

Articles

Money and the Law: Why Comply with the Public International Law of Money?

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INTRODUCTION

The assumption that international law influences governmental choices and international outcomes underlies the work of legal scholars and practitioners alike. Indeed, explicating the law is arguably only useful to the extent that international rules have an impact on outcomes that themselves are deeply valued by sovereign governments, private actors, or the international community at large. Certainly, most legal scholars and practitioners believe that the rules at the center of their analysis do indeed matter to the design of foreign policy and the conduct of international relations.¹ Scholars of international relations, steeped in “realist” theories of international relations and critical of the inferences drawn from a select (biased) set of cases,

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1. The classic work is LOUIS HENKIN, *HOW NATIONS BEHAVE* 46–48 (1979). *See also* Abram Chayes & Antonia Chayes, *On Compliance*, 47 INT’L ORG. 175, 176 (1993).

however, have been far more skeptical.² Despite broadening interest in whether and to what extent international law influences state behavior,³ the evidence and argumentation remains highly inconclusive.

This Article seeks to contribute to our understanding of international law compliance by focusing on a particular area—the public international law of money. This is a critical terrain for examining compliance with international commitments, for money has traditionally been one of the key aspects of national sovereignty. The creation, valuation, and convertibility of a state's national currency have long been considered a national legal prerogative,⁴ as well as a potent symbol of national autonomy.⁵ Yet, after World War II, governments established for the first time in history a public international law of money,⁶ which required adherents to maintain par values for their currencies, maintain a unified exchange rate regime, keep their current accounts free from restrictions, and consult on a regular basis regarding these matters. The development of these rules allows us to ask and attempt to answer questions that go to the very purposes of international law itself: Why do sovereign governments commit themselves to international rules that will bind their future behavior? Once committed, what conditions are associated with compliance? Do governments that make specific behavioral commitments behave any differently than similarly situated countries who do not commit?

The argument developed here suggests that an international legal commitment is a signaling device that governments use to convince private market actors as well as other governments of a serious intent to eschew the proscribed behavior. The commitment improves access to future benefits: international trade and investment, capital flows, and other benefits of good standing in the international economic community. In order to be convincing, however, such a commitment has to be credible. Hence, governments tend to make such commitments when they are in a plausible position to comply with the legal requirements in question. Moreover, as more countries commit themselves to a rule, *non-commitment* sends a strong *negative* signal about a government's willingness to comply, which explains the "snowballing" or "momentum" effects observed with respect to international law commitments

2. The best contemporary account is that of George W. Downs et al., *Is the Good News About Compliance Good News About Cooperation?*, 50 INT'L ORG. 379 (1996).

3. For example, "Implementation, Compliance, and Effectiveness" was the theme of the 1997 annual meeting of the American Society for International Law. See Shirley A. Whitfield, *Testing the Effectiveness of the International Court of Justice: The Nuclear Weapons Case*, 91 AM. SOC'Y INT'L L. PROC. 1 (1998).

4. See Joseph Gold, *Legal Models for the International Regulation of Exchange Rates*, 82 MICH. L. REV. 1533, 1533 (1984) (citing Case of Serbian Loans, 1929 P.C.I.J. (ser. A) Nos. 21–22, at 44).

5. See generally BENJAMIN J. COHEN, *THE GEOGRAPHY OF MONEY* (1998).

6. For a discussion of exactly what comprises the "public international law of money," see M.R. SCHUSTER, *THE PUBLIC INTERNATIONAL LAW OF MONEY* 1–19 (1973). For a history of the international monetary system from a legal perspective, see generally KENNETH W. DAM, *THE RULES OF THE GAME: REFORM AND EVOLUTION IN THE INTERNATIONAL MONETARY SYSTEM* (1982); and Joseph Gold, *Public International Law in the International Monetary System*, 38 SW. L.J. 799 (1984).

in a number of issue areas.⁷ Governments comply with their legal commitments largely to preserve their reputation for providing a stable framework for the protection of property rights and to enjoy future economic benefits on favorable terms. Indeed, there is suggestive evidence that the more a polity has invested in such a reputation, the less willing a government will be to tarnish its reputation through non-compliance with its international legal obligations. Moreover, the international context in which reputations are developed and defended is crucial to the compliance decision. Rampant violation by other governments, especially those in the same region, reduces the costs of non-compliance as investors find it more difficult to “punish” any one violator. Conversely, the damage to one’s reputation is amplified if the government is one of a handful of violators in its region.

The final argument of this Article is that international law has a significant impact on governments’ behavior. Even in the face of conditions that make compliance difficult—the crucial test for the impact of law on compliance behavior—international legal commitments encourage states to try that much harder to make choices consistent with the law than they do in the absence of such commitments. This is especially true of governments that have recently removed restrictive policies that violated international law, indicating a desire to reestablish a reputation for compliance. In short, rules matter *independently* of a broad range of other influences on states’ behavior. This provides strong evidence that international law does much more than formalize policies that governments would have chosen in any case.⁸

Legal institutions matter in this view because they focus expectations on particular standards of behavior, and in so doing change the incentive structures governments face to comply. In order to be able to play this role, it is not necessary for the rules to be enforced in a highly centralized fashion. Indeed, the evidence presented here is consistent with decentralized “enforcement” on the part of civil society (domestic and international) that can impose costs on governments who stray from their commitments. These costs can be economic, as is the case when those who would engage in international business transactions are deterred from investing or trading due to the uncertainty of the government’s commitment to protect property rights and refrain from impeding the fulfillment of international contracts. Governments that choose to violate their obligations are potentially also subject to domestic political costs on the part of actors that view the government’s disregard of principled constraints as threatening or costly. The impact of law on behavior, in this conception, does not rely on an Austinian central enforcer. The chief candidate for such a role is the International

7. See generally Harold K. Jacobson & Edith Brown Weiss, *Strengthening Compliance with International Environmental Accords: Preliminary Observations from a Collaborative Project*, 1 GLOBAL GOVERNANCE 119 (1995).

