the two countries started to diverge, with Bulgaria staying comfortably within the parameters of its standby program, whereas Romania's started to slip. Since the difference during the first year cannot be attributed to greater popular resistance to painful reforms, I argue that the failure of the Romanian reforms in late 1997/early 1998 can be explained by the gap between an overly ambitious IMF-inspired reform agenda and the limited institutional capacity and political cohesion of the Romanian government. To start, there is little doubt that the designers of the Romanian reform program in the spring of 1997 had underestimated the negative response of the Romanian economy: instead of an expected mid-year recovery, the economy continued to plummet in the second part of the year for a total decline of almost 7%, almost three times higher than initially forecast. By contrast, the Bulgarian economic contraction was concentrated in the first few month of the 1997 (largely before the SDS government took office in April), and by mid-year Bulgaria had returned to growth, which was to continue (admittedly at moderate rates) for the next three years.

While a more detailed explanation of these differences is beyond the scope of the present discussion, the consequences of this growth differential were important for both economic and political reasons. From an economic point of view, the unexpected depth of the Romanian

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213 According to the Soros Public Opinion Barometer in March 1998 the Romanian government was still viewed positively by more than half the population.
214 In defense of the IMF it should be said that other external observers were equally overoptimistic about Romanian economic prospects: thus, in May 1997 the reputable EIU Country Report predicted that a recession could be avoided due to healthy growth in the second part of 1997.
215 One may speculate that Bulgaria's 10% contraction in the previous year had already started the process of “shrinking back to healthy growth.”
recession led to significant stagflationary effects, which undermined the government's efforts to control inflation, thereby creating problems with IMF target fulfillment. Politically, the rapid return to growth of the Bulgarian economy was an important factor in convincing both politicians and the public that reforms were working, which contributed to a virtuous cycle of political commitment to reforms and good economic performance, and was reinforced by the significant capital inflows associated with the Fund's approval of Bulgarian economic policies.

By contrast, Romania entered a vicious cycle, in which poor growth exacerbated political conflicts within the ruling coalition, which in turn led to incoherent economic policies and low levels of external financing. In other words, I argue that the crucial juncture occurred at some point in late 1997, when the Bulgarian government managed to consolidate its reform gains by starting negotiations for the 1998 EFF program and slowly moving from shock to therapy, whereas the Romanian government slipped into political infighting and lost the momentum necessary to fulfill the demanding conditions of the IMF reform program. While it is unclear whether adhering religiously to IMF prescriptions would have led to similarly successful outcomes in Romania as it did in Bulgaria, there is little doubt that Romania's post-1997 reform strategy (or lack thereof) seems to have achieved the worst of both worlds, with high social and economic costs and low benefits (at least in terms of IMF recognition and funding).

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216 Varujan Vosganian, a Romanian economist, argues that the excessive focus on demand-side determinants of inflation ignored the serious supply-side effects of the adjustment process, which meant that even though money supply declined in real terms, inflation continued to grow due to the even faster decline of output (1999:145-146).

217 Thus, from 1997-2000, Bulgaria received over $1.36bn from the IMF, compared to only $350m for Romania. Moreover, FDI in Bulgaria increased by almost 400% in 1997 and by 2000 it was almost nine times higher than in 1996. (EIU Country Data)

218 With the exception of a large (and excessive) initial inflow of funding in 1997, Romania suffered net capital outflows between 1998-2000, partially due the negative effects of the Russian crisis in 1998 and the Kosovo crisis in 1999.

219 After all, the IMF medicine seems to have worked better in Bulgaria than in Romania even before the Romanian reform program derailed in late 1997.

220 Elsewhere (Pop-Eleches 2001) I have argued that despite their numerous failures, the successive center-right governments of the 1997-2000 period made significant progress with fiscal reforms and financial sector restructuring, as well as, to a lesser extent, with state sector restructuring and privatization.
The fragile equilibrium of reform: political and institutional factors

Given that the prospects for successful economic reforms in Romania declined steadily starting in mid-1998, due to the increasing popular distrust in the CDR-led coalition government and the rising popularity of the PDSR and other anti-reform parties, the present discussion will focus primarily on the “honeymoon” period, during which the reformist government appeared to have a strong reform mandate following its victory in the 1996 elections. In addition to the already discussed overly ambitious reform targets of the 1997 economic program, I argue that the Romanian government’s reform efforts were hampered by two structural factors: government fragmentation and weak institutional capabilities.

The first factor, government fragmentation, has been frequently invoked in the Romanian media as the prime reason for the country’s economic woes, largely because the constant political infighting between the coalition partners became an everyday aspect of Romanian public life. Ironically, the roots for this political paralysis go back to the fact that things under the PDSR had not been nearly as bad as under the BSP in Bulgaria. Given that at the time of the 1996 elections there were few obvious signs of an imminent economic crisis, the PDSR defeat in the 1996 elections was not nearly as devastating as the BSP loss in Bulgaria in April 1997. Even though the two parties obtained almost identical vote shares (around 22%), the PDSR’s position in parliament was comparatively stronger, given that the election winners, the Democratic Convention (CDR), a broad center-right coalition, had only obtained 30% of the vote, and had to form a coalition with the center-left Democratic Party (PD) led by former Prime Minister Petre Roman and with the ethnic Hungarian Democratic Union in Romania (UDMR). The relative
ideological heterogeneity of this coalition was exacerbated by the lack of a strong leadership in the CDR, which had not recovered after the death of Corneliu Coposu, the leader of the National Peasants' Party (PNTCD), in late 1995. Meanwhile, in Bulgaria, the victorious SDS not only commanded an absolute majority in parliament (even without the support of its minor coalition partners) but the party had become a great deal more cohesive in the months preceding the 1997 elections, aided by the BSP's catastrophic governance and the good organizational capabilities of the SDS leader, Ivan Kostov.

When the economic and political costs of the radical reforms became apparent in mid-1997, the heterogeneity and fragmentation of the Romanian government started to become an obstacle for the implementation of the IMF program, as the two minority coalition partners threatened to withdraw their support for the Ciorbea government. While some of these conflicts had no direct connection with the IMF program, others were driven by the PD's concern about the rising social costs of economic reforms, and thereby contributed to the more cautious approach to restructuring in late 1997. However, despite growing IMF criticisms about the slowdown of structural reforms in October 1997, the fatal blow to Romanian reforms was the intense and protracted governmental crisis, which started with the PD's withdrawal from the Ciorbea government in late December and did not subside until Ciorbea's resignation and his replacement with Radu Vasile in April 1998. During the three months of political paralysis, economic reforms were stalled, leading to the suspension of funding under the 1997 IMF standby agreement. Since the incoming Vasile government was unable to negotiate a new agreement until mid-1999, the governmental crisis of late 1997 can effectively be considered the death knell of rapid reforms in Romania. By contrast, the Bulgarian government, admittedly facing more

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221 Thus, the PD and the CDR disagreed over the size of land restitution, the UDMR was primarily concerned with the fulfillment of its ethnic rights claims, and many of the disputes were of a purely personal nature, such as the conflict between Prime Minister Victor Ciorbea and the PD Minister of Transport, Traian Basescu.
favorable economic and political conditions, was able to keep a united front through the first three years of reforms, which helps explain its remarkable consistency in IMF program implementation.

Turning to the second structural factor, weak institutional capabilities, the Romanian case provides rather convincing evidence that part of the problem was not that the government did not want to implement reforms but that they did not know how to go about it. Since, with the exception of a few PD leaders (who had participated in the pre-1992 FSN government), most members of the post-1996 cabinets had very limited policy-making experience, it is hardly surprising that the CDR government had a difficult time handling the complex challenges of economic reforms, particularly with respect to privatization and restructuring.222 In this respect, it is telling that in November 1997 the Minister of Reform, Ulm Spineanu, resigned following IMF criticisms that reforms had been slowed by the lack of inter-departmental coordination within his ministry. (EIU Country Report, 4th quarter 1997) The consequences of these weak administrative institutional capabilities were that restructuring proceeded at a slower pace than expected and undermined stabilization, thereby drawing repeated criticisms from the IMF and the World Bank. Even when restructuring occurred, the lack of government expertise undermined the benefits of reforms: thus, in mid-1997, the government offered miners prohibitively costly severance packages to induce them into leaving. While this approach avoided short term labor unrest, it not only placed a high burden on the budget but it also failed to solve the long run employment problem in the affected regions, since it was not accompanied by adequate programs to help the miners find alternative employment and income sources. Moreover, the government's effectiveness was also undermined by the failure of successive CDR

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222In fact, a recent paper (Stan 2001) argues that the quality of governance in Romania has declined substantially in the 1997-2000 period compared to the previous government (1993-1996).
governments to combat corruption, despite the prominent role of anti-corruption measures in its electoral campaign and a number of early successes.\textsuperscript{223}

While institutional weakness explains (or at least is compatible) with the Romanian debacle, how can we explain the Bulgarian “miracle”? After all, at least at the outset of reforms, there was little evidence that Bulgarian institutions were functioning significantly better than their Romanian counterparts, especially after the chaos of the crisis in late 1996.\textsuperscript{224} Nevertheless, the Bulgarian government somehow managed to largely avoid the types of policy blunders, which had undermined the credibility of the Romanian government. There are three tentative explanations for this outcome: first, the Bulgarian SDS could draw on its (albeit limited) governing experience in 1991-2, during which the new Prime Minister, Ivan Kostov, had served as a Finance Minister. Second, the Bulgarian government proved more effective in combating corruption, which arguably improved the functioning of the state apparatus (Ganev 2000). Finally, despite its comfortable parliamentary majority, the government promoted a more inclusionary style of economic policy making, which minimized the conflicts with both the parliamentary opposition and the labor unions, thereby facilitating the implementation of politically sensitive economic reforms. By contrast, the post-1997 Romanian governments resorted to governmental decrees for many key reform measures (arguably since the low levels of party discipline hampered the legislative approval of such measures), which further undermined the legitimacy of economic reforms, as well as the likelihood of their successful implementation. The greater success of Bulgaria’s more inclusive policy making process

\textsuperscript{223}Thus, whereas in December 1997 opinion polls indicated that 59\% of Romanians approved of the government's performance in reducing corruption, the figure fell to 29\% by June 1998 and finally to 4\% in November 2000, which was below the 1996 approval ratings of 8\% of the PDSR government.

\textsuperscript{224}Thus, the two countries' scores on the Nations in Transit “quality of governance and public administration” measure were almost identical during 1996 and 1997, though the Bulgarian score improved in later years, whereas Romania stagnated along this measure as well.
confirms the positive correlation between democracy and that program implementation revealed by the region-wide statistical patterns presented in Chapter 5.

**Implications and conclusions**

This comparison of the Bulgarian and Romanian reform trajectories and IMF interactions before and after 1997 illustrates a number of political and institutional mechanisms, which shape the dynamics of IMF programs. Prior to losing power in late 1996/early 1997, the Socialist governments of Romania and Bulgaria pursued very similar strategies of stop-go reforms, oscillating between their largely anti-reform preferences and constituencies, and their recognition that they needed international support to address their countries' significant economic problems. The narrow maneuvering room left by IMF conditionality eventually contributed to the electoral defeat of the two parties, but whereas in the case of the BSP, IMF pressures led to a last-minute (and ultimately failed) attempt to implement drastic reforms, the financially less dependent Romanian government instead chose a more extreme nationalist-populist policy alternative, which reduced its political losses.

In contrast to their earlier parallel developments, the reform trajectories of the two countries diverged significantly starting in late 1997. This divergence can be traced to the unexpected depth of the Romanian recession, which was exacerbated by the government's lack of experience, fragmentation and heterogeneity and ultimately undermined the ability of the Romanian authorities to pursue IMF-style reforms. Meanwhile, the Bulgarian government, despite dealing with similar structural difficulties, managed to take advantage of its higher political coherence and succeeded in implementing IMF-style reforms successfully for the entire
duration of its tenure, which eventually led to a virtuous cycle of good economic performance, political stability and foreign assistance mutually reinforcing each other. Thus, the comparison of the two cases underscores the delicate political and institutional balance inherent in the implementation of IMF programs and the need to design programs, which are more responsive to the specific political and economic conditions of the program countries.

Conclusions

Along with the statistical findings in Chapter 5, the case studies confirm the importance of many classical explanations of economic reforms, including intense financial need, ideological commitments to neoliberalism, powerful and unified governments, and capable bureaucracies. However, even the necessarily brief profiles of the eight Latin American and East European countries discussed in this chapter demonstrate that none of these factors represent either necessary or sufficient conditions for successful IMF programs. Instead the comparison of the different national trajectories reveals the complexity of the interactions between economic crises, ideological preferences, domestic power relations, and institutional constraints in shaping the trajectory of IMF program initiation and implementation in the two regions. Beneath this complexity, however, it is possible to discern several key themes, which can help us gain a clearer understanding of the domestic political dynamics of economic reforms in Latin America and Eastern Europe.

First, the case studies confirm the fundamental cross-regional differences in how governments of different ideological persuasions reacted to varying degrees of economic crises. In Latin America severe inflationary and/or balance-of-payments crises triggered ambitious orthodox economic reform efforts from right and center-right governments in Chile, Bolivia
(under Paz), and Peru (under Belaunde). At the same time, similar crises resulted in more inconsistent policy responses under the centrist Alfonsin government in Argentina, whereas among the region’s leftist governments, extreme hyperinflationary crises resulted in either policy paralysis (Bolivia under Siles) or outright defiance (Peru under Belaunde), which actually further reduced the prospects of IMF cooperation. By contrast, the experiences of Slovakia under Meciar and at certain junctures of the Socialist governments of Romania and Bulgaria confirm that, unlike in Latin America, in Eastern Europe the anti-reform ideological preferences of nationalist/populist and ex-communist governing parties mattered only in relatively stable domestic economic environments, in which governments could afford the luxury of pursuing their partisan agendas at the expense of better relations with the Fund. However, as soon as inflationary pressures or balance of payments difficulties intensified, East European governments appeared to be much more willing than their Latin American counterparts to cast aside their ideological aversion to IMF-style reforms, as illustrated by the reform efforts of former Communists in Moldova (1993-7), Romania (1993-4) and even Bulgaria (1996).

Second, the comparison of the relationship between democratic politics and IMF programs in the countries of the two regions complements the statistical findings about the greater compatibility of IMF conditionality with democracy in the post-communist transition than during the Latin American debt crisis. The trajectories of the three democratic Latin American countries, which were discussed in this chapter (Argentina, Bolivia, and Peru), suggest that successful long-term economic stabilization in a democratic context could only be achieved when a newly elected government coming to power following a period of traumatic economic crisis was able to take advantage of its political honeymoon legitimacy to break the traditional war-of-attrition between business and labor, which has fueled Latin American political and
economic instability for several decades. The experiences of Peru under Garcia, Bolivia under
Siles, and Argentina under Alfonsin suggest that once a government missed the initial
opportunity to undertake neoliberal economic reforms to tackle the domestic economic crisis, its
ability to respond to later inflationary crises was greatly reduced even when the costs of inaction
were very high in both political and economic terms. Moreover, the steep price exacted by IMF-
style austerity measures created significant trade-offs between respect for civil and political
rights on one hand, and program implementation on the other; this tension led to some significant
deviations from democracy under the Paz government in Bolivia, while undermining the
compliance efforts of the Alfonsin administration in Argentina, the Siles government in Bolivia
and the Belaunde government in Peru. By comparison, in East Europe democratic politics were
less at odds with neoliberal economic reforms, at least in part because the more reluctant
economic reformers (such as the HZDS in Slovakia, the PDSR in Romania, and the PCM in
Moldova) were also less committed to democratic norms than their pro-reform political
opponents. Unlike in Latin America, where elections usually undermined economic reforms,225
East European voters were more likely to recognize the necessity of neoliberal adjustment
policies, and, therefore, showed greater patience for the considerable economic costs inherent in
such reforms. In this respect it is telling the following several years of stop-go reform efforts
with significant IMF involvement, voters in Romania (1996), Bulgaria (1997), and Moldova
(1998) decided to vote their respective reformed ex-communist governments out of office in
favor of broad anti-communist coalitions, which had campaigned on platforms of accelerating

225 This could happen either because governments would abandon costly reforms prior to elections (e.g. the
Belaunde government in Peru) or because electoral outcomes would shift the political balance in favor of parties
opposed to IMF reforms (e.g. Peru in 1985, Argentina in 1987). The one notable exception is the 1985 election in
Bolivia, where the abysmal results of the governance by the leftist UDP coalition set the stage for a democratic
mandate for faster economic reforms.
economic reforms. The greater popular legitimacy of market-based economic policies, combined with the more marginal role of the weakly organized East European labor and business sectors, had two important implications for the relationship between democratic politics and IMF style reforms: first, the weaker societal resistance to reforms meant that post-communist democratic governments appear to have been less dependent on the post-electoral window of opportunity in their efforts to address economic crises, as illustrated by the successful mid-term reform initiatives in Moldova (1993) and Romania (1994). Second, the weakness of interest groups placed a much lower emphasis on government insulation for successful IMF program implementation in the post-communist context than during the debt crisis in Latin America. In fact, the comparison of Bulgaria’s and Romania’s post-1996 reforms suggests that the more inclusive and consultation-based governing strategy of the Bulgarian SDS facilitated IMF program compliance to a much greater extent than the top-down executive decree-based approach of the Romanian CDR.

Finally, the case studies emphasize that even a combination of significant economic crisis and ideologically pro-reform governments may not be sufficient to guarantee the successful design and implementation of IMF-backed economic reforms. A first important stumbling block for would-be reformers was the penchant for political infighting in fragmented government coalitions, which could undermine the coherence and credibility of economic reform efforts. Thus, the often paralyzing conflict between the parties in the governing coalition further undermined the cautious reform efforts of the Siles government in Bolivia in 1982-5 but its political successor, under the leadership of Victor Paz Estenssoro, largely managed to maintain government unity through the use of an elaborate patronage-sharing system. In Eastern Europe,

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226 Even though all three governments eventually lost subsequent elections, the main reasons for this electoral rejection were not excessively ambitious economic reforms but rather due to prominent corruption scandals (in Bulgaria) and the inability to implement reforms due to infighting and incompetence (in Romania and Moldova).
in line with the statistical findings, government fragmentation played an important role in explaining the inconsistent IMF program implementation under pro-reform coalition governments in Moldova (1998-2001) and Romania (1997-2000), whereas the more cohesive Bulgarian reformers had a much better compliance record.\textsuperscript{227} Another potentially serious obstacle - especially in the former communist countries – was the weakness of state institutions and the lack of qualified bureaucratic personnel, which hampered reform efforts in Eastern Europe, particularly in situations such as Moldova (after 1998) and Romania (after 1996), where anti-communist governments had little prior governing experience. In Latin America, state capacity limitations arguably undermined macroeconomic stability by limiting tax revenues (especially in poor countries such as Bolivia), but at the top leadership level the human capital deficit was generally a lot less problematic than in Eastern Europe.

Overall, the analysis of the domestic politics of IMF program initiation and implementation in the eight Latin American and East European countries discussed in this chapter suggests that there is no single foolproof “recipe” for successful IMF-style reforms that holds across countries and regions. In Latin America during the 1980s, the most reform-conducive domestic political constellation combined severe domestic and external economic crises, a government with a pro-market ideology, and weak opposition whose anti-reform objections could be either suppressed (in an authoritarian regime such as Chile) or dismissed as illegitimate following severe crises and decisive electoral defeats in democracies (as in Bolivia in 1985-6). In Eastern Europe during the post-communist transition, domestic economic crises and external financial need also played an important catalytic role for IMF-style reforms, but ideological differences mattered much less for crisis-driven reforms, and successful

\textsuperscript{227} The highly fragmented Slovak reformers managed to initiate and comply with an IMF standby agreement but since they were swept out of power after less than half a year into the program, it is too early to tell whether they would have been able to avoid the paralyzing internal conflicts of their Romanian and Moldovan counterparts.
implementation hinged primarily on cohesive governments and capable bureaucracies rather than on the political power to shut out the parliamentary and societal opposition.
In December 1998 the Argentine President, Carlos Menem, addressed the joint meeting of the International Monetary Fund and the World Bank in the wake of the East Asian financial crisis, during which Fund’s policy prescriptions had attracted sharp and widespread criticism from a wide range of observers. Menem recounted Argentina’s remarkable turnaround following the hyperinflationary chaos of the 1989-1991 period, and ascribed this success to his government having “worked side by side with the IMF, the World Bank, and the IDB to achieve macroeconomic stability, deepen structural reforms, and adopt policies aimed at improving the economic fortunes of the poorest members of society.”228 Coming from the leader of the populist, labor-based Peronist party a year before a crucial presidential and parliamentary contest, this neoliberal proclamation in the very cradle of the “Washington Consensus” would have been inconceivable barely a decade earlier. And Menem was not alone in this posture of an unexpected Latin American neoliberal: the list of committed market reformers also included Brazilian President Enrique Cardoso, one of the intellectual founders of the Latin American dependency school, and Alberto Fujimori, the Peruvian populist President, whose initial electoral campaign in 1990 had stressed the avoidance painful austerity measures. However, barely a few years later, the political pendulum in Latin America seems to be swinging back to the left following a series of decisive victories for presidential candidates ranging from moderate Social Democrats, such as Chile’s Bachelet, Uruguay’s Vazquez and (somewhat unexpectedly) Brazil’s Lula, to more combative Leftists such as Argentina’s Kirchner, and particularly Bolivia’s Morales and Venezuela’s Chavez.

While this chapter is not intended as a detailed analytical account of these two remarkable ideological swings, its focus on the politics of Latin American IMF programs from 1990-2001 complements the earlier analysis of the Latin American debt crisis and the post-communist transition, and, thus, creates a broader framework for understanding the interaction between economic crises, Western conditionality, and partisan politics in shaping the economic policy choices of developing countries. The analysis in the preceding four chapters has revealed a series of important differences in the political dynamics of IMF programs and policy responses to economic crises in Eastern Europe and Latin America: thus, during the debt crisis of the 1980s Latin American governments had reacted to domestic and international crises in ideologically divergent ways, and neoliberal adjustment policies were generally hard to reconcile with democratic politics, whereas during the post-communist transition, economic crises had triggered policy convergence among governments of different ideological orientations and economic reforms were not only compatible with but even facilitated by democratic politics.

However, as discussed in Chapter 1, the two IMF program episodes differed along a number of different dimensions, which could have contributed to the divergent political dynamics revealed by the comparison: first, the much more hostile international economic environment of the debt crisis and the widespread perception of the IMF as the debt collector for Western commercial banks created an adversarial relationship between the Fund and Latin American debtors, which contrasted with the more constructive IMF role as a reform and international integration advisor during the post-communist transition. As a corollary, the severe domestic economic crisis of the early transition period was widely regarded as a legacy of communist-era economic mismanagement, which arguably facilitated the nonpartisan response to the crisis and the greater popular support for painful adjustment measures in Eastern European
countries. By contrast, in Latin America the debt crisis exacerbated the latent domestic economic imbalances of the traditional ISI models, thereby triggering widespread popular opposition to neoliberal reforms and paving the way for the ideologically divergent interpretations of the roots and solutions to the stagflationary crises experienced by many countries in the region during the early 1980s.

But the two regions also differed with respect to their domestic social and political landscape, in the sense that Latin America in the 1980s had much better organized interest groups (especially labor and business organizations) than their East European counterparts, whose social and organizational capital had been decimated by decades of totalitarian communist rule. As a consequence, Latin American political parties, which had largely survived the much shorter authoritarian spells in their respective countries, had stronger institutional ties to organized interests, and were therefore more constrained in their ability to shift their policy positions to accommodate IMF demands, even if the economic costs of non-compliance were significant. East European parties on the other hand, largely “floated” on top of disarticulated and atomized societies, and, therefore, had greater leeway in pursuing policies demanded by international financial institutions including the IMF. Seen from this perspective, the compatibility of painful economic reforms with democracy in the post-communist transition is not the result of synergies between economic and political liberalism but rather a consequence of the inability of post-communist citizens to hold their governments accountable for their policies between successive elections.\textsuperscript{229} By the same token, the tension between democracy and IMF-style reforms during the Latin American debt crisis can be interpreted as being a function of the much greater organizational capacity of Latin American reform opponents, which often left governments with the difficult choice of either allowing these groups to derail (or at least slow

\textsuperscript{229} For a discussion of electoral accountability without policy accountability in Eastern Europe, see Innes (2002).
down) economic reforms or to use repressive measures in order to push through their reform agenda.

