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considered them in breach of their obligation.[44] As time went on, this kind of uncertainty could be expected to wane through approval decisions and executive board clarification.

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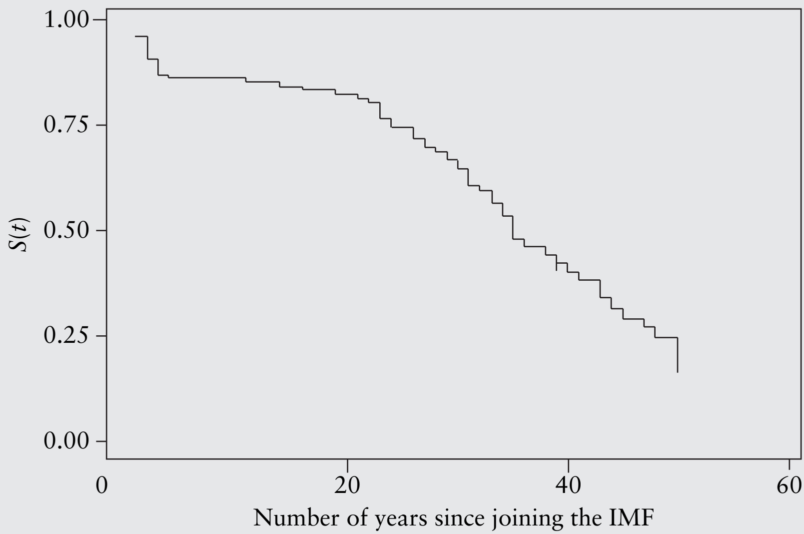
Before proceeding to more complicated analyses, it is useful to make a visual inspection of the data. The data set used is a panel of 138 countries. The only criterion for their inclusion was membership in the IMF by 1980. Of these countries, we have time varying and case varying data for 110 countries that have chosen Article VIII status since 1966. Using yearly observations for these countries, it is useful to construct a Kaplan-Meier "survival function" that describes the period of transition prior to making an Article VIII commitment (see Figure 22.1).[45]

One fact becomes obvious from this visual representation of the data: the "transitional" regime could in fact last a long period of time for a number of countries. The Kaplan-Meier function estimates about a 25 percent chance of accepting Article VIII status in the first twenty-four years of IMF membership, a 50 percent chance within thirty-five years, and about a 75 percent chance after fifty years. Clearly, many countries have been in no rush to commit legally to keeping their current account free from restrictions.

What affects the rate at which governments make the commitment? Table 22.1 presents the findings of the Cox proportional hazard estimation for a combination of variables discussed earlier. (Note that ratios of more than 1 indicate an increase in the rate of Article VIII acceptance, and ratios of less than 1 indicate a reduction in the rate of acceptance. Thus the null hypothesis is that the hazard ratio is not significantly different from 1.) Consider first the ability to comply, which I argue is essential

[44] For example, the United Kingdom did not want the stigma of a board decision that they maintained an illegal multiple currency practice as a result of what the United Kingdom considered a legitimate way to control capital movements. Implementation of Article XIV and Article VIII Decision, minutes of staff visit to the United Kingdom, 27 July 1960, S424, Trans. Arrange., Move to Art. VIII Mission (IMF Archives). Uncertainty over board interpretation inhibited early commitment. Generally, see Policy Aspects of the Article VIII and Article XIV Problem, 21 October 1954, S424, Trans. Arrange., Art. VIII and XIV, 1954–55 (IMF Archives).

[45] The literature usually terms the event of interest a "failure" and the time elapsed until its occurrence as "survival" regardless of the substantive problem modeled. Proponents of international openness and free markets would in this case view "survival" analysis as "transition" analysis, and an Art. VIII commitment as a "success"; those who favor closer government management of markets might agree that the customary appellations are in fact more apt.