8. See Downs et al., *supra* note 2; John Mearsheimer, *The False Promise of International Institutions*, 19 INT’L SECURITY 5 (1994–95).

Monetary Fund (IMF),⁹ but as I argue below, the Fund has not been especially active in enforcing the obligations of its members. Nor does compliance depend heavily on enforcement in domestic courts, though the sheer volume of the legal literature devoted to national court rulings contributes to the opposite impression.¹⁰ Competitive market forces, rather than overt policy pressure from the International Monetary Fund or the possibility of litigation, is the most likely “enforcement” mechanism. International transactions require confidence in the protection of property rights. The risk of deterring international business is what gives international monetary law its constraining influence.

These points are developed in four parts. The first broadly discusses the literature on international law compliance and its relationship to international relations. Scholarly work on compliance has burgeoned recently, with important contributions from legal scholars as well as social scientists, and sometimes as a result of collaborative work between the two. Yet, despite growing attention, work on compliance continues to be plagued by serious conceptual, methodological, and theoretical issues that make it difficult to draw firm conclusions. Part II provides an overview of the substantive monetary rules under consideration. While the end of the par value system of

9. One interpretation is that the Fund uses the threat of increased legal liability to enforce its preferences against current account restrictions. *See, e.g.*, Paul B. Stephens, *Accountability and International Lawmaking: Rules, Rents, and Legitimacy*, 17 *Nw. J. INT'L L. & BUS.* 681, 719 (1996–97). Stephens writes:

In effect the IMF staff uses its capacity to interpret the Articles as a means of expanding their control over the budgets of debtor countries. Governments that share control over their finances with staff obtain a valuable privilege that can be used to avoid liability in other countries' courts. Those that prove recalcitrant face not only a denial of access to IMF funds, but also an increased risk of legal liability outside of its borders.

Id. For an early and enthusiastic look at the enforcement capabilities of the IMF, see William M. Reisman, *The Role of Economic Agencies in the Enforcement of International Judgments and Awards*, 19 *INT'L ORG.* 929, 934–47 (1965). Several authors have characterized the Fund's role as one of ensuring compliance with these obligations contained in the IMF Articles of Agreement. *See, e.g.*, Francois Gianviti, *International Monetary Law*, in 2 *CURRENT LEGAL ISSUES AFFECTING CENTRAL BANKS* 1, 6 (Robert Effros ed., 1994); *see also infra* note 10 (describing the IMF Articles of Agreement).

10. The legal literature on the public international law of money has primarily dealt with national courts' rulings with respect to the IMF Articles of Agreement, and specifically with article VIII, section 2(b), which holds that “[e]xchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member.” Articles of Agreement of the International Monetary Fund, Dec. 27, 1945, 2 *U.N.T.S.* 39, *amended* May 31, 1968, 726 *U.N.T.S.* 266, 20 *U.S.T.* 2775, *amended* Apr. 30, 1976, 29 *U.S.T.* 2203, *amended* June 28, 1990, 31 *I.L.M.* 1307 [hereinafter *IMF Agreement*]. For works centrally concerned with this provision in domestic courts, see generally *CURRENT LEGAL ISSUES AFFECTING CENTRAL BANKS*, *supra* note 9; 1 JOSEPH GOLD, *THE FUND AGREEMENT IN THE COURTS* 139–53 (1962); 2 JOSEPH GOLD, *THE FUND AGREEMENT IN THE COURTS* (1982); Joseph Gold, *The Restatement of the Foreign Relations Law of the United States (Revised) and International Monetary Law*, 22 *INT'L LAW.* 3 (1988); Gerhard Wegen, *2(b) or Not 2(b): Fifty Years of Questions—The Practical Implications of Article VIII Section 2(b)*, 62 *FORDHAM L. REV.* 1931 (1994); and Stephen Zamora, *Recognition of Foreign Exchange Controls in International Creditors' Rights Cases: The State of the Art*, 21 *INT'L LAW.* 1055 (1987). For a discussion of the significance of domestic litigation and international arbitration involving article VIII, section 2(b), see Werner F. Ebke, *Article VIII, Section 2(b), International Monetary Cooperation, and the Courts*, 23 *INT'L LAW.* 677, 677 (1989).

exchange rates reduced IMF members' obligations with respect to their conduct of international monetary affairs, they are still obligated by article VIII, section 2(a) of the Articles of Agreement to keep their current account free from restrictions and by article VIII, section 3 to avoid the use of multiple exchange rate systems without the approval of the Fund. Part III discusses the compliance issues surrounding article VIII. It begins by noting why governments might, under some circumstances, want to implement restrictions that breach their obligations, and then lays out a series of expectations regarding the conditions under which governments might be expected to violate their legal obligations. This part also presents data to address the three central questions of this study: What explains legal commitment; who complies; and what difference does a legal commitment make? Part IV explores the findings, suggests interpretations, and draws conclusions. The evidence suggests that legal commitments are crucial to policy choice. Taken as a whole, it is most consistent with an interpretation that governments make commitments to further their interests in international business and comply with those commitments to preserve their reputation for predictable behavior in the protection of property rights. Strong regional effects suggest that reputations develop around regional standards of behavior. A positive reputation for respecting the rule of law is associated with compliance, suggesting that reputations are valuable and are not easily parsed into international and domestic components. This implies that an international breach may prove more costly to a polity that has invested heavily in a reputation for respect for the rule of law generally. Despite the formal ability of the IMF to enforce the rules, it is likely to be the market that provides the broader enforcement context for the public international law of money. Enforcement need not be overt and centralized to give behavioral rules their bite.

