The Legalization of International Monetary Affairs

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Sovereign control over money is one of the most closely guarded national prerogatives.[1] Creating, valuating, and controlling the distribution of national legal tender is viewed as an inherent right of a nation-state in the modern period. Yet over the course of the twentieth century, international rules of good monetary conduct have become "legalized" in the sense developed in this volume. This historic shift took place after World War II in an effort to bolster the confidence that had been shattered by the interwar monetary experience.[2] If the interwar years taught monetary policymakers anything, it was that economic prosperity required credible exchange-rate commitments, open markets, and nondiscriminatory economic arrangements. International legalization of monetary affairs was a way to inspire private actors to once again trade and invest across national borders.

Sensitivity to the sovereignty costs continues to preclude dense hard law in this area. This is especially obvious when compared to other areas of economic relations, such as trade in goods and services. The Bretton Woods institutions involved only three international legal obligations regarding the conduct of monetary policy. The best known of these was to establish and maintain a par value, an obligation that was formally eliminated by the Second Amendment to the International Monetary Fund's (IMF) Articles of Agreement in 1977. But two other obligations remain: to keep one's current account free from restrictions, and to maintain a unified exchange-rate

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1. Cohen 1998.
2. See Eichengreen 1992; and Simmons 1994.

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system. The first requires that if a bill comes due for imports or an external interest payment, national monetary authorities must make foreign exchange available to pay it. The second proscribes exchange-rate systems that favor certain transactions or trade partners over others. IMF members can voluntarily declare themselves bound by these rules (Article VIII status) or they can choose to maintain, though not augment, the restrictions that were in place when they joined the IMF (a form of grandfathering under Article XIV).

My premise is that legalization of international monetary relations helps governments make credible policy commitments to market actors. As I will argue, the central mechanism encouraging compliance is the desire to avoid reputational costs associated with reneging on a legal obligation. As Kenneth Abbott and Duncan Snidal suggest in this volume, legalization is a tool that enhances credibility by increasing the costs of reneging. The hard commitments encoded at Bretton Woods were thought to be necessary because the soft arrangements of the interwar years had proved useless. Governments have used commitment to the rules contained in the Articles of Agreement as a costly commitment to stable, liberal external monetary policies. This does not mean that compliance is perfect, but it is enhanced when other countries comply and when governments have a strong reputation for respecting the rule of law. When these conditions obtain, rule violation entails disproportionate reputational costs, as I shall argue.

In the first section of the article I examine the international monetary system prior to World War II and show that "hard" international legal obligations played virtually no role in monetary relations during that time. In the second section I demonstrate that the Bretton Woods system ushered in a new "public international law of money" that peaked just prior to the breakdown of the par value obligation in the 1970s. Although governments are no longer legally required to maintain fixed exchange rates, they can still (voluntarily) obligate themselves to maintain a unified exchange-rate system and to keep their current accounts free from restrictions. Thus the trajectory of legalization in this issue area is far from linear. In the third section I investigate why, given a choice, governments commit to and comply with the IMF's monetary rules. Since commitment to these rules is voluntary, why do governments obligate themselves to abide by them? I argue that governments are much more likely to choose to commit under conditions in which such a commitment would be credible, but that commitment is also conditioned on other countries' willingness to commit. In the fourth section I examine the conditions under which commitment affects behavior. Since the IMF is unlikely to enforce these rules in a direct way, what explains compliance? The findings suggest that the desire to avoid reputational costs is crucial. Costs are higher if comparable countries are complying, and if a state has heavily invested in maintaining a strong reputation for respecting the rule of law. In short, legalization strengthens commitment. It is this quality that makes formal treaty arrangements desirable in the first place.

The International Monetary System Before 1945: National Laws and International "Understandings"

The Nineteenth-Century Gold Standard

The stability of the international monetary system in the nineteenth century owed nothing to international legal agreements. Not a single international treaty addressed obligations of countries under the gold standard. Rather, the international system was anchored in national rules, often in the form of statutes, that specified the rights of private parties to import and export gold. In Britain, at the center of the system, the Peel Act of 1819[3] gave individuals the right to convert bank notes to gold by presenting them to the Bank of England. The Bank Charter Act (1844) extended to individuals the right to acquire notes for gold, and created a legal obligation on the part of the Bank of England to maintain gold backing pound for pound, for all outstanding Bank of England notes beyond the "fiduciary issue" of 14 million pounds.[4]

Although the gold standard certainly had a clear legal basis, there was nothing international about the legal structure on which it rested. It was, at most, a decentralized system of regulatory harmonization.[5] To access international capital and trade, other countries had an incentive to follow Britain onto gold. So in 1871 the German Empire made gold its standard (even though this required Germany to hold much more gold in reserve than did Britain). Switzerland and Belgium followed in 1878. France adopted the gold standard but restricted convertibility when the franc was weak. The Austro-Hungarian gulden floated until the passage of (what was purported to be) gold standard legislation in 1891. In 1900 the United States declared gold as the "standard unit of value," which put the country officially on the gold standard (though silver coins still circulated). None of these national decisions involved the international community in their making. Indeed, when international conferences did take place, they tended to favor bi-metalism.[6]

Nor was this system managed through international legal arrangements. Even if one does not accept the traditional description of balance-of-payments adjustment under the classical gold standard as fully "automatic," its cooperative aspects knew no international legal guidelines. W. M. Scammell described the adjustment mechanism as "quasi-organizational, being operated by a team of central bankers under the leadership of the Bank of England on behalf of the world community."[7] But at no point in the pre–World War I period could one point to an international legal framework within which such cooperation was to take place. It is not difficult to see why this should be so. This decentralized system of harmonized national rules seemed to provide a good degree of stability—at least for international traders and investors at

3. Amended in 1921.
4. Dam 1982, 23–25.
5. See, for example, the description by the MacMillan Committee on Finance and Industry, Cmd. 3897, HMSO 1931, as reprinted in Eichengreen 1985, 185–99.
6. Dam 1982, 23.
7. Scammell 1985, 105.

the industrialized core of the system.[8] As long as investors were confident that the system would be maintained,[9] there was little reason to design an elaborate international legal structure for its maintenance.

The Interwar Years

World War I disrupted not only the economic relationships but also the domestic political and social stability that underlay the confidence in the gold standard.[10] As a result, the interwar years were a "largely unsuccessful groping toward some form of organizational regulation of monetary affairs."[11] Increasingly, the major governments turned to negotiated agreements that had the feel of "soft law" as described by Abbott and Snidal. For example, the Brussels Conference of 1920 met to consider creating a new addition to the League of Nations, the Economic and Financial Commission, to which some responsibilities for economic stabilization might be delegated. In 1922 the governments of the major European countries met in Genoa to agree informally to the principles of a gold exchange standard, which would economize on gold by encouraging smaller financial centers to hold a portion of their reserves in foreign exchange rather than gold. Although this agreement did in fact have an important impact on the composition of reserves, it was at most a soft admonition to economize gold holding. When the Bank for International Settlements was created in 1930, governments were careful to limit their mutual obligations while solidifying the bank as their agent in the collection of reparations from Germany.[12] As the Permanent Court of International Arbitration noted, the international community had quite clearly "accepted [the] principle that a State is entitled to regulate its own currency."[13]

Virtually every important exchange-rate decision made in the interwar years was made unilaterally. On 21 September the British government implemented the Gold Standard (Amendment) Act of 1931, suspending payments of gold against legal tender and officially leaving the gold standard. Even as multilateral negotiations were in progress, the Roosevelt administration unilaterally imposed exchange controls and an export embargo.[14] Even when governments tried to coordinate their actions, diplomatic declarations were chosen over legal commitments. The Gold Bloc, formed in July 1933 among the governments of Belgium, France, Switzerland, and the Netherlands to cooperate to defend existing parities, was a "soft" legal arrangement created