Thus, the cross-regional divergence in political responses during the two crisis episodes can be attributed to two different (but not necessarily mutually exclusive) mechanisms: the first stresses the link between the international environment, the resulting role of IMF interventions, and the domestic political perceptions about the nature of the crisis and the appropriate policy responses. The second explanation instead emphasizes differences in the domestic articulation and aggregation of economic interests, and their consequences for the partisan politics of economic reforms. The analysis of Latin American programs in the 1990s and beyond, which is presented in this chapter, offers the ideal testing ground for evaluating the relative explanatory power of these two approaches. Thus, Latin American countries in the 1990s, like their post-communist counterparts, benefited from the more favorable international economic and political environment following the resolution of the debt crisis and the end of the Cold War. At the same time, Latin American governments of the early 1990s inherited the polarized social and political landscape of the previous decade, even though this landscape started to evolve rather dramatically in response to the deep structural transformations of the last fifteen years.230 Therefore, to the extent that the international environment explanation is correct, we should expect the political dynamics of Latin American IMF programs in the 1990s to resemble those of the transition economies during the same period, i.e. to produce crisis-driven ideological convergence and to display a harmonious coexistence between neoliberal economic reforms and democratic politics. If, on the other hand, the earlier divergence was due primarily to deep-seated institutional differences in the articulation of domestic economic interests, then the changed

230 For an interesting discussion of how this transformed social and political landscape affects the democratic prospects of the region, see Kurtz (2004).
international environment should not alter the traditional patterns of ideological polarization and hard-to-reconcile tensions between democracy and economic reforms, which had characterized Latin America in earlier decades.

To anticipate the answer provided by the analysis in this chapter, the political dynamics of the post-1990 Latin American IMF programs were more similar to those of Eastern Europe during the same time period, in that economic crisis reduced the policy differences among governments of different ideological persuasions, and democratic politics were no longer incompatible with neoliberal economic reforms. These findings emphasize the importance of the more favorable international economic and political environment of the 1990s, which provided greater rewards for countries complying with the neoliberal policy prescriptions of the IMF (and the Washington Consensus more broadly), and, therefore, led to greater support for economic reforms - or at least less spirited opposition - at both the elite and the popular level. However, two important caveats are in order: first, the structural reforms of the 1990s undermined the collective action capabilities of the Latin American popular sector (especially with respect to organized labor), and, therefore, reduced the ability of reform opponents to mount effective political challenges to neoliberal economic policies. Second, even in the favorable international context of the 1990s, Latin America did not experience an East European-style mutually reinforcing relationship between economic and political liberalism, and once the boom of the 1990s gave way to the gloom of the post-2001 era, Latin America once more returned to greater ideological polarization and a much more ambivalent attitude towards IMF programs, and Western economic and political conditionality more broadly. Therefore, on balance, the post-1990 Latin American track record with IMF programs suggests that – in line with the theoretical approach advanced in this book – the politics of IMF-style reforms have to be understood as an
interaction between the nature of international environment, which was considerably more favorable during the “roaring 1990s” than in the periods immediately preceding and following them, and the much more deeply rooted cross-regional differences in the organization of societal interests and popular attitudes towards Western conditionality. Seen from this perspective, the relatively consensual politics of economic reforms in Latin America during the 1990s were brought about by a combination of an international credit boom, a more forgiving IMF stance on conditionality, and a partial reduction in the organizational capacity of reform opponents. However, once the international environment, punctuated by the 9/11 attacks and the Argentine crisis, changed for the worse, the previously subdued resistance to the IMF promoted neoliberal reforms of the 1990s once again found a political outlet and contributed to the recent increase in anti-market and anti-American rhetoric and policies in large parts of Latin America.

In the remainder of this chapter, I first briefly outline the broad economic and political background of Latin American IMF programs in the 1990s. The main part of the chapter presents the broad economic and political drivers of the patterns of IMF program initiation of implementation during this period, and compares these dynamics to the earlier findings from the Latin American debt crisis and the post-communist transition. The following section briefly revisits the four countries, discussed in Chapters 4 and 6 (Argentina, Bolivia, Peru, and Chile), to trace the political trajectories of their economic reforms in the 1990s and beyond. The final part discusses the theoretical implications of these findings and of the recent left-turn experienced by much of Latin America.

A region transformed – Latin America after 1990

Back in business: Latin American economic trends in the “roaring nineties”
Latin America emerged from the “lost decade” of the debt crisis with a decidedly mixed economic situation. The various economic adjustment efforts - whether orthodox or heterodox - had ultimately resulted in steep social and economic losses, as reflected in the decline in per capita income and real wages, and the rise in unemployment and poverty for most Latin American countries and for the region overall. To add insult to injury, even the indicators for the main objectives of the painful adjustment process of the 1980s were rather disappointing: thus, the region's external debt still accounted for 45.8% of gross national income at the end of 1989, which was significantly higher than 36.2% in late 1981 prior to the debut of the debt crisis. Meanwhile, international reserves had declined from 4.4 months of imports in 1985 to less than 3 months in 1989, while the share of multilateral debt had more than doubled compared to 1981 as a consequence of the limited access to private capital markets during the 1980s. Nor had anti-inflationary efforts been much more successful, considering that the relative successes of Bolivia, Mexico, and Costa Rica were overshadowed by the dramatic hyperinflationary episodes raging in Argentina, Brazil, Peru, and Nicaragua.

On the other hand, amid all the gloom, there were also a few signs of hope, coming largely from the outside. Thus, the Brady Plan of March 1989, along with a series of Paris Club debt reschedulings in the late 1980s and early 1990s led to a gradual but significant decline in overall indebtedness, which, as illustrated in Figure 8.1, declined from 62% of gross national income in 1987 to 35% in 1994. Even more importantly, the debt renegotiations, combined with declining US real interest rates after 1989, led to a significant reduction in the interest payment burden from 5.5% in 1984 to 1.7% in 1993. At the same time, the financial recovery of the Western commercial banks and the new-found appetite of international financial markets for emerging-markets bonds contributed to a massive inflow of new outside funding into the region.
As illustrated in Figure 8.2, the remarkable foreign lending boom of the 1990s marked a drastic departure from the lean years of the 1980s, during which voluntary lending to most of Latin America had been virtually non-existent.

The domestic economic reverberations of this international turnaround were equally impressive. Relieved of much of the debt burden, which had choked growth and fueled fiscal deficits and inflation in the 1980s, Latin American economies started to recover vigorously starting in 1991, and except for a dip in 1995 (following the Mexican Tequila Crisis), regional economic growth averaged a healthy 4.1% between 1991 and 1998. Moreover, during this time period governments in the region managed to reduce the endemically high inflation, which had been a trademark of Latin American political economy for several decades: thus, by late 1992 the governments of Argentina, Peru, and Nicaragua had successfully reigned in the hyperinflationary crises they had inherited at the start of the decade, leaving Brazil as the last inflationary problem-child in the region. After Brazil’s successful stabilization in mid-1995, inflationary crises virtually disappeared from the Latin American economic and political agenda, with most countries achieving and maintaining single-digit or low double-digit inflation by the mid to late 1990s.231

Thus, while the domestic economic stagnation of the 1980s had been triggered and exacerbated by an extremely unfavorable international economic environment, the region's substantial recovery in the early and mid-1990s also had important external roots. This clear link between the international lending boom and domestic economic recovery had important repercussions for the domestic and international political economy of neoliberal reforms and IMF programs in Latin America during the 1990s. First, Latin American political and economic

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231 The only partial exceptions to this trend were Ecuador (where inflation briefly exceeded 100% in the second part of 2000) and Venezuela (which experienced inflation in the 100-110% range in late 1996).
elites quickly realized that in order to take advantage of the international credit boom, they had to pursue economic policies in line with the increasingly hegemonic prescriptions of neoliberalism. Compared to the commercial bank lending of recycled oil profits in the 1970s, the foreign direct investment and portfolio investment of the 1990s was much more likely to respond to positive or negative signals about the economic and political climate in a given country. Therefore, unlike in the 1970s, the IMF was not relegated to just dealing with the basket cases left outside the regional lending boom, but played an important signaling role for international investors looking for guidance about the credibility of Latin America reform efforts. Whereas during the debt crisis compliance with IMF conditionality had largely meant fiscal austerity and higher debt service payments (in return for fairly limited concessions from the creditors), in the 1990s IMF cooperation had the potential to unlock significant outside funding, and, therefore, set the stage for the more harmonious relationship between the Fund and Latin American governments, which was mentioned by Menem in his 1998 Washington address.

Second, the return to growth and the remarkably successful fight against inflation played an important role in swaying popular sentiment towards neoliberal reforms. Even though Latin American publics were still wary of many individual components of the neoliberal reform agenda promoted by the IMF, reform-minded governments could at least point to some tangible economic benefits of such reforms. Even though the uneven distribution of these gains meant that large segments of society experienced minimal improvements in living standards, the situation nevertheless compared favorably to the economic turmoil of the 1980s, as illustrated by the genuine popular support for Fujimori and Menem in the early to mid-1990s despite the contrast between their populist campaign promises and the reality of their neoliberal reform policies. As a consequence, Latin American voters no longer viewed IMF-style reforms as
inevitably harmful foreign impositions, which meant that politicians no longer faced as stark a tradeoff between satisfying the policy requirements of Western conditionality and abiding by the rules of democratic politics.

The only game in town: democratic stability in the 1990s

As the debt crisis drew to an end in 1989, Latin America’s political landscape presented a mixed picture. On the positive side, despite the staggering economic costs of the debt crisis, the region's fledgling democracies emerged from the 1980s shaken but largely intact. Moreover, the end of the Cold War contributed to a more pro-democratic international climate, as the United States began to withdraw support from its authoritarian allies in the region, a shift which contributed to the end in 1989 of two of the most resilient Latin American dictatorships - Pinochet in Chile and Stroessner in Paraguay – and led to the ouster of Manuel Noriega in Panama. On the other hand, Latin American democracies had experienced significant difficulties in coping with the political challenges of economic adjustment, raising significant concerns about the long-term viability of democracy in countries such as Argentina and Peru, which managed democratic turnovers of power in 1989-90 but remained mired in significant economic and political turmoil. Nonetheless, by the beginning of 1990, almost three quarters of the 22 Latin American and Caribbean included in the present analysis could be considered democratic,232 most of them with at least five years of democratic experience. In this respect, the Latin American experience of the 1990s differed significantly from that of Eastern Europe, where the former communist countries were just taking their first tentative steps towards democratization, while at the same time attempting market reforms from a much lower base than most Latin American countries.

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232 The standard used for this classification is a score of at least 6 on the -10 to +10 Polity regime scale.
After decades of rapidly alternating episodes of democratic and authoritarian experiments, the 1990s finally ushered in a period of unprecedented democratic stability for most Latin American and Caribbean countries. The democratic transitions of late 1989/early 1990 in Chile, Panama, Nicaragua and (somewhat more gradually) Paraguay, were followed by the mid-1990s by civilian takeovers in Guatemala and Haiti, and by the gradual liberalization of Mexico's one-party dominated system. Of course, the process was not a uniform, irreversible march towards democracy: thus, Peru experienced a temporary but significant democratic setback following Fujimori’s 1992 autogolpe, civil and political liberties continued to be tenuous in several countries (including Honduras, Guatemala, and the Dominican Republic), popular riots with military participation triggered questionable government changes in Ecuador and Haiti, and two of the region’s oldest democracies (Colombia and Venezuela) experienced a gradual erosion of democracy in recent years. Nonetheless, except for Castro’s Cuba, free and relatively fair elections became the norm for most of the countries of the region throughout the 1990s, in line with an international environment dominated by Western democracy promotion efforts and fewer geopolitically motivated exceptions for “friendly dictators.”

This remarkable resilience of electoral democracy and its surprisingly harmonious coexistence with market-oriented reforms for much of the 1990s raises the interesting question of why Latin America was largely able to avoid the most extreme political expressions of the deeply ingrained social and class tensions bred by the region’s endemic poverty and inequality: riots and coups. In addition to the beneficial effects of the economic boom discussed in the previous section, this unexpected tranquility of Latin American politics may have also been supported by the relatively recent memories of the high economic and political costs of the military dictatorships of the 1970s and the massive strikes and riots of the 1980s. Just as
importantly, however, two parallel processes fundamentally changed the nature of democratic politics in Latin America starting in the early 1990s. First, the privatization and labor market reform components of the structural reform packages introduced in the late 1980s and early 1990s triggered a profound transformation of the Latin American social and political fabric by weakening the labor union movement and contributing to the growth of the informal sector throughout the region. As a consequence, the popular sector had a much harder time overcoming collective action challenges in order to pursue its economic agenda by putting direct political pressure on parties and elected officials. On the positive side, the lower degree of popular mobilization in the 1990s reduced the potential for violent social conflict and political instability compared to earlier decades. The trade-off, however, was that many Latin American democracies in the 1990s resembled O'Donnell’s model of delegative democracies, in which citizens only influence policymaking during relatively brief pre-electoral periods but essentially delegate decision-making power to political elites for the rest of the electoral cycle.

The second factor that reinforced the lower government accountability towards its citizens, was connected to the external policy constraints imposed by the much higher capital mobility following the financial deregulation and liberalization of the last two decades. In other words, even democratically elected governments only had to worry about voters once every few years in order to get reelected but could be punished quite swiftly by highly mobile international investors, who could relocate their capital much more easily than the average Latin American citizen could have moved to another country. Therefore - and this was one of the key points of the anti-globalization left - it is not surprising that despite their redistributive electoral promises, even leftist and populist governments usually pursued rather prudent, market friendly economic policies once in power. The net result of these developments was a shallower democracy, which
provided fewer redistributive benefits to the poor but for the same reason provoked fewer concerns among the rich, and, therefore, contributed to the survival of democracy by removing the classic justification for anti-democratic coups.\textsuperscript{233} Therefore, in the statistical analysis presented in the next section, we should expect to see much less tension between democracy and IMF programs during the 1990s, as well as fewer ideologically-driven policy reversals than in earlier decades.

\textit{The politics of IMF programs in the 1990s}

By the end of the 1980s the future of IMF involvement in Latin America was hanging in the balance. Despite having managed to prevent a disastrous international financial meltdown, the Fund’s thankless job as a middleman between distressed borrower countries and equally distressed Western commercial banks drew criticisms from all quarters. Even relatively sympathetic observers tended to question the continued relevance of the Fund in international financial environment, which had largely outgrown the IMF’s original mission. Thus, an editorial in \textit{The Economist} (1988) painted a rather bleak picture of the Fund’s future relevance: “There may be no way out for the IMF. As co-operation on exchange-rate policy continues to evolve, the Fund will be tossed occasional bones -- some statistics to collect, some indicators to keep an eye on, and so forth. But if the past few years are any guide, the agreements that matter will be settled privately between the finance ministers of the big economies.”

\textit{Back for more: IMF program initiation in the 1990s}

\textsuperscript{233} For an interesting formal model treatment of this mechanism, see Acemoglu and Robinson (2005).
Even apart from the broader questions about its systemic relevance, the continued IMF presence in Latin America during the 1990s was highly uncertain considering that its policy interventions in the region during the 1980s had been largely reviled as external impositions on countries with few outside options. In the much more favorable international financial context of the 1990s, during which the credit ratings and market access of most Latin American countries rebounded considerably, one should have expected the IMF to return to its 1970s role of providing emergency financing to the small number of basket cases, which were unable to access private lending to cover their financing need. Instead, the IMF continued to be actively involved in Latin America throughout the 1990s: thus, the 22 Latin American and Caribbean countries in my sample initiated forty-eight new high-conditionality IMF programs between 1990 and 2001. Even though this tally represents a lower concentration of programs than during the previous decade (or compared to transition countries during the same time period), it nevertheless suggests a fairly prominent role of the Fund in the region's political economy. Indeed, several countries, including Argentina, El Salvador, Peru, and Uruguay, were almost permanent IMF clients during this period, and almost all countries in the region had at least some exposure to IMF conditionality after 1990.

While the frequency and the broad distribution of programs did not change dramatically after the end of the debt crisis, the drivers of IMF program initiation during the 1990s in Latin America differed substantially from the dynamics of the debt crisis and the post-communist transition. As discussed in chapters 3-6, inflationary crises played a central role in the domestic

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234 This sentiment is echoed in The Economist’s (1988) assessment that following its highly politicized role during the debt crisis, “it may be too late for the IMF to retreat to its neutral role as a short-term provider of finance.”

235 See Figure 2 in Chapter 3 for an illustration of the rapid and steady improvement of the region's sovereign credit ratings after 1990 based on the Institutional Investor Survey (IIS) average for the 22 countries in the present sample.

236 Thus, 18 of the 22 countries in the sample initiated new IMF programs between 1990 and 2001. Of the remaining four, Chile successfully finished its earlier standby agreement by late 1990 (but then stayed away for the rest of the decade), Bolivia had two lower-conditionality PRGF programs in the mid 1990s, Paraguay waited until 2003 to initiate its first IMF program, which leaves only Cuba completely outside the IMF orbit.
economic calculus of IMF involvement during both episodes, whereas external concerns were dominated by the priorities of foreign debt service in Latin America during the 1980s and by a discussion of the of foreign reserves in the post-communist countries. By contrast, the Latin American experience of the 1990s lacked a unifying crisis “theme”: thus, the burden of interest payments declined substantially from its peak in the late 1980s, inflation also ceased to be a critical concern after 1992 for most countries in the region, and international reserves, which even in the 1980s had been significantly higher than in Eastern Europe, continued to improve as a consequence of the easier access to hard-currency loans for most countries in the region.

The statistical results, presented in Table 7.1, confirm the lower overall salience of traditional financial need and economic crisis indicators in driving IMF program initiation in the 1990s. First, in marked contrast to the debt crisis and the post-communist transition, governments dealing with high inflation were actually less likely to initiate IMF programs, as illustrated by the significantly negative effect of lagged inflation in Models 1 and 3-7, and of hyperinflation in Model 2. These findings confirm the much lower profile of inflation in the political economy of post-1990 Latin America, and suggest that governments generally tried to get their house in order before entering IMF agreements. Second, the lower prominence of interest payments on the balance sheets of Latin American governments was also reflected in their modest effects on IMF programs in the 1990s: thus, even though the coefficients for Interest/GNI in Models 1-3 and 5-7 were consistently positive, none of them approached statistical significance. Finally, in line with the traditional IMF role of providing balance-of-payments support, governments in countries with low international reserves were more likely to

237 The results were not affected by excluding hyperinflationary cases, and were consistent across different time periods.
enter IMF agreements, as illustrated by the consistently negative and generally significant effects of higher *Reserves in months of imports* in Table 7.1.238

The findings so far confirm that by the 1990s Latin America had largely left economic woes of the debt crisis behind. Nonetheless, the aftershocks of the crisis left their imprint on IMF programs, especially in the early 1990s: according to Model 3, new IMF agreements coincided with more generous reschedulings of foreign debt. Since debt reschedulings were crucial for allowing Latin American countries the necessary breathing space for domestic economic recovery and an orderly return to international financial markets, the Fund’s facilitating role in this process gave it important leverage over many debtors, especially during the early 1990s.239 Moreover, large Latin American debtors were still significantly more likely to be involved with the IMF, as reflected by the substantively large and statistically significant positive effect of debt size across the different models in Table 7.1.240 As illustrated most vividly by the Argentine case, the Fund was more likely to get involved in countries whose economic stability had wider regional and international repercussions. Unlike in the 1980s, however, large debtors were more likely to enter IMF programs regardless of the severity of their economic crisis,241 with Argentina turning to the Fund not only in the midst of crisis (e.g. in 1991 and 2001) but also under circumstances of relative economic stability. This shift confirms the broader transformation of the Fund's Latin American mission from emergency crisis management in the

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238 It should be noted, however, that these results were generally substantively smaller and not as consistently statistically significant as during the debt crisis and the post-communist transition, reflecting the more comfortable reserve position of Latin America in the 1990s.

239 Unlike for other economic indicators, the model uses current rather than lagged values of rescheduled debt as a predictor of program initiation. Even though technically debt renegotiation agreements occurred after a program was announced, the implicit (and often explicit) link between IMF approval and debt concessions certainly played an important role in driving Latin American governments into IMF agreements.

240 Similar but weaker effects were found when using alternative indicators of economic importance (GDP size and total imports), which suggests the continued Western concerns about debt in the 1990s.

241 Thus, the interaction effects between debt size and reserves and interest payment levels were substantively small and statistically significant (results omitted.)
1980s to a more balanced role in the 1990s, which combined crisis management (e.g. in Mexico 1994, Brazil 1999, Argentina 2001) with more “prophylactic” policy advice to governments attempting to navigate the tempting but dangerous waters of international financial markets.

In addition to reflecting the changing international economic environment, Latin American IMF programs of the 1990s also reveal a fundamentally different picture of partisan policy responses to external economic challenges. Unlike the divergent ideological responses to the debt crisis, external financial pressures triggered policy convergence among governments of ideological orientations: thus, as illustrated in Figures 8.3 and 8.4 (based on Models 3 and 4 in Table 8), left governments were more likely to avoid the IMF when facing comfortable external financial positions – such as higher reserves and low interest payments - but they reacted much more strongly to financial duress than their right-leaning counterparts, and, therefore, actually had higher initiation rates in situations of extreme financial difficulties. These ideological patterns of crisis response are much more similar to the findings from the post-communist transition than to the ideologically charged environment of the debt crisis, which suggests that in the favorable international context of the 1990s, ideological differentiation only occurred as a “luxury” in low-crisis environments but was likely to be discarded in the face of significant economic challenges.242

Nonetheless, a closer look at the electoral dynamics of program initiation reveals that ideological differences were not entirely erased by the Washington Consensus and the region’s “love affair” with neoliberalism in the 1990s. Thus, while Latin American governments were generally less likely to enter IMF agreements during the political honeymoon following

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242 With respect to inflationary crises, ideological differences were completely irrelevant, as indicated by the very weak interaction effect between inflation and government orientation (results omitted.)
elections, this reluctance was much stronger among left-leaning governments,\textsuperscript{243} which reinforces the earlier finding that when given the choice - due to either favorable economic conditions or high political legitimacy - even the “new Left” in Latin America preferred to keep its distance from the Fund to a greater extent than its right-leaning political adversaries. Similarly, despite its modest statistical significance, the interaction effect between ideology and pre-electoral period in Model 6 offers at least tentative evidence of ideological differentiation, in that right-leaning parties became more likely to enter IMF agreements prior to elections while leftist parties were less likely to do so.

Overall the dynamics of Latin American IMF program initiation in the 1990s marked an important departure from the earlier interactions between the Fund and Latin American debtors. IMF programs were no longer driven by concerns about inflationary crises and interest payments, though Fund support was still instrumental for dealing with debt reschedulings and low international reserves. Since IMF conditionality during the lending boom of the 1990s was generally associated with the benefits of greater access to international financial markets rather than the pain of debt repayment, external financial crises triggered policy convergence among governments of different ideological persuasions. Nonetheless, ideological differences persisted beneath the veneer of the neoliberal consensus of the 1990s, even though its manifestations were largely muted by the strong international economic incentives for complying with the dominant pro-market policy paradigm, which dominated the first post-Cold War decade.

\textit{Drivers of program implementation in the 1990s}

\textsuperscript{243} While the effect in Model 6 was statistically significant at .05 for all but right governments, the substantive effect differences were very large (the odds ratio was four times larger for a center-left than for a center-right government in a post-electoral period.)
The compliance record of post-1990 IMF programs in Latin America and the Caribbean was slightly better than during the Latin American debt crisis and the post-communist transition, with program countries eligible to draw on the committed funds for almost three quarters of the time in which agreements were in place. While this performance was not dramatically higher than in the other two episodes, it nevertheless confirms the more voluntary nature of IMF programs compared to the impositions of the 1980s and the lower degree of institutional uncertainty compared to the transition countries. However, the relative performance of different countries once again varied significantly, ranging from the modest performance of Haiti and Venezuela, to the more consistent compliance records of Peru and Argentina.