I. INTERNATIONAL LAW COMPLIANCE: A CONCEPTUAL OVERVIEW

A. *The Recent Literature*

The recent enthusiasm surrounding the study of international law compliance has been a long time coming. For decades, the study of the impact of international law on state behavior had fallen through the interstices of well-established disciplinary scholarship: the study of law and the study of international relations.¹¹ Legal scholars have traditionally viewed their task as illuminating the rules of state international behavior, often leaving analysis of the impact of these rules to the social scientist. Scholars of international relations have long viewed explaining state behavior as their central concern.

11. See, e.g., Stephen M. Schwebel, *The Compliance Process and the Future of International Law*, 75 AM. SOC'Y INT'L LAW PROC. 178-85 (1981); Stephen M. Schwebel, *Commentary*, in COMPLIANCE WITH JUDGMENTS OF INTERNATIONAL COURTS 39, 39 (M.K. Bulterman & M. Kuijer eds., 1996) (asserting that the judgments of international tribunals are largely complied with).

International law, however, has not played a central role in their explanations. No doubt this is largely due to the primacy of realism in the social scientific as well as the policy community in the early years following the Second World War. Early modern realists were responding to a world wracked by major power confrontation. Their focus on questions of war and peace rested centrally on the operation of the balance of power as a guarantor of world stability. International law was viewed essentially as a flawed mechanism for maintaining order in international affairs. In the words of Stanley Hoffmann, legally sovereign states operated "in a tenuous net of breakable obligations."¹² International law's fundamental weakness lay in its highly decentralized nature.¹³ Decentralized law creation, enforcement, and interpretation all contributed to the view that international law could do little more than "merely ratify the fate of arms and the arbitration of force."¹⁴ Nor is international law part of the international structure that, according to "neo-realists," determines state behavior.¹⁵ The hegemony of realist thinking in international relations has done much to discourage inquiries into the role that international law might play in explaining international outcomes.

Increasingly, however, serious work is being done to examine the impact of international legal obligations on the regulatory and foreign policy choices of governments.¹⁶ One reason for this may be that the world has changed in ways that realist conceptual lenses have been unable to bring into focus. The long peace among the major powers, the tremendous growth in codified international instruments over the course of the past few decades, and the rise of economic and quality of life issues have drawn many scholars to examine the role that rules and institutions play in regulating conduct among states.¹⁷

12. Stanley Hoffmann, *The Role of International Organizations: Limits and Possibilities*, 10 INT'L ORG. 357, 364 (1956). Some legal practitioners are also skeptics. See, e.g., Francis A. Boyle, *The Irrelevance of International Law*, 10 CAL. W. INT'L L.J. 193 (1980); Robert H. Bork, *The Limits of International Law*, 18 NAT'L INTEREST 3 (1989-90).

13. See, e.g., HANS J. MORGENTHAU, *POLITICS AMONG NATIONS: THE STRUGGLE FOR POWER AND PEACE* (6th ed. 1985).

14. RAYMOND ARON, *PEACE AND WAR: A THEORY OF INTERNATIONAL RELATIONS* 109 (1981).

15. See, e.g., KENNETH WALTZ, *THEORY OF INTERNATIONAL POLITICS* 79-101 (1979).

16. See, e.g., ABRAM CHAYES & ANTONIA HANDLER CHAYES, *THE NEW SOVEREIGNTY: COMPLIANCE WITH INTERNATIONAL REGULATORY AGREEMENTS* (1995) (proposing a theory for managing compliance); *ENGAGING COUNTRIES: STRENGTHENING COMPLIANCE WITH INTERNATIONAL ENVIRONMENTAL ACCORDS* (Edith Brown Weiss & Harold K. Jacobson eds., 1998) (studying compliance with environmental accords by various countries); ORAN YOUNG, *COMPLIANCE AND PUBLIC AUTHORITY* (1979) (analyzing compliance with the Partial Nuclear Test Ban Treaty and the International North Pacific Fisheries Convention); Downs et al., *supra* note 2 (looking at treaty compliance); Anne-Marie Slaughter Burley, *International Law and International Relations Theory: A Dual Agenda*, 87 AM. J. INT'L L. 205 (1993).

17. Key volumes in the development of the study of international institutions include *INTERNATIONAL REGIMES* (Stephen Krasner ed., 1983); ROBERT O. KEOHANE, *AFTER HEGEMONY: COOPERATION AND DISCORD IN THE WORLD POLITICAL ECONOMY* (1984); and ROBERT O. KEOHANE & JOSEPH NYE, *POWER AND INTERDEPENDENCE: WORLD POLITICS IN TRANSITION* (1977). Though these works are centrally concerned with rules, norms, and institutions, they do not directly refer to international law. However, a forthcoming special issue of *INTERNATIONAL ORGANIZATIONS* (Summer 2000), edited by Robert Keohane, Anne-Marie Slaughter, Miles Kahler, and Judith Goldstein, is the

Most of the scholarly attention has focused on the “puzzle” of why states cooperate with each other by creating international institutions—a question that flowed naturally from the dominant paradigm that downplayed institutions’ importance.¹⁸

Voices speaking to the question of legal compliance were few and far between in the 1970s and 1980s. Often these works were neglected by scholars in both international law and international relations. Only recently has compliance scholarship been rediscovered by a broader research community. In international relations, for example, early quantitative work suggested that much international behavior is consistent with international law, even in the conduct of hostilities between states.¹⁹ While these findings were provocative and important, few similar studies followed. More conceptually, the early work of Oran Young brought public choice to the question of international law compliance and highlighted the collective action problems associated with rule compliance. Young proposed that we might profitably think of an international legal system as a public good, in which many polities may have an interest, but for which few are willing to pay the costs.²⁰ In the legal field, the work of Roger Fisher began to explore the ways in which law could channel politics toward legally condoned behaviors (without simplistically asserting that law was a substitute for politics).²¹ His work drew lessons for international law by looking at the analogies posed by domestic constitutionalism, which faces similar difficulties in enforcement.²²

result of collaborative work between international relations and international legal scholars, and deals explicitly with the rise of international law in ordering international life.