8. Ford 1985.
9. Eichengreen writes extensively about the confidence that investors had in the prewar gold standard. Eichengreen 1992.
10. Simmons 1994.
11. Dam 1982, 50.
12. Simmons 1993.
13. *Case of Serbian Loans*, Permanent Court of International Justice, ser. A, nos. 20/21, 44, 1929, cited in Gold 1984b, 1533. Thus, researchers often speak of the "norms" of the gold standard (for example, Simmons 1994), but these were never codified in international agreements.
14. Presidential Proclamations 2039 (6 March 1933) and 2040 (9 March 1933); Executive orders 6111 (20 April 1933) and 6260 (28 August 1933). Cited in Dam 1982, 47, 55.

by declaration and communiqué, rather than a formal treaty. When France left the gold standard, for domestic reasons leaders needed multilateral cover and sought it in the form of the "Tripartite Agreement" of 1936. This agreement was the loosest of arrangements, in which Britain, the United States, and France issued separate declarations rather than sign a single document. Without mentioning devaluation, France announced the "readjustment" of its currency, while promising, as far as possible, to minimize the disturbance of such action on the international exchanges. France, Britain, and the United States agreed to arrange "for such consultations for this purpose as may prove necessary." The declarations also expressed the governments' intentions to take actions to relax the system of trade quotas and exchange controls that were in effect at that time and expressed the "trust that no country will attempt to obtain an unreasonable competitive exchange advantage and thereby hamper the effort to restore more stable economic relations which it is the aim of the three governments to promote."[15] Most historians of the period have concluded that the Tripartite Agreement did little to change international economic relations in the 1930s.[16] For our purposes, it was undoubtedly intended to create only the softest of obligations.

That governments tried at all to coordinate their monetary choices during this period had much to do with the growing incentives governments faced after World War I to externalize their problems of economic adjustment. The international monetary system was still dependent on national law, but the nature of the national rules had changed. Certainly governments could no longer passively accept internal adjustments in the face of mounting political demands to manage the economy. In contrast to the nineteenth century, during the 1930s a number of countries claimed to be on a "gold standard" even though gold had little to do with the money supply and hence held no implications for internal adjustment.[17] Once the national rules no longer commanded respect for internal adjustments, governments were increasingly faced with the need for international rules to put limits on external adjustments. Efforts to formalize international monetary relations arose from the need for credible limits on external adjustment.

The IMF and International Monetary Law: Toward the Formalization of "Rules of Good Conduct"

The legalization of international monetary relations burgeoned after World War II.[18] In rejecting the less formalized arrangements of the past century and establishing for

15. All quotations from the Tripartite Monetary Agreements of 25 September 1936 are from the version printed by the Bank for International Settlements, Monetary and Economic Department, Basle, January 1937. The sections quoted can be found nearly verbatim in all three declarations.

16. See Sauvy 1967, 224; Kindleberger 1986, 255, 257, 259; and Clarke 1977.

17. In the United States it was illegal after 1933 (Exec. order 6260) for a resident to hold gold coins or bullion. Sterilization funds in both the United States and Great Britain further severed the relationship between gold flows and international monetary policy.

18. The expression "rules of good conduct" is used by Gold 1965, passim.

the first time a public international law of money,[19] negotiators from the United States and the United Kingdom were consciously choosing an international legal framework to enhance the system's credibility. Moreover, the IMF was to be, among other things, a fund, the purpose of which was to extend loans to members in balance-of-payments trouble. This alone led to a huge increase in legal detail, since these rules are analogous to banking law or at least to banking practice, where terms of loans and their repayment are spelled out in contracts and often limited by statutes and regulations. The IMF was created by a multilateral treaty arrangement, by which signatories agree to pay in subscriptions in exchange for voting and drawing rights. Of course, the decision to create an intergovernmental organization and to codify basic rules required domestic ratification of all signatories. In the United States, this meant that the Articles of Agreement had to be ratified by two-thirds of the Senate and, because of the need for implementing legislation, a simple majority of both houses of Congress. With the entry into force of the IMF's Articles of Agreement, money—like activity on the seas and diplomatic relations among states—was drawn under the system of public international law and became newly subject to its broader norms and principles.[20]

Fixed Exchange Rates: The Rise and Fall of Legalization

The Articles of Agreement set forth two primary regulatory goals that reflected lessons drawn from the interwar years: governments should be obligated to peg exchange rates and to remove exchange controls and discriminatory practices that affected current transactions. Legalization was designed, of course, to fulfill the broader objectives of the IMF's founding members, especially those of the United Kingdom and United States. According to Article IV of the Articles of Agreement, "The essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services, and capital among countries, and . . . a principle objective is the continuing development of the underlying conditions that are necessary for financial and economic stability."[21] To this end, the original White Plan had advocated "the general policy of foreign exchange trading in open, free, and legal markets, and the abandonment as rapidly as conditions permit of restrictions on exchange controls." Controls that were once under the sovereign control of national governments now had to be justified to the international community and were collectively condoned only to the extent necessary "to carry out a purpose contributing to general prosperity."[22] In short, in the postwar monetary system, public international law was to be used as it had been for decades in trade relations: to

19. Gold 1984a, 801. A French plan was offered at the beginning of the postwar monetary negotiations. Although it played no direct role, it did indicate the French preference for agreement among the "principal nations" somewhat analogous to the Tripartite Agreement. The French plan saw an international institution as optional. Dam 1982, 76.

20. Gold 1980, 5. Nonetheless, legal treatments of these obligations are surprisingly few. See generally Denters 1996, 16–20.

21. Art. IV, sec. 1.

22. From the White Plan. Horsefield and De Vries 1969, 3:64.

help facilitate the international exchange of goods and services by providing for currency convertibility in open, free, and legal markets.

The international community thus explicitly recognized for the first time that exchange rates were properly a matter of international concern. To become a member of the IMF, a country had to communicate a "par value" for its currency by direct or indirect reference to gold. This might involve minor negotiations with the IMF staff, but it basically established par values very close to those prevailing just prior to membership. Members then had an obligation to maintain that par value within the margins prescribed in the articles.[23] Members were required, without exception, to consult with the IMF before making a change in their initial or subsequent par values; failing to do so constituted a breach of a legal obligation. And although the IMF could not propose a change in a member's par value, by using its resources it could influence a member's decisions to adopt a particular par value. In short, "the authority over exchange rates granted to the Fund by the original articles was unprecedented in international law."[24]

Not all members complied with the obligation to peg. Some were able to do so only by maintaining other undesirable (or illegal) practices, such as multiple currency arrangements or restrictions on current account, which will be analyzed later. Among the industrialized countries, Canada failed to comply and instituted generalized floating for many years,[25] and Germany and the Netherlands briefly were in breach as well.[26] The most spectacular instance of noncompliance—that of the United States in 1971—ultimately reversed the trend begun in the 1940s to harden exchange-rate obligations. Outside of the IMF's legal framework, the "Group of 10" (G-10) industrialized countries met in an attempt to stabilize exchange rates by loosening the margins. The ensuing "Smithsonian Agreement" was adopted as a temporary set of rules by the IMF's executive board on the same day that it was announced in the G-10 communiqué.[27] Rules for generalized floating were then negotiated by the "Group of 20"—again, outside of the legal framework of the IMF—and were adopted by the executive board as nonmandatory guidelines.[28] The heyday of multilateral

23. Art. IV, sec. 4. Furthermore, Art. IV, sec. 2 provided that "no member shall buy gold at a price above par value plus the prescribed margin, or sell gold at a price below par value minus the prescribed margin." A central bank could not enter into any gold transaction with another central bank other than at par without one or the other violating the articles.