The economic and political drivers of program implementation, which are illustrated by the statistical results in Table 7.2, confirm the initiation-stage findings about the particular nature of the political economy of reforms in Latin America during the 1990s. Thus, inflationary crises did not provide a compliance impetus for governments engaged in IMF programs: in fact, higher levels of inflation tended to undermine implementation during the 1990s, as indicated by the consistently negative (and largely statistically significant) effects of pre-program inflation across the different statistical models in Table 7.2. Higher interest payment burdens, which had played at least a modest catalytic role at the initiation stage, did not help compliance efforts in the 1990s, and may have even undermined them judging by the negative effects of Interest/GNI across different model specifications. This finding suggest that the potential reform impetus of greater financial need was cancelled by the negative side effects on fiscal balance and the timely repayment of debt obligations. Finally, countries with lower international reserves appear to have been more likely to comply with IMF conditionality, but the statistical results in Table 7.2 reveal
a substantively and statistically less significant effect than for IMF programs during the debt
crisis and the post-communist transition.

Once again, the politics of debt rescheduling appears to have had the greatest effect
among the external financial considerations: thus, the prospects of rescheduling significant
amounts of debt contributed to more conscientious implementation by Latin American
governments, as indicated by the large and statistically significant positive effect of Rescheduled
debt/GNI in Model 2 of Table 7.2. Another echo from the past - the preferential IMF treatment
of large debtors in the name of international financial stability - can also be detected at the
implementation stage, as suggested by the positive and marginally significant effect of Total debt
in Table 7.2. While such treatment may have contributed to the more cooperative relationship
between the Fund and the region's largest debtors (Argentina, Brazil, and Mexico) in the 1990s,
it also drew criticisms (especially in the Argentine case) for allowing them to postpone necessary
adjustment measures, which ended up exacerbating later crises.

The partisan policy responses to external financial need at the program implementation
stage closely mirrored the earlier political dynamics during initiation. As illustrated in Figures
8.5 and 8.6, left-leaning governments had a worse implementation record when their countries
faced comfortable external positions, characterized by high levels of international reserves and
low interest payments. However, leftist governments were much more sensitive to
deteriorating external financial situations, and, as a consequence, actually had stronger
implementation records than their rightist counterparts in situations of extreme financial

\[244\] Thus, a one standard deviation increase in the amount of rescheduled debt led to a 2.5-fold increase in the
predicted odds of compliance (significant at .01).

\[245\] See, for example, Feldstein (2002).

\[246\] However, this leftist implementation deficit was only statistically significant (at .01) at low levels of Interest/GNI
(based on the interaction effect in Model 3), whereas at high reserves the statistical significance of government
orientation was rather modest (.4 based on the interaction effect in Model 2).
duress.\textsuperscript{247} Overall, these policy patterns confirm the significant departure from the “classical” ideological blueprint of the 1980s: rather than reacting to crises by becoming more entrenched against IMF reform pressures, in the 1990s left-leaning Latin American governments were more likely to respond by embracing IMF-style policies, and in doing so they often outdid their right-leaning counterparts, in a manner reminiscent of the unlikely crisis-driven reformist zeal of former communists in Eastern Europe.

The results in Table 7.2 also reflect another important departure from the acrimonious politics of IMF programs during the debt crisis: whereas in the 1980s democratic regimes had experienced a significant implementation disadvantage compared to their authoritarian counterparts, this handicap disappeared in the 1990s. In fact, the consistently positive (though statistically insignificant) effect of \textit{Regime} in Table 7.2 suggests that more democratic regimes may have actually had a slight edge in their implementation efforts, which confirms the greater compatibility of democracy and neoliberal economic reforms in the more favorable international context of the 1990s. On the other hand, however, the democratic boost to economic reforms was not nearly as strong in Latin America as in Eastern Europe. Moreover, implementation was adversely affected by electoral campaigns, especially in the case of centrist and center-left governments, as illustrated by the results in Model 5 of Table 5.2.\textsuperscript{248} Finally, according to Model 4, compliance also suffered irrespective of the government’s ideology in the aftermath of elections,\textsuperscript{249} which suggests that Latin American governments were not particularly eager to

\textsuperscript{247} Based on the conditional standard errors for the interaction effects in Models 2 and 3, the leftist implementation advantage was statistically significant at .05 for reserves below 3.5 months of imports and Interest above 3.7% of GNI.
\textsuperscript{248} For example, the odds of compliance for a centrist government in the two quarters prior to an election were almost 75% lower than under normal circumstances (significant at .05).
\textsuperscript{249} The odds of compliance fell by almost half in the year following an election but the statistical significance of the results was relatively weak (.22).
spend their electoral political capital on implementing IMF programs (particularly if these programs were legacies of the previous government.)

This section’s brief analysis of Latin American IMF programs in the 1990s has revealed a political economy landscape, whose dynamics were closer to those of the post-communist transition than to the Latin American experience during the debt crisis of the 1980s: thus, external financial pressures reduced and even reversed traditional ideological policy differences between the left and the right, and democracy was no longer incompatible with the neoliberal reform agenda promoted by the IMF. Seen from this perspective, the crucial driver of this transformation appears to have been the dramatic change from the inhospitable international economic environment of the 1980s to the much more favorable climate of the 1990s. Given the Fund’s intermediary role between developing country governments and international financial markets, this international economic transformation set a very different basic tone for the interactions between the Fund and its potential clients: thus, as a debt collector with more sticks than carrots at its disposal, the IMF’s interventions during the 1980s triggered heated ideological debates and widespread popular resistance, thereby shaping the divisive and confrontational nature of economic reforms during the debt crisis. By contrast, the significant economic benefits of the international financial and economic boom of the 1990s allowed the Fund to play a much more constructive role as a facilitator of international economic integration, which muted the ideological undertones of domestic policy debates and reduced the tensions between democratic politics and neoliberal reforms.
The end of the neoliberal consensus?

The findings of the statistical analysis in the preceding section explain why until recently scholars of Latin American political economy focused much of their attention on the roots and implications of the remarkable neoliberal consensus, and of the remarkable coexistence of neoliberal economic policies and democratic politics in a region traditionally known for the tension between the two. However, by the end of the 1990s the neoliberal consensus started to come under increasing pressure and recent years have witnessed a regionwide reverse political wave: thus, Hugo Chavez’s presidential victory in Venezuela in late 1998 was followed by a series of electoral victories by leftist and populist/nationalist candidates, including Lula in Brazil (2002), Lucio Gutiérrez in Ecuador (2002), Nestor Kirchner in Argentina (2003), Tabaré Vázquez in Uruguay (2004), Evo Morales in Bolivia (2005) and René Preval in Haiti (2006). While the policy implications of the Latin American left turn have been mixed - ranging from open confrontation with the Western economic and political establishment in the case of Chavez to centrist pragmatism in the case of Lula - it nevertheless signals a significant shift in the public mood towards economic neoliberalism and the raises important questions about the nature of the earlier neoliberal consensus the reasons for its rather sudden demise.

In hindsight it is clear that beneath the surface of macroeconomic stability, growth, and international investor confidence, Latin America had not fully succeeded in squaring the circle of achieving a stable equilibrium characterized by sustainable development, neoliberal economic policies, and democratic governance. While an exhaustive discussion of what went wrong - and

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250 See e.g. Armijo and Faucher (2002).
251 See Kurtz (2004).
252 Meanwhile, outspoken leftist candidates are among the front-runners in the upcoming elections in Mexico (Andrés Manuel López Obrador) and Peru (Ollanta Humala and Alan García).
whether it could have been avoided - is well beyond the scope of the present chapter, it is nevertheless useful to identify some of the key elements, which contributed to the gradual dissolution of Latin America's “neoliberal consensus” of the 1990s. The most obvious element was rooted in the changing Latin American fortunes in international financial markets: as reflected in Figure 8.2, long-term loan disbursements to Latin America declined significantly after 1998 in response to growing investor uncertainty following the East Asian financial crisis of 1997 and the Russian default of 1998, which were reinforced in the Latin American context by the Brazilian crisis of 1999 and the Argentine default of 2001. Even though access to foreign funding has not dried up to nearly the same extent as during the debt crisis of the 1980s, the comparative trends of net flows and interest payments on long-term debt in Figure 8.2 provide a telling story: thus, during the heyday of the credit boom (1993-8) net flows on foreign debt for the region exceeded interest payments, which meant that Latin America experienced a net inflow of funds even once we account for the cost of borrowing. However, by 1999, interest payments, which had been rising steadily since the mid-1990s, started to outstrip the net flow of long-term loans resulting in a return to the pattern of the 1980s with Latin America experiencing a net outflow of hard currency as a result of its interaction with international financial markets. At the same time, regional GDP and consumption growth have significantly slowed down after 1999, reaching levels that more closely resemble the stagnant 1980s than the economic boom of the 1990s. In other words, despite some significant variations in the nature and sources of international lending, the credit boom of the 1990s followed by the gloom of recent years bears some striking resemblance to the previous international lending cycle in which the commercial

253 Net flows represent the difference between new loan disbursements and principal repayments on long-term total debt (WDI 2006).

254 Thus, the average regional growth for Latin America was 1.25% for 1982-90, 3.67% for 1991-98, and 1.95% for 1999-2004. For household final consumption expenditure the corresponding growth averages were 1.4%, 3.8%, and 1.3% respectively. (Data based on WDI 2006)
bank lending of the 1970s fueled impressive but ultimately unsustainable economic growth, only to be followed by the painful reckoning of the debt crisis in the 1980s.

At this point, it is too early to judge whether Latin America is heading for a decade of renewed economic stagnation or whether the economic recovery of 2004/5 will prove to be sustainable. What is clear, however, is that the changing international circumstances have increasingly led to a return to the logic of a zero-sum relationship between domestic economic and political priorities on one hand and the interests of international investors and international financial institutions on the other. Thus, the negotiations surrounding the Argentine default of 2001 marked a return to earlier disputes about the appropriate way to apportion the inevitable economic losses produced by the default. The recent decisions by the Argentine and Brazilian governments to pay off their IMF obligations ahead of schedule in a nod towards domestic critics of IMF-style policies,255 further emphasize the significantly cooler relationship between the Fund and Latin American debtors compared to the heyday of cooperation in 1998.256 Opposition to IMF-promoted structural reforms also played an important role in Evo Morales’ electoral appeal, though it is too early to judge the extent to which he will reverse Bolivia’s earlier cooperation with the Fund.

However, the significant mood change towards neoliberal economic policies in Latin America in recent years cannot be solely attributed to the weaker financial incentives related to the cyclical nature of international lending. Two additional factors undermined the hegemony of neoliberal economic ideas starting in the late 1990s. The heated debates sparked by the Fund’s handling of the East Asian financial crisis meant that the IMF was no longer under fire only from

255 See *The Economist* (2005).
256 For example in November 1998, IMF singled out Brazilian President Cardoso and Argentine President Menem among “the best of modern political leaders” who “do not cower when crisis looms.” (cited in Deutsche Presse-Agentur 11/10/1998)
the anti-globalization left but from within the Washington establishment, as prominent figures such as World Bank chief economist, Joseph Stiglitz, joined the chorus of IMF critics with unexpected vigor. In other words, the “Washington Consensus” was no longer a consensus even in Washington, which lowered the costs to politicians and policy makers intent on deviating from the conventional wisdom of neoliberal economics. These costs have been further reduced by the spate of leftist victories throughout the region, which has reduced the specter of international and regional isolation to which leftist regimes such as Castro’s Cuba and Chavez’s Venezuela had been condemned until very recently.

At the same time, as illustrated in greater detail by the case evidence from Bolivia, Argentina, and Peru in the following section, neo-liberal economic policies became increasingly unpopular on the domestic front. The earlier statistical results about the electoral politics of IMF programs in the 1990s suggest that even in their heyday, IMF-style economic policies were not exactly popular among Latin American voters, and were, therefore, downplayed during electoral campaigns. By the late 1990s the widespread and highly publicized corruption allegations against many of the most prominent promoters of neoliberal reforms – including Menem in Argentina and Fujimori in Peru – further undermined the legitimacy and popularity of neoliberal reform efforts. With respect to performance-based legitimacy, the initial relief about the victory over inflation gradually gave way to a sense of disappointment over the slow pace of tangible improvements in the everyday life of ordinary citizens. This economic discontent was amplified by the post-1998 economic slowdown, which, combined with the region’s high and rising inequality, provided ample ammunition for domestic critics, who charged that the reforms of the

257 See e.g. Stiglitz (2000).
258 The deep and visible tensions between the United States and Western Europe during the run-up to the Iraq invasion arguably exacerbated this trend by exposing additional fault lines within the previously more monolithic “Western democracies.”
1990s had primarily benefited the economic and political elites, while the poor had to bear their costs in the form of price liberalizations, government spending cuts, and increased job insecurity.

**Neoliberal reforms and their aftermath: country evidence**

This final section briefly revisits the four Latin American country cases discussed in Chapters 4 and 6. This discussion makes no claim to provide a detailed analytical account of the political economy trajectory Argentina, Bolivia, Peru, and Chile after 1990 - rather, it is intended as a postscript to the earlier case studies and as an illustration of the theoretical points raised by this chapter. The first three cases represent interesting variations on the broader theme of the rise and fall of popular support for neoliberalism across a range of different political constellations: neoliberal populism in Menem’s Argentina, elite pacts in post-1985 Bolivia, and a mixture of populism and authoritarianism in Peru under Fujimori. Somewhat ironically (given its experience under the Pinochet dictatorship), Chile managed to steer a much steadier middle-ground under a succession of center-left *Concertacion* governments, and provides one of the few instances where market-oriented economic policies have been consistently compatible with democratic politics.

**Argentina’s unlikely reforms**

When Carlos Menem was elected president in 1989, Argentina hardly seemed like a promising candidate for becoming one of the showcase examples of neoliberalism for the following decade. The country was mired in political paralysis and hyperinflation after almost six years of inconclusive reform efforts by the centrist Alfonsin government, and Menem’s
populist electoral campaign combined with the Peronists’ parliamentary opposition to Alfonsín’s last-ditch adjustment efforts, hardly promised a drastic turnaround in the country’s political and economic trajectory. Once in power, however, Menem almost immediately signaled his reform intentions by entering an IMF agreement in late 1989, and despite some setbacks during the two years in power, oversaw the implementation of the *Convertibility Plan* in mid-1991, which finally succeeded to stabilize the Argentine economy. Even though these reforms were at odds with Menem's electoral promises and the traditional power base of the Peronist party, Menem was able to implement his agenda through a mixture of skillful political deals and favorable domestic and international circumstances. Even though some of the more popular policies were instituted through presidential decrees, Menem benefited from the Peronist majority in Congress and the weakness of the opposition following the debacle of the last two years of Alfonsín’s rule. With respect to the extra-parliamentary opposition, Menem was able to leverage his party's traditional ties to the union movement to broker a number of political deals, which assured the acquiescence of the union leadership, and, therefore, avoided the labor protests, which had undermined similar efforts by the Alfonsin administration. Since the successful control of hyperinflation by late 1991 was complemented by strong economic growth in the context of a favorable international environment, Menem was reelected by a decisive margin in 1995, which confirmed not only his personal popularity but also the broad popular endorsement of his government’s economic policy agenda in the early 1990s.

Despite the strong political mandate of the 1995 electoral victory, Menem's second presidential term already signaled the declining political fortunes of neoliberalism in Argentina. Even though the economy recovered relatively quickly from the recession induced by the

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259 See Etchemendy (2002) for an interesting discussion of these political deals.
260 The economy grew by more than 35% from 1991-94 (data from EIU Country Data).
Mexican *Tequila Crisis*, the more volatile international economic environment took its toll on the economy, which never returned to the impressive growth levels of the early 1990s.\(^{261}\) Moreover, as the memories of inflation and economic stagnation during the “lost decade” of the 1980s started to recede into the past, voters started to focus more on the downsides of reforms, such as the stagnant real wages and the significant rise in unemployment since the early 1990s.\(^{262}\) Nonetheless, the Peronist electoral losses in the parliamentary election of 1997 and the presidential contest of 1999 cannot be interpreted as an outright popular rejection of neoliberal policies because the centrist Alianza, which emerged victorious, had not advocated a drastic change in the country's economic policies. Instead, much of the opposition targeted the widespread corruption in the Menem administration, which had been denounced publicly by the architect of the Argentine *Convertibility Plan* prior to his resignation from his ministerial post in 1996. In the end, some of the very political deals, which had facilitated the implementation of reforms in the early 1990s, ended up undermining the political appeal of “Menemism” - and in the long run of neoliberalism - in Argentina.

Argentina's decisive break with neoliberalism did not fully occur until the financial collapse of 2001, and as such had important international roots. As mentioned at the outset of the chapter, Menem's time in office marked an unprecedented rapprochement with the IMF, and resulted in Argentina becoming a somewhat unexpected poster child of successful neoliberalism in Latin America until the end of the 1990s. However, the Currency Board, which been the center-piece of the Convertibility Plan of 1991, and had played an important role in restoring international investor confidence in Argentina, became an increasing economic and political

\(^{261}\) After shrinking by 2.8% in 1995, growth averaged almost 6% from 1996-8 but was followed by another 3.4% decline in 1999.

\(^{262}\) Thus real wage increases average less than 1% from 1997-9, while unemployment had fallen from its peak of 18.8% in 1995 but was still above 14% in 1999.
liability by the late 1990s, when the appreciation of the dollar undermined the competitiveness of Argentine exports and contributed to an alarming growth in the current account deficit. This imbalance was exacerbated by the Brazilian devaluation of 1999, and by the declining flows of fresh foreign investment after 1998. Despite a series of increasingly desperate IMF-backed attempts by the Argentine government to reassure foreign investors and save the Currency Board, Argentina eventually defaulted on its foreign debt by December 2001 following weeks of violent protests and the early resignation of President De la Rua.

The immediate economic fallout from the crisis was profound: the economy shrank by more than 15% in 2001-2, as did real wages and private consumption levels, unemployment levels rose to almost 20%, a large part of domestic savings were wiped out, and half the Argentine population was living below the poverty level. Even though the vigorous economic recovery since 2003 has brought GDP, wage and consumption levels back above pre-crisis levels, the crisis had significant long-term repercussions for the country’s domestic power balance, as well as its relationship to the Fund and international financial markets. The crisis aftermath marked a return of the more traditional leftist wing of the Peronist party under the interim presidency of Eduardo Duhalde, and, following the 2003 elections, under the leadership of Néstor Kirchner. Kirchner largely lived up to the leftist political agenda he laid out during the 2003 presidential campaign by assuming a rather tough bargaining stance during the debt renegotiation process with the country’s foreign creditors between 2003-5. Once this strategic objective was achieved, Kirchner followed Lula’s example and payed back all of Argentina outstanding financial obligations to the Fund ahead of schedule, in a symbolic move meant to mark the country's independence from IMF conditionality. On the domestic front, Kirchner.
clearly distanced himself from Menem’s neoliberal policies and resisted Fund pressures for faster structural reforms.

Thus, the end of Argentina’s neoliberal reform experiment had a number of significant commonalities with its birth more than a decade earlier: first, it occurred in the midst of a profound domestic economic crisis, which convinced large parts of the population that the existing political economy approach had failed and needed to be replaced. Second, the domestic crisis was triggered at least in part by the country's inability to honor its foreign debt obligations and in the context of serious pressures from the IMF and international financial markets. Finally, both the and the demise of neoliberalism originated in the country’s most powerful political machine – the Peronist party – which was able to harness its appeal among the poor and its ties to organized labor to enact policy turnarounds, which eschewed its predecessors from the UCR.

However, the two episodes also differed in important ways, which explains the opposite direction of the two policy reorientations: thus, in 1989/90 international financial markets were emerging from the debt crisis, and cooperation with the Fund’s neoliberal policy prescriptions promised (and delivered) substantial financial rewards in terms of foreign funding inflows, which helps explain Argentina's much better compliance record with IMF conditionality in the 1990s. Moreover, whereas the primary domestic economic concern in 1989 - the crippling and persistent inflation - could plausibly be addressed through orthodox stabilization measures (as illustrated by Bolivia's experience in 1985-86), the main domestic concerns after 2001 were the high unemployment levels and the weak economic growth a recent years, for which IMF-style austerity measures seemed like an unlikely solution. Finally, while Menem had successfully hijacked the Peronist party in support of his neoliberal reforms, by 2001 the traditional party base

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263 For a detailed discussion of the negative repercussions of IMF programs on economic growth and inequality, see Vreeland (2003).
among organized labor and the country’s poor had largely rallied behind the leftist wing of the party represented by Duhalde and Kirchner, and was once again ready to take to the streets to voice its concerns. Therefore, throughout its extended neoliberal adventure in the 1990s, the Argentine society continued to harbor important latent elements, which would ultimately reverse Menem’s ambitious marketization drive, including a strong mobilizational culture, a deep-seated distrust of the Western agenda in the region, and a political party whose traditional popular sector roots were not completely severed during the economic reforms of the 1990s.

Bolivia – the limits of democratic neoliberalism in a poor country

As discussed in Chapter 6, after 1985 Bolivia under the leadership of Victor Paz Estenssoro had emerged as one of the few instances of successful orthodox economic stabilization under a reasonably democratic regime. Even though the social costs of the austerity measures and the country’s slow growth undermined the high initial popularity of Paz’ government, the two parties of the ruling coalition (the center-right MNR and the right ADN) occupied the first two positions in 1989 parliamentary and presidential elections with over 45% of the vote, compared to only 7.2% for the candidate of the leftist Izquierda Unida. These results confirm that despite the drawbacks of the neoliberal economic policies of the late 1980s, Bolivians were willing to extend their support for the representatives of the pro market status quo. However, as a result of the collapse of the ruling pact between the MNR and ADN in early 1989, Banzer’s ADN backed the third place finisher, Jaime Paz Zamora (from the center-left Movimiento de la Izquierda Revolucionaria) in the parliamentary runoff vote and handed him the Presidency. The somewhat odd resulting Acuerdo Patriotico alliance between the two erstwhile
enemies from the 1970s confirmed the pragmatic, deal-based governing approach of the Bolivian political elite and ensured the continuity of pro-market economic policies until the 1993 elections. Even though the government’s tenure was riddled by allegations of corruption and ties to drug traffickers, the country’s solid economic performance during this time period, combined with the continued disunity of leftist parties and the declining mobilizational capacity of organized labor, led to a renewed electoral domination by the mainstream political parties (MNR, ADN and MIR) in the 1993 elections and a fairly strong political mandate for the presidential winner, the outspokenly neoliberal former Finance Minister from the 1985-9 period, Gonzalo Sánchez de Lozado. Despite the widespread popular opposition to some of Sánchez de Lozado ambitious structural reforms, the 1997 elections once again merely amounted to a shuffle between the traditional parties, and resulted in a new ADN-MIR coalition government. Even though Hugo Banzer’s presidential campaign had promised to reverse some of the unpopular reforms of the previous government, and, once elected, he included two smaller populist parties in the governing coalition, the election did little to signal a significant challenge to the neoliberal status quo of the previous 12 years. The first more significant electoral challenge came in 2002, when Evo Morales, leader of the left-wing Movimiento al Socialismo (MAS), finished second in the presidential poll, but the second round runoff in the parliament went to Sánchez de Lozado by a 2-1 margin.