18. For an example of the debate between “realists” and “institutionalists,” see Mearsheimer, *supra* note 8, at 5; and Robert Keohane & Lisa Martin, *The Promise of Institutional Theory*, 20 INT’L SECURITY 39 (1995).

19. See Charles W. Kegley & Gregory A. Raymond, *International Legal Norms and the Preservation of Peace 1820–1964: Some Evidence and Bivariate Relationships*, 8 INT’L INTERACTIONS 171 (1981). This study derives norms from 244 authoritative legal treaties in effect between 1815 and 1974 in order to identify the kind of behavior legal authorities perceived as legally permissible at the time they were writing. The study finds that “there is a substantial positive association between the importance attributed to arbitration and the frequency with which major powers arbitrate their disputes.” *Id.* at 180; see also Charles W. Kegley Jr. & Gregory A. Raymond, *Normative Constraints on the Use of Force Short of War*, 23 J. PEACE RES. 213 (1986) [hereinafter Kegley & Raymond, *Normative Constraints*] (focusing on the period between 1815 and 1870); Herbert K. Tillema & John R. Van Wingen, *Law and Power in Military Intervention*, 26 INT’L STUD. Q. 220 (1982). Kegley and Raymond found that norm formation is stimulated by violence, but also that shared norms among the major powers can contain violence, and that the most effective international rules permit but place limits on the use of violence. See Kegley & Raymond, *Normative Constraints*, *supra*. Tillema and Van Wingen looked at the role that law plays in military interventions, analyzing 70 military interventions involving the United States, U.S.S.R., Britain, and France since 1946. See Tillema & Van Wingen, *supra*. Tillema and Van Wingen’s study addresses compliance with the U.N. Charter. “Compliance” is defined as a strict interpretation of what the United Nations requires for an intervention to be legal. Tillema and Van Wingen find that most interventions in the post-World War II years have not been in accordance with this strict definition, but that they have been in accordance with the standards that prevailed during the more permissive interwar years. See *id.* at 226.

20. See YOUNG, *supra* note 16, at 26, 114.

21. See ROGER FISHER, *IMPROVING COMPLIANCE WITH INTERNATIONAL LAW* 16 (1981).

22. According to Fisher,

[i]n contrast to the individual criminal, a government is involved so deeply with law that it will find it difficult, if not impossible, to adopt an antilaw posture. A government is a

Intellectual momentum is now gathering to assess the impact of international rules, institutions, and law on international outcomes.²³ A cluster of major studies in the last few years has helped to create a research and policy community committed to the proposition that rules influence policy choices of sovereign states. The most sustained research effort has been in the area of international environmental accords, where major scholars have conducted an impressive array of cross-national and cross-treaty research.²⁴ For example, Harold Jacobson and Edith Brown Weiss have recently compared the compliance performance of eight countries and the European Union with respect to six environmental accords.²⁵ Their work concludes, among other things, that administrative and technical capacities (including knowledge and training, adequate authority and financial resources, and access to relevant information) are crucial to compliance with international environmental agreements.²⁶ These arguments are less telling, however, where governments are obligated to *refrain* from particular activities rather than to implement complex technical accords.²⁷ Nonetheless, the very scope of this

legal structure operating pursuant to legal powers, administering a system of laws. Its power depends upon obedience to law by its subordinate officials and by the public at large. It uses the adoption and enforcement of laws as the basic means of governing.

Id. at 17.

23. For general or collected studies of international law compliance, see, for example, *id.*; COMMITMENT AND COMPLIANCE: THE ROLE OF NON-BINDING NORMS IN THE INTERNATIONAL LEGAL SYSTEM (Dinah Shelton ed., forthcoming 2000); and CONNIE PECK, THE UNITED NATIONS AS A DISPUTE SETTLEMENT SYSTEM (1996) (emphasizing the legitimacy of the ICJ). See also Robert Keohane's description of a research project on U.S. compliance with its international obligations in *Compliance with International Commitments: Politics Within a Framework of Law*, AM. SOC'Y INT'L L. PROC. 176 (1992). See generally CONTROL OVER COMPLIANCE WITH INTERNATIONAL LAW (W.E. Butler ed., 1991) (discussing public international law during the cold war); INTERNATIONAL COMPLIANCE WITH NONBINDING ACCORDS (Edith Brown Weiss ed., 1997) (analyzing post-cold-war compliance with public international law).

24. The work on international environmental law compliance is vast. See, e.g., JAMES CAMERON ET AL., IMPROVING COMPLIANCE WITH INTERNATIONAL ENVIRONMENTAL LAW (1996); THE EFFECTIVENESS OF INTERNATIONAL ENVIRONMENTAL AGREEMENTS (Peter Sand ed., 1992); ENGAGING COUNTRIES, *supra* note 16; THE IMPLEMENTATION AND EFFECTIVENESS OF INTERNATIONAL ENVIRONMENTAL COMMITMENTS: THEORY AND PRACTICE (David G. Victor et al. eds., 1998); INSTITUTIONS FOR THE EARTH: SOURCES OF EFFECTIVE INTERNATIONAL ENVIRONMENTAL PROTECTION (Peter Haas et al. eds., 1993); ORAN YOUNG, INTERNATIONAL GOVERNANCE: PROTECTING THE ENVIRONMENT IN A STATELESS SOCIETY (1994); Jacobson & Weiss, *supra* note 7; Ronald B. Mitchell, *Compliance with International Treaties: Lessons From Intentional Oil Pollution*, 37 ENVIRONMENT 10 (1995); Ronald B. Mitchell, *Regime Design Matters: Intentional Oil Pollution and Treaty Compliance*, 48 INT'L ORG. 425 (1994).