24. Gold 1988, 48.

25. Canada's decision to float in 1950 was a violation of the Articles of Agreement, but the IMF did not want to force a showdown with Canada; instead it issued an explanation that amounted to pragmatic toleration of floating rates. No major currency followed Canada (at least for the next two decades), so the case was more of an aberration than a precedent.

26. Gold 1988, 31.

27. Executive board decision, Central Rates and Wider Margins: a Temporary Regime, 18 December 1971. See Dam 1982, 191. The board tried to reconcile the Smithsonian Agreement with the articles. The decision stated that the temporary arrangement "would enable members to observe the purposes of the IMF to the maximum extent possible during the temporary period preceding the resumption of effective par values with appropriate margins in accordance with the Articles." Gold 1979, 559.

28. The executive board decision called on members to "use their best endeavors to observe the guidelines." Decision of 13 June 1974 (IMF 1974, 112). The guidelines said that a member "should" intervene "to prevent or moderate sharp and disruptive fluctuations from day to day and from week to week, . . .

legalized exchange-rate relations were effectively over. It was only left for the IMF membership to officially acknowledge the reassertion of national sovereignty in exchange-rate relations by composing the Second Amendment to the Articles of Agreement, which took effect in 1977.

Remaining Monetary Obligations: Article VIII

Despite the softening of legal obligations with respect to the system of par values, governments who are members of the IMF do retain two important obligations in the conduct of their external monetary policy. Both of these are contained in Article VIII of the Articles of Agreement, which spells out the general obligations of members. These rules prohibit restrictions on the making of payments and transfers for current international transactions; they also prohibit multiple currency practices without the approval of the IMF itself.[29] Article VIII section 2(a) provides that governments must make foreign exchange available for goods, services, and invisibles.[30] By agreeing to this standard, governments obligate themselves to make available to their citizens foreign exchange to settle all legal international transactions (it remains up to the government to determine which are legal).[31] They also agree to refrain from delaying, limiting, or imposing charges on currency transfers if these have the effect of inhibiting or increasing the costs of making payments.[32] Interestingly, this provision appears to be the only part of the Bretton Woods Agreements that constitutes an obligation of member states toward their own residents.[33]

Multiple currency practices that establish different rates of exchange have always been prohibited by the Articles of Agreement. Article VIII section 3 creates a hard legal obligation to avoid such practices,[34] which were viewed as a threat to the original parity rule, potentially discriminatory, and always distortionary. As with the restrictions in section 2, the IMF could, however, approve temporarily such practices, which can serve to soften the proscription in the short run. Multiple currency practices were rampant after World War II: about a third of all the countries involved in the Bretton Woods negotiations had multiple currency systems in place. As late as

should not normally act aggressively with respect to the exchange value of its currency," should adopt a "target zone of rates," and should consult with the IMF.

29. Art. VIII, sec. 2, para. (a), and sec. 3. Member states are, however, permitted to maintain or impose exchange restrictions under certain conditions: (1) if they are necessary to regulate international capital movements (art. VI, sec. 3); (2) with the approval of the IMF (art. VIII, sec. 2 (a)); (3) if the IMF has declared a currency "scarce" (art. VII, sec. 3 (b)); and (4) if the exchange restrictions were effective at the time the state became a member of the IMF (art. XIV, sec. 2).

30. The restriction applies only to payments and transfers for current international transactions. The IMF articles explicitly permit the regulation of international capital movements (Art. VI, sec. 3).

31. See Executive Board Decision 1034 (60/27), 1 June 1960, para. 1, *Selected Decisions of the International Monetary Fund and Selected Documents*, 11:259 (Washington, D.C.: IMF). See also Horsefield and de Vries 1969, 3:260.

32. Edwards 1985, 391 (see fn. 39 for original documentary sources); and Horn 1985, 295.

33. Boehlhoff and Baumanns 1989, 108.

34. Art. VIII, sec. 3 says: "No member shall engage in, or permit any of its fiscal agencies referred to in Article V, Section 1 to engage in, discriminatory currency arrangements or multiple currency practices . . . except as authorized under this agreement or approved by the Fund."

1971, a major member, France, introduced a multiple exchange-rate system. The United Kingdom also maintained a separate investment rate as late as 1979.

Why were rules forbidding these practices considered necessary? For two general reasons: Governments may want to support developmental objectives that favor certain kinds of imports over others based on established state priorities.[35] More often, however, governments use exchange controls and multiple currency practices as one among a variety of methods to deal with balance-of-payments problems.[36] For either purpose, they may require exporters to surrender foreign currencies received in export sales to government authorities, at governmentally determined rates.[37] In turn, importers are required to obtain foreign currency from the governmental authority or authorized bank. Such systems allow for foreign currency rationing or import discrimination in which foreign currency is made available (or available at favorable rates) for some goods or some transactions but not others.[38]

The IMF has always viewed such systems of control as dangerous substitutes for economic adjustment and inhibitions to the development of free foreign exchange markets. However, because many of the IMF's founding members could not immediately achieve full convertibility at unified rates, Article VIII obligations are made voluntarily. Upon joining the IMF, new members can avail themselves of "transitional" arrangements, under Article XIV, which in effect "grandfather" practices that were in place on their accession to the Articles of Agreement.[39] Even so, Article XIV countries are expected to withdraw restrictions when they are no longer needed for balance-of-payments reasons[40] and are required to consult annually with the IMF about retaining restrictions inconsistent with Article VIII.[41] In the course of these consultations the IMF tries to persuade members gradually to move from "transitional" practices—foreign exchange rationing, multiple exchange rates, foreign exchange licensing systems—to the IMF's traditional approach: reduction of domestic inflation, comprehensive fiscal reform, devaluation if necessary, and simplification of exchange restrictions to remove their tax and subsidy effects. Once these fundamentals are in place the IMF usually urges the Article XIV country to commit itself to Article VIII status.[42]

35. See, for example, India and Article VIII, 11 July 1955, S424, Transitional Arrangements, Article VIII Country Studies (Washington, D.C.: IMF Archives).

36. See Edwards 1985, 381–82; and Gold 1988, 255.

37. Edwards 1985, 391. Surrender requirements are not prohibited, because surrender in itself is not considered to be an impediment to the making of payments. Gold 1984a, 813.

38. Edwards 1985, 382. A very comprehensive system of exchange controls might prohibit residents to transfer the state's currency to nonresidents except with the state's permission on a case-by-case basis, or prohibit residents to hold foreign currencies except with the state's permission.

39. Art. XIV, sec. 2. An Art. XIV country can also adapt its restrictions without the need for IMF approval. But an Art. XIV country cannot introduce new restrictions without approval, adapt multiple currency practices without IMF approval, nor maintain restrictions that the member cannot justify as necessary for balance-of-payments reasons. See Horsefield and De Vries 1969, 1:248–59.

40. Art. XIV, sec. 2.

41. Art. XIV, sec. 3.

42. Ideally, the IMF wants the removal of restrictions to coincide with the assumption of Art. VIII obligations, though it has recognized that this might not always be possible and that waiting for the complete removal of every last restriction would only serve to delay the making of such a commitment.