Note: The Kaplan-Meier estimator for maintaining Article XIV status beyond time *t* is the product of the probability of maintaining this status in time *t* and the perceding periods:

$$S(t) = \prod_{j=t0}^{t}\{(nj - dj)/nj\}$$

where *n* represents those cases that neither accepted Article VIII status nor were censored, and *d* represents the number of acceptances during the time period.

	Country-years at risk	Incidence rate	Number of countries	Survival time		
				25%	50%	75%
Total	3,125	.01999	110	24	35	50

FIGURE 22.1. *The Kaplan-Meier survival function: Duration of Article XIV status over time.*

for a credible commitment. My expectation is that countries are more unlikely to make Article VIII obligations when their payments are volatile and they tend toward deficit. In the models developed here, balance-of-payments levels (the average balance of payments for the period as a whole) are interacted with balance-of-payments volatility.[46] This

[46] Reserve levels and volatility, as well as terms of trade volatility, were also analyzed, but because the results were insignificant they are not reported here.

TABLE 22.1. *Influences on the Rate of Article VIII Acceptance*

	Rate of Article VIII acceptance (hazard ratios)			
	Model 1	**Model 2**	**Model 3**	**Model 4**
Average balance of payments	—	—	1.364** (.145)	1.352** (.180)
Balance-of-payments volatility	—	—	.390** (.170)	.400* (.205)
Balance-of-payments (volatility*mean)	—	—	.887** (.035)	.891** (.046)
Universality	1.073*** (.015)	1.330*** (.092)	1.385*** (.111)	1.553*** (.386)
Regional norm	1.030*** (.005)	1.043*** (.009)	1.045*** (.010)	1.040*** (.010)
Surveillance	.608 (.289)	.047*** (.042)	.041*** (.047)	.061** (.087)
Openness	1.009*** (.003)	1.015*** (.003)	1.018*** (.004)	1.018*** (.005)
Democracy	—	1.078* (.050)	1.081* (.044)	1.079* (.044)
Year	—	—	—	.904 (.199)
N	1,988	1,757	1,754	1,754
Time "at risk"	2,517.97	2,296.98	2,294.98	2,294.98
Log likelihood	−182.45	−93.39	−90.15	−89.96
χ^2	132.12	75.63	66.09	74.76
Prob. > χ^2	0.00	0.00	0.00	0.00

Note: Table shows estimated hazard rates using a Cox proportionate hazard model with time varying covariates. Robust standard errors are in parentheses.
*** $p > |Z| = .01$.
** $p > |Z| = .05$.
* $p > |Z| = .10$.

specification is meant to distinguish volatility effects conditional on whether the balance-of-payments position is relatively strong or weak. The results displayed in Table 22.1 show that, as anticipated, balance-of-payments volatility reduces the proportional hazard rate substantially. In model 3, it reduces the rate by (1 − .390), or .610, when mean deficits are equal to zero. Substantively, volatility is very likely to reduce the rate at which countries accept Article VIII obligations. Also as expected, countries that have better balance-of-payments positions are more likely to accept Article VIII obligations (36.4 percent more likely for every percentage point of balance of payments as a proportion of gross domestic product, GDP, according to model 3). Interestingly, the negative effects of volatility may be slightly greater in countries with better payment positions on average, as indicated by the statistically significant but substantively small impact of the interaction term. These findings about the balance of payments support the hypothesis that countries that are more capable of compliance are more likely to commit. The commitment is, in turn, more likely to be credible.