Thus, between 1985 and 2002, Bolivian voters reliably returned politicians associated with neoliberal economic policies through democratic elections. Even though the political parties associated with this political mainstream nominally represented different ideological orientations (ranging from the center-left MIR to the right-wing ADN) and in some cases even had a bitter,  

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264 Even though Sánchez de Lozado’s first-round vote share was only 33.8%, this support was significantly higher than the one received by the winners of the previous two presidential contests, and determined second-placed Banzer to step down in the parliamentary runoff.
long-standing ideological rivalries,265 their economic policies revealed little variation and stayed within the broad confines of the broader neoliberal consensus of the 1990s, even though the intensity of neoliberal reform efforts was probably higher during the MNR administrations of 1985-89 and especially 1993-7. This neoliberal policy continuity in a poor, democratic country with a long history of coups, riots and policy reversals can be traced to a number of favorable circumstances: first, the country’s close cooperation with the IMF throughout the 1990s266 yielded significant financial benefits not only in direct IMF, World Bank and IADB loans but also by helping the country secure a large amount of debt service relief from official external creditors under two successive rounds of the Heavily Indebted Poor Countries (HIPC) Initiative.267 Second, while hardly spectacular given the country’s low starting point, Bolivia experienced fairly steady output, consumption and wage growth in the context of low inflation for much of the 1990s,268 an outcome which compared favorably to the disastrous economic performance under the leftist Siles government in 1982-5. Third, the political pacts between the three main parties of the mainstream political elite (MIR, ADN, and MNR) contributed to considerable political stability and avoided the polarization and infighting, which had paralyzed successive pre-1985 governments. Finally, despite a series of local riots and protests throughout the 1990s, the opponents of neoliberal policies lacked the organizational capacity to mount a serious challenge to the neoliberal establishment due to the weakness and fragmentation of leftist parties and the noticeable decline in the fortunes of the previously combative labor union movement as a result of structural reforms.

265 For example, the leftist MIR was heavily persecuted during the military dictatorship of future ADN leader, Hugo Banzer in the 1970s.
266 Even though the country did not enter another standby agreement until 2003, it was quasi-permanently involved in a series of lower conditionality PRGF programs.
268 Thus, average GDP growth from 1990-98 was 4.4%, while private consumption grew by 3.7% per annum during this time period.
The demise of the Bolivian neoliberal miracle was surprisingly swift considering its remarkable resilience for almost two decades since its improbable birth amid the hyperinflationary crisis of 1985. Even though popular protests against particular economic reform measures had occurred repeatedly in the late 1980s and through most of the 1990s, successive Bolivian governments had managed to minimize their political fallout, even if at times that meant resorting to excessively forceful interventions. However, these protests against neoliberal policies began to intensify starting in 2000, fueled by the government’s unpopular war on coca producers and the controversial scheme to use a Chilean pipeline to export Bolivian natural gas. By 2003 these protests gained sufficient momentum to lead to political paralysis and the resignation of President Sánchez de Lozado, following months of massive protests, which were violently repressed by security forces and resulted in dozens of deaths. Strikes and protests continued throughout the following two years amid growing popular opposition to neoliberalism, and eventually led to early elections, which were won with a clear majority by Evo Morales, on an outspokenly anti-neoliberal and anti-Western electoral platform.

While it is too early to assess the economic and political consequences of Morales’ victory, it clearly marks the end of almost two decades of Bolivia’s peculiar brand of democratic neoliberalism. Some of the roots of this ultimate failure echo the Argentine case: thus, while the use of the state resources had played an important role in ensuring the survival of (sometimes unlikely) pro-reform coalitions, the widespread corruption involving key figures from all the major parties eventually undermined the legitimacy of not only the implicated politicians but

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269 For example in late 1989, President Jaime Paz Zamora declared a state of siege in response to massive strike of the teachers’ union, which resulted in 2000 arrests and the internal deportation of 200 of those arrested.

270 In April 2000, President Hugo Banzer declared a state of emergency in response to widespread protests and violent clashes between demonstrators and police following the controversial privatisation of the Cochabamba water supply.

271 For example, in 1996, during the first Sánchez de Lozada presidency, 8 MNR deputies were forced to resign and 10 others were temporarily suspended due to a corruption scandal over fabricated expenses. Meanwhile, Paz
of the entire neoliberal reform enterprise because it fueled popular perceptions that economic reforms had added to the wealth of the political elite at the expense of the country’s impoverished masses. Like in Argentina, popular support for neoliberalism declined as the memories of successful solution to hyperinflation receded into the past, and were replaced by concerns about economic stagnation and poverty. However, the role of international factors in the demise of neoliberalism differed significantly from the Argentine case: thus, Bolivia, which even during the lending boom of the mid 1990s had relied primarily on bilateral and multilateral loans, was less affected by the reversals in international lending patterns after 1999, and did not suffer from an external shock of the magnitude of the 2001 Argentine crisis. However, Bolivian popular discontent was fueled by the cooperation of successive Bolivian governments with the US-led war on drugs, and triggered the rise of the coca-growers’ union under the leadership of Evo Morales. Moreover, the controversial role of Western multinationals in the Bolivian economy (especially during the Cochabamba water scandal and the exploitation of the country’s recently discovered vast natural gas reserves) provided a focal point for a variety of different opponents of neoliberalism. This focal point was particularly important since, unlike in Argentina, the Bolivian opposition to neoliberalism did not find an outlet through any of the traditional political parties but rather grew out of a variety of loosely connected interest groups and social movements, including the traditional labor unions, indigenous groups, and coca growers. Since many of these groups represented the many Bolivians who felt that they had been excluded from the neoliberal consensus of the 1990s, the Bolivian case illustrates the limitations of democratic neoliberalism in poor and unequal countries. On the other hand, it is equally unclear whether the heterogeneous coalition, which propelled Morales to the Presidency in 2005,

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Zamora, the MIR leader and Bolivian President (1989-93) had his US visa revoked in 1996 due to his questionable ties narco-traffic circles.
will survive the demise of its common enemy and manage to articulate a coherent developmental vision for Bolivia, or whether it merely represents a new stage in the all-too-familiar Latin American political economy cycle.

Peru under Fujimori

The economic and political evolution of Peru under the leadership of Alberto Fujimori represents an interesting deviation from the broad general pattern of democratic neoliberalism, which dominated Latin American political economy in the 1990s. On one hand, in the early 1990s Fujimori oversaw a remarkable economic policy turnaround, which reversed the economic freefall of the last three years of the Garcia administration and brought the country back into the favors of international financial markets and the IMF. In fact, since 1993 Peru has been involved quasi-permanently in a series of largely implemented IMF programs, which added the international seal of approval on the country’s ambitious neoliberal policies after 1990. However, countering the region-wide democratization trend of the last two decades, Peru experienced a lengthy period of democratic retrenchment after Fujimori’s 1992 constitutional coup, and despite the legitimating effect of his 1995 electoral victory, Fujimori’s ten-year rule was marred by a series of significant deviations from democracy all the way until his controversial reelection in 2000, and his resignation less than a year later.

At first glance, therefore, the Peruvian experience of the 1990s appears like a throwback to the authoritarian economic reformers of the 1980s. However, a closer look at the succession of political events surrounding Fujimori’s authoritarian adventure suggests a more complicated picture. Leading up to his surprising 1990 electoral victory on a vague platform of “work, technology, honesty,” Fujimori was arguably seen by most voters as a compromise solution
between Garcia’s costly anti-Western heterodoxy and the unabashedly pro-market message of his main rival, Mario Vargas Llosa. However, once in office, Fujimori joined Menem as one of the quintessential examples of a new breed of Latin American neoliberal populists. Faced with Alan Garcia’s disastrous economic legacy, which combined persistent hyperinflation, a deep recession and quasi-complete international economic isolation, Fujimori instituted a drastic program of economic reforms – popularly referred to as *Fujishock* – to tackle the debilitating crisis. The initial results of these reforms were remarkably positive in the sense that within a year of assuming power, Fujimori had succeeded in checking hyper-inflation, restoring economic growth (at an admittedly modest rate of 2.2% in 1991) and reducing unemployment (from 8.3% in 1990 to 5.9% in late 1991). As the intensity of the economic crisis began to subside, however, Fujimori found himself increasingly at odds with the parliament, which was largely controlled by the traditional political parties and opposed Fujimori’s austerity measures for the 1992 budget. Lacking Menem’s congressional support and control over an effective political machine, Fujimori instead resorted to an army-backed *autogolpe* in April 1992, during which he dissolved Congress and the judiciary with the stated aim of rooting out corruption. Thus, on one hand, Fujimori’s coup fits the earlier pattern of Latin American regimes overstepping the boundaries of democratic politics in order to impose market reforms. On the other hand, despite being clearly anti-democratic from a procedural point of view, Fujimori’s *autogolpe* actually had overwhelming popular support due to the promising economic results of the initial economic reforms and the appeal of his claim that the measures were necessary to overcome entrenched interests of the country’s traditional political elite. Thus, unlike the typical pattern of authoritarian repression of popular resistance to austerity measures, Fujimori’s transgression was of a more plebiscitary nature given his genuine popular support among ordinary Peruvians eager

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272 See e.g. Weyland (1999).
for a solution to the country’s prolonged economic and political malaise. This popularity was confirmed during the (admittedly flawed) parliamentary elections of November 1992, and once more by Fujimori’s overwhelming victory in the presidential and parliamentary elections of 1995.

The international reaction to Fujimori’s autogolpe is indicative of the significant changes in the global political and economic environment since the 1980s. The coup provoked strong reactions not only from Latin American governments and the Organization of American States, but also from the US and West European governments, which suspended foreign aid to the Peruvian government. Even the IMF, despite commending Fujimori for his austerity budget, threatened to withhold promised funding and delay the normalization of Peru’s relationship with the international financial community until the country resumed its democratic path. This remarkably consistent international reaction to the coup marked a clear departure from the 1980s, when Western donors condoned the Fund’s close ties to Latin American authoritarian regimes, such as Pinochet’s Chile. Faced with the prospect of extremely costly economic sanctions, Fujimori did not backtrack on his actions but compromised by meeting with the opposition parties and calling earlier parliamentary elections (in November 1992) than originally envisioned. The effectiveness of Western democratic conditionality helps explain why in the 1990s IMF-style reforms were more likely to be accompanied by at least formally democratic governance, given that compliance with only the economic aspects of Western liberalism no

273 Fujimori’s Cambio 90 secured an absolute majority of seats based on a 38% vote share in an election, which was largely considered free and fair by international observers but which had been boycotted by the major opposition parties in protest over the greatly increased power of the presidency vis-à-vis parliament following the constitutional changes earlier that year.

274 Fujimori won 64.4% of votes compared to 21.8% for his closest rival, Javier Pérez de Cuéllar, while his party secured 67 of the 120 parliamentary seats (Keesing’s vol.41 April 1995).
longer provided the same benefits as during the more “pragmatic” Western approach to foreign policy in the 1980s.

While this prompt international reaction arguably reduced the coup’s negative repercussions for Peruvian democracy, ulterior developments illustrate some of the limitations of the new Western approach to promoting economic and political liberalism in the developing world. Thus, despite the problematic nature of the 1992 parliamentary elections and the persistence of important deviations from standard democratic practice throughout the 1990s, Peru’s relationship with the international community largely normalized by late 1992, which facilitated the resumption of bilateral aid and international financial reintegration. Arguably, the crucial driver behind this swift normalization was the fact that U.S. concerns about the Shining Path insurgency and the Peruvian cooperation with American drug eradication efforts ultimately overshadowed concerns about democratic practices as long as Fujimori was willing to maintain at least a semblance of democratic rule. The extensive human rights violations, which accompanied the government’s anti-insurgency campaign, further undermined the quality of Peruvian democracy but had limited repercussions on Fujimori’s domestic and international legitimacy due to the campaign’s unexpected success in getting the rebellion under control after more than a decade of widespread violence. Therefore, the drivers and the political feasibility of Fujimori’s semi-authoritarian leadership style were rooted in Peru’s geopolitical exceptionalism rather than in the tension between his aggressive neoliberal reforms and democratic politics. This interpretation is further justified by the fact that once the insurgency threat had virtually disappeared by the late 1990s, both domestic and international public opinion

275 Thus, Peru’s average Freedom House political rights score from 1992-2000 was a 5 on a 1-7 scale (where higher scores are worse), whereas on the -10 to 10 Polity regime scale, Peru scored between -3 and 1, well below the usual cutoff point of 6.

276 The process was greatly accelerated by the capture of Sendero Luminoso leader Abimael Guzmán in September 1992.
showed a lot less patience towards Fujimori’s deviations from democracy, and eventually contributed to his downfall in 2000.

Fujimori’s political star began its descent almost immediately following his electoral triumph in 1995. However, unlike in neighboring Bolivia, the main reason for Fujimori’s declining popularity was not his continued pursuit of neoliberal reforms in close cooperation with the IMF. Even though output and private consumption growth slowed down considerably starting in 1998, while real wages declined steadily since their pre-electoral spike in 1994, Peru did not experience significant popular mobilization against neoliberal policies, despite the prominent role played by foreign companies in the privatization process and the extraction of natural resources. Instead, the political opposition focused increasingly on the corruption allegations against Fujimori and his entourage, as well as on the government’s occasionally heavy-handed attempts to control the media, repress the opposition, and manipulate the judiciary. Therefore, the main challenge during Fujimori’s controversial third bid for the Presidency, came from Alejandro Toledo, a U.S.-educated economist focusing on Fujimori’s corruption and patronage legacy rather than on reversing economic neoliberalism. Even though Fujimori managed to win the controversial 2000 elections amid fraud allegations and widespread protests, his third term was cut short in the fall of 2000 when a final high-profile corruption scandal led to his resignation and exile to Japan.

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277 Thus, GDP growth averaged only 1% between 1998-2000, compared to 7.1% per year from 1993-97, while for private consumption changes the corresponding averages were 0.7% and 6% respectively.

278 The one notable exception was a one-day general strike in April 1999, which criticized low wages and the government’s privatization program but also decried Fujimori’s attempt to change the constitution in order to run for president for a third time.

279 Fujimori’s image suffered significantly as a result of repeated corruption allegations from his estranged wife following a highly publicized divorce in 1985.

280 The scandal involved a tape of Vladimiro Montesinos, one of Fujimori’s closest associates and head of the security services, bribing an opposition Congressman, Alberto Kouri, in order to ensure a congressional majority for the President.
Even though economic grievances played only a secondary role in Fujimori’s declining popularity during the late 1990s, domestic opposition to neoliberalism has steadily increased since his resignation. The first clear signal of this change in public mood came during the 2001 presidential elections, in which Fujimori’s main challenger from 2000, Alejandro Toledo barely defeated the former President, Alan Garcia, despite the latter’s relatively recent abysmal governing record from 1985-90. Despite the relatively healthy economic recovery of the last four years, Toledo’s administration has been plagued by a series of high-level corruption scandals, as well as increasing levels of popular protest against his government’s continuation of neoliberal economic policies under IMF guidance. Somewhat ironically, popular patience with neoliberalism seems to be running low just as democratic governance was finally restored after Fujimori’s resignation. The fate of Peruvian neoliberalism currently hangs in the balance, as the upcoming presidential elections pit the right-leaning, pro-market Unidad Nacional candidate, Lourdes Flores, against Ollanta Humala, whose outspoken anti-neoliberal rhetoric and past history as a coup organizer echoes the background of Venezuelan President Hugo Chavez.

Despite their obvious differences in democratic governance, the neoliberal reform trajectories of Peru and Argentina reveals some interesting parallels. In both cases reforms were initiated in the midst of severe inflationary crises by recently elected presidents, who, once in power, quickly reversed their vague populist electoral promises gradual reforms and instead took advantage of their political capital and of the temporary disarray of traditional reform opponents to impose drastic market reforms with IMF backing. It both cases, the considerable short-term

\begin{enumerate}
\item GDP grew by an average of almost 4.9% from 2002-05, and real wages finally started to recover after their decline in the late 1990s.
\item Under Toledo’s presidency, Peru has been one of the few remaining Latin American countries to be engaged in quasi-permanent precautionary IMF programs in recent years.
\item The two candidates were virtually tied in the most recent polls, and were followed relatively closely by Alan Garcia.
\end{enumerate}
economic success of these adjustment policies translated into genuine popular support for the two leaders, Menem and Fujimori, who won convincing electoral victories in the mid-1990s. However, as the memories of the traumatic crises of 1989-90 started to fade, the two leaders became victims of their own governing styles as corruption scandals (for both Menem and Fujimori) and growing concerns about Fujimori’s authoritarian tendencies contributed to their eventual political demise. In doing so, however, Menem and Fujimori compromised not only their own political careers but also the popular appeal of neoliberalism, whose fortunes were indelibly linked to image of the two leaders, and, therefore, lost much of its moral legitimacy.

*Pinochet’s unexpected legacy: Stable democratic neoliberalism in Chile after 1990*

Following the remarkable stability of its neoliberal authoritarian political economy model under Pinochet’s dictatorship, Chile’s trajectory after 1990 once again stands out for its continuity in a region marked by volatile politics and increasingly volatile economic policies. Since the reestablishment of democracy following the elections of December 1989, successive governments of the center-left Concertacion coalition have pursued consistently pro-market economic policies in a democratic context without triggering the types of societal protests and electoral challenges, which ultimately undermined neoliberalism in Argentina, Bolivia, and increasingly in Peru. The drivers of this Chilean exceptionalism, which will be briefly discussed in this section, help identify the circumstances under which the neoliberal consensus of the 1990s could survive the changing international economic and political environment of the post-2001 era. In particular, the resilience of liberal economic policies in Chile was facilitated by the country’s better track record in fighting poverty and corruption, the ideological moderation and
consistency of the mainstream political parties, as well as by the greater societal reluctance (and capacity) to engage in widespread protests given the chaotic experience of the Allende regime and the subsequent repression under Pinochet.

Somewhat ironically, many of the drivers of Chile’s stable, democratic neoliberalism are a legacy of Pinochet’s military dictatorship the 1970s and 1980s. Thus, unlike the Bolivian reformers in 1985 and their Argentine and Peruvian counterparts in 1989/90, the comfortably low inflation inherited by the victorious Concertacion alliance in Chile did not require the kind of drastic adjustment policies, which eventually ended hyperinflation in its much more chaotic neighboring countries. Instead, one may have expected the new government to reverse some of the features of the “Chilean economic model” instituted during the military dictatorship, given that much of Concertacion’s electoral support came from the popular sector, which had suffered disproportionately from the high social costs of the austerity measures of the early to mid-1980s. Moreover, while excluding the hard-line Communists, the governing coalition nonetheless largely consisted of left-of-center parties,284 which by the partisan logic of the 1980s should have redirected the country’s economic policies towards greater state intervention and government spending to compensate for the decade and a half of sustained neoliberal reforms.

Instead, over the last decade and a half, successive Concertacion governments have pursued remarkably consistent neoliberal economic course, characterized by prudent fiscal and monetary policies, continued structural reforms, and international financial liberalization and economic integration. Moreover, even though Chile did not initiate any IMF agreements following the successful completion in November 1990 of the “legacy” standby agreement initiated in the final weeks of the outgoing Pinochet government, Chilean economic policy has

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284 Thus, in late 1989, the Partido Socialista (PS) was still officially committed Marxism (a position that it only renounced 1996), and even the centrist Partido Demócrata Cristiano (PDC) only dropped its traditional advocacy of “communitarian socialism” from its party program in late 1991. (EIU Country Profile 1996)
repeatedly met with IMF approval, which confirms that the absence of official IMF involvement was a sign of Chile having “graduated” from a group of countries needing IMF conditionality to reassure foreign investors and ensure economic discipline. Just as remarkably (considering the experience of its neighbors), this economic orthodoxy has not triggered the rise of significant anti-neoliberal challenges at either the electoral or the societal level: indeed, since 1989, Concertacion has achieved the remarkable performance of five consecutive electoral victories in the region known for its fickle political allegiances, and in each of these elections the main challenge has actually come from the right of the political spectrum, i.e. from parties advocating even greater reliance on markets.

The explanation for this seeming paradox, which further confirms the statistical findings about the much lower salience of ideology and the greater compatibility between democratic politics and economic neoliberalism in the 1990s, relies on a combination of broader regional trends and country-specific factors (which nevertheless have important theoretical implications.) First, after the painful recession of 1982-3, the Chilean economy had started to recover gradually, and by late 1989 was in the third year of an economic boom, with average GDP growth of 8.8% from 1987-89, rising consumption levels and steadily declining unemployment.285 Under such circumstances it would have been risky to attempt to fix an economic policy course that by early 1990 clearly was not broken, especially because the healthy economic growth promised to attenuate some of the key concerns of the left, such as poverty and redistributive conflicts. This performance-based legitimacy of neoliberalism has arguably continued to be one of the crucial factors for its political stability throughout the post-1990 period: thus, the Chilean economy grew at an impressive rate for most of the 1990s and its export-led growth was much less affected by the regional economic downturn in recent years.

285 Thus, employment declined from a staggering 19.6% in 1982 to 5.3% in 1989. (EIU Country Data).
than for most of its neighbors. Perhaps more importantly for the political appeal of neoliberalism, the Chilean government’s commitment to fight poverty has not been only rhetorical but has resulted in a significant reduction of poverty and extreme poverty levels since 1990, whereas elsewhere in the region poverty levels have actually increased even during the economic boom of the 1990s. As a consequence, despite the persistence of high levels of inequality, Chilean neoliberalism has been much less vulnerable to the common charge that the benefits of neoliberal growth have largely eluded the poorest members of society, which may explain the virtual absence of riots and significant left-populist electoral challenges in the last decade and a half.

The second reason for the unexpected continuity of neoliberal economic policies under the center-left Concertacion echoes the earlier discussion about the powerful international incentives to adopt pro-market policies in the early 1990s. In the Chilean case, these incentives were arguably accentuated by the fact that at the start of the decade Chile emerged as one of the region’s most creditworthy countries, and as such was ideally positioned to take advantage of the emerging international financial market boom. The importance of securing more favorable loan terms was further amplified by the continued high interest payment burden, which was one of the highest in the region at more than 6% of GDP in 1989-90. Finally, in line with the statistical findings, Chile’s compliance with its 1990 IMF program may have been driven at least in part by the fact that the rescheduling of $4.2bn of its foreign debt in 1990 could have been

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286 From 1990-98, the average growth rate was 7.5% per year, and after a one-year recession triggered by the Brazilian crisis of 1999, growth resumed once more at a respectable average rate of 4.3% from 2000-05.

287 Thus, in Chile the proportion of the population living on less than $1/day (PPP) declined from 6.2% in 1990 to 2% in 2000, while during the same time period it had increased from 2% to 3.3% in (pre-crisis) Argentina, from 5.7% to 14.4% in Bolivia and from 2% to 18% in Peru.

288 In fact, Chile had the highest IIS credit rating score in the region in early 1990, and it defended and even extended its lead for the rest of the decade.

289 Meanwhile, countries such as Bolivia and Peru had decidedly dimmer prospects regardless of the domestic policies they pursued.
significantly complicated if the new government had initiated a drastic reversal of neoliberal economic policies.

The third – and decidedly more problematic – reason for the policy restraint of Chile’s leftist government and the virtual absence of organized societal resistance to neoliberalism is an even more direct political legacy of the Pinochet dictatorship. In the most immediate sense, having exited power through a negotiated transition and with considerable societal support, the military continued to be a towering presence during the early years of Chile’s nascent democracy, and could therefore impose rather tight constraints on acceptable economic policies due to the implicit threat of renewed military intervention. At least in the early 1990s this credible threat probably also acted as a disincentive for strikes and societal protests against neoliberal reforms. Even beyond these immediate constraints, the systematic and brutal repression of labor unions and left-wing political organizations during the 16 years of the dictatorship significantly undermined the organizational capacity of the most likely reform opponents. In this respect, the Chilean experience more closely resembles the political situation in the post-communist countries, where the longer and “deeper” authoritarian experience resulted in a weaker articulation of societal interests (Bunce 1998), and, therefore, reduced active popular resistance to neoliberal economic policies.

Finally, successive Chilean governments have managed to eschew corruption to a much greater extent than most other Latin American countries, and have, therefore, avoided crippling corruption scandals, which have undermined the credibility of neoliberal reformers in Argentina, Bolivia, and Peru. Judging by the overtime evolution in the Transparency International Corruption Perception Index for the four countries, illustrated in Figure 8.7, corruption levels in

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290 One exception in this respect was a 1994 trade union protest asking for direct negotiations on wages and social conditions. (Keesing’s vol. 40 April 1994)
Chile have not only been uncharacteristically low by regional standards\textsuperscript{291} but they have been slightly improving since the mid-1990s. By contrast, the corruption situation has been deteriorating steadily in Peru, and has been fluctuating at catastrophic levels in Argentina and Bolivia. Given that Uruguay, the country with the second best corruption track record in Latin America, has also experienced a high degree political stability and neoliberal policy continuity in a democratic context in the 1990s, it appears that the importance of corruption in the eventual demise of Latin American neoliberalism may be generalizable beyond the four cases discussed in this chapter. At the same time, however, it is important to recall that in both Argentina and Bolivia the tenuous political coalitions in favor of neoliberal reforms were held together through strategic use of discretionary resources. Since the line between such political deals and outright corruption is often very blurry, these findings suggest a rather paradoxical conclusion, namely that in countries with mobilized anti-reform groups, the very tactics necessary to build reform coalitions usually end up undermining the long-term legitimacy and visibility of neoliberal reforms.