Legal Commitment: Expectations and Evidence

But why should a government voluntarily assume Article VIII obligations? And why should it continue to comply with them? After all, the articles specify neither a time period nor a set of criteria for ending the transitional period.[43] And although the IMF encourages countries they believe are in a position to do so to make an Article VIII commitment, the IMF does not provide direct positive or negative incentives for doing so.[44] Nor does it directly "enforce" these obligations.[45] It does publish data on states' policies from which one can infer compliance (see the data appendix). The executive board can also "approve" restrictions (or not) and has done so as an accompaniment to adjustment programs it is supporting. But the consequences of nonapproval are questionable, since the board does not generally make its decisions public.[46] The executive board can declare a member ineligible to use the IMF's resources if the member "fails to fulfill any of its obligations" under the articles,[47] and noncompliance sometimes does interrupt drawings under standby and extended arrangements.[48] But, in fact, the IMF has used these formal remedies very sparingly. Noncompliers rarely have to worry about retaliation directly from the IMF, since members that vote for some kind of punishment may be concerned about drawing a retaliatory

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See Article VIII and Article XIV, memo prepared by Irving S. Friedman, Exchange Restrictions Department, 24 May 1955, S424, Transitional Arrangements, Art. VIII and XIV, September 1954–55, (IMF Archives). In a few cases, developing countries that were not in an especially strong position to accept Art. VIII had no restrictions in place, and the IMF urged them to go ahead and commit, since they had nothing to "grandfather" under Art. XIV. See Haiti, memo from H. Merle Cochran to Irving S. Friedman, 30 October 1953, C/Haiti/424.1, Trans. Arrange., Members' Intent to Use (IMF Archives); and Letter, Ivar Rooth, M.D., to Jose Garcia Ayber, Governor of the Central Bank of the Dominican Republic, 1 August 1953, C/Dominican Republic/424.1, Trans. Arrange., Members' Intent to Use (IMF Archives). These countries often turn out to be long-term noncompliers.

43. Horsefield and De Vries 1969, 2:225. The IMF staff discussed on various occasions the imposition of time limits for the removal of restrictions and the unification of exchange rates, but rejected them as impractical. Article VIII and Article XIV, memo prepared by Irving S. Friedman, 24 May 1955, S 424, Trans. Arrange. (IMF Archives). There were also debates over the IMF's legal authority to declare an end to the transitional period. Furthermore, there were debates in the early period about exactly what "transitional" referred to. Extract, Executive Board Informal Session 54/2, 19 November 1954, S424, Trans. Arrange. (IMF Archives).

44. However, sometimes countries in fairly tenuous balance-of-payments positions who were willing to accept Art. VIII obligations were provided standby arrangements. For example, see Costa Rica (1965), Executive Board Minutes, EBM/65/7, 29 January 1965, C/Costa Rica/424.1, Trans. Arrange., Members' Intent to Use (IMF Archives).

45. In 1948, the executive board explicitly disapproved France's multiple exchange-rate practice and declared France ineligible to use IMF resources, invoking Art. IV, sec. 6 sanctions. The sanction failed to induce France to adopt a unitary rate. The use of sanctions was perceived as a failure and never invoked again. Dam 1982, 132.

46. Although the board is not barred from publishing reports that communicate the board's views, doing so requires a two-thirds majority of the total voting power to make this decision. Gold 1979, 153.

47. Art. XV, sec. 2 (a).

48. According to Gold, "All standby arrangements include a uniform term on measures that directly or indirectly affect exchange rates. Under this term a member is precluded from making purchases under an arrangement if at any time during the period of the arrangement the member: 'i. imposes [or intensifies] restrictions on payments and transfers for current international transactions, or ii. introduces [or modifies] multiple currency practices, or iii. concludes bilateral payments agreements which are inconsistent with Art. VIII, or iv. imposes [or intensifies] import restrictions for balance of payments reasons.' " Gold 1988, 466.

vote in the future. The IMF is much more likely to use persuasion than to apply a remedy for continued noncompliance.[49]

Hypotheses about why countries commit and whether they comply relate to the function that international legal commitments play in international monetary relations. I have argued that the shift to legalization in the postwar regime was an effort to lend credibility to various monetary policy commitments that were shattered after World War I. Governments commit themselves in order to send a costly signal to market actors as well as other governments that they plan to maintain a stable, open, and nondiscriminatory stance. A legal commitment helps make this signal more credible. It does this through many of the mechanisms Abbott and Snidal outline in their paper. An Article VIII commitment is more costly to breach than are other kinds of policies. For one, breaching a commitment has consequences in domestic courts in cases in which contract performance is contested. Exchange contracts that reflect illegal or unapproved restrictions are required by the articles to be unenforceable in the courts of any member state.[50] This should, in theory at any rate, create disincentives to make exchange contracts with private or public entities that operate under national rules that do not comply with international obligations.[51]

More important, however, is the signal that an Article VIII commitment sends to markets. It indicates a serious intention not to interfere in free exchange and thus to protect property rights of those engaged in international transactions.[52] It is a potentially costly signal to send, since noncompliance could be expected to involve domestic political costs. Recall that the proscription of current account restrictions amounts to a right of access to foreign exchange to nationals. Abrogation, then, amounts to the denial of an expected right of a domestic constituency, which is likely to raise criticisms by affected groups. Of course for a signal to be credible, there must be a good possibility that it will be complied with. That is why almost every country considering a move to Article VIII status has tried to assure markets and the IMF staff that they are in a tenable balance-of-payments position.[53]

49. Gold 1979, 185

50. Art. VIII, sec. 2, para. (b). This provision was originally designed to support the par value system; in particular to assuage the United Kingdom that New York would not become a significant black market for discounted sterling the value of which the United Kingdom was unable to defend through gold sales. Gold 1989, 73. It was originally placed alongside the exchange-rate provisions (Art. IV). According to Gold, "If a contract is unenforceable as a result of the provision, a court may not decree performance of the contract or give damages for nonperformance. . . . The provision establishes a defense rather than a condition for the institution of proceedings." Gold 1989, 90.

51. In practice, many domestic courts have been reluctant to refuse to enforce such contracts, especially when the interests of national firms or major financial institutions are involved. Gold 1989, 6–7.

52. Archival materials thoroughly support such an interpretation. To cite two examples among many, executive board members, in discussing Argentina's acceptance, "thought that Article VIII status would add substantially to the domestic and external confidence in the intentions of the authorities." Argentina—Acceptance of Article VIII, sections 2, 3, and 4, EMB/68/122, 14 August 1968 (IMF Archives). Executive board members, in discussing Costa Rica's acceptance, noted, "The move to Article VIII status was further proof of its determination to maintain a liberal payments system." Costa Rica (1965), EBM/65/7, 29 January 1965, Trans. Arrange., Members' Intent to Use (IMF Archives).

53. Thus, "it may be assumed that it is countries with relatively strong balance of payments positions that would most likely feel able to assume Article VIII status." Article VIII and Article XIV, memo prepared by Irving S. Friedman, 24 May 1955, p. 5, S424, Trans. Arrange. (IMF Archives).

Thus our first hypothesis is that the decision to commit is tied to expectations regarding the ability to comply in the future.[54] The ability to comply is necessary to making a credible commitment. Accordingly, the commitment is likely to be useful only to those countries with a good chance of complying. Countries with economies that are vulnerable to highly volatile swings in their external position are likely to face future conditions in which current account restrictions provide a handy policy instrument in the short run. Since balance-of-payments problems are the main reason governments interfere with the current account in the first place, it is reasonable to expect that external economic pressure or excessive demands for external payments could discourage governments from making an Article VIII commitment. And why should they? Markets are not likely to respond positively when the commitment is incredible. Hence our first hypothesis: susceptibility to balance-of-payments pressures will make a government less likely to accept Article VIII obligations.