The next two variables, "universality" and "regional norm," are meant to test the proposition that taking on an obligation is likely to be contingent on similar actions by others. "Universality" is the proportion of all IMF members who have accepted Article VIII status, and "regional norm" is the proportion of countries within each subregion (as defined by the World Bank) that have done so. (All variable measures and sources are discussed in the data appendix.) Both of these variables have a large and positive influence on the acceptance rate. According to model 3, for example, every 1 percent increase in the proportion of IMF members accepting Article VIII increases the likelihood of acceptance by 38.5 percent. Similarly, a 1 percent increase in the regional proportion of Article VIII adherents increases a country's likelihood of acceptance by 4.1 percent. This translates into a 49 percent increase for every 10 percent increase in regional accession.[47] Clearly, as the number of countries who accept Article VIII increases, there is a greatly increased chance that an uncommitted government will do so. Note that this impact is significant even if we control for time ("year" in model 4). We can be fairly confident, then, that the universality and regional norms variables evaluated here do not simply reflect the fact that adherents increase over time. What most influences the acceptance rate is not time, but the proportion of adherents. This finding is consistent with the incentives of the competitive economic environment in which governments declare their legal adherence to Article VIII.

Domestic political demands that flow from trade-openness also have an important impact on the acceptance rate. Openness to the international trade system raises the proportional hazard rate significantly. According to model 3, every one point increase in imports plus exports as a proportion of GDP increases the likelihood of Article VIII acceptance by 1.8 percent. This could account for a 67 percent difference in acceptance probability for countries with trade profiles as different

[47] Which is calculated by raising the estimated hazard ratio to the tenth power.

as, say, Malaysia (imports plus exports totaling approximately 80 percent of GDP for the period under consideration) and the Philippines (where the corresponding figure is about 50 percent).[48] Certainly, the demands of importers and exporters have much to do with the government's willingness to commit. Interestingly, whether or not a country was democratic only marginally affected the decision, if at all. In the improbable event that a country transformed itself from a complete nondemocracy to a highly democratic society, the possible impact on the probability of accepting Article VIII would only be about 19 percent. Our confidence in this effect barely reaches standard levels of significance, however.[49]

There is also evidence that institutional incentives have made a big difference in Article VIII acceptance. "Surveillance" here is a dummy variable that takes on a value of zero prior to 1977 and 1 thereafter. Once surveillance has been extended to all countries – not just those availing themselves of the Article XIV transitional regime – the impact has been to reduce drastically the probability of accepting Article VIII, as we expected, though our confidence in this result is reduced somewhat by the exclusion of democracy as an independent explanation. The hazard ratio indicates that once the surveillance advantage of Article VIII states was removed, countries were anywhere from 40 percent to as much as 96 percent less likely to accept Article VIII status, other conditions held constant. The end of discriminatory surveillance seems to have mattered greatly to governments' willingness to commit. On the other hand, the simple passage of time had little effect. This could be because the uncertainty regarding obligations that motivated the inclusion of this variable was highly concentrated in the very earliest years of the IMF. There is little reason to believe that time itself accounts for changes in the rate of commitment.

The evidence suggests that governments are more likely to commit to Article VIII status when the commitment is credible and when other countries, especially countries in their own region, have done so as well. Although other factors influence the decision to commit, these results are consistent with the use of legal commitments as a signal to markets of a serious intent to maintain open and nondiscriminatory foreign exchange markets.

[48] Calculated in this case by raising the estimated hazard ratio to the twenty-ninth power.

[49] Subtracting the polity scores on autocracy from those on democracy, yielding a scale from –10 to 10, does not significantly alter this general conclusion.

WHO COMPLIES? EXPLAINING THE COMPLIANCE DECISION

* * *

If legalization is an attempt to make a commitment more credible, then governments should resist violating international law because they want to preserve their reputations as law abiding. The incentive for such a reputation in the monetary area is clear: governments want to convince markets that they provide a desirable venue for international trade and investment. Investors and suppliers seeking opportunities for international commerce should prefer to do business with firms in countries that provide a more certain legal framework with respect to the nondiscriminatory fulfillment of international contracts. Although there is no central enforcement of this obligation, the desire to avoid reputational costs should motivate compliance.