25. These eight countries are Brazil, Cameroon, China, Hungary, India, Japan, Russia, and the United States. The treaties are the Montreal Protocol on Substances That Deplete the Ozone Layer, Sept. 16, 1987, 26 I.L.M. 1550; Vienna Convention for the Protection of the Ozone Layer, Mar. 22, 1985, 1513 U.N.T.S. 293, 26 I.L.M. 1529; International Tropical Timber Agreement, Nov. 18, 1983, U.N. Doc. TD/Timber/11/Rev.1 (1984), available at <<http://sedac.ciesin.org/pidb/texts/tropical.timber.1983.html>> (visited Apr. 22, 2000); Washington Convention on International Trade in Endangered Species of Wild Fauna and Flora, Mar. 3, 1973, 27 U.S.T. 1087, 993 U.N.T.S. 243; Convention on the Prevention of Maritime Pollution by Dumping of Wastes and Other Matter, Dec. 29, 1972, 26 U.S.T. 2403; and Convention for the Protection of the World Cultural and Natural Heritage, Nov. 16, 1972, 1037 U.N.T.S. 151.

26. See Harold K. Jacobson & Edith Brown Weiss, *Assessing the Record and Designing Strategies to Engage Countries*, in ENGAGING COUNTRIES, *supra* note 16, at 511.

project has yielded a variety of insights, including the importance of monitoring by the private sector in a democratic society and the importance of “international momentum” in encouraging would-be laggard governments to commit to and comply with environmental accords. If there is a weakness to a study as sweeping as this one, it is that almost any hypothesis would receive *some* support to *some* degree for *some* treaties in the case of *some* countries. As a whole, the study is much more useful for stimulating further theorizing than it is for eliminating possible explanations for the decisions governments make.

International human rights is another substantive area in which a good deal of research has recently been published on compliance.²⁸ Far more than any other issue area, studies of compliance with international human rights accords have been subject to thorny debates over what constitutes an “objective” measure of compliance.²⁹ More than other issue areas, the literature here is largely descriptive and prescriptive rather than explanatory.³⁰ One tack has been to link human rights abuses with the “macro conditions” that tend to give rise to those abuses.³¹ But without careful specification of an argument linking the denial of human rights to such conditions, findings can read like a jejune list of already widely held impressions. The abuse of civil and political rights, for example, appears to correlate with the level of economic development, equality, literacy, nonmilitary rule, and per capita income.³² This tells us nothing, of course, about the conditions under which governments facing such adverse circumstances nonetheless manage to avoid

27. For reviews of the compliance literature, see Benedict Kingsbury, *The Concept of Compliance as a Function of Competing Conceptions of International Law*, 19 MICH. J. INT'L L. 345 (1998); Harold Kongju Koh, *Why Do Nations Obey International Law?*, 106 YALE L.J. 2599 (1997); S.V. Scott, *Explaining Compliance with International Law—Broadening the Agenda for Enquiry*, 30 AUSTL. J. POL. SCI. 288 (1995); and Beth A. Simmons, *Compliance with International Agreements*, 1 ANN. REV. POL. SCI. 75 (1998).

28. For research that looks at compliance with international human rights law, see, for example, AMERICAN CIVIL LIBERTIES UNION, HUMAN RIGHTS VIOLATIONS IN THE UNITED STATES: A REPORT ON U.S. COMPLIANCE WITH THE INTERNATIONAL COVENANT ON CIVIL AND POLITICAL RIGHTS (1993); R.R. Churchill & J.R. Young, *Compliance with the Judgments of the European Court of Human Rights and Decisions of the Committee of Ministers: The Experience of the United Kingdom, 1975–87*, 62 BRITISH YEARBOOK OF INTERNATIONAL LAW 283 (1992); and James M. McCormick & Neil Mitchell, *Human Rights Violations, Umbrella Concepts, and Empirical Analysis*, 49 WORLD POL. 510 (1997). For research that focuses more narrowly on Soviet compliance with the family reunification and emigration provisions of the Helsinki Final Act of 1975 and subsequent CSCE agreements, see Sandra L. Gubin, *Between Regimes and Realism—Transnational Agenda Setting: Soviet Compliance with CSCE Human Rights Norms*, 17 HUM. RTS. Q. 278 (1995).

29. This problem closely parallels the broader debate over whether it is possible to reach universal agreement on norms of civil, political, and social rights. See generally JACK DONNELLY, UNIVERSAL HUMAN RIGHTS IN THEORY AND PRACTICE (1989).

30. This is completely appropriate, since the purpose of much of the research is to draw attention to abuses and to call for better international monitoring and more resources to assure adequate compliance. See, e.g., D.M. Stetson, *Human Rights for Women—International Compliance with a Feminist Standard*, 15 WOMEN & POL. 71 (1995); Alicia Ely Yamin & Deborah P. Maine, *Maternal Mortality as a Human Rights Issue: Measuring Compliance with International Treaty Obligations*, 21 HUM. RTS. Q. 563 (1999).

31. See MICHAEL HAAS, IMPROVING HUMAN RIGHTS (1994).

32. See *id.*

abuses, much less about the role that an international legal commitment might play in policy and practice. Research that is potentially much more interesting focuses on principled advocacy groups and the role they have played in holding governments accountable to the international community for violations of their own international legal commitments.³³ The findings of this literature indicate that transnational actors, often operating through principled advocacy groups linked to non-governmental organizations, have a significant impact on norm observance in a number of cases.