\textit{Conclusion}

This chapter has analyzed economic and political drivers of Latin American IMF programs after 1990. The statistical findings and the case evidence from Argentina, Bolivia, Chile, and Peru reveal that in the 1990s IMF-style reforms were no longer at odds with democratic politics and did not elicit the ideologically charged policy reactions, which had been typical during the debt crisis of the 1980s. Instead, as in the post-communist transition,

\textsuperscript{291} Chile’s corruption “peers” were Western democracies such as Germany and the United States, and it scored significantly better than several EU members (including Spain and Portugal, especially Italy and Greece.)
ideological differences only mattered at low levels of financial need but vanished (and were even reversed) in the face of serious external economic crises. The two strongest economic drivers of IMF programs in the 1980s – inflation and interest payments – no longer mattered in the 1990s as high inflation virtually disappeared after the 1992 and debt service burdens declined in the context of the more favorable international economic environment. Nonetheless, the IMF still played an important role in countries with low international reserves and in facilitating the debt rescheduling agreements of the early 1990s, which paved the way for the reentry of Latin American debtors into international financial markets.

The similarities between the political dynamics of East European and Latin American IMF programs of the 1990s and the contrasts to the more antagonistic interactions of the 1980s confirm the importance of the changing international economic and geopolitical environment, which allowed the IMF to play a much less controversial role during the economic boom of the 1990s than during the debt crisis. The greater international benefits of adopting IMF-style policies, combined with the domestic successes of neoliberal reformers in controlling hyperinflation and delivering economic growth paved the way for a period of unprecedented democratic neoliberalism in Latin America, as illustrated by the Argentine, Bolivian, and Chilean cases discussed in this chapter. Even where democratic politics suffered significant temporary setbacks – as in Peru after 1992 – democracy was not undermined by neoliberal reforms (which were broadly popular) and international pressures (including from the IMF) were less likely to ignore democratic concerns in favor of pro-market economic policies.

In recent years, however, this neoliberal consensus has unraveled throughout much of Latin America giving way to a wave of leftist electoral victories and social movements opposed to the neoliberal policies of the 1990s. Judging by its timing and the comparative evidence from
Argentina, Bolivia, and Peru, this chapter has argued that this political economy reversal has been driven to a large extent by the changing dynamics of international financial markets, which have been a lot less favorable towards Latin America in recent years and have had negative repercussions on domestic economic performance in Argentina and elsewhere. However, the analysis also reveals significant differences between the resilience of democratic neoliberalism in Chile, its ultimate collapse in Argentina and Bolivia, and its uncertain status in Peru. These contrasts suggest that the broader international changes were filtered through the particular political and economic circumstances of individual countries: in particular, the ability of Chilean reformers to control corruption and reduce poverty has played an important role in ensuring the continued legitimacy and political feasibility of neoliberalism in Chile, whereas in Argentina, Bolivia, and Peru widespread corruption and increasing poverty have undermined the credibility of neoliberal reformers and have fueled the eventual backlash against neoliberalism. These findings suggest that the widespread compatibility between democracy and the IMF-style reforms in Latin America during the 1990s was in many cases the product of a favorable international environment, but where neoliberal reformers failed to address the crucial developmental problems of their countries, the fair-weather reform alliances dissipated in the face of the domestic and international economic slowdown after 1999.
Chapter 8

Theoretical Conclusions and Policy Implications

This book has analyzed the political dynamics of IMF programs in the developing world. The complex picture that emerges from this analysis reflects the location of IMF programs at the intersection of a variety of domestic and global interests. Any given IMF program may be shaped by the economic and political priorities of actors as diverse as the U.S. State Department, technocrats within the IMF and the finance ministries of developing countries, government and opposition political parties, labor and business organizations, or guerrilla movements. As a consequence, it is hardly surprising that despite the relative uniformity of the Fund's theoretical approach to conditionality, the actual trajectories of IMF programs are as diverse as the political and economic environments in which they unfold.

Towards a more comprehensive theory of neoliberal reforms

While acknowledging and capturing the complex drivers of IMF-style reforms, the structured cross-regional and cross-temporal comparative analysis developed in this book allows us to go one step farther and to propose a more integrated theoretical explanation of the political dynamics of IMF programs, and of neoliberal reforms in the developing world more broadly. The book’s central comparison - between IMF programs during the Latin American debt crisis and the post-communist transition - reveals a wide range of differences in the political economy of IMF program initiation and implementation, which will be summarized in more detail below. However, the defining difference between the two crisis episodes was that in Latin America during the 1980s IMF interventions triggered significant domestic and international political
contention, which resulted in divergent ideological policy responses to economic crises and pitted neoliberal reform priorities against the region’s nascent democratic politics. Meanwhile, in Eastern Europe democracy was compatible and even conducive to IMF-style economic reforms, and economic crises triggered policy convergence between governments of different ideological persuasions.

The contrast between these two crucial episodes of IMF interventions in the developing world has important theoretical implications for the domestic and international political economy of neoliberal reforms. As illustrated by the analysis in Chapters 3 and 4, the tone and the broad parameters of the interaction between the IMF and the governments of the two regions were largely determined by the international financial and political environment in which the two crises unfolded. Western concerns for international financial stability and the survival of the troubled Western commercial banks resulted in an IMF agenda that heavily emphasized a combination of debt servicing and domestic austerity measures for Latin American debtors in the 1980s. The bitter medicine prescribed by the IMF, combined with the weak palliative prospects of private lending as a reward for compliance, resulted in widespread popular opposition to the neoliberal reform agenda of the IMF, thereby creating significant trade-offs between compliance with IMF conditionality and democratic politics. Moreover, given that the debt crisis occurred in the bipolar international environment of the last decade of the Cold War, the Fund's policy prescriptions and the nature of the region’s economic crisis triggered divergent ideological reactions, as the Right largely agreed with the IMF diagnosis and initiated orthodox economic reforms in response to economic crises, while populist and left-leaning governments either avoided reforms or attempted heterodox policy alternatives.

292 At least until the late 1980s, the existence of the communist bloc offered both an ideological reference point for left-wing parties and potential economic support to counter (at least partially) the US economic and political dominance of the region.
Meanwhile, Western priorities for the post-communist transition primarily targeted the integration of East European countries into the world economy while avoiding political unrest and a possible return to communism. Since debt played only a marginal role in Eastern Europe, the IMF played a much less controversial role as a neoliberal reform adviser to countries dealing with the complicated economic legacy of communism and trying to gain access to the international financial boom of the 1990s. Therefore, reform-oriented governments could point to the significant economic gains associated with IMF compliance, while blaming many of the costs on the communist-era distortions, a strategy which led to much greater popular support for market reforms and a more harmonious relationship between democracy and neoliberalism. Moreover, in the absence of a real ideological alternative to the liberal Washington Consensus, the policy choices of governments of different ideological persuasions converged in the face of economic crisis, as even former Communists went along with the Fund's policy prescriptions. The crucial importance of the international economic and political environment is further confirmed by the analysis in Chapter 7, which indicates that in the context of the financial boom of the 1990s, and the ideological exhaustion of alternatives to Western liberalism, the politics of Latin American IMF programs were more similar to the post-communist experience than to their own recent track record during the debt crisis. The unexpectedly peaceful coexistence of democratic politics and neoliberal reforms and the equally remarkable “death of ideology” in a region with a history of deeply rooted class conflict and ideological polarization reinforces the book’s argument about the crucial importance of the international “reward structure” in driving the political dynamics of IMF programs and of neoliberal reforms more broadly.

The importance of international economic policy incentives is further emphasized by the recent left turn in Latin American politics: as discussed briefly in Chapter 7, the net funding
outflows from Latin America after 1999, combined with the growing internal fissures in the
Washington Consensus have weakened the incentives for Latin American governments to comply with IMF policy prescriptions, and has contributed to a significant cooling down of the earlier close cooperation with the Fund by the Argentine and Brazilian governments. This new international reality also had important repercussions for the domestic politics of economic reforms, as recent years have witnessed a renewed rise of popular opposition to neoliberalism and a series of leftist and populist political parties and leaders, whose economic policy stance marks a much more significant departure from neoliberalism than had been the norm since the end of the debt crisis.

Despite the obvious importance of systemic incentives, several aspects of the present analysis suggest that the domestic politics of economic reforms cannot be simply reduced to a mechanical reproduction of global economic and ideological trends at the national level. Instead, these international pressures and incentives are filtered through the domestic constellations of economic and political interests as well as through domestic institutional and cultural legacies, which differed significantly across regions, as well as between countries within the two regions. Thus, even during the heyday of the 1990s, several countries from both Latin America and Eastern Europe293 resisted the neoliberal policy advice of the IMF and other international financial institutions. Similarly, the recent turn away from neoliberalism has not affected all Latin American countries equally.294 Finally, a closer look at the individual cases suggests that even in countries with superficially similar economic reform trajectories - such as Argentina and Peru in the 1990s - the politics behind the rise and fall of the neoliberal consensus were driven by

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293 Examples include Cuba and more recently Venezuela in Latin America, as well as Belarus, Uzbekistan, Turkmenistan, and until recently Yugoslavia among the post-communist countries.

294 As discussed in Chapter 7, the recently reelected center-left Concertacion coalition in Chile is likely to continue its steady pro-market policies of the last 16 years. Similarly, Oscar Arias’ (admittedly close) recent victory in Costa Rica signals a continuation of the countries earlier economic policy course.
very different constellations of domestic and international factors.

Just as importantly, Eastern Europe has not experienced a similar left-turn in recent years, which raises some interesting questions about the roots of the renewed resurgence of political resistance to IMF-style reforms in Latin America. One reason is arguably the persistence in Latin America of a latent popular distrust of the IMF throughout the boom of the 1990s, which is underscored by the worse IMF program implementation record of Latin American governments prior to elections. Moreover, the continued economic and political incentives of European integration for many transition countries have arguably reduced the impact of the recent changes in international financial markets in recent years. The other crucial reason for this disjuncture was the persistence of important cross-regional differences in the domestic articulation of economic and political interests: even though the decline of labor unions and the rise of the informal sector have weakened the strong traditional organizational bases for social mobilization, the popular sector in Latin America nevertheless retained a stronger organizational capacity and protest culture than the highly disarticulated economic interests of post-communist citizens. As a consequence, the rising popular discontent with neoliberal policies since the late 1990s has given rise to a wave of anti-neoliberal protests in much of Latin America, accompanied by a rise of leftist parties that appear more responsive to these policy demands than most of the nominally leftist Communist successor parties in Eastern Europe.

Thus, the comparative analysis of Latin American and East European IMF programs in the last two decades suggest that the broad compatibility of neoliberal economic policies and democratic politics in the 1990s were not the beginning of a liberal Fukuyama-style “end of history” but rather a rational response of elites and populations in the two regions to the powerful

295 Thus, the victories of Communists in Moldova and of reformed ex-Communists in Bulgaria have been more than balanced by the victories of pro-Western reformers in Romania, Ukraine, and Georgia, as well as by the clear victory of the pro-market right in Poland.
economic incentives of a global financial boom and the unprecedented international dominance of Western economic and political liberalism. However, in periods with weaker and/or contradictory international incentives, such as the debt crisis of the 1980s and to a lesser extent the post-9/11 era, politics of IMF programs were more likely to reflect the domestic tensions between the redistributive demands of democracy and the uneven gains of neoliberal economic policies. However, the extent to which these tensions had significant political and policy reverberations was mediated to a great extent by the organizational capacity of societal actors, which has generally been significantly higher in Latin America than in post-totalitarian Eastern Europe.

**Dealing with Complexity: Methodological Considerations**

Considering the complex and continuously evolving nature of the domestic and international drivers of IMF programs, the quest for definitive explanations of the political dynamics of program initiation and implementation is likely to be elusive (and ultimately misguided). While attractive in their brevity for both theoretical and practical reasons, monocausal explanations of IMF program dynamics - as of most other complex political phenomena - run the inevitable risk of doing violence to reality as soon as their theoretical predictions are exported beyond the original set of cases. Obviously, monocausal claims can be justified when trying to explain empirical outcomes in a single case or a small set of similar cases: thus, for example, Slovakia's rocky relationship with the IMF in the mid 1990s can be explained rather convincingly by the rhetorical and ideological tensions between Meciar's nationalist-populist discourse and the narrow constraints of IMF and Western conditionality.
during the heyday of the Washington Consensus. The importance of ideology in the Slovak case is emphasized not just by the suggestive rhetorical war between the two sides but also by the fact that during the six-month interregnum in 1994, the first political initiative of the reformist Moravcik government was to initiate and implement an IMF program, which was then promptly derailed upon Meciar's return to power later that year, despite negligible changes in the economic and institutional parameters affecting IMF programs.

On the other hand, the theoretical “mileage” we get from monocausal explanations depends to a large extent on the validity of the implicit *ceteris paribus* assumption underlying such claims, and unfortunately - at least for social scientists - all other things are rarely equal, especially when we compare cases across time and space. Consider the cases of Peru and Argentina, whose governments both employed confrontational rhetoric and policies towards the IMF in the mid-1980s but with radically different consequences. As discussed in chapter 4, the dramatic change in Peru's relationship with the IMF and Western creditors after 1985 can be largely explained as the inevitable result of Alan Garcia's confrontational rhetoric against the international financial establishment, and particularly the IMF. The problem with this explanation is that Argentina's rhetoric during the 1984-85 period was hardly more accommodating but did not result in a similarly sharp deterioration in its relationship with the IMF. One possible explanation for these different outcomes was that Argentina's size and the timing of its confrontational tactics resulted in different payoffs for Western lenders, whose interests were seriously threatened by a possible Argentine default, especially in the context of the precarious financial position of Western banks prior to 1985. Meanwhile, Peru's default was much less threatening not only because of the smaller overall size of its debt but also because by mid 1986 the worst of the debt crisis was over at least from the point of view of the commercial
banks. At that point the importance of the demonstration effect of the Peruvian case outweighed
the direct financial losses and resulted in a more uncompromising attitude by the IMF and the
West. This comparison between Argentina and Peru does not, however, imply that ideological
confrontations were irrelevant in the context of the debt crisis, but that their effect on a country's
relationship with the IMF were mediated in important ways by the broader international
economic and political context and by the timing of these conflicts.

At the other extreme of the methodological spectrum, one can argue that since no two
IMF programs are exactly alike, any attempt to go beyond “thick descriptions” of individual
program instances is likely to do injustice to the rich social and political context in which these
programs unfold. While detailed case studies are obviously important for both generating and
testing theoretical claims, as well as for substantiating broad correlations across cases, this book
has proceeded from the methodological belief that deductive theorizing and broad cross-country
and cross-regional comparisons are important complements for case-specific empirical
knowledge in driving our understanding of social science phenomena. Therefore, this book has
developed a theoretical framework that is at once sufficiently comprehensive to capture the key
factors driving a certain phenomenon, flexible enough to accommodate causal variation across
cases and case clusters, and tractable enough to produce reasonably specific and testable
empirical hypotheses.

The Theoretical Model

The formal model developed in Chapter 2 captures the variety of political and economic
considerations that influence the decisions of the program country government and the IMF. The
government tries to balance its partisan policy preferences\textsuperscript{296} with the financial considerations inherent in IMF programs\textsuperscript{297} subject to the political constraint of having to placate domestic opposition to economic reforms. The opposition, which may be located either in parliament (opposition parties) or in the broader political system (e.g. labor unions and business groups), has its own partisan policy preferences but can be “bought off” by the government by receiving a share of the rents associated with being in power. The potential influence of the opposition's preferences is expected to be stronger when the internal political competition is more intense\textsuperscript{298}

Finally, I assume that the IMF also attempts to pursue a number of potentially conflicting objectives: first, from the point of view of its interests as a financial institution that cares about being repaid, the Fund has an incentive to lend only to countries pursuing policies conducive to the timely repayment of loans; second, given its role as an international lender of last resort the IMF is expected to be more willing to lend to countries facing serious crises, particularly if the size of the country in crisis poses a credible threat to international financial stability; and, finally, the Fund may deviate from the technocratic principles above in order to accommodate the strategic geopolitical goal of its largest contributors (primarily the United States and its Western European allies).

The formal model yields a series of testable hypotheses about the economic and political drivers of IMF program initiation and implementation. Beyond the “disciplining” aspect of

\textsuperscript{296}These partisan preferences arise from a combination of ideal and material interests of the political party/parties in power and determine a set of policies that the government would like to implement in the absence of any external or internal political constraints.

\textsuperscript{297}There are two main components influencing the financial calculus: first, the size of the disbursed amount and any indirect additional funding (e.g. by improved access to private capital markets or official lending) and, second, by the financial need of the government.

\textsuperscript{298}Thus, the government has three options for dealing with its political opponents: first, it can try to implement policies that are reasonably close to the partisan preferences of the opposition; second, it can reward the opposition with material benefits for its acquiescence to unfavorable economic policies; and finally it can try to reduce the political power of the opposition (by legal or coercive measures) and thereby minimize its influence on economic policy making.
having to be explicit about the preferences of the key actors and the structure of interaction between them, the key benefit of using a formal model in the current analysis was the emphasis on the importance of interaction effects between the main components. Thus, the model predictions did not merely reflect the assumptions contained in the definition of preferences - e.g. that governments facing higher degrees of financial need should be more likely to initiate and comply with IMF programs - but added to a more nuanced understanding of program dynamics by predicting for example that higher financial need should matter more for economically or politically important countries and in situations characterized by well functioning bureaucratic institutions. Similarly, the model predicted that the effects of structural and institutional variables such as regime type, government fragmentation and levels of discretionary resources should be mediated by their interaction with the relative partisan preferences of the government and the opposition.

From a different perspective, the model formalizes an intuitive understanding of IMF programs as the end result of a political process driven by the interaction between what the government would like to do in an ideal world, what it has to do (or not do) to placate the demands of the IMF and the domestic opposition, and what it can do given its expertise and reliability of program implementation by the state apparatus. The starting point is the government's ideal and material interests (ranging from lofty ideas to naked material self-interest), which determine the policy the government would choose in the absence of domestic political and international economic constraints. Next, the country's financial need and its position in the global economy determines the relative costs and benefits of initiating and implementing an IMF program and thereby introduces a set of external constraints on government policies. At the same time government policies are constrained domestically by the
political demands of the opposition, whose importance depends on the relative power balance between the main political players. Finally, once the government decides on the politically optimal policy course, the actual policy outcomes and the fate of IMF programs depend on the ability of the state apparatus to implement the policies desired by the government.

Testing the Model: Cross-Country Statistical Tests and Case Comparisons

In the interest of ensuring cross-case comparability, the statistical tests of the formal model's predictions in Chapters 3, 5 and 7 were executed separately for the two regions. As discussed in more detail in the introduction, this decision was justified by the important changes in the international economic environment, the differences in IMF conditionality, the variation in the nature of the economic adjustment task facing developing countries and the differences in the domestic political setting in which IMF programs unfolded. The variation in some of the crucial parameters affecting IMF program dynamics in the two regions questions the assumption of causal homogeneity that would have to be fulfilled in order to justify “lumping together” the cases of the two regions into one statistical model. Put differently, rather than assuming uniform IMF intervention patterns in the developing world over two decades, the current analysis has addressed the more specific question of how the political dynamics of IMF programs in Latin America during the 1980s have differed from the interventions in the former communist countries (and Latin America) during the 1990s. Of course, such an approach does not preclude the possibility that some factors may have played very similar roles across regions and time periods. Indeed, the tests for two regions confirmed not only the overall importance of external financial need in driving program initiation and compliance but also the interesting interaction with a country's economic size, which suggests the persistence in the Fund's differential treatment of countries whose economic difficulties could destabilize the global economy.
On the other hand, a comparison of the statistical results for some of the other factors reveals the additional analytical leverage provided by the separate treatment of the two IMF program clusters: thus, whereas in Latin America higher inflation levels increased the likelihood of program initiation for rightist governments but reduced it for leftist ones, in the former Soviet bloc higher inflation made all governments more likely to enter IMF agreements but the effect was stronger for ex-communist and nationalist/populist governing parties, which suggests a different logic of the interaction between domestic economic crisis and partisan preferences in the two regions. Similarly, whereas higher levels of discretionary resources had similar effects on IMF program initiation in the two regions, the interaction between the size of the state sector and the government's political orientation played out very differently in implementation of Fund programs in the two regions. In Latin America, in line with the predictions of the formal model, rightist governments were able to translate their control over discretionary resources into the political capital necessary for higher compliance with IMF conditionality, whereas for leftist governments the effect was reversed. Meanwhile, the rents associated with larger state sectors in the transition economies supported the compliance efforts of ex-communist governments to a much larger extent than for their non-communist counterparts, which suggests important interregional differences in the politics of party-state linkages and the mechanisms for creating political coalitions for economic reforms.

While the cross-national statistical tests for the three episodes of IMF programs provided substantial empirical support for the changing nature of the interaction between international and domestic politics in the two regions and time periods, the case studies of the trajectory of four Latin American and four East European countries in chapters 4, 6, and 7 complemented these broad cross-national trends in a number of different ways. First, the cases painted a more detailed
and nuanced picture of the causal mechanisms underlying the correlational patterns established by the statistical tests. For example, the contrast between the Paz government’s decisive reaction to Bolivia's hyperinflationary crisis of 1985 compared to the paralysis of the Siles administration in 1983-5 and the outright defiance of Alan Garcia in the late 1980s illustrates the complicated mix between economic pressures and ideological concerns in the context of crisis driven policy reforms. Similarly, the divergent trajectories of post-1997 economic reforms in Romania and Bulgaria despite their similar prior economic and political evolution, reveals an interesting path dependent causal mechanism whereby the deeper initial economic crisis in Bulgaria contributed to a more decisive electoral victory of neoliberal reformers, and ultimately ensured the greater political viability of IMF-style reforms in Bulgaria compared to Romania.

Second, the case studies have helped identify and discuss important aspects of the political economy of IMF programs, which do not lend themselves to being analyzed statistically, either because the phenomena are not easy quantifiable or because sufficient data is not available for cross-country regressions. One prominent example in this respect was the important role of the relationship between Latin American governments and labor and business organizations during the 1980s. Thus, the tense relationship with the labor unions and the mutual distrust that prevailed in the relations with the business sector played a key role in the failure of reform efforts by the Siles and Alfonsin governments, whereas Paz’s ability to marginalize the unions and co-opt business support significantly eased the implementation of reforms. Another instance where the case comparisons provided new theoretical insights, which an exclusive reliance on statistical testing would have been missed, was the role of corruption and poverty in the eventual decline of the neoliberal consensus in Latin America in the 1990s. Thus, while the coverage of poverty and corruption data is insufficient to allow for systematic statistical tests,
Chile’s superior performance in combating corruption and poverty during the 1990s compared to the significant shortcomings of neighboring neoliberal governments in Argentina, Bolivia, and Peru helps account for the greater legitimacy and continuity of neoliberal economic policies in Chile even after the end of the international lending boom of the 1990s.