The question is, when will reputational costs have their greatest impact? My first hypothesis is that costs are greatest when a violator is an outlier among comparable countries. That is, rule violation is most costly when comparable countries manage to continue to comply. On the one hand, the more competitors are willing to comply, the greater the pressure for any one country to comply, even in the face of economic pressure to protect the national economy through restrictions or multiple exchange rates. On the other hand, if it is common for Article VIII countries in the region to disregard their commitment, this should increase the probability that any given country in that region will decide against compliance. Rampant violation makes it difficult for markets to single out any one violator for "punishment." Thus, we should expect compliance to be positively influenced by what other countries choose to do.

Consider next characteristics of the domestic polity itself. Several analysts have implied that compliance with international legal commitments is much more prevalent among liberal democracies, pointing to the constraining influence exercised by domestic groups who may have interests in or a preference for compliant behavior.[50] In this view participatory politics might put pressure on the government to comply, especially in the case where noncompliance involves curtailing the rights of residents to foreign exchange (it is less clear how this argument relates to the choice to implement or maintain a unified exchange-rate system). Others have argued that the most important characteristic of liberal democracy when it comes to international compliance is its strong domestic commitment

[50] See Young 1979; and Schachter 1991. See also Moravcsik 1997.

to the rule of law. *** In essence, these are affinity arguments: they seem to suggest that domestic norms regarding limited government, respect for judicial processes, and regard for constitutional constraints[51] "carry over" into the realm of international politics. They rest on an intuitively appealing assumption that policymakers and lawmakers are not able to park their normative perspectives at the water's edge.[52]

There are other reasons, however, to expect the rule of law to be associated with Article VIII compliance. Countries respecting the rule of law have a strong positive reputation for maintaining a stable framework for property rights. Markets expect them to maintain their commitments, and to undermine this expectation would prove costly. Countries that score low with respect to the rule of law do not have much to lose by noncompliance; erratic behavior is hardly surprising to investors and traders. I use an indicator for the rule of law that is especially appropriate to test the market's assessment of the reputation for rule of law: a six-point scale published by a political risk analysis firm expressly to assess the security of investments.[53] The scale represents the willingness of citizens peacefully to implement law and adjudicate disputes using established institutions. Higher scores on this six-point measure indicate the presence of such institutional characteristics as a strong court system, sound political institutions, and provisions for orderly succession. Low scores reflect an increased use of extra-legal activities in response to conflict and to settle disputes.

Since I have argued that the purpose of legalization is to make more credible monetary commits, that compliance is market enforced, and that markets prefer certainty in the legal framework, the comparison between the participatory characteristics of democracy and rule-of-law regimes should be especially telling. We have little reason to expect that democracy alone provides the stability that economic agents desire; on the contrary, popular participation along with weak guarantees for fair enforcement of property rights can endanger these rights. Clearly, these two variables are positively correlated (Pearson correlation = .265), but they are certainly conceptually distinct and may have very different effects on the

51 "International law is not unlike constitutional law in that it imposes legal obligations on a government that in theory the government is not free to ignore or change." Fisher 1981, 30. Constitutional constraints most often rest on their shared normative acceptance, rather than on the certainty of their physical enforcement, providing another possible parallel to the international setting.

52 See Risse-Kappen 1995b; and Lumsdaine 1993.

53 See Knack and Keefer 1995, 225.

decision to comply with Article VIII obligations. Thus we are able directly to compare two regime characteristics that are often conflated: democracy with its participatory dimensions on the one hand and the rule of law with its emphasis on procedural certainty on the other. Monetary compliance should therefore be conditioned by (1) compliance by other countries in the region, and (2) a country's reputation for respecting the rule of law. Participatory democracy is expected to have no effect.