Recent studies on international trade,³⁴ security and arms controls,³⁵ European integration,³⁶ and various adjudicatory bodies³⁷ also indicate a growing interest in the relationship between rules and governmental behavior. Yet only rarely have these studies explicitly attempted to link outcomes *causally* to legal commitments. As I shall argue below, doing so raises serious conceptual and methodological issues that scholars have only begun to tackle.

B. *Conceptualization, Measures, and Methods*

The first conceptual challenge in the study of international law compliance is to develop a defensible understanding of compliant behavior. The approach taken here and elsewhere is to understand compliance as behavior that conforms to treaty or customary rules.³⁸ In his groundbreaking study on compliance with international public authority, Oran Young

33. See, e.g., MARGARET KECK & KATHRYN SIKKINK, *ACTIVISTS BEYOND BORDERS: ADVOCACY NETWORKS IN INTERNATIONAL POLITICS* (1998); Susan D. Burgerman, *Mobilizing Principles: The Role of Transnational Activists in Promoting Human Rights Principles*, 20 HUM. RTS. Q. 905 (1998).

34. In the area of international trade law compliance, see generally *ADJUDICATION OF INTERNATIONAL TRADE DISPUTES IN INTERNATIONAL AND NATIONAL ECONOMIC LAW* (Ernst-Ulrich Petersmann & Gunther Jaenicke eds., 1992); ROBERT E. HUDEC, *ENFORCING INTERNATIONAL TRADE LAW: THE EVOLUTION OF THE MODERN GATT LEGAL SYSTEM* (1993); JOHN H. JACKSON, *THE WORLD TRADING SYSTEM* (1989); JOHN H. JACKSON ET AL., *IMPLEMENTING THE TOKYO ROUND* (1984); MIRIAN KENE OMALU, *NAFTA AND THE ENERGY CHARTER TREATY: COMPLIANCE WITH, IMPLEMENTATION, AND EFFECTIVENESS OF INTERNATIONAL INVESTMENT AGREEMENTS* (1999); and Curtis Reitz, *Enforcement of the General Agreement on Tariffs and Trade*, 17 U. PA. J. INT'L ECON. L. 555 (1996).

35. On security and arms control, see *COMPLIANCE AND THE FUTURE OF ARMS CONTROL* (Gloria Duffy ed., 1988); *GLOBAL ENGAGEMENT: COOPERATION AND SECURITY IN THE 21ST CENTURY* (1994); LEONARD SPECTOR, *NUCLEAR AMBITIONS* (Janne Nolan ed., 1994); A.A. Angelova, *Compelling Compliance with International Regimes: China and the Missile Technology Control Regime*, 38 COLUM. J. TRANSNAT'L L. 419 (1999); and Gloria Duffy, *Conditions That Affect Arms Control Compliance, in US-SOVIET SECURITY COOPERATION* (Alexander George et al. eds., 1988).

36. On compliance with directives of the European Union, see ANDRE NOLLKAEMPER, *GLOBAL COMPETITION AND EU ENVIRONMENTAL POLICY: IMPROVING COMPLIANCE WITH THE INTERNATIONAL LAW OF MARINE ENVIRONMENTAL PROTECTION: THE ROLE OF THE EUROPEAN UNION* (EUI Working Paper RSC No. 98/4, 1998) available at <http://www.iuet.it/PUB/rsc_fm.html>; and Peter M. Haas, *Compliance with EU Directives: Insights from International Relations and Comparative Politics*, 5 J. EUR. PUB. POL'Y 17 (1998).

37. On compliance with decisions of international adjudicatory bodies, see *COMPLIANCE WITH JUDGMENTS OF INTERNATIONAL COURTS*, *supra* note 11; and 1 LAWYERS COMMITTEE FOR HUMAN RIGHTS, INT'L CRIM. CT. BRIEFING SER. NO. 5, *COMPLIANCE WITH ICC DECISIONS* (1997).

38. See Jacobson & Weiss, *supra* note 7, at 123; David G. Victor et al., *Introduction and Overview, in THE IMPLEMENTATION AND EFFECTIVENESS OF INTERNATIONAL ENVIRONMENTAL COMMITMENTS: THEORY AND PRACTICE* (David G. Victor et al. eds., 1998).

suggested that compliance can be said to occur when the actual behavior of a given subject conforms to prescribed behavior, and non-compliance or violation occurs when actual behavior departs significantly from prescribed behavior.³⁹ This definition distinguishes compliance behavior from treaty implementation, which is the adoption of domestic rules or regulations meant to facilitate, but which themselves do not constitute, compliance with international agreements. It also distinguishes compliance from effectiveness, since it is entirely possible that a poorly designed agreement could achieve high levels of compliance without much impact on the phenomenon of concern (e.g., pollution levels).⁴⁰ While compliance may be necessary for effectiveness, there is no reason to view it as sufficient.