Furthermore, it is likely that one influence on the decision to accept Article VIII status is that others are doing so. If making a legal commitment is a way to credibly commitment in a competitive economic environment, then following the lead of one's major competitors may be necessary. A country's firms may find themselves at a competitive disadvantage in international transactions if competitors make commitments to refrain from foreign exchange restrictions while the home government does not. The risk of government interference could result in a premium charged by foreign firms on transactions with residents. For competitive reasons, a government might want to avoid such a premium and follow the suit of its major economic competitors. In addition, international socialization toward accepted standards of behavior, accelerated by the growing dominance of neoliberal economic ideas touted by the IMF itself, may reinforce expectations of openness.[55]

Governments therefore face something of a dilemma: there are costs to being the first to liberalize (including the possibility of direct balance-of-payments pressures), but there are also costs to lagging too far behind international or regional norms. Governments have keenly felt this dilemma in formulating their policies regarding Article VIII. The major Western European countries, for example, assumed Article VIII obligations in unison, since "None of the six countries wanted to move in advance of the other, and all of them preferred to come under Article VIII at the same time as the United Kingdom."[56] A similar decision was made by the African franc

54. Downs and Rocke have used this insight to develop an endogenous explanation of treaty commitments based on uncertainty over future compliance. Downs and Rocke 1995.

55. External normative influences are important in the work of Keck and Sikkink 1998; Legro 1997; Fisher 1981; Kratochwil 1989; and Finnemore 1996. Margaret Levi, in her study of compliance with conscription efforts, combines both rational and normative elements in describing a form of "contingent consent" in which some compliance is "the result of . . . incentives, but at least some compliance expresses a confirmation in the rightness of policies." Levi 1997, 18.

56. Implementation of Article XIV and Article VIII Decision, minutes of staff visit to the United Kingdom, 22 July 1960, S424, Trans. Arrange., Move to Article VIII Mission, minutes of meetings (IMF Archives). The IMF archives contain ample evidence that no European power wanted to pay the potential costs of being the first mover, yet none wanted to lag a decision by other countries in the region. Thus, "The French policy with regards to restrictions depends on the policy followed by other European countries, especially Great Britain. It might even be said in large measure it is conditioned by that policy."

zone countries three and a half decades later. When Argentina committed to Article VIII, executive board members indicated that they were "not surprised to see one more Latin American country assuming the obligation," since most of the other Article VIII countries were from Latin America. Board members predicted that "now that Argentina had assumed the obligations of Article VIII perhaps Brazil would also do the same soon and Chile would follow."[57] In discussions of the timing of Article VIII acceptance with the IMF, Peru's prime minister "agreed Peru should not jump out ahead of the others, but . . . definitely does not want to 'miss the boat.' "[58] These concerns are understandable if legal commitment is viewed as a way to reassure markets in a competitive economic environment. Although there may be few incentives to liberalize first, governments need to be cognizant of the signal they may be sending by refusing to commit, especially when other countries with whom they might compete for capital or trade have done so.

If a legal commitment to Article VIII is a way to improve access to capital and trade by in effect raising the costs of interfering in foreign exchange markets, then we should expect commitment to be influenced by two factors: (1) a basic ability to comply (which is necessary for a credible commitment), and (2) the commitment decisions of other countries (which avoids the costs of being the first to move and reduces the costs of lagging).

We should also consider a set of plausible control variables that could reveal a spurious correlation with these hypothesized relationships. I am not suggesting that a credible commitment is the only reason a government would commit to Article VIII but investigating whether it stands up to a range of plausible alternatives. The first is a straightforward argument based on domestic demands: commitment is likely to be a function of domestic policy demands, just like any other aspect of foreign economic policymaking.[59] Such arguments must consider the source and nature of domestic preferences and the extent to which the political system reflects these preferences. Article VIII provides a right of access to foreign exchange for residents and

F. A. G. Keesing, 1 July 1955. S424, Trans. Arrange., Art. VIII Country Studies (IMF Archives). For a similar position by the Netherlands, see Netherlands and Article VIII. 23 June 1955, S424, Trans. Arrange., Art. VIII Country Studies (IMF Archives). On the United Kingdom's unwillingness to move alone, see memo from Rooth to E. M. Bernstein, 20 May 1955, S424, Trans. Arrange., Art. VIII and XIV, Sept. 1954–55 (IMF Archives). On the incentives for a general snowball effect within Europe, see memo from F. A. G. Keesing, 13 May 1955, S424, Trans. Arrange., Art. VIII and XIV, 1954–55 (IMF Archives).

57. Argentina—Acceptance of Article VIII, sections 2, 3, and 4, p. 4, 14 August 1968, EMB/68/122 (IMF Archives).

58. Memo from Jorge del Canto to Per Jacobsson, IMF Managing Director, 23 September 1960, C/Peru/424.1, Trans. Arrange., Members' Intent to Use (IMF Archives). Peru was basically free from all restrictions in 1960, and IMF staff members wondered whether they should be encouraged to assume Art. VIII obligations as soon as possible or wait and go with the Europeans. In a handwritten note in the margins, Per Jacobsson wrote, "No. It would not profit Peru to move first—more advantageous to be 'drawn by movement' with others." Memo from Jorge del Canto to Per Jacobsson, 17 May 1960, C/Peru/424.1 (IMF Archives).

59. The literature linking foreign economic policymaking to domestic political demands is vast. Most of this work concentrates on demands for trade protection. See, for example, Aggarwal, Keohane, and Yoffie 1987; Alt et al. 1996; Destler and Odell 1987; Goodman, Spar, and Yoffie 1996; McKeown 1984; Milner 1988; and Rogowski 1989. For works on financial and monetary policy, see Simmons 1994; and Frieden 1991.

nonresidents, and demands for such a right are likely to be greater in countries where trade is an important part of the national economy. A right of free access to foreign exchange is valuable to importers: it provides a guarantee to foreign firms that the government is not likely to use interference in the foreign exchange market to intervene in international business transactions.[60] It is also likely to be favored by export groups, whom recent research has shown to be concerned with issues of reciprocity and retaliation.[61] For these reasons, economies that depend on trade are likely to be among the most willing to make legal commitments to free and open foreign exchange markets.[62]

The IMF staff, in their discussions of who was ready to commit, clearly recognized the incentives that trade dependence created. Indonesia was deemed unlikely to commit, for example, because "The restrictive system is somewhat peripheral to the broad economic issues in which the public are interested: foreign trade is only 6% of GDP. And non-nationals control the major industries" (jute and tea).[63] On the other hand, when Guyana made the Article VIII commitment, the executive board noted explicitly that "Guyana was one of those very few developing countries in the world whose imports and exports, taken separately, were larger than 50 per cent of GNP, and this necessarily meant that the country was highly vulnerable to swings both in capital and in trading magnitudes." Trade dependence made Guyana a good candidate for Article VIII but also implied a possible need for IMF assistance should liberalization prove destabilizing. A standby arrangement was considered simultaneously.[64]

Furthermore, we might expect that the demand for guaranteed foreign exchange access is most likely to be addressed by a democratic regime. The political organization around this issue area is likely to be that of civil society versus the state: on the one hand, it is difficult to conceive of a private interest that would organize to actively oppose free access to foreign exchange. On the other hand, the concentrated rents go to the government, as the dispenser of limited access to hard currency. If one of the primary characteristics of democracy is the extent to which it empowers civil demands vis-à-vis the state, and if it is also true that these demands are likely to favor those who want free access to foreign exchange, then we should expect democratic governance to be positively associated with the acceptance of Article VIII.

60. According to Horsefield and De Vries, for example, "Article VIII status had come to signify over the years either that a country had a sound international balance of payments position, or that if its payments position was threatened, it would avoid the use of exchange restrictions." Horsefield and De Vries 1969, 2:285–86.

61. Gilligan 1997.

62. Relatedly, the IMF staff thought that Art. VIII obligation created the most advantages for countries whose currencies tended to be traded internationally. See the staff discussion contained in Peru—Aspects of Article VIII, C/Peru/424.1, Trans. Arrange., Members' Intent to Use (IMF Archives).

63. Indonesia and Article VIII, 14 July 1955, S424, Trans. Arrange., Art. VIII Country Studies (IMF Archives).

64. Guyana—Acceptance of Obligations of Article VIII, Sections 2, 3, and 4, Initial Par Value, and Stand-by Arrangement, 13 February 1967, EMB/67/10, C/Guyana/424.1, Trans. Arrange., Members' Intent to Use (IMF Archives).