The central explanation for compliance should revolve around these reputational factors. Still, it is important to control for other factors that could influence the compliance decision. Consistent with the reputational argument, it may be more costly for a country that is highly dependent on world trade to violate Article VIII. Certainly, retaliation would be more costly to nationals of such a country. Second, it is plausible that countries defending a fixed exchange rate might find it more difficult to maintain Article VIII obligations; countries that had shifted to more flexible regimes would not be under the same pressure to conserve foreign exchange for purposes of defending the currency's peg.[54] Third, use of the IMF's resources could provide an incentive to comply. Pressure from the IMF should be especially strong when countries are in need of a loan. Fourth, it may be the case that compliance is enhanced by the nesting of the Article VIII regime within a broader regime of free trade. Membership in the General Agreement on Tariffs and Trade (GATT) might encourage a country to maintain free and nondiscriminatory foreign exchange markets.[55] Finally, compliance may simply become easier with the passage of time. Thus the following control variables provide a small sample of other factors that could encourage compliance: (1) positive economic conditions,

[54] The board clearly recognized this was the case: "It was quite evident that flexible rates made it easier for a country to eliminate payment and trade restrictions. This made the fact that several European countries were now accepting the obligations of Art VIII on the basis of a fixed parity all the more significant." Peru's currency was still fluctuating. Executive board minutes, 8 February 1961, EBM/61/4., p. 15, C/Peru/424.1, Trans. Arrange., Members' Intent to Use (IMF Archives).

[55] Indeed, the date of GATT's entry into force was conditioned on the acceptance of Art. VIII, sec. 2, 3, and 4 obligations by the contracting parties to the GATT. According to a memo circulated among the staff of the IMF, "The date of entry into force of the revised [GATT] rules concerning discrimination and quantitative restrictions is linked specifically to the date at which the obligations of Article VIII, Sections 2, 3, and 4 of the Fund Agreement become applicable to such contracting parties as are members of the Fund, the combined foreign trade of which constitutes at least 50 per cent of the aggregate foreign trade of all contracting parties." Article VIII and Article XIV, memo prepared by Irving S. Friedman, 24 May 1955 (IMF Archives).

(2) a high degree of trade dependence, (3) flexible exchange rates, (4) use of IMF resources, (5) membership in the GATT, and (6) the passage of time.

In this case the compliance decision is modeled using logistical regression (logit), with the dependent variable taking on a value of 1 for the presence of restrictions or multiple exchange rates and zero for the absence of both. (Since we are analyzing only Article VIII countries, each instance of restrictions or multiple-rate systems is also a case of apparent noncompliance.) Because the data consist of observations across countries and over time, with a strong probability of temporal dependence among observations, a logit specification is used that takes explicit account of the nonindependence of observations.[56] The results are reported in Table 22.2.

One of the most important findings of this analysis is, again, the clustering of compliance behavior within regions. Article VIII countries are much more likely to put illegal restrictions on current account or use illegal multiple exchange-rate regimes if other countries in the region are doing so. The impact of regional behavior is substantial: the difference between a region with no violators compared to one with nearly all violators increased the probability of noncompliance by 79 percent. Could this be the result of common economic pressures sweeping the region? This explanation cannot be completely ruled out, but it is rendered less likely by the range of economic variables included in the specification. The inclusion of various measures of current account difficulty and GDP growth failed to wash out apparent regional convergence. Compliance decisions are apparently not being made on the basis of economic conditions alone, but with an eye to standards of regional behavior. The most obvious reason for this concern would be reputational consequences in a competitive international economic environment.

The domestic political variables tell an interesting story about regime characteristics. In contrast to theories of international behavior that concentrate on the law consciousness of democracies, the evidence presented here suggests that, in this set of countries, democracy may be associated with a greater tendency to violate the country's international monetary obligations.[57] Substantive interpretation of the coefficients

[56] Beck, Katz, and Tucker 1998. A counter vector was employed using the STATA routine made available on Richard Tucker's Web site at <http://www.fas.harvard.edu/~rtucker/papers/grouped/ grouped3.html>. Three cubic splines were included in the analysis but are not reported here.

[57] This conclusion is not significantly altered by the use of the combined democracy-autocracy variable.