Finally, the case studies revealed a number of factors, which greatly affected the trajectories of IMF programs and neoliberal reforms in individual or small groups of countries but whose significance at the broader regional level would have been negligible, and therefore hard to detect statistically. Examples in this respect include the effects of the war on drugs, which have alternatively facilitated and complicated the relations of successive Bolivian and Peruvian governments with the United States (and implicitly with international financial institutions), and Moldova’s need to secure Western political support in its attempts to counter Russian threats to its independence and territorial integrity. Besides underscoring the multiplicity of IMF program drivers, such country-specific factors may at times reveal crucial facets of IMF conditionality in the developing world, such as the potential for smaller countries such as Bolivia after 1985 and Moldova in the mid-1990s (as well as to some extent Chile in the 1980s and Bulgaria in the late 1990s) to secure preferential IMF treatment by fulfilling the important political role of neoliberal reform showcase.
Interpreting the Empirical Evidence: Comparative Assessments and Policy Implications

Rather than providing an extensive review of the specific empirical findings that emerged from the statistical tests and the case studies from the two regions, this final section emphasizes a number of key themes that have emerged from the preceding analysis of Latin American and East European IMF programs. In doing so, I discuss some of the theoretical contributions of the book to a number of academic debates in domestic and international political economy, as well as some of the policy implications of these findings for the design of more politically feasible IMF programs in the future.

Financial Need, Foreign Dependence and Adjustment: Developing Country Strategies on the International Stage

One of the most consistent empirical regularities emerging from both the statistical tests and the case studies is the importance of external financial need as a driver of IMF program initiation and implementation. Despite regional variations in the predominant nature of financial dependence - in Latin America debt service burden were crucial, whereas in Eastern Europe low levels of international reserves played a more important role - there can be little doubt that most governments in the two regions entered IMF programs in response to external financial constraints, which is hardly surprising considering the significant reduction in policy maneuvering space inherent in IMF conditionality. These effects were significantly weaker in Latin America during the 1990s, where countries entered IMF programs less in response to immediate financial crises than to facilitate access to international financial markets.
Even though occasionally countries avoided IMF programs even in situations of extreme financial need, the Peruvian case after 1985 demonstrates the extremely high economic costs of such resistance, given the Fund's importance not only as source of scarce direct funding but also as a gatekeeper for many other potential credit sources, including World Bank, bilateral and private sector lending. Since few developing countries were (or are) economically or politically important enough to pose a significant unilateral threat to Western interests, and because collective action problems and Western pressures have undermined developing countries' efforts to form a credible interest coalition, individual governments have generally suffered from an important power imbalance in their negotiations with the IMF. As a consequence, in the design of IMF programs the domestic social concerns and political priorities program countries have generally been of secondary importance compared to the systemic economic and political concerns of the Fund's largest members and the theoretical tenets of the economic orthodoxy prevailing within the IMF at a given point in time.

Despite these clear international priorities in the Fund's overall approach to conditionality, the empirical evidence presented in this book suggests that the experiences of individual countries varied significantly along at least two dimensions. First, economically and politically important countries were more likely to receive preferential treatment during IMF program negotiations, as confirmed by the statistical results for program initiation in both regions: thus, large Latin American debtors and large East European aid recipients were significantly more likely to enter IMF programs when confronting serious financial distress but were more likely to be “left alone” when not affected by an immediate crisis. As discussed in Chapter 4, Western concerns about a possible Argentine debt default explain the Fund's willingness to “put up” with Argentina's defiant stance in 1984 and early 1985, and then to
support an economic stabilization plan whose heterodox emphasis on price and wage controls deviated in important ways from IMF orthodoxy. Meanwhile, Peru's more marginal international economic role resulted in a more inflexible IMF negotiating position despite the cooperative attitude of the Belaunde government and eventually contributed to the country's complete international isolation after Alan Garcia adopted a more confrontational stance towards the IMF and Western banks.

The comparison between Argentina and Bolivia, however, reveals a different facet of the relative costs and benefits of size in the context of the Latin American debt crisis: whereas Argentina “paid” for its relative domestic economic policy freedom by receiving relatively few concessions in terms of debt forgiveness (due to the higher cost of such measures for Western creditors), the Bolivian reformers were able to use their strict domestic adherence to economic orthodoxy and the small overall size of the country's foreign debt to obtain the most generous debt renegotiation in the region. Even more remarkably, Bolivia was allowed to get away with a complete moratorium on its foreign debt service during the early and crucial period of its reforms, whereas Peru had to pay a steep price for its decision to limit the debt service payments to 10% of exports during the same period.

The Fund's preferential treatment of Bolivia during this period emphasizes not only the importance of rhetorical nuances in the charged political context of the debt crisis but also reveals a possible strategy for marginal countries to receive preferential treatment in their relations with the IMF. Due to the high political costs of IMF compliance for many governments the Fund occasionally needs to be able to point to obvious success stories in order to counter criticisms and to illustrate the benefits of compliance. Elements of this “showcase phenomenon” are also reflected in the concessions Chile received during the 1980s, as well as in the generous
terms of Poland's debt renegotiation in conjunction with its IMF supported shock therapy in 1990, Moldova's temporary preferential status as a model post-Soviet reformer, and in Bulgaria's treatment during its successful reform turnaround after 1997. With the partial exception of Chile, in all of these cases preferential treatment did not mean a relaxation of IMF conditionality (since doing so would have diluted the “educational value” of the example). However, the showcase reformers received more generous financial incentives through both direct IMF funding and through successful coordination with other private and official lenders. While such examples provide neither a generalizable blueprint (considering the diminishing marginal utility of such showcase examples), nor a recipe for domestic political success (given that none of the governments in the showcase countries mentioned above actually gained reelection), they nevertheless suggest a way in which marginal developing countries can “play the system” and make the best of their otherwise limited policy options.

Aside from the significant implications of a country’s economic and political importance, the relative payoffs of different country strategies for dealing with the IMF also depended on their relative timing. Thus, whereas the Peruvian and Chilean experiences of the early 1980s illustrate the steep economic and political costs of adherence to IMF orthodoxy, the Bolivian post-1985 experience reveals the significantly higher rewards of domestic economic orthodoxy during the second half of the 1980s as Western priorities shifted from saving the commercial banks to promoting neo-liberal reforms in the developing world. Similarly, the much higher international price exacted by Garcia’s confrontational rhetoric towards the West and the IMF from 1986-9 compared to the negligible repercussions of Argentina's resistance from 1983-5 were arguably due not only to size differences but also to the fact that prior to 1985 the real possibility of a debtors cartel could have seriously undermined Western commercial banks,
whereas after 1985 such a scenario became highly unlikely. Finally, the steep economic costs of Meciar’s populist rhetoric in the mid-1990s despite the country’s prudent fiscal and monetary policies suggest that IMF and Western tolerance for deviations from neoliberalism had further declined since the 1980s at least as far as economic and politically marginal countries were concerned.

Domestic Economic Crisis and Political Responses

Despite the undeniable importance of systemic factors in driving the nature of the IMF conditionality into two regions, the crises experienced by most IMF program candidates had important and in many cases predominantly domestic roots. Particularly for the transition economies there can be little doubt that the underlying domestic economic imbalances would have had to be addressed through comprehensive social and economic reform programs even in the absence of any political pressures from the IMF. At the outset of the two main crises discussed in this book, the traditional economic models in the two regions - ISI-based state capitalism in Latin America and centralized command economies in the Soviet bloc - showed important symptoms of exhaustion. At the same time, however, these economic problems hardly created an overnight social consensus behind neoliberal reforms, especially in the context in which influential economic and political actors had a vested interest in the preservation of the status quo. Many of the economic reforms promoted by the IMF - particularly expenditure cuts, price and trade liberalization, and industrial restructuring - entailed important short-term costs

299In Latin America these symptoms included a dramatic slowdown in economic growth by the late 1970s, as well as rising inflationary pressures as the large fiscal deficits could not be financed through external borrowing after the debut of the debt crisis. In Eastern Europe and the Soviet Union growth had also slowed down significantly during the 1980s, and economic problems were compounded by shortages, repressed inflation and declining living standards.
for large segments of the population in exchange for uncertain future benefits. In view of these important political obstacles, how can we explain the sweeping reforms implemented in many countries of the two regions during the time periods discussed in this book?

One potential explanation - Western imposition via IMF conditionality - is useful in explaining the similarity of many reform blueprints but it misses many important cross-country and cross-temporal variations in both the initiation and implementation of IMF-style reforms in the two regions. A more promising explanatory alternative - advanced by a number of studies on the comparative political economy of reforms (Haggard and Kaufman 1995, Remmer 1998) - is the importance of the depth of the initial economic crisis, which can help reduce resistance to reforms and thereby facilitate reform initiation. Indeed, the statistical tests presented in chapter 5 confirm that - especially among the transition economies, where domestic considerations trumped international pressures - higher levels of inflation were associated with higher likelihoods of IMF program initiation and implementation even controlling for other potential domestic or international political and economic factors.

However, both the statistical results and the case study evidence presented in this book suggest some important qualifications of the crisis hypothesis. From a political point of view - and not unlike the international crisis dynamics discussed earlier - domestic crises were at least to a certain extent “in the eye of the beholder.” Due to the complex and often controversial nature of the determinants of economic crisis, the causes and even the severity of a given crisis were open to different interpretations. A reform consensus does not emerge through some functionalist miracle from the rubble of the economic crisis. In fact, the statistical results for Latin America suggest that higher inflation levels triggered opposite reactions from governments of different partisan orientations, inducing right governments to initiate IMF programs but
making leftist governments even less likely to introduce IMF-style reforms. In the transition economies, by contrast, higher inflation levels increased the program initiation and implementation odds of all governments, but played a more important role in convincing ex-communist governments of the necessity of economic reforms. Irrespective of these regional differences, the statistical results suggest that the catalytic effects of economic crisis are mediated in important ways by the partisan identities of key political players.

The case studies reveal some important nuances and political mechanisms of the complicated path from economic crisis to successful reform initiation and implementation. First, the economic crisis has to be sufficiently intense and affect a broad enough range of people so that the continuation of the status quo policies would be considered undesirable by the majority of relevant political actors. In this respect, hyperinflationary situations, such as the ones experienced by Bolivia in 1985, Argentina in 1989 and to a lesser extent Bulgaria in 1997, have the most far-reaching social consequences are therefore ideally suited as a starting point for the dramatic reorientation of a given country's political economy trajectory. The least favorable crisis scenario is probably the one characterized - as in Romania in early 1997 and to a certain extent in Bolivia in 1982 and Argentina in 1983- by important structural weaknesses (near bankrupt banking systems, looming fiscal deficits), whose full effect on the real economy has not yet “hit” at the time when the political opportunity for initiating reforms - usually an electoral victory - presents itself. Under such circumstances, would-be reformers have a much more difficult time making a convincing argument that the bitter medicine of neoliberal reforms is the only plausible cure for the country's economic illness. Instead, as happened in Romania, reformers get blamed for the cumulative woes of the inherited economic crisis and the painful neoliberal “treatment.”
Beyond the intensity of the preceding economic crisis, a crucial element for the emergence of a crisis-born reform consensus is the willingness and ability of a political leader or party to galvanize public support in favor of reforms through the skillful use of crisis rhetoric in the period immediately preceding and following the announcement of economic reforms. As several of the case studies indicate, such an action has a number of prerequisites: first, as Alfonsin's over-optimism in late 1983 suggests, the political leaders have to recognize the severity of the crisis; second, unlike Garcia in post-1985 Peru and (to a lesser extent) the Moldovan Communists in 2001, they have to diagnose the crisis as driven by domestic economic and political problems rather than Western imperialism; and, finally, judging by the failed reform efforts of the Bolivian government in late 1984, the Alfonsin administration in 1988 and the Bulgarian Socialists in late 1996, political leaders need sufficient domestic and international credibility to be able to take advantage of crisis situations in launching IMF-style reforms.

While the skillful exploitation of crisis rhetoric usually sufficed to secure political support for the initial launch of economic reforms - particularly in the political honeymoon period of newly elected democratic governments - the crucial task of ensuring the long-term political viability of reform programs turned out to be considerably more complicated. After all, Belaunde in 1980, Alfonsin in late 1985, the Romanian reformers in 1997 and their Moldovan counterparts in 1998 were all democratically elected governments backed by (what at that time appeared to) a solid political mandate for economic reforms, only to watch this “consensus” evaporate over the following three to four years as the memories of the initial crisis faded in comparison to the more immediate social costs of economic reforms.

Judging by the experience of the more resilient reformers discussed in this book - Chile, Bulgaria and (for almost two decades) Bolivia - the key ingredient facilitating the continuation of
reforms beyond the initial honeymoon period was the creation of durable political coalitions in support of the government's economic policies and concerted actions to shift the long-term balance of political power in society in favor of neoliberal reformers. Whereas the “Chilean model” of the 1980s - based on insulated technocratic decision-making in conjunction with repressive measures against leftist parties and labor unions and combined with the cooptation of the domestic business sector - has traditionally received the most attention in the literature, the experiences of post-1985 Bolivia, post-1997 Bulgaria and post-1990 Chile reveal a number of interesting - and more palatable - functional political equivalents in a more democratic setting. Having failed to secure a parliamentary majority in the 1985 connections, the Paz government initiated a patronage-based political pact with the largest parliamentary opposition party, thereby avoiding serious legislative challenges to the government's economic reform agenda. At the societal level the Bolivian government combined the use of moderate repression and selective incentives in a successful bid to reduce the political power of the militant labor movement, while at the same time gaining business support without subordinating economic policy to special-interest pressures. The Bulgarian government managed to avoid repression altogether, partly because it faced a much less militant labor movement and popular sector but also because of its ability to use its parliamentary strength and the weakness of its largely compromised political opponents to create quasi-consultative procedures that greatly improved legitimacy of economic reforms. Moreover, Bulgaria's adoption of a Currency Board under the “national unity” government prior to the 1997 elections, effectively allowed the Bulgarian government to counter redistributive pressures by pointing to the prohibitive costs of abandoning the Currency Board, a political strategy that worked remarkably well for most of the government's four years in power.

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300 As discussed in Chapter 7, however, the post-1985 Bolivian neoliberal “model” started to show signs of exhaustion amid rising anti-market protests in the late 1990s and came to an official end following the decisive electoral victory of Evo Morales in the December 2005 presidential contest.
despite the austerity measures inherent in the country's strict adherence to IMF conditionality during this period. Finally, the continuity of liberal economic policies in democratic Chile after 1990 was the result of a mix of solid economic performance, clean government, and greater concern for reform losers by successive center-left governments. Combined with the relative organizational weakness of reform opponents, this centrist approach created a political environment in which market-oriented economic policies were democratically feasible in the long-term, even in the absence of severe economic crisis or external pressures.

The Contested Relationship between Democracy and Economic Reforms

The findings in this book also contribute to what can in many respects be considered the most important political economy debate of the last two decades: the relationship between democracy and economic reforms in the developing world. By the very nature of the analytical approach adopted in this book, I can make no broad claims to have discovered a straightforward “iron law” of the relationship between these two factors. Indeed one of the crucial conclusions of the analysis is that the compatibility of democratic politics and neoliberal economics depends on international and domestic political considerations, which vary significantly across time and space.

Thus, the empirical evidence from the three clusters of IMF programs discussed in this book reveals three different correlational patterns between democracy and program compliance. During the Latin American debt crisis, the high social costs of IMF-promoted austerity programs, combined with the active resistance from highly mobilized labor unions and populations, created important tensions between governments' respect for democratic principles
and their ability to implement IMF-style reforms. In some instances - such as Peru under Belaunde and Argentina under Alfonsin - external economic adjustment was eventually subordinated to the preservation of democracy, whereas in other situations - such as Bolivia under Paz - democratically elected governments resorted to repressive measures in their reform implementation efforts. By comparison, for Eastern Europe in the 1990s both the statistical results and the prolonged compliance with IMF conditionality by democratic governments in countries like Moldova and Bulgaria indicate that democratic governments actually had an advantage over their authoritarian counterparts in implementing IMF-supported economic reforms. Finally, in Latin America during the 1990s the initiation and implementation of IMF-style reforms was largely unrelated to regime type, but the widespread coexistence of economic and political liberalism suggests a significant reversal of the significant tensions between the two during the 1980s.

These different base-line effects of democracy can be traced to the different nature of IMF programs in the two regions: whereas Latin American IMF programs in the 1980s were largely perceived as Western-imposed attempts to save the troubled Western commercial banks, for the transition economies IMF programs often played more of a supporting and legitimizing role for domestic reform initiatives. The important interregional differences in the relative weight of domestic and external determinants of program initiation may explain why, even though IMF-style reforms were hardly popular among East Europeans, IMF programs nevertheless met with considerably less open hostility than in Latin America during the debt crisis, where strikes and riots were the standard response to IMF-imposed austerity measures.

The remarkable coexistence of democratic politics and neoliberal economic reforms in both Eastern Europe and Latin America, does not, however, necessarily imply that economic and
political liberalism were mutually reinforcing. Thus, neither the Bulgarian nor the Moldovan reformers were subsequently reelected, whereas in Romania IMF-supported reforms failed at least in part due to the inability of a fragmented democratic government to overcome political opposition at the parliamentary and societal level. Similarly, many economic reform measures were enacted through methods which circumvented the democratic political process, such as emergency ordinances and decrees in Romania and Russia, or backstage political deals in Argentina and Bolivia.

Instead, the present analysis suggests a number of alternative explanations for the different political dynamics of economic reforms in the 1990s compared to the 1980s. First, IMF programs during the 1990s arguably entailed less dramatic social costs due to the reduced emphasis on unpopular fiscal expenditure cuts, partly in response to criticisms about the Fund's socially insensitive handling of the Latin American debt crisis and partly because debt service payments imposed smaller burdens on government budgets. Second, compliance with Western conditionality (including IMF interventions) entailed greater benefits during the economic boom of the 1990s than during the Latin American debt crisis, when the emphasis on debt repayments led to a zero-sum relationship between their debtor and lender interests in the region. Moreover, the more consistent Western emphasis on democracy as a precondition economic integration benefits in the 1990s (especially but not exclusively in the context of European integration) meant that governments had stronger incentives to pursue economic and political liberalism simultaneously. Finally, the weakness of labor unions and the political apathy of the general public reduced the scope of active popular resistance against painful reform measures and thereby mostly spared democratic governments the dilemma faced by Latin American governments of choosing between the continuation of economic reforms and the preservation of
basic democratic rights. While this trend may have contributed to a shallower version of
democracy in the 1990s in both Latin America (Kurtz 2004, Weyland 2002) and Eastern Europe
(Innes 2002) it nonetheless facilitated the coexistence of electoral democracies and neoliberal
economics even in poor countries such as Moldova and Bolivia.

Policy Implications

Much of the preceding discussion has been devoted to providing a more nuanced picture
of the delicate political balance underlying the initiation and implementation of IMF-style
reforms. Rather than uncovering a foolproof reform recipe for developing countries, the analysis
has revealed the complex interplay of domestic and international political pressures on program
country governments during IMF program initiation and implementation. The case studies from
the two regions confirm that - with a few notable exceptions - most developing country
governments eventually respond to the combination of external pressures, financial need and
domestic economic crises by initiating economic reforms in the context of IMF programs.
However, the weak compliance record of many programs continues to be a serious problem in
many developing countries. Therefore, this final section draws upon the analysis in this book to
identify a number of policy implications for a more effective political approach to IMF
conditionality. Such an approach may contribute to the design of more politically feasible IMF
programs and therefore reduce the incidence of program breakdowns, partial reforms, and policy
reversals, which have plagued many developing countries in the last two decades.

Given the Fund’s delicate political position as a mediator between developing countries
on one hand and international financial markets and advanced industrial democracies on the other, the legitimacy and effectiveness of IMF interventions hinges to a large extent on the credibility of the Fund’s claim of technocratic impartiality. In situations where the IMF is widely regarded as privileging Western economic interests over those of developing countries - as happened most prominently during the Latin American debt crisis - IMF programs are likely to trigger popular resistance, partisan polarization and ultimately halfhearted implementation. From this perspective, the evidence of politically motivated favoritism towards important countries in the two regions arguably undermines the effectiveness of conditionality not only (as Stone 2002 demonstrates) in the privileged countries but also elsewhere in the developing world, by reinforcing the stereotypical view of the IMF as a tool for Western political and economic interests. Therefore, it would be important to curb the practice of using “soft conditionality” IMF loans as a way to reward strategic Western allies. Such a practice is not only an inefficient use of scarce IMF resources but significantly complicates the Fund’s delicate political mission in the developing world.

An alternative venue for improving the effectiveness of IMF programs is to increase the financial rewards of compliance. Even though the statistical results in Chapter 3 suggest that, once we account for the endogenous nature of IMF loan size, there is no systematic evidence that larger loans exact better compliance, the financial dimension of IMF conditionality should not be downplayed for a number of reasons. First, given the relatively modest size of direct financing under the current setup, it is conceivable that the funding differences across programs are not sufficiently large to capture the potential strength of financial incentives. Second, as illustrated by the Moldovan case, the financial incentives of IMF programs can be greatly amplified when the lending decisions of various bilateral and multilateral official lenders are closely coordinated,
since compliance with IMF conditionality can unlock significant additional funding. Finally, the Fund’s approval of a country's economic policies can help unlock significant private funding but for such multiplier effects to function properly, the program country must be at least reasonably attractive to foreign investors and the Fund’s signals must be sufficiently credible. The IMF’s credibility and effectiveness in this respect largely depend on the willingness of large IMF shareholder countries to abstain from using the Fund for geopolitical purposes, as discussed above.

Rather than focusing exclusively on “fixing the IMF,” analysts and policy makers intent on improving the dynamics and consequences of IMF programs should pay closer attention to the domestic politics of IMF-style reforms. As the analysis in this book has demonstrated, the success of most IMF programs ultimately hinges on the domestic constellations of economic and political interests, power relations and institutional arrangements. To the extent that neoliberal reforms in a democratic context succeeded in any but the most developed countries of the two regions, the examples discussed in this book - post-1985 Bolivia, post-1990 Peru and Argentina and post-1997 Bulgaria – were initiated by newly elected governments assuming power during a deep economic crisis, and taking advantage of this crisis to build political reform coalitions. While provoking hyperinflationary crises can hardly represent acceptable policy advice for neoliberal reformers in search of political consensus, the Bolivian and Bulgarian successes highlight the importance of taking advantage of the initial economic crisis not only in rhetorical terms but also to forge a more durable political coalition in support of economic reforms.

While – as illustrated by Argentina in the 1980s and Romania from 1997-2000 – the importance of such coalitions is easy to ignore during the post-electoral honeymoon period, democratic governments that succumb to the temptation of insulated economic policy decision-
making have a much more difficult time sustaining economic reforms once their popularity is undermined by the sometimes sizeable social costs of such reforms. Therefore, domestic reformers and their outside advisers would be well advised to adopt a more inclusive, consultative approach to economic decision-making even if such an approach may entail some short-term delays in passing the required legislation.  

On a related note, the complicated task of building durable reform coalitions reveals another interesting dilemma facing the architects of the neoliberal reform programs. On one hand, the statistical results and the discussion of the unlikely neoliberal consensus in Argentina, Bolivia, and Peru confirm the importance of rent sharing as the glue that binds together social and political actors of otherwise different and even conflicting political agendas. From this perspective, the Fund’s emphasis on privatization, deregulation and public employment reductions may undercut the very basis of the political coalitions that ensured the feasibility of neoliberal reforms in the first place. In other words, if the state has increasingly fewer discretionary resources at its disposal, governments are likely to find it progressively harder to buy off the potential political opponents of economic reforms, thereby facilitating a return to the costly and destabilizing stop-go economic policy cycle in the democracies of the developing world. On the other hand, the prominent role of corruption in the eventual decline of neoliberalism in Argentina and Bolivia (and to a lesser extent in Peru) suggests that despite their effectiveness in the short to medium term, patronage-based neoliberal reform coalitions may ultimately be politically untenable in the long run. Therefore, would-be neoliberal reformers

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301 However, such an inclusive approach should not be confused with allowing special-interest groups to hijack the government's policy agenda, especially given the deleterious effects of corruption on the legitimacy of neoliberal reforms in Latin America (discussed in Chapter 7).

302 The importance of these mechanisms has already been discussed in the context of Russian privatization (Shleifer and Treisman 2000), Argentine reforms under Menem (Etchemendy 2002, Treisman 2003).
must be sufficiently attuned to the realities of political deal-making in the developing world while at the same time making sure that these political means do not undermine the ends by degenerating into endemic corruption. In this respect, IMF conditionality has to strike a careful balance between allowing governments sufficient maneuvering space to ensure the political feasibility of reforms while at the same time sanctioning excessively corrupt government practices.