It is also important to control for the institutional incentives provided by the IMF for those who commit. An early inducement for countries to choose Article VIII status was the fact that multilateral surveillance applied only to Article XIV countries until the Second Amendment (revisions to Article IV) extended mandatory surveillance to the entire IMF membership.[65] Prior to 1977, governments willing to announce acceptance of Article VIII obligations could actually avoid multilateral surveillance.[66] Article XIV countries, on the other hand, were subject to wide-ranging, even invasive "consultations," during which the staff broadly reviewed the member's balance-of-payments position. The executive board would then follow up with an official "view" of the member's situation. Thus until 1977, members faced a perverse incentive to accept Article VIII obligations: the commitment gave them the ability to avoid discriminatory and potentially humiliating surveillance and formal board review. We can hypothesize that the acceptance rate was therefore higher, all else being equal, before 1977 than after.

Finally, controlling for time is appropriate in this analysis. One important reason is that countries may have been reluctant to commit to Article VIII in the early years of the IMF because it was unclear just how the executive board would interpret the obligation. Countries clearly did not want to commit and then be surprised that the executive board considered them in breach of their obligation.[67] As time went on, this kind of uncertainty could be expected to wane through approval decisions and executive board clarification.

Our control variables suggest that four other factors might influence commitment: (1) the degree of trade dependence of the economy, (2) whether the country is democratic, (3) whether those who commit are exempt from surveillance, and (4) the passage of time.

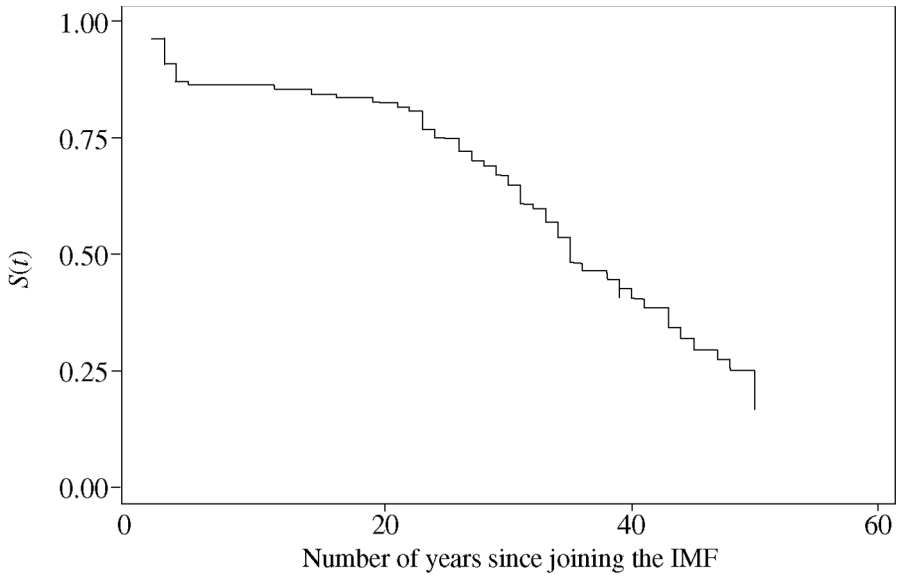
Before proceeding to more complicated analyses, it is useful to make a visual inspection of the data. The data set used is a panel of 138 countries. The only criterion for their inclusion was membership in the IMF by 1980. Of these countries, we have time varying and case varying data for 110 countries 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 1).[68]

65. James 1995, 773, 775.

66. Gold 1983, 474–75. Consultations with Art. VIII countries were established in 1960 but were completely voluntary. Horsefield and De Vries 1969, 2:246–47.

67. 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).

68. 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 preceding 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 1. *The Kaplan-Meier survival function: Duration of Article XIV status over time*

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 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 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.[69] This 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 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 payments 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.[70] 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

69. 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.

70. Which is calculated by raising the estimated hazard ratio to the tenth power.

TABLE 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**	1.352**
			(.145)	(.180)
Balance-of-payments volatility	—	—	.390**	.400*
			(.170)	(.205)
Balance-of-payments (volatility*mean)	—	—	.887**	.891**
			(.035)	(.046)
Universality	1.073***	1.330***	1.385***	1.553***
	(.015)	(.092)	(.111)	(.386)
Regional norm	1.030***	1.043***	1.045***	1.040***
	(.005)	(.009)	(.010)	(.010)
Surveillance	.608	.047***	.041***	.061**
	(.289)	(.042)	(.047)	(.087)
Openness	1.009***	1.015***	1.018***	1.018***
	(.003)	(.003)	(.004)	(.005)
Democracy	—	1.078*	1.081*	1.079*
		(.050)	(.044)	(.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. $> \chi^2$	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.
***$p > |Z| = .01$.
**$p > |Z| = .05$.
*$p > |Z| = .10$.

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 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).[71] 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.[72]

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.

Who Complies? Explaining the Compliance Decision

Members of the IMF are legally required to comply with their commitments to keep the current account free from restrictions and to maintain unified exchange rates, and twenty-six members in our sample have perfect compliance records on both counts.[73] However, a number of Article VIII countries have far from a perfect record (see Tables 2 and 3). Most of the long-term noncompliers are concentrated in Latin

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

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

73. Among the countries who were members of the IMF in 1980, as of 1997, Bahrain, Canada, Denmark, Djibouti, Finland, Gambia, Germany, Indonesia, Lebanon, Malaysia, Mauritius, New Zealand, Norway, Panama, Portugal, Qatar, Saudi Arabia, Seychelles, Spain, Sweden, Switzerland, Thailand, Trinidad and Tobago, United Arab Emirates, United States, and Yemen Arab Republic all had perfect records of compliance with their Art. VIII status.

TABLE 2. *Article VIII noncompliers, restrictions on current account (rates and years of noncompliance, 1967–95)*

Country	*Rate of noncompliance (1967–95)*	*Years committed (1967–95)*[a]	*Dates of restrictions*
Dominican Republic	1.000	29	1967–95
El Salvador	.931	29	1967–93
Jamaica	.862	29	1968–69, 1973–95
Guyana	.828	29	1967, 1971–93
Iceland	.750	12	1984–92
Chile	.722	18	1983–95
South Africa	.682	22	1979–93
Argentina	.630	27	1972–77, 1983–93
Fiji	.600	5	1989–92
Costa Rica	.586	29	1972–73, 1975, 1982–95
Guatemala	.552	29	1967–73, 1981–89
Peru	.552	29	1971–78, 1985–92
Nicaragua	.517	29	1979–93
Ecuador	.440	25	1983–93
Honduras	.414	29	1982–93
St. Lucia	.400	15	1981–86
St. Vincent	.357	14	1982–86
Morocco	.333	3	1993
Italy	.276	29	1975–82
Austria	.241	29	1967–73
Bolivia	.179	28	1982–86
Mexico	.172	29	1983–87
France	.138	29	1969–71, 1983
Haiti	.138	29	1968–71
Japan	.107	28	1968–70

Source: IMF, various years, *Exchange Arrangements and Restrictions.*

Note: Noncompliers are defined as countries that have declared themselves obligated by Article VIII but have implemented restrictions on current account. These are in apparent contravention of Article VIII, section 2(a), but no effort is made here to distinguish between "approved" and "unapproved" restrictions.

[a]Countries with fewer than two years of observations have been omitted.