TABLE 22.2. *Influences on the Decision to Violate Article VIII Obligations*

Explanatory variables	**Model 1**	**Model 2**	**Model 3**	**Model 4**
Constant	−17.8*** (4.75)	−17.13*** (4.88)	−17.3*** (4.89)	−17.9*** (4.77)
Rule of law	−.340*** (.020)	−.346*** (.119)	−.272** (.133)	−.333*** (.120)
Democracy	.017* (.010)	.016 (.010)	.018* (.010)	.018* (.010)
Regional noncompliance	5.57*** (.554)	5.47*** (.540)	5.21*** (.567)	5.45*** (.553)
Balance of payments/GDP ($t-1$)	−.030** (.013)	−.031** (.013)	−.029** (.013)	−.030** (.012)
Balance-of-payments volatility	.753*** (.257)	.794*** (.262)	.793*** (.276)	.716*** (.266)
Change in GDP	−.055* (.032)	−.057* (.032)	−.056* (.033)	−.055* (.031)
Openness	−.014*** (.003)	−.014*** (.003)	−.014*** (.003)	−.014*** (.003)
Year	.198*** (.051)	.188*** (.053)	.186*** (.052)	.203*** (.052)
Flexible exchange rates	—	.270 (.404)	—	—
Use of fund resources	—		.601 (.404)	—
GATT member		—	—	−.377 (.334)
N	593	593	593	593
Wald χ^2	(11) 207.63	(12) 207.04	(12) 215.52	(12) 220.2
Prob. > χ^2	0.000	0.000	0.000	0.000
Log likelihood	−137.7	−137.4	−136.6	−137.3

Note: The dependent variable is an apparent Article VIII violation, either a restriction on current account or multiple exchange-rate system. This analysis covers Article VIII countries only. Logit coefficients are reported with correction for nonindependence of observations. Robust standard errors are in parentheses. Estimation includes three cubic splines, which are not reported here.

*** $p > |Z| = .01$.

** $p > |Z| = .05$.

* $p > |Z| = .10$.

reveals a highly asymmetrical impact; however, a move from zero to 5 on the democracy scale increases the chances of violating a commitment by only 2.89 percent, whereas a move from 5 to 10 on that scale increases the probability of violating by 10.8 percent. Why this might be so is not difficult to understand. A rich literature in political economy suggests that a potential cost of democracy is that the public does not always fully anticipate the consequences of its aggregate demands. For example, if democracies allow for macroeconomic policies that exhibit an inflationary bias,[58] participatory politics may complicate the international compliance problem. However, a strong domestic commitment to the rule of law contributed positively to Article VIII compliance. Again, the impact is somewhat asymmetrical for values on the explanatory variable. A move from 1 to 3 on the six-point rule-of-law scale reduced the probability of violating Article VIII by 17.7 percent, whereas a move from 4 to 6 reduced the probability of violating by about 4 percent. The effect of the rule of law is understandable in light of the argument about uncertainty and reputation: governments that have invested heavily in a reputation for respecting the rule of law – one aspect of which is protecting property rights – have a lot to lose by reneging on their international obligations.

None of the control variables affects these findings. As anticipated, a weakening balance of payments, as well as higher volatility, contributes to violation, as does a worsening business cycle. Governments of more open economies work hard to abide by their obligation of policy openness, consistent with our expectation. Surprisingly, compliance with these obligations does not improve over time; if anything, violations worsen over the years when other variables in the model are held constant. Flexible exchange rates, GATT membership, and the use of IMF resources may be important institutional contexts for international economic relations, but they do not systematically affect the compliance decision.

CONCLUSIONS

The legalization of some central aspects of the international monetary regime after World War II allows us to examine the conditions under which law can influence the behavior of governments in the choice of their international monetary policies. Historically, this policy area has been devoid of international legal rules. The classical gold standard did

[58] See the review of this literature in Keech 1995.