Of course, even armed with a clear definition, it is very difficult to judge whether a particular policy constitutes compliance at all. Often international agreements are written so as to permit a range of interpretations regarding the parties' obligations. Furthermore, compliance is rarely a transparent, binary choice. Actors frequently will behave in ways that are intentionally ambiguous, dilatory, or confusing, often under conditions in which verification is difficult.⁴¹ In other contexts, actors may make good faith efforts to comply that nonetheless fall a bit short of an agreement's prescribed behavior. Abram Chayes and Antonia Chayes have dealt with these difficulties by making assessments of compliance in the context of generally prevailing expectations.⁴²

Some scholars deny that such efforts suffice. Indeed, some scholars assert that one cannot determine compliance objectively at all, arguing that standards of compliance are socially constructed. A judgment about behavior must not be imposed by the analyst, making each compliance assessment, at best, highly context-specific.⁴³ This concern is part of a broader critique of social scientific methods that attribute meaning to actions, rather than allowing these meanings to reveal themselves through intersubjective discourse.⁴⁴ Social constructivists—including John Ruggie, Friedrich

39. See YOUNG, *supra* note 16, at 2–6.

40. See Oran Young & Marc A. Levy, *The Effectiveness of International Environmental Regimes*, in *THE EFFECTIVENESS OF INTERNATIONAL ENVIRONMENTAL REGIMES* 1, 4 (Oran Young ed., 1999); see also Kal Raustiala, *Compliance and Effectiveness in International Regulatory Cooperation*, 32 *CASE W. RES. J. INT'L L.* 2 (2000).

41. See YOUNG, *supra* note 16, at 59–62, 79–88 (discussing compliance with the Nuclear Test Ban Treaty and with the International Pacific Fisheries Convention); see also Susan Subank, *Verifying Compliance with an Unmonitorable Climate Convention*, 9 *INT'L ENVTL. AFF.* 147 (1997).

42. See Chayes & Chayes, *supra* note 1.

43. This position is most consistent with theorists writing in a social constructivist vein. An early influence on this approach was HEDLEY BULL, *THE ANARCHICAL SOCIETY: A STUDY OF ORDER IN WORLD POLITICS* 125–61 (1977). For a discussion of social constructivism's approach to international law (though without explicit consideration of the problem of compliance), see ANTHONY CLARK AREND, *LEGAL RULES AND INTERNATIONAL SOCIETY* 124–48 (1999).

44. See Friedrich Kratochwil & John Gerard Ruggie, *International Organization: A State of the Art on an Art of the State*, 40 *INT'L ORG.* 753, 768 (1986) (“The common practice of treating norms as ‘variables’—be they independent, dependent, intervening or otherwise—should be severely curtailed. So too should be the preoccupation with the ‘violation’ of norms as the beginning, middle and end of the compliance story.”).

Kratochwil, and Benedict Kingsbury—argue that it is difficult to infer the *meaning* of compliance by focusing only on objectively observable patterns of behavior.⁴⁵

These are important theoretical and conceptual considerations the resolution of which is beyond the scope of this Article. The approach taken here is that law is, indeed, a social phenomenon, but that it is possible to examine the rational purposes behind law compliance or non-compliance. In fact, the making of legal commitments is one way in which actors signal their intentions to an international community of states, internationally active economic agents, and domestic civil society. When actions are interpreted by a multilateral institution, such as the International Monetary Fund, we have some evidence of the socially understood meaning of that action. In effect, the IMF publishes yearly data from which it is relatively straightforward to infer whether or not members have implemented policies that contravene their legal obligations.⁴⁶

The methods I use to analyze this data systematically construct a plausible story to explain why governments decide to commit their state to a particular legal rule, why they do or do not comply, and whether this makes any difference to state behavior. The last is important because countries that are not legally obligated can and do act consistently with the rule.⁴⁷ Is legal obligation causal or coincident to such behavior? By comparing similarly situated countries—some that have made and some that have not made the legal commitment under consideration here—it is possible to determine the marginal effects that such a commitment makes to behavior. Furthermore, it is essential to account for *alternative* explanations for behavior as much as possible. I have included control variables in order to raise our confidence that there is not some obvious explanation for behavior that a mono-causal analysis would overlook.

Finally, it is possible to address one perennial issue that plagues research on international law compliance: How do we know that rules do not simply *reflect* rather than *alter* or *influence* governments' interests in pursuing a particular course of action? International relations scholars deeply influenced

45. Benedict Kingsbury argues that an approach to compliance that focuses only on objectively observable patterns of behavior implicitly takes these patterns as proxies for internal attitudes and other relevant normative effects. Such proxies may be adequate in some policy situations, but there is frequently a risk that policy based on the circumscribed view of norms employed in rationalist instrumentalist theories will be sub-optimal or dysfunctional.

Benedict Kingsbury, *The Concept of Compliance as a Function of Competing Conceptions of International Law*, 19 MICH. J. INT'L L. 345, 356 (1998).

46. As Edwards notes, the tables at the end of each *Annual Report on Exchange Arrangements and Exchange Restrictions* (which is the source for my compliance data) match the Fund's definition of behavior on the part of an article VIII country that is on its face non-compliant: "Except for the security reason exception, the definition [of restrictions given in the tables] is intended to have the same meaning as 'restrictions on the making of payments and transfers for current international transactions' as used in Section 2(a) of Article VIII." RICHARD W. EDWARDS JR., INTERNATIONAL MONETARY COLLABORATION 403 (1985).

47. See, e.g., Raustiala, *supra* note 40.

by the realist tradition often view international agreements as formalizations of what governments were going to do anyway,⁴⁸ and conclude that law adds little to an understanding of interests. Of course, not even a legal idealist would defend law as somehow contrary to states' interests, but the interesting question is: *Does law constrain under conditions when it is inconvenient to be constrained?* The best way to construct a case for law-influenced behavior is to examine a long period of time that encompasses periods in which compliance can be assumed to be quite difficult—in this study, periods of balance of payments distress. The greater the temporal distance between these distress periods and the prior decision to commit, the more likely they are to represent *unanticipated* crisis situations. Unanticipated difficulties provide strong tests of the independent power of an existing obligation to constrain. Looking at yearly data on current account restrictions from 1967 to 1996 greatly improves the likelihood that commitment explains compliance, and not the other way around. The following section specifies in much more detail the nature of the obligations under examination and just what constitutes “compliant” behavior with respect to the public international law of money.