The statistical evidence from the two main crisis episodes has also emphasized the importance of well-functioning bureaucratic institutions for the successful initiation and implementation of IMF-style reforms. The role of functional bureaucracies was particularly salient in the post-communist context, where the legacy of under-developed state institutions was exacerbated by the emphasis on technically demanding structural reforms in IMF programs during the 1990s. Therefore, if IMF-style neoliberal reforms are to succeed in the long run without creating inordinate social costs and political tensions, they must be accompanied by a sustained effort to build effective bureaucracies and states, which, as the last two decades have made abundantly clear, do not emerge spontaneously from the happy marriage of democracy and capitalism. What is less clear, however, is how such institutions can be fostered, given the inadequacy of our current theoretical understanding of institution-building for sustainable economic and political development. (Dunning and Pop-Eleches 2005)

Finally, the analysis in this book holds a more general lesson for the design of IMF programs and of external policy conditionality more broadly. Thus, the remarkable context specificity of economic and political dynamics of IMF programs in the three clusters of cases discussed in this book should make us extremely wary of grand theoretical claims about the politics of economic policymaking in the developing world. Instead our attention should focus on
identifying the particular constellations of political and economic factors, which make sustainable economic reforms in a democratic setting feasible. The country cases discussed in this book have revealed the extraordinarily delicate political balancing act required of democratic governments attempting to reconcile the conflicting demands of international financial markets and domestic political constituencies. In order to facilitate the long-term viability of such reforms, IMF conditionality should allow governments more flexibility in the timing and details of policy reforms. Even though in the short run such an approach may lead to slower reforms, the possible costs are likely to be greatly outweighed by the benefits of avoiding the disruptive effects of political failures that are usually triggered by overly ambitious targets. Finally, to the extent the ultimate goal of reformers (in the IMF and elsewhere) is the long-term coexistence of pro-market economic policies and genuine democracy, neoliberal reforms will have to find a more effective way to ensure that the everyday lives of the world’s poor are improved by these reforms in tangible ways. Otherwise, the political economy of neoliberal reforms and IMF programs will continue to fluctuate in line with international business cycles and produce the costly political conflicts and policy reversals that have been the norm in much of the developing world in recent decades.
Appendix 1

Figure 2.0: Analytical Overview

Appendix 1.1: Setting the program parameters: the IMF's maximization task

The IMF has to decide on the amount of funding to commit to a certain program and to a set of policy targets that the government needs to meet in order to receive the funding. In reality negotiations can and do cover both the amount of funding and the degree of conditionality. For brevity reasons I will here discuss only the model's implications for the amount of funding attached to a given IMF program, while assuming conditionality $q_p$ to be exogenously determined. This does not imply that I assume program conditions to be the same across space and time - even though some observers have criticized the IMF for its cookie-cutter approach to enforcing the dominant orthodoxy in its program design in different countries. The model can in fact be used to generate hypotheses about the factors affecting the strictness of the IMF conditionality but these predictions are quite similar in their logic to the discussion below about the amounts of funding, and since valid cross-national measures of program target strictness do
not exist, the discussion was omitted here.

The expected utility of the IMF during initiation can be obtained from expression (3), keeping in mind that the IMF does not actually observe the realized value of $q^*$ but instead has to use the expected value of the policy realization in its calculations. However, the IMF has the advantage of being able to cut its losses during implementation, by refusing to disburse money to countries whose policies do not meet the $q_{\text{min}}$ threshold. Thus we can write the IMF's utility as a function of of the committed amount $M_p$ and the probability of compliance $\Pr(comp)$:

$$U_{\text{IMF}} = -M_p (q_0^{\text{unc}} - q_p)^2 + \mu_p M_p - \frac{j}{M_{\text{tot}} - M_p} \Pr(comp) +$$

$$+ \left[ -\frac{j}{M_{\text{tot}} - M_p} \right] [1 - \Pr(comp)]$$

$$= -M_p (q_0^{\text{unc}} - q_p)^2 \Pr(comp) + \mu_p M_p \Pr(comp) - \frac{j}{M_{\text{tot}} - M_p}$$

Setting the first order condition $\frac{\partial U_{\text{IMF}}}{\partial M_p} = 0$, we get the following expression:

$$\frac{\partial U_{\text{IMF}}}{\partial M_p} = -(q_0^{\text{unc}} - q_p)^2 \Pr(comp) - 2M_p (q_0^{\text{unc}} - q_p) \frac{\partial q_0^{\text{unc}}}{\partial M_p} \Pr(comp) -$$

$$- M_p (q_0^{\text{unc}} - q_p)^2 \frac{\partial \Pr(comp)}{\partial M_p} + \mu_p \Pr(comp) +$$

$$+ \mu_p M_p \frac{\partial \Pr(comp)}{\partial M_p} - \frac{j}{(M_{\text{tot}} - M_p)^2}$$

$$= -(q_0^{\text{unc}} - q_p)^2 \Pr(comp) - M_p (q_0^{\text{unc}} - q_p) \frac{\mu}{k(c_{gov} + s_{opp})} \Pr(comp) -$$

$$- M_p (q_0^{\text{unc}} - q_p)^2 \frac{\mu}{2k^2 (c_{gov} + s_{opp})} + \mu_p \Pr(comp) +$$

$$+ \mu_p M_p \frac{\mu}{2k^2 (c_{gov} + s_{opp})} - \frac{j}{(M_{\text{tot}} - M_p)^2}$$

Based on (10) we can try to determine how changes in the model components affect the optimal
level of program funding. First, after rearranging the terms it is easy to see that for

\[ q_{0}^{unc} < q_{p} - \sqrt{\Psi} = q_{\text{min}} \]

we have \( \frac{\partial U_{\text{IMF}}}{\partial M_{p}} \), which yields the corner solution \( M_{p} = 0 \), implying

that the IMF is not willing to commit funds to programs with very low chances of success. Given

that for \( q_{0}^{unc} > q_{p} - \sqrt{\Psi} = q_{\text{min}} \) the equation is difficult to solve in \( M_{p} \), we need to derive

the relationship between the optimal \( M_{p} \) and the other variables in the model in an implicit

manner (see Appendix 2 for a more thorough explanation of this method). Thus, we find that

politically more important countries should be expected to receive more generous loans relative
to their size \( \left( \frac{\partial M_{p}}{\partial p} > 0 \right) \), whereas the effect of financial need on the size of the IMF loan

commitments should be positive \( \left( \frac{\partial M_{p}}{\partial \mu} > 0 \right) \), which confirms the intuition that we would expect

the IMF to lend more to desperate countries, both because of the impact of such lending on
global financial markets (by avoiding defaults and international contagion) and because

governments facing severe crises should be more likely to comply with external conditionality.

With respect to the government's partisan position \( q_{gov} \), we find that as long as we do not get a

corner solution (i.e. if \( M_{p} = 0 \)) more reformist governments are expected to receive more

generous loans \( \left( \frac{\partial M_{p}}{\partial q_{gov}} > 0 \right) \). Within the context of this model the often cited “rightist bias” of

the IMF can be explained without resorting to conspiracy theories but simply because IMF

programs initiated by reformist governments are more likely to succeed \( \left( \frac{\partial \Pr_{(comp)}}{\partial q_{gov}} > 0 \right) \) and are

likely to reduce the “cognitive dissonance” arising from IMF funding disbursements despite

imperfect compliance since \( \frac{\partial q_{0}^{\text{unc}}}{\partial q_{gov}} > 0 \).
Appendix 2.2: Implicit Differentiation

The implicit differentiation method is based on the fact that for any parameter $t$ of the model it is true that:

$$\frac{\partial^2 U^{IMF}}{\partial M_p^2} \frac{\partial M_p}{\partial t} + \frac{\partial^2 U^{IMF}}{\partial M_p \partial t} = 0$$

Therefore, we can obtain the sign of $\frac{\partial M_p}{\partial t}$ as long as we know the signs for the other two elements in equation (11). The sign of $\frac{\partial^2 U^{IMF}}{\partial M_p^2}$ can be derived from the fact that in order for $M_p$ to define a utility maximum for the IMF, the second derivative with respect to $M_p$ has to be less than zero (the function has to be concave in $M_p$). Therefore, we obtain $\frac{\partial^2 U^{IMF}}{\partial M_p^2} < 0$ Using this finding and equation (11) we find that $\frac{\partial M_p}{\partial t}$ and $\frac{\partial^2 U^{IMF}}{\partial M_p \partial t}$ have the same sign. Therefore, to determine the effect of a change in a parameter $t$ on the optimal level of $M_p$ chosen by the IMF, we only have to take the derivative of the expression in equation (10) with respect to the parameter $t$.

Appendix 2.3: Solving for uncertainty

Substituting $q^* = q_0 + \theta$ and using the fact that:

$$E(x + \theta)^2 = E(x^2 + 2x\theta + \theta^2) = x^2 + 2xE(\theta) + E(\theta^2) = x^2 + 2x\mu_\theta + \mu_\theta^2 + \sigma_\theta^2$$

where $\mu_\theta$ is the average value of $\theta$, and $\sigma_\theta^2$ is the variance, we can rewrite $U^{gov}$ as:
\[ U_{gov} = E[-c_{gov}(q^*-q_{gov})^2] + E(\mu F) + E[-sc_{opp}(q^*-q_{opp})^2] + E[f(G)] + E[f(R-G)] \]
\[ = -c_{gov}(q_0-q_{gov})^2 - 2c_{gov}(q_0-q_{gov})\mu_\theta - c\mu_\theta^2 - c\sigma_\theta^2 + E(\mu F) - \]
\[ -sc_{opp}(q_0-q_{opp})^2 - 2sc_{opp}(q_0-q_{opp})\mu_\theta - sc_{opp}\mu_\theta^2 - sc_{opp}\sigma_\theta^2 + f(G) + sf(R-G) \]

Since for the uniform distribution of \( \theta \) used in this model, we have \( \mu_\theta = 0 \) and \( \sigma_\theta^2 = \frac{1}{3}k^2 \), we can simplify the expression above and we get the following expression for \( U_{gov} \):

\[ U_{gov} = -c_{gov}(q_0-q_{gov})^2 - \frac{1}{3}ck^2 + E(\mu F) - sc_{opp}(q_0-q_{opp})^2 - \frac{1}{3}sc_{opp}k^2 + f(G) + sf(R-G) \]
Appendix 2: Tables and Figures for Chapter 3

Figure 3.0: International drivers of IMF programs

Figure 3.1: Reserves and Program Initiation in Eastern Europe and Latin America
Figure 3.2: Credit ratings - Latin America (regional average)

Figure 3: Credit ratings and IMF program initiation
Fig 4a: Effects of Interest Payment Burden at for Different Debtors (Latin America)

Fig 4b: Reserves and Initiation for Different Aid Recipients (Eastern Europe)
Figure 5: Credit ratings and compliance

Figure 6a: Size, Interest Payments and Compliance in Latin America
Figure 6b: Reserves, aid and compliance (Eastern Europe)

Prob (Compliance) vs. Reserves (months of imports)

- Low aid
- Medium aid
- High aid
Table 3.1a Descriptive statistics - Latin America (1982-1989)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
<th>St. dev.</th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Operationalization</th>
<th>Source</th>
</tr>
</thead>
<tbody>
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<td>New Agreement</td>
<td>0.061</td>
<td>0.240</td>
<td>704</td>
<td>0</td>
<td>1</td>
<td>1 if IMF agreement signed in a given quarter, 0 – otherwise</td>
<td>Author’s coding based on IMF Survey</td>
</tr>
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<td>Active Agreement</td>
<td>0.682</td>
<td>0.466</td>
<td>255</td>
<td>0</td>
<td>1</td>
<td>1 if IMF agreement active in a given quarter, 0 – otherwise</td>
<td>Author’s coding based on IMF Survey + IMF country desks</td>
</tr>
<tr>
<td>Bureaucratic Quality</td>
<td>2.318</td>
<td>1.099</td>
<td>704</td>
<td>0</td>
<td>5</td>
<td>0 (low)- 5(high)</td>
<td>International Country Risk Guide (ICRG)</td>
</tr>
<tr>
<td>IIS Credit Rating</td>
<td>24.35</td>
<td>14.074</td>
<td>697</td>
<td>4.3</td>
<td>71.5</td>
<td>0 (lowest) -100 (highest) Int’l reserves (prev. quarter)/ Imports (prev.year) in months</td>
<td>Institutional Investor</td>
</tr>
<tr>
<td>Reserves/imports</td>
<td>4.006</td>
<td>3.673</td>
<td>704</td>
<td>0.019</td>
<td>16.282</td>
<td>Interest payments/GNP (prev. year) – logged</td>
<td>Int’l Financial Statistics</td>
</tr>
<tr>
<td>Interest/GNP</td>
<td>1.554</td>
<td>0.555</td>
<td>704</td>
<td>0.262</td>
<td>3.020</td>
<td>Total foreign debt ($bn prev.year) – logged</td>
<td>Global Development Finance</td>
</tr>
<tr>
<td>Total debt</td>
<td>2.085</td>
<td>1.170</td>
<td>704</td>
<td>0.353</td>
<td>4.793</td>
<td>Economic share of SOEs (% prev. year) – logged</td>
<td>Global Development Finance</td>
</tr>
<tr>
<td>SOEs as %GDP</td>
<td>2.109</td>
<td>0.812</td>
<td>704</td>
<td>0.470</td>
<td>4.564</td>
<td>DEM score – AUT score +10 → 0 (low)-20(high) scale</td>
<td>Bureaucrats in Business database (1995)</td>
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<tr>
<td>Regime</td>
<td>12.513</td>
<td>6.872</td>
<td>704</td>
<td>1</td>
<td>20</td>
<td>0 (Right) – 4 (Left) – coalitions as weighted averages based on seat share</td>
<td>Polity database</td>
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<td>Government orientation</td>
<td>1.752</td>
<td>1.269</td>
<td>704</td>
<td>0</td>
<td>4</td>
<td>Ln (15+CPI in prev. quarter)</td>
<td>Coppendge (1995) + author’s coding</td>
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<tr>
<td>Inflation (t-1)</td>
<td>3.917</td>
<td>1.236</td>
<td>704</td>
<td>0.626</td>
<td>10.251</td>
<td>% of time spend under IMF agreements in 10 years prior to current year</td>
<td>Int’l Financial Statistics</td>
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<td>IMF program history</td>
<td>0.310</td>
<td>0.289</td>
<td>704</td>
<td>0</td>
<td>0.972</td>
<td>% of neighboring countries with IMF programs in prev. quarter</td>
<td>Author’s coding based on IMF Survey data</td>
</tr>
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<td>Neighbors’ IMF program</td>
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<td>704</td>
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<td>1</td>
<td>Size of IMF loan (per year) as % of GDP</td>
<td>Author’s coding based on IMF Survey data</td>
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<td>Promised loan/GDP</td>
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<td>0</td>
<td>7.169</td>
<td></td>
<td>Author’s coding based on IMF Survey and WDI data</td>
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<td>Variable</td>
<td>Mean</td>
<td>St. dev.</td>
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<td>Minimum</td>
<td>Maximum</td>
<td>Operationalization</td>
<td>Source</td>
</tr>
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<td>---------</td>
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<td>New Agreement</td>
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<td>1072</td>
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<td>1 if IMF agreement signed in a given quarter, 0 – otherwise</td>
<td>Author’s coding based on IMF Survey</td>
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<td>.480</td>
<td>409</td>
<td>0</td>
<td>1</td>
<td>1 if IMF agreement active in a given quarter, 0 – otherwise</td>
<td>Author’s coding based on IMF Survey + IMF country desks</td>
</tr>
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<td>Quality of governance</td>
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<td>1.448</td>
<td>1072</td>
<td>0</td>
<td>5.25</td>
<td>0 (lowest) - 100 (highest)</td>
<td>Nations in Transit + author’s coding</td>
</tr>
<tr>
<td>IIS Credit Rating</td>
<td>29.385</td>
<td>14.875</td>
<td>697</td>
<td>4.3</td>
<td>71.5</td>
<td>Int’l reserves (prev. quarter)/Imports (prev.year) in months</td>
<td>Institutional Investor</td>
</tr>
<tr>
<td>Reserves/imports</td>
<td>2.328</td>
<td>1.819</td>
<td>1056</td>
<td>0</td>
<td>8.605</td>
<td>Interest payments/GNP (prev. year) – logged</td>
<td>Int’l Financial Statistics</td>
</tr>
<tr>
<td>Interest/GNP</td>
<td>.727</td>
<td>.529</td>
<td>1036</td>
<td>0</td>
<td>1.930</td>
<td>Total foreign debt ($bn – prev.year) – logged</td>
<td>Global Development Finance</td>
</tr>
<tr>
<td>Total debt</td>
<td>1.458</td>
<td>1.276</td>
<td>1040</td>
<td>0</td>
<td>5.189</td>
<td>State sector/GDP (% prev. year) – logged</td>
<td>Global Development Finance</td>
</tr>
<tr>
<td>State sector/GDP</td>
<td>3.990</td>
<td>.398</td>
<td>1060</td>
<td>2.708</td>
<td>4.615</td>
<td>DEM score – AUT score +10 → 0 (low) -20(high) scale</td>
<td>EBRD – Transition reports</td>
</tr>
<tr>
<td>Regime</td>
<td>13.992</td>
<td>6.032</td>
<td>1072</td>
<td>1</td>
<td>20</td>
<td>1 – ex-communist or nationalist-populist gov’t, 0 - otherwise</td>
<td>Polity database</td>
</tr>
<tr>
<td>Government orientation</td>
<td>.590</td>
<td>.492</td>
<td>1072</td>
<td>0</td>
<td>1</td>
<td>Ln (15+CPI in prev. quarter)</td>
<td>Coppedge (1995) + author’s coding</td>
</tr>
<tr>
<td>Inflation (t-1)</td>
<td>4.262</td>
<td>1.487</td>
<td>1072</td>
<td>1.583</td>
<td>1.080</td>
<td>% of time spend under IMF agreements in 5 years prior to current year</td>
<td>Int’l Financial Statistics, EIU Country Data</td>
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<td>.305</td>
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<td>1</td>
<td>% of neighboring countries with IMF programs in prev. quarter</td>
<td>Author’s coding based on IMF Survey data</td>
</tr>
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<td>Neighbors’ IMF program</td>
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<td>.268</td>
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<td>0</td>
<td>1</td>
<td>Size of IMF loan (per year) as % of GDP</td>
<td>Author’s coding based on IMF Survey and WDI data</td>
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<tr>
<td>Promised loan/GDP</td>
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<td>.883</td>
<td>409</td>
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<td>5.868</td>
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Table 3.2a: Financial Need and Program Initiation in Latin America (1982-9)

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<tr>
<th>Variable</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
<th>Model 5</th>
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<tbody>
<tr>
<td>Reserves (t-1)</td>
<td>.773*** [.0032]</td>
<td>--</td>
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<td>1.329 [.2382]</td>
<td>.758*** [.0032]</td>
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<td>Reserves (t-1) squared</td>
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<td>--</td>
<td>.934* [.0935]</td>
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<tr>
<td>Low reserves</td>
<td>--</td>
<td>--</td>
<td>1.814** [.0692]</td>
<td>--</td>
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<tr>
<td>Interest/GNP</td>
<td>2.007** [.0442]</td>
<td>1.986** [.0501]</td>
<td>2.001** [.0403]</td>
<td>1.582* [.1512]</td>
<td>1.857** [.0845]</td>
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<td>IIS Credit Rating</td>
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<td>--</td>
<td>--</td>
<td>--</td>
<td>1.160* [.0194]</td>
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<td>IIS Credit Rating (squared)</td>
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<td>--</td>
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<td>.997**</td>
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<tr>
<td>Inflation (t-1)</td>
<td>1.368** [.0286]</td>
<td>1.326** [.0450]</td>
<td>1.372** [.0282]</td>
<td>1.345** [.0378]</td>
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<td>.0032 [.0000]</td>
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<td>74.70</td>
<td>77.80</td>
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Odds ratios with p values in parentheses * significant at 10%; ** significant at 5%; *** significant at 1% (one-tailed where appropriate)

Note: Since coefficients are odds ratios, values below 1 signify negative effects.
Table 3.2b: Financial Need in Post-Communist Program Initiation

<table>
<thead>
<tr>
<th>Variable</th>
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<th>Model 3</th>
<th>Model 4</th>
<th>Model 5</th>
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<td>Reserves (t-1)</td>
<td>.551***</td>
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<td>--</td>
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<td>.625**</td>
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<tr>
<td></td>
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<td>[.4469]</td>
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<td>Reserves (t-2)</td>
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<td>.554***</td>
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<td></td>
<td></td>
<td>[.0001]</td>
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<tr>
<td>Interest/GNI</td>
<td>1.229</td>
<td>1.214</td>
<td>1.324</td>
<td>1.190</td>
<td>1.669</td>
</tr>
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<td>--</td>
<td>1.217*</td>
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<td></td>
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<td>[.0271]</td>
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<tr>
<td>IIS Credit Rating (squared)</td>
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<td>--</td>
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<td>.996*</td>
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<td>1.136</td>
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<td>1.442*</td>
<td>1.670*</td>
<td>1.813**</td>
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<td>.973</td>
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<td>3.398#</td>
<td>3.151</td>
<td>3.683#</td>
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<td></td>
<td>[.0936]</td>
<td>[.0878]</td>
<td>[.1119]</td>
<td>[.0774]</td>
<td>[.1876]</td>
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<td>Anti-reform government</td>
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<td>.720</td>
<td>.685</td>
<td>.779</td>
<td>.671</td>
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<td>Inflation (t-1)</td>
<td>1.132</td>
<td>1.118</td>
<td>1.271*</td>
<td>1.220#</td>
<td>1.170</td>
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<td>IMF Program History</td>
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<td>9.392*</td>
<td>5.230*</td>
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<td>.000*</td>
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<td>84.69</td>
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Odds ratios with p values in parentheses * significant at 10%; ** significant at 5%; *** significant at 1% (one-tailed where appropriate)

Note: Since coefficients are odds ratios, values below 1 signify negative effects.
### Table 3.3a: Financial Need and Political/Economic Importance in Latin American Program Initiation (1982-9)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
<th>Model 5</th>
<th>Model 6</th>
<th>Model 7</th>
<th>Model 8</th>
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<tbody>
<tr>
<td>Reserves (t-1)</td>
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<td>.768**</td>
<td>.772**</td>
<td>.758**</td>
<td>.769**</td>
<td>.772**</td>
<td>.767**</td>
<td>.602*</td>
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<td>Interest/GNP</td>
<td>1.986#</td>
<td>1.841#</td>
<td>1.991*</td>
<td>.487</td>
<td>1.701</td>
<td>1.224</td>
<td>1.261</td>
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<td>.123**</td>
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<td>.722</td>
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<td>Foreign aid</td>
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<td>Total debt*</td>
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<td>--</td>
<td>3.195**</td>
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<td>Interest/GNP</td>
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<td>Total debt* Interest/GNI</td>
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<td>Population* Interest/GNI</td>
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<td>[1.1574]</td>
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<td>Total debt* Reserves</td>
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</tr>
<tr>
<td>Quality of bureaucracy</td>
<td>1.485*</td>
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<td>1.442*</td>
<td>1.741*</td>
<td>1.296</td>
<td>1.439*</td>
<td>1.440#</td>
<td>1.507*</td>
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<td>.785</td>
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<td>1.039</td>
<td>1.033</td>
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<td>1.040</td>
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<td>.894</td>
<td>.852</td>
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<td>.877</td>
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<tr>
<td>Inflation (t-1)</td>
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<td>1.390*</td>
<td>1.356*</td>
<td>1.584**</td>
<td>1.388*</td>
<td>1.405*</td>
<td>1.337*</td>
<td>1.387*</td>
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<td>13.538*</td>
<td>15.918*</td>
<td>13.981*</td>
<td>22.200*</td>
<td>15.971*</td>
<td>12.848*</td>
<td>18.194*</td>
<td>13.239*</td>
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<td>.000***</td>
<td>.000***</td>
<td>.000***</td>
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<td>73.90</td>
<td>73.44</td>
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<td>73.84</td>
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</table>