America, though liberalization increased markedly in this region in the mid-to-late 1990s. Although data limitations prevent the inclusion of very recent years, almost all of the noncompliance associated with the global financial crisis of 1996–97 elicited foreign exchange restrictions rather than the implementation of multiple exchange rates. A few Article VIII countries have implemented one measure inconsistent with their obligations but not the other. Belgium, Hong Kong, and the Netherlands, for example, have in the past implemented multiple exchange rate systems but not restrictions on current account, whereas Austria, Korea, Singapore, and Japan have made the opposite choice.

What explains this variance among countries that chose to obligate themselves to openness? The strategy in this section is to examine only cases in which governments

TABLE 3. *Article VIII noncompliers, multiple exchange-rate systems (rates and years of noncompliance, 1967–95)*

Country	*Rate of noncompliance (1967–95)*	*Years committed (1967–95)*[a]	*Dates of multiple exchange rates*
Bahamas	1.000	24	1974–97
Costa Rica	.81	31	1967–91
Belgium/Luxembourg	.77	31	1967–90
Peru	.77	31	1968–91
Chile	.75	20	1983–97
Dominican Republic	.68	31	1973–91, 1996–97
Nicaragua	.68	31	1967–74, 1979–90
Venezuela	.67	21	1977–90
Argentina	.59	29	1972–77, 1982–92
South Africa	.54	24	1977–82, 1986–92
Bolivia	.43	30	1967, 1983, 1985–95
United Kingdom	.42	31	1967–79
Guyana	.39	31	1967–68, 1984–85, 1987–91, 1993–95
Ireland	.39	31	1967–78
El Salvador	.32	31	1982–91
Guatemala	.32	31	1985–94
Honduras	.32	31	1986–93, 1996–97
Jamaica	.29	31	1967–68, 1978–79, 1987–91
Mexico	.29	31	1983–91
Italy	.26	31	1973–74, 1976–78, 1980–82
France	.10	31	1972–74
Netherlands	.10	31	1972–74
Ecuador	.07	27	1972–73
Haiti	.06	31	1991–92
Hong Kong	.06	31	1970–71
Kuwait	.06	31	1970–71
Australia	.03	31	1968
Suriname	.03	31	1994

Source: IMF, various years, *Exchange Arrangements and Restrictions.*

Note: Noncompliers are defined as countries that have declared themselves obligated by Article VIII but have some form of multiple exchange-rate system. These are in apparent contravention of Article VIII, section 2(a), but no effort is made here to distinguish between "approved" and "unapproved" systems.

[a]Countries with fewer than two years of observations have been omitted.

have committed to Article VIII and then to explain the decision nevertheless to implement restrictions on current account or multiple exchange rate regimes.[74] The first and most obvious explanation for noncompliance is unexpected economic pressures that make the maintenance of an open current account and unified exchange rates

74. This is presented as a priori evidence of noncompliance, even though at this point I do not examine the technical question as to whether or not the executive board of the IMF has approved of the restrictions in place, thus rendering them "legal" temporarily.

very difficult. Certainly economic conditions are likely to have influenced Latin American noncompliance in the 1980s. Thus in the tests that follow I control for the changes in economic growth, current account balance, and current account volatility, all standardized over GDP.

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.[75] 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 to the rule of law. There are many variants of the argument—from Anne-Marie Slaughter's view that independent judiciaries in liberal democracies seem to share some of the same substantive approaches to law to a more general argument that domestic systems that value rule-based decision making and dispute resolution are also likely to respect rules internationally.[76] In essence, these are affinity arguments: they seem to suggest that domestic norms regarding limited government, respect for judicial processes, and regard for constitutional con-

75. See Young 1979; and Schachter 1991. See also Moravcsik 1997.

76. Slaughter 1995a. This captures the flavor of some of the democratic peace literature, for example, Doyle 1986; Dixon 1993; and Raymond 1994.

straints[77] "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.[78]

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.[79] 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 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

77. "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.

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

79. See Knack and Keefer 1995, 225.

would not be under the same pressure to conserve foreign exchange for purposes of defending the currency's peg.[80] 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.[81] 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, (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.[82] The results are reported in Table 4.

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

80. 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).

81. 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).

82. 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.

TABLE 4. *Influences on the decision to violate Article VIII obligations*

Explanatory variables	*Model 1*	*Model 2*	*Model 3*	*Model 4*
Constant	−17.8***	−17.13***	−17.3***	−17.9***
	(4.75)	(4.88)	(4.89)	(4.77)
Rule of law	−.340***	−.346***	−.272**	−.333***
	(.020)	(.119)	(.133)	(.120)
Democracy	.017*	.016	.018*	.018*
	(.010)	(.010)	(.010)	(.010)
Regional noncompliance	5.57***	5.47***	5.21***	5.45***
	(.554)	(.540)	(.567)	(.553)
Balance of payments/GDP ($t-1$)	−.030**	−.031**	−.029**	−.030**
	(.013)	(.013)	(.013)	(.012)
Balance-of-payments volatility	.753***	.794***	.793***	.716***
	(.257)	(.262)	(.276)	(.266)
Change in GDP	−.055*	−.057*	−.056*	−.055*
	(.032)	(.032)	(.033)	(.031)
Openness	−.014***	−.014***	−.014***	−.014***
	(.003)	(.003)	(.003)	(.003)
Year	.198***	.188***	.186***	.203***
	(.051)	(.053)	(.052)	(.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)	(12)	(12)	(12)
	207.63	207.04	215.52	220.2
Prob. $> \chi^2$	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.

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

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

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

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.[83] Substantive interpretation of the coef-

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

ficients 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,[84] 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 not depend on international legal commitments for its reputed stability. "Soft" international legal commitments began to develop only in the interwar years, largely in response to markets' shattered confidence in the ability of governments to maintain the commitments they had made unilaterally in the previous period. Driven by the need to limit the externalization of macroeconomic adjustment costs, some governments sought international commitments as a way to enhance certainty and reassure markets. However, these commitments were in the softest

84. See the review of this literature in Keech 1995.

possible form and did little to constrain behavior or encourage the confidence of economic agents.

The Bretton Woods agreement brought to an end the unbridled national legal sovereignty over monetary affairs. They hardly represent the triumph of legalization over market forces, however, as attested to by the breakdown of the original legal obligation to defend a par value system. Legal obligations cannot stifle market forces: capital mobility has made fixed rates very nearly unmanageable, treaty arrangements to the contrary notwithstanding. The end of the legal obligation to defend pegged rates is a clear reminder that legalization cannot be viewed in teleological terms. Obligations that increasingly frustrate major players as market conditions change are not likely to remain obligations for long.

Members of the IMF still have legal obligations regarding the conduct of their monetary policy. In fact, a growing number of members voluntarily assume these obligations every year. Article VIII Section 2(a) obligates members to keep their current accounts free from restrictions and proscribes the use of multiple exchange-rate systems. Conveniently, the IMF then publishes information on whether countries have imposed what the staff believes constitute restrictions or multiple rate systems. Thus it has been possible in this case to establish a precise account of, first, the rate of commitment and, second, the rate of compliance with international monetary law by looking at states' decisions to accept the obligations of nondiscriminatory current account convertibility and their subsequent behavior. My strategy in this article has been to model the factors contributing to the rate of Article VIII acceptance and to test a set of hypotheses regarding compliance with this commitment.

Legalization is one way governments attempt to make credible their international monetary commitments. The evidence shows that governments are hesitant to make international legal commitments if there is a significant risk that they will not be able to honor them in the future. The hazard models of the rate of acceptance of Article VIII indicate that commitment is associated with conditions that one can reasonably anticipate will make compliance possible. Balance-of-payments weakness and volatility could and did delay the acceptance of obligations for openness significantly. Furthermore, economic downturns and unanticipated balance-of-payments difficulties were associated with noncompliance among Article VIII countries. However, both the archival evidence and the quantitative analysis presented here suggest that governments wanted to be relatively sure they could comply before they committed legally to the open foreign exchange regime. Legal commitment was part of a strategy to make a credible commitment to maintain a liberal foreign exchange regime.