Odds ratios with p values in parentheses * significant at 10%; ** significant at 5%; *** significant at 1% (one-tailed where appropriate)

Note: Since coefficients are odds ratios, values below 1 signify negative effects.
Table 3.3b: Financial Need and Political/Economic Importance in Post-Communist Program Initiation

<table>
<thead>
<tr>
<th>Variable</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
<th>Model 5</th>
<th>Model 6</th>
<th>Model 7</th>
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</thead>
<tbody>
<tr>
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<td>Imports from US</td>
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<td>1.079 [.2633]</td>
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<td>1.189 [.1477]</td>
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<td>.822</td>
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<td>Imports from US*</td>
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<td>1.730*</td>
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<td>1.144 [.1626]</td>
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<td>1.357# [.0529]</td>
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<td>Foreign aid*Reserves (t-1)</td>
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<td>Population*Reserves (t-1)</td>
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<td>.000* [.0451]</td>
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<td>.000* [.0360]</td>
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</table>

Odds ratios with p values in parentheses * significant at 10%; ** significant at 5%; *** significant at 1% (one-tailed where appropriate)

Note: Since coefficients are odds ratios, values below 1 signify negative effects.
Table 3.4: Drivers of Program Financing and Conditions

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<td>Loan/Quota LA</td>
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<td>.018</td>
<td>-.051</td>
<td>.006</td>
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<td>(.034)</td>
<td>(.018)</td>
<td>(.102)</td>
<td>(.087)</td>
<td>(.190)</td>
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<td># Total Cond EE</td>
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<td>Reserves (t-1)</td>
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<td>(.190)</td>
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<td>Total debt</td>
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<tr>
<td>Regime</td>
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<td>(.043)</td>
<td>(.256)</td>
<td>(.174)</td>
<td>(.556)</td>
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Models 1&2 – OLS coefficients with robust standard errors in parentheses
Models 3-5 – Poisson coefficients robust standard errors in parentheses *significant at 10%; ** significant at 5%; *** significant at 1%
Table 3.5a: Financial Need and Political/Economic Importance in Latin American Program Implementation (1982-9)

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Odds ratios with p values in parentheses * significant at 10%; ** significant at 5%; *** significant at 1% (one-tailed where appropriate)

Note: Since coefficients are odds ratios, values below 1 signify negative effects.
Table 3.5b: Financial Need and Political/Economic Importance in Post-Communist Program Implementation

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<td></td>
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<td>4.561***</td>
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<td>(.000)</td>
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Odds ratios with p values in parentheses * significant at 10%; ** significant at 5%; *** significant at 1% (one-tailed where appropriate)
Note: Since coefficients are odds ratios, values below 1 signify negative effects.
Table 3.6: Effects of Loan Size on Compliance (Latin America and Eastern Europe)

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<td>6.469 (.119)</td>
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<td>.781** (.031)</td>
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<td>.640** (.015)</td>
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<td>.883 (.579)</td>
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<td>2.053* (.063)</td>
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Odds ratios with p values in parentheses * significant at 10%, ** significant at 5%; *** significant at 1% (one-tailed where appropriate)

Note: Since coefficients are odds ratios, values below 1 signify negative effects.
## Appendix 3: Tables and Figure for Chapter 5

### Table 5.1a: Inflationary crises and program initiation in Latin America (1982-9)

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<td>0.568**</td>
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<td>2.808**</td>
<td>2.735**</td>
<td>2.521**</td>
<td>3.129**</td>
<td>3.044**</td>
<td>3.258**</td>
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<tr>
<td>Interest/GNP</td>
<td>(0.017)</td>
<td>(0.021)</td>
<td>(0.024)</td>
<td>(0.028)</td>
<td>(0.046)</td>
<td>(0.016)</td>
<td>(0.027)</td>
<td>(0.011)</td>
</tr>
<tr>
<td>Total debt</td>
<td>0.145**</td>
<td>0.160**</td>
<td>0.173**</td>
<td>0.187**</td>
<td>0.225**</td>
<td>0.144**</td>
<td>0.136**</td>
<td>0.114**</td>
</tr>
<tr>
<td></td>
<td>(0.025)</td>
<td>(0.030)</td>
<td>(0.035)</td>
<td>(0.043)</td>
<td>(0.068)</td>
<td>(0.024)</td>
<td>(0.028)</td>
<td>(0.011)</td>
</tr>
<tr>
<td>SOEs as %GDP</td>
<td>0.883</td>
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<td>0.897</td>
<td>0.903</td>
<td>0.895</td>
<td>0.868</td>
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<td></td>
<td>(0.668)</td>
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<td>(0.693)</td>
<td>(0.628)</td>
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<td>1.062</td>
<td>1.063</td>
<td>1.066</td>
<td>1.068</td>
<td>1.066</td>
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<td>(0.150)</td>
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<td>(0.120)</td>
<td>(0.114)</td>
<td>(0.134)</td>
<td>(0.249)</td>
<td>(0.135)</td>
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<td>Government orientation</td>
<td>0.747**</td>
<td>0.747**</td>
<td>0.752**</td>
<td>0.759*</td>
<td>0.756*</td>
<td>0.748**</td>
<td>0.721**</td>
<td>0.764*</td>
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<td>(0.091)</td>
<td>(0.090)</td>
<td>(0.098)</td>
<td>(0.107)</td>
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<td>(0.092)</td>
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<td>IMF Program History</td>
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<td>21.45***</td>
<td>21.51***</td>
<td>21.08***</td>
<td>17.47***</td>
<td>21.96***</td>
<td>25.35***</td>
<td>20.94***</td>
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<td>(0.001)</td>
<td>(0.001)</td>
<td>(0.001)</td>
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<td>(0.001)</td>
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<td>(0.002)</td>
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<tr>
<td>Chi-squared</td>
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<td>47.573</td>
<td>47.431</td>
<td>47.282</td>
<td>46.931</td>
<td>47.787</td>
<td>41.795</td>
<td>47.222</td>
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</tbody>
</table>

Odds ratios with p values in parentheses * significant at 10%; ** significant at 5%; *** significant at 1% (one-tailed where appropriate).

Note: Since coefficients are odds ratios, values below 1 signify negative effects.
Table 5.1b: Inflationary crises and program initiation in Eastern Europe (1990-2001)

<table>
<thead>
<tr>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
<th>Model 5</th>
<th>Model 6</th>
<th>Model 7</th>
<th>Model 8</th>
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<tbody>
<tr>
<td>Inflation (t-1)</td>
<td>1.132</td>
<td>(0.400)</td>
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<td>Inflation (t-2)</td>
<td>1.262**</td>
<td>(0.092)</td>
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<tr>
<td>Inflation (t-3)</td>
<td>1.337**</td>
<td>(0.024)</td>
<td>3.085**</td>
<td>1.198</td>
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<tr>
<td>Inflation (t-4)</td>
<td></td>
<td></td>
<td>1.274**</td>
<td>(0.054)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inflation (t-3)</td>
<td></td>
<td></td>
<td></td>
<td>2.338***</td>
<td>(0.019)</td>
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</tr>
<tr>
<td>&gt; 40%</td>
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</tr>
<tr>
<td>Inflation (t-3)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2.272*</td>
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</tr>
<tr>
<td>&gt; 1000%</td>
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<td></td>
<td></td>
<td></td>
<td>(0.134)</td>
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<tr>
<td>Quality of governance</td>
<td>1.699***</td>
<td>(0.019)</td>
<td>1.738***</td>
<td>(0.014)</td>
<td>1.722***</td>
<td>(0.015)</td>
<td>1.692***</td>
</tr>
<tr>
<td>Reserves (t-1)</td>
<td>0.551***</td>
<td>(0.000)</td>
<td>0.559***</td>
<td>(0.000)</td>
<td>0.563***</td>
<td>(0.000)</td>
<td>0.559***</td>
</tr>
<tr>
<td>Reserves (t-3)*Reserves</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest/GNI</td>
<td>1.229</td>
<td>(0.000)</td>
<td>1.298</td>
<td>(0.054)</td>
<td>1.303</td>
<td>(0.015)</td>
<td>1.238</td>
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<td>Total debt</td>
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<td>(0.018)</td>
<td>1.125</td>
<td>(0.035)</td>
<td>1.127</td>
<td>(0.035)</td>
<td>1.138</td>
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<td>Regime</td>
<td>0.987</td>
<td>(0.018)</td>
<td>0.989</td>
<td>(0.014)</td>
<td>0.993</td>
<td>(0.015)</td>
<td>0.995</td>
</tr>
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<td>State sector/GDP</td>
<td>3.293</td>
<td>(0.187)</td>
<td>2.971</td>
<td>(0.0231)</td>
<td>2.746</td>
<td>(0.0269)</td>
<td>2.797</td>
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<tr>
<td>Anti-reform government</td>
<td>0.738</td>
<td>(0.378)</td>
<td>0.793</td>
<td>(0.503)</td>
<td>0.831</td>
<td>(0.595)</td>
<td>0.819</td>
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<td>IMF Program History</td>
<td>8.315**</td>
<td>(0.034)</td>
<td>8.068**</td>
<td>(0.036)</td>
<td>8.466**</td>
<td>(0.031)</td>
<td>8.881**</td>
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<tr>
<td>Observations</td>
<td>639</td>
<td>(0.032)</td>
<td>639</td>
<td>(0.027)</td>
<td>639</td>
<td>(0.033)</td>
<td>639</td>
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<tr>
<td>Chi-squared</td>
<td>49.752</td>
<td>(0.029)</td>
<td>50.949</td>
<td>(0.027)</td>
<td>52.160</td>
<td>(0.033)</td>
<td>51.435</td>
</tr>
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</table>

Odds ratios with p values in parentheses * significant at 10%; ** significant at 5%; *** significant at 1% (one-tailed where appropriate)

Note: Since coefficients are odds ratios, values below 1 signify negative effects.
Table 5.2a: Economic crises, ideology, and governance in program initiation in Latin America (1982-9)

<table>
<thead>
<tr>
<th>Model</th>
<th>Inflation (t-1)</th>
<th>Inflation*Gov’t Orientation</th>
<th>Inflation (t-1)* Quality of bureaucracy</th>
<th>Inflation (t-4)</th>
<th>Inflation (t-4)* Quality of bureaucracy</th>
<th>Interest/GNP</th>
<th>Interest/GNP Gov’t orientation</th>
<th>Reserves (t-1)</th>
<th>Reserves (t-1)* Gov’t orientation</th>
<th>Government orientation</th>
<th>Quality of bureaucracy</th>
<th>Interest/GNI*Quality of bureaucracy</th>
<th>SOEs as %GDP</th>
<th>SOEs as %GDP* Partisan Difference</th>
<th>Partisan Difference</th>
<th>Regime</th>
<th>Total debt</th>
<th>IMF Program History</th>
<th>Observations</th>
<th>Chi-squared</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2.157***</td>
<td>0.816**</td>
<td>1.345*</td>
<td>1.336</td>
<td>0.994</td>
<td>2.000**</td>
<td>0.622*</td>
<td>0.777***</td>
<td>0.835*</td>
<td>1.570</td>
<td>1.408*</td>
<td>2.004**</td>
<td>0.945</td>
<td>0.746**</td>
<td>1.532</td>
<td>1.043</td>
<td>0.939</td>
<td>16.533***</td>
<td>527</td>
<td>45.989</td>
</tr>
<tr>
<td>2</td>
<td>1.202</td>
<td>(0.006)</td>
<td></td>
<td>(0.043)</td>
<td></td>
<td>6.201**</td>
<td>(0.156)</td>
<td>0.797***</td>
<td>(0.074)</td>
<td>1.701</td>
<td>1.197</td>
<td>(0.046)</td>
<td>0.756</td>
<td>0.809</td>
<td></td>
<td></td>
<td>1.088</td>
<td>13.966***</td>
<td>527</td>
<td>46.982</td>
</tr>
<tr>
<td>3</td>
<td>1.294*</td>
<td>(0.298)</td>
<td></td>
<td>(0.110)</td>
<td></td>
<td>2.276**</td>
<td>(0.029)</td>
<td>1.051</td>
<td>(0.013)</td>
<td>1.159</td>
<td>1.328</td>
<td>(0.049)</td>
<td>0.839</td>
<td>0.850</td>
<td></td>
<td></td>
<td>1.037</td>
<td>25.814***</td>
<td>527</td>
<td>46.777</td>
</tr>
<tr>
<td>4</td>
<td>0.763</td>
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<td>(0.015)</td>
<td></td>
<td>3.212***</td>
<td>(0.049)</td>
<td>0.792***</td>
<td>(0.015)</td>
<td>0.742**</td>
<td>0.499</td>
<td>(0.015)</td>
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<td>0.808</td>
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<td>0.799</td>
<td>12.302***</td>
<td>527</td>
<td>47.651</td>
</tr>
<tr>
<td>5</td>
<td>1.398**</td>
<td>(0.511)</td>
<td></td>
<td>(0.009)</td>
<td></td>
<td>2.221**</td>
<td>(0.015)</td>
<td>0.783***</td>
<td>(0.009)</td>
<td>0.766*</td>
<td>0.499</td>
<td>(0.009)</td>
<td>0.908</td>
<td>0.850</td>
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<td></td>
<td>1.061</td>
<td>15.222***</td>
<td>527</td>
<td>45.848</td>
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<tr>
<td>6</td>
<td>1.357*</td>
<td>(0.043)</td>
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<td>(0.128)</td>
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<td>0.635</td>
<td>(0.054)</td>
<td>0.785***</td>
<td>(0.013)</td>
<td>0.801</td>
<td>1.392</td>
<td>(0.035)</td>
<td>0.850</td>
<td>0.809</td>
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<td>0.799</td>
<td>10.290**</td>
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<td>47.507</td>
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<td>7</td>
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<td>(0.043)</td>
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<td>(0.128)</td>
<td></td>
<td>2.406**</td>
<td>(0.035)</td>
<td>0.754***</td>
<td>(0.003)</td>
<td>0.801</td>
<td>0.382</td>
<td>(0.046)</td>
<td>0.809</td>
<td>0.809</td>
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<td></td>
<td>1.147</td>
<td>9.793**</td>
<td>527</td>
<td>46.542</td>
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</tbody>
</table>

Odds ratios with p values in parentheses * significant at 10%; ** significant at 5%; *** significant at 1% (one-tailed where appropriate)

Note: Since coefficients are odds ratios, values below 1 signify negative effects.
Table 5.2b: Economic crises, ideology, and governance in program initiation in Eastern Europe (1990-2001)

<table>
<thead>
<tr>
<th></th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
<th>Model 5</th>
<th>Model 6</th>
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</thead>
<tbody>
<tr>
<td>Inflation (t-3)</td>
<td>1.101</td>
<td>1.330**</td>
<td>1.344**</td>
<td>1.343</td>
<td>1.349**</td>
<td>1.320**</td>
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<tr>
<td></td>
<td>(0.570)</td>
<td>(0.027)</td>
<td>(0.023)</td>
<td>(0.292)</td>
<td>(0.020)</td>
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<tr>
<td>Inflation (t-3)*Gov't orientation</td>
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</tr>
<tr>
<td></td>
<td>(0.058)</td>
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<td>Inflation (t-3)*Bur.Quality</td>
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<tr>
<td>Interest/GNI</td>
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<td>1.293</td>
<td>1.302</td>
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<td>(0.542)</td>
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<td>Reserves (t-1)</td>
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<td>0.596***</td>
<td>0.563***</td>
<td>0.685</td>
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<td></td>
<td>(0.000)</td>
<td>(0.000)</td>
<td>(0.006)</td>
<td>(0.000)</td>
<td>(0.160)</td>
<td>(0.000)</td>
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</tr>
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<td></td>
<td>(0.620)</td>
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<td>Nat'L/Ex-Comm Gov't</td>
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<td></td>
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<td>(0.573)</td>
<td>(0.987)</td>
<td>(0.595)</td>
<td>(0.686)</td>
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<tr>
<td>Quality of governance</td>
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<td>1.751***</td>
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<td>1.735</td>
<td>1.952***</td>
<td>1.643**</td>
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<td>(0.020)</td>
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<td>(0.015)</td>
<td>(0.215)</td>
<td>(0.014)</td>
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<td>(0.403)</td>
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<td>State sector/GDP</td>
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<td>2.891</td>
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<td>(0.229)</td>
<td>(0.249)</td>
<td>(0.269)</td>
<td>(0.249)</td>
<td>(0.349)</td>
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<tr>
<td>SOEs as %GDP*Partisan Difference</td>
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</tr>
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<td></td>
<td>(0.427)</td>
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</tr>
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<td>Partisan Difference</td>
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<td>(0.486)</td>
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<td>Total debt</td>
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<td>1.161</td>
<td>1.139</td>
<td>1.127</td>
<td>1.145</td>
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<td>(0.319)</td>
<td>(0.355)</td>
<td>(0.295)</td>
<td>(0.390)</td>
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<td>Regime</td>
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<td>0.993</td>
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<td>(0.960)</td>
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<td>(0.810)</td>
<td>(0.779)</td>
</tr>
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<td>(0.026)</td>
<td>(0.027)</td>
<td>(0.032)</td>
<td>(0.027)</td>
<td>(0.027)</td>
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<td>639</td>
<td>639</td>
<td>639</td>
<td>639</td>
<td>639</td>
</tr>
<tr>
<td>Chi-squared</td>
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<td>52.051</td>
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Odds ratios with p values in parentheses * significant at 10%; ** significant at 5%; *** significant at 1% (one-tailed where appropriate)

Note: Since coefficients are odds ratios, values below 1 signify negative effects.
Table 5.3a: Democratic politics and program initiation in Latin America (1982-9)

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Odds ratios with p values in parentheses * significant at 10%; ** significant at 5%; *** significant at 1% (one-tailed where appropriate)

Note: Since coefficients are odds ratios, values below 1 signify negative effects.
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Odds ratios with p values in parentheses * significant at 10%; ** significant at 5%; *** significant at 1% (one-tailed where appropriate).

Note: Since coefficients are odds ratios, values below 1 signify negative effects.
Table 5.4a: Economic crises, ideology, and governance in program implementation in Latin America (1982-9)

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Odds ratios with p values in parentheses * significant at 10%; ** significant at 5%; *** significant at 1% (one-tailed where appropriate)

Note: Since coefficients are odds ratios, values below 1 signify negative effects.
Table 5.4b: Economic crises, ideology, and governance in program implementation in Eastern Europe (1990-2001)

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Odds ratios with p values in parentheses * significant at 10%; ** significant at 5%; *** significant at 1% (one-tailed where appropriate)

Note: Since coefficients are odds ratios, values below 1 signify negative effects.
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Odds ratios with p values in parentheses * significant at 10%; ** significant at 5%; *** significant at 1% (one-tailed where appropriate)

Note: Since coefficients are odds ratios, values below 1 signify negative effects.
Table 5.5b: Democratic politics and program implementation in Eastern Europe (1990-2001)

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<td>0.587***</td>
<td>0.627***</td>
<td>0.626***</td>
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<td>(0.611)</td>
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<td>(0.573)</td>
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<td>Total debt</td>
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<td>Inverse Mills Ratio</td>
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<td>Chi-squared</td>
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Odds ratios with p values in parentheses * significant at 10%; ** significant at 5%; *** significant at 1% (one-tailed where appropriate)

Note: Since coefficients are odds ratios, values below 1 signify negative effects.
Figure 5.0: Domestic drivers of IMF programs
Fig. 5.1a: Inflation, ideology and program initiation in Latin America

Fig. 5.1b: Inflation, ideology and program initiation in Eastern Europe
**Fig. 5.2a: Inflation, bureaucracy and initiation in Latin America**

- **Weak bureaucracy (t-1)**
- **Good bureaucracy (t-1)**
- **Weak bureaucracy (t-4)**
- **Good bureaucracy (t-4)**

**Fig. 5.2b: Inflation, governance and program initiation in Eastern Europe**

- **Weak**
- **Medium**
- **High**
Fig. 5.3a: Interest payments, bureaucratic quality and initiation in Latin America

Fig. 5.3b: Reserves, governance and initiation in Eastern Europe
Fig 5.4a: Discretionary Resources, Ideology and Initiation in Latin America

Fig 5.4b: Discretionary resources, ideology and initiation in Eastern Europe
Fig. 5.5a: Inflation, ideology and implementation in Latin America

Fig. 5.5b: Inflation, ideology and implementation in Eastern Europe
Fig. 5.6a: Inflation, bureaucracy and program implementation in Latin America

Inflation

Pr(Active)

Fig. 5.6b: Inflation, quality of governance and implementation in Eastern Europe

Pre-prog. inflation

Pr(Active)

Weak bureaucracy
Medium bureaucracy
Good bureaucracy

Weak governance
Medium governance
Good governance
Figure 5.7a: Discretionary resources and program implementation in Latin America

Figure 5.7b: Discretionary resources and program implementation in Eastern Europe
Figure 5.8: Democracy and program implementation in Latin America

Figure 5.9: Government fragmentation and program implementation in Eastern Europe
Appendix 4: Tables and Figures for Chapter 7

**Indebtedness and Interest Burden in Latin America (1981-2004)**

![Graph showing trends in Debt/GNI(%) and Interest/GNI(%) from 1980 to 2005.](image)

**Fig. 8.2: Total long-term debt trends - Latin America (1981-2004)**

![Graph showing trends in disbursements, net flows, and interest payments from 1981 to 2004.](image)
Fig. 8.3: Reserves and ideology in program initiation - Latin America 1990s

Figure 8.4: Interest payments and ideology in program initiation - Latin America 1990s
Figure 8.5: Reserves and ideology in program implementation - Latin America 1990s

Figure 8.6: Interest payments and ideology in program implementation - Latin America 1990s
Fig. 8.7: Corruption in Latin America (1996-2005)
Table 7.1: Drivers of program initiation in Latin America (1990-2001)

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<td>0.583**</td>
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<td>(0.056)</td>
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<td>Hyper-inflation (&gt;1000%)</td>
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Odds ratios with p values in parentheses * significant at 10%; ** significant at 5%; *** significant at 1% (one-tailed where appropriate)

Note: Since coefficients are odds ratios, values below 1 signify negative effects.
Table 7.2: Drivers of program implementation in Latin America (1990-2001)

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<td>Pre-program inflation</td>
<td>0.677** (0.043)</td>
<td>0.634** (0.021)</td>
<td>0.746 (0.158)</td>
<td>0.675** (0.037)</td>
<td>0.666** (0.041)</td>
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<tr>
<td>Reserves (t-1)</td>
<td>0.876* (0.157)</td>
<td>1.002 (0.987)</td>
<td>0.796** (0.012)</td>
<td>0.883* (0.127)</td>
<td>0.875* (0.177)</td>
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<tr>
<td>Reserves (t-1)*</td>
<td>0.929 (0.200)</td>
<td>1.002</td>
<td>0.796**</td>
<td>0.883*</td>
<td>0.875*</td>
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<td>Interest/GNI</td>
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<td>0.016*** (0.000)</td>
<td>0.370 (0.137)</td>
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<td>Interest/GNI* Gov't Orientation</td>
<td>10.208*** (0.000)</td>
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<td>0.796**</td>
<td>0.883*</td>
<td>0.875*</td>
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<td>Rescheduled debt/GNI</td>
<td>1.893*** (0.006)</td>
<td>1.002</td>
<td>0.796**</td>
<td>0.883*</td>
<td>0.875*</td>
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<td>3.344*** (0.000)</td>
<td>1.862** (0.049)</td>
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<td>0.875*</td>
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<tr>
<td>Pre-Electoral Period</td>
<td>0.368 (0.200)</td>
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<td>0.796**</td>
<td>0.883*</td>
<td>0.875*</td>
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<tr>
<td>Pre-Electoral Period* Gov't Orientation</td>
<td>0.827 (0.692)</td>
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<td>0.796**</td>
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<td>0.875*</td>
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<td>5.269*** (0.000)</td>
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Odds ratios with p values in parentheses. * significant at 10%; ** significant at 5%; *** significant at 1% (one-tailed where appropriate).

Note: Since coefficients are odds ratios, values below 1 signify negative effects.
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**Washington Times.**