Among Article VIII countries, two regime effects had clear consequences for compliance. Surprisingly for those who view the international behavior of democracies as somehow distinctive with respect to law and obligation, the more democratic the Article VIII country, the more likely it may have been ($p = .10$) to place restrictions on current account. On the other hand, regimes that were based on clear principles of the rule of law were far more likely to comply with their commitments. This finding indicates that rules and popular pressures can and apparently sometimes do pull in opposite directions when it comes to international law compliance. There is no rea-

son to think, based on these findings, that democracy itself is a positive influence on the rule of law in international relations. On the contrary, there is more reason to associate compliance with the extent to which the polity in question respects institutional channels for mediating domestic conflict and protecting property rights than with a participatory or competitive political system. Some analysts have argued that this finding can be understood as a normative constraint on foreign policy choice. But it is also consistent with rational market incentives, since rule-of-law regimes have more to lose reputationally than do capricious regimes in the event of a legal violation.

One of the most interesting findings of this research has been the evidence that commitment and compliance are related to the commitment and compliance patterns beyond one's own borders. The hazard model clearly indicates that the breadth of acceptance influenced acceptance by uncommitted governments. Both worldwide and regional acceptance of Article VIII status had this effect, even when controlling for time. Furthermore, the pervasiveness of restrictions within a region has a negative effect on the compliance decision among Article VIII countries. It is impossible to know from these associational effects, of course, exactly what kinds of mechanisms might be at play in such a relationship. I have argued that these kinds of regional and universal effects likely reflect the strategic nature of implementing restrictions: punishment by economic agents and retaliation or other pressures by trading partners, for example, may be minimal where restrictions are common (since it is prohibitively costly to punish everyone). Those who offer more normative explanations of state behavior might interpret this pattern as an example of the importance of regional norms of appropriate behavior. Or perhaps it is simply the case that although governments feel some moral obligation to obey the law, their willingness to comply breaks down as others abandon the rules at will. Although these tests cannot distinguish these distinct explanations, the ability to document a degree of contingent compliance provides a basis for disentangling the possible mechanisms in future research. What we can say is that compliance and commitment are likely influenced, for whatever reason, by the actions taken by other members of the international system.

This research has broader implications for the study of legalization and compliance with international legal obligations. It shows that legalization as a tool for commitment is limited by economic conditions and market forces. International monetary legalization can be characterized by an inverted "J" pattern: legalization was nonexistent under the classical gold standard and soft during the interwar years. It peaked between 1946 and 1971, when treaty obligations regulated the central relationship among currencies, and now involves definite obligations over a more limited range of policies. Much of the behavior that constitutes international monetary relations remains completely outside of legalized relationships, especially rules and practices with respect to the provision of liquidity.[85]

85. Art. VII, sec. 2 empowered the IMF to borrow from a member but also provided that no member should be obliged to lend to the IMF. Thus the General Agreement to Borrow was negotiated by the

Rather than debating whether compliance is pervasive or minimal,[86] my purpose here has been to examine the conditions under which compliance is likely. The study of international law compliance is rife with problems of conceptualization and measurement,[87] but in this case it has been possible to match a treaty obligation with authoritative assessments of behavior over time for a large number of countries and to match the suggested mechanisms with contextual archival materials. The evidence taken together points to law as a hook for making a credible commitment, with compliance largely "enforced" by the anticipation of reputational consequences.

Data Appendix

Dependent Variables

Article VIII Acceptance: Coded 1 if the country has accepted Article VIII status and zero if it remains subject to Article XIV transitional arrangements. Acceptance indicates the end of a "spell" for purposes of the Cox proportional hazard model.[88]

Violate: Coded 1 if restrictions exist and/or if a multiple exchange rate system is in place, zero otherwise. Since this dependent variable is used only to analyze policies of Article VIII countries, it is interpreted as noncompliance.[89]

Explanatory Variables

Universality: Proportion of current IMF members who have accepted Article VIII status.[90]

Regional norms: Proportion of current IMF members within each region who have accepted Article VIII status. Classification of economies by region (East and Southern Africa, West Africa, East Asia and Pacific, Eastern Europe and Central Asia, Rest of Europe, Middle East, North Africa, Americas) is based on World Bank categories.[91]

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managing director and representatives of the signatory countries outside normal IMF channels. Reminiscent of the Tripartite Agreement, it was enshrined as a series of identical letters among participating countries. Swaps are also soft arrangements created by central banks and operating through the Bank of International Settlements. These were developed completely outside of the IMF framework. Dam 1982, 150. Nor are IMF standby arrangements a contract in the legal sense. Failure to carry out the performance criteria in the letter of intent is not a breach of any agreement and certainly not a breach of international law. All the "seal of approval" effects come despite the nonlegal nature of this commitment. The Executive board's decision of 20 September 1968 explicitly concerns the nonlegal status of standby arrangements. Gold 1979, 464–66.

86. On this point, compare Chayes and Chayes 1993 and 1995 and Henkin 1979 with Downs, Rocke, and Barsoom 1996.

87. These issues are discussed in Simmons 1998.

88. IMF various years, analytical appendix.

89. Ibid.

90. Ibid.

91. Ibid.

Surveillance: A dummy variable indicating whether the time period is before (coded zero) or after (coded 1) 1978, indicating a comprehensive regime of IMF surveillance for all members, whether Article XVI or Article VIII status.

Openness: Imports (total value of goods and services: sum of merchandise f.o.b., imports of nonfactor services, and factor payments at market prices in current U.S. dollars) plus exports (total value of goods and services; sum of merchandise f.o.b, exports of nonfactor services, and factor receipts at market prices in current U.S. dollars), as a proportion of GDP, multiplied by 100.[92]

Democracy: Democracy score (ranging from a low of zero to a high of 10) denoting the degree to which democratic institutions exist within each country.[93]

Mean balance of payments: The mean current account balance (the sum of net exports of goods and nonfactor services, net factor income, and net private transfers as a percentage of GDP, before official transfers) as a proportion of GDP for each country for the period under observation.[94]

Balance-of-payments volatility: The log of the standard deviation of current account balance as a proportion of GDP (defined earlier).[95]

Change in GDP: GDP average annual growth rate, for sum of GDP at factor cost and indirect taxes, less subsidies.[96]

Regional noncompliance: Proportion of current IMF members within each region who place restrictions on their current account and/or used multiple exchange-rate systems. Classification of economies by region (East and Southern Africa, West Africa, East Asia and Pacific, Eastern Europe and Central Asia, Rest of Europe, Middle East, North Africa, Americas) is based on World Bank categories. Since this explanatory variable is used only to analyze policies of Article VIII countries, it is interpreted as noncompliance.[97]

Rule of law: A six-point scale measuring the extent to which a country's domestic polity is based on practices and institutions that respect the rule of law.[98]

Use of IMF credit: Coded 1 if a country has made use of IMF credits during a given year and zero if it has not.[99]

Exchange-rate flexibility: Coded 1 if exchange rates are relatively flexible and zero if they are relatively inflexible; coded individually for each country-year.

GATT member: Coded 1 if a country had acceded to GATT and zero if had not.

92. World Bank 1995 and 1998, indicators (210 + 119)/38.

93. POLITY III data set. For a complete discussion of the conceptualization and coverage of this data set and comparisons with other measures of democracy, see Jaggers and Gurr 1995.

94. World Bank 1995 and 1998, indicator 181.

95. World Bank 1995 and 1998.

96. World Bank 1995 and 1998, indicator 181.

97. IMF, various years, analytical appendix.

98. International Country Risk Guide. For a full discussion of the conceptualization of this variable, see Knack and Keefer 1995.

99. World Bank 1995.