II. THE PUBLIC INTERNATIONAL LAW OF MONEY: EXCHANGE RESTRICTIONS AND MULTIPLE CURRENCY SYSTEMS

The Articles of Agreement of the International Monetary Fund (“IMF Agreement”) is the first international agreement in history to obligate signatories to particular standards of monetary conduct.⁴⁹ This embodiment of postwar agreements in monetary affairs significantly curtailed decentralized decision making with respect to monetary affairs and created a legal and institutional edifice that sharpened obligations, enhanced surveillance, and centralized peer judgment on what constitutes appropriate international monetary policy. Today,

[t]he international monetary system consists of a complex of relationships among countries on matters affecting the adjustment or financing of the balance of payments that are governed by rules and understandings that are more extensive than international monetary law as a branch of public international law. Nevertheless, public international law, principally in the treaty form, is now at the heart of the international monetary system.⁵⁰

48. See Downs et al., *supra* note 2; Mearsheimer, *supra* note 8, at 5.

49. See IMF Agreement, *supra* note 10.

50. Gold, *supra* note 6, at 801–02; see also JOSEPH GOLD, THE RULE OF LAW IN THE INTERNATIONAL MONETARY FUND 5 (IMF Pamphlet Series No. 32, 1980) [hereinafter GOLD, RULE OF LAW]. According to Evensen and Oh, “When the International Monetary Fund was established, not only was an international monetary system created, but also new legal obligations and new legal privileges for its member states.” Jane B. Evensen & Jai Keun Oh, *Editor’s Preface* to JOSEPH GOLD, LEGAL AND INSTITUTIONAL ASPECTS OF THE INTERNATIONAL MONETARY SYSTEM: SELECTED ESSAYS, at xvii (1979). Nonetheless, legal treatments of these obligations are surprisingly few. See ERIK DENTERS, LAW AND POLICY OF IMF CONDITIONALITY 15–20 (1996).

The IMF Agreement includes what can reasonably be interpreted as “obligations of good conduct”⁵¹ created intentionally by member states to foster a more liberal economic order.⁵²

Of course, members’ obligations under the Fund Agreement were significantly curtailed with the collapse of the par value system of fixed exchange rates.⁵³ Yet important obligations remain. These are found in article VIII, which is headed “General Obligations of Members.” Article VIII, sections 2 and 3 set out the obligations of currency convertibility.⁵⁴ Section 2(a) proscribes members from making restrictions on payments and transfers for current international transactions⁵⁵ without the approval of the Fund itself.⁵⁶ Current transactions include payment for goods, services, and

51. The phrase is Joseph Gold’s. See JOSEPH GOLD, *THE INTERNATIONAL MONETARY FUND AND PRIVATE BUSINESS TRANSACTIONS: SOME LEGAL EFFECTS OF THE ARTICLES OF AGREEMENT* (1965).

52. According to article IV, section 1 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 that sustains sound economic growth, and that a principal objective is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability

IMF Agreement, *supra* note 10. The original White Plan, which represented the American position when negotiating the postwar monetary order, articulated the norm:

that there be accepted 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, should be taken to mean that there shall be acceptance of the principle that controls and restrictions will be employed only when they are clearly justified by the economic circumstances, and only to the extent necessary to carry out a purpose contributing to general prosperity.

3 J. KEITH HORSEFIELD, *THE INTERNATIONAL MONETARY FUND, 1945–1965*, at 64 (1969).

53. Under the original Articles of Agreement, in order to become a member of the Fund, a country had to communicate a “par value” by direct or indirect reference to gold. This might involve minor negotiations with the Fund, but 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 the Articles. See IMF Agreement, *supra* note 10, art. IV, § 10. Furthermore, article IV, section 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.” *Id.* art. 4, § 2 The Second Amendment effectively ended the legal obligations relating to the par value system. See IMF Agreement, *supra* note 10.

54. See generally Arthur Nussbaum, *Exchange Control and the International Monetary Fund*, 59 *YALE L.J.* 421 (1950).

55. The proscription is directed against only payments and transfers for *current* international transactions. The IMF Agreement explicitly permits the regulation of international capital movements. See IMF Agreement, *supra* note 10, art. VI, § 3. Current payments may also include payments of moderate amounts for amortization of loans. See IMF Agreement, *supra* note 10, art. XXX(d)(3); Gianviti, *supra* note 9, at 6.

56. See IMF Agreement, *supra* note 10, art. VIII, § 2. Member states are, however, permitted to maintain or impose exchange restrictions under certain conditions:

- if they are necessary to regulate international capital movements, *see* art. VI, § 3;
- with the approval of the Fund, *see* art. VIII, § 2(a);
- if the Fund has declared a currency “scarce,” *see* art. VII, § 3(b);
- if the exchange restrictions were effective at the time the state became a member of the Fund, *see* art. XIV, § 2.

Furthermore,

members are not bound by the Articles to put the Fund’s conclusions into effect, except when the Fund concludes that a member is violating its obligations. Members are not bound to obtain the Fund’s approval of their exchange arrangements, the exchange

“invisibles”—insurance charges, warehousing charges, shipping, business and tourist travel, family remittances, royalties, dividends, interest, and other non-capital transactions.⁵⁷ The guiding principle in determining whether a measure is proscribed in this fashion is “whether it involves a direct governmental limitation on the availability or use of exchange as such.”⁵⁸ Article VIII, section 2(a) is meant to insure that currency restrictions do not frustrate the completion of otherwise lawful transactions; it does not require that the underlying transactions themselves be permitted.⁵⁹

Article VIII, section 2(a) appears to be the only part of the Bretton Woods Agreements⁶⁰ that is not limited to creating rights and obligations between the governments of its member states, but which directly affects the rights of each state’s citizens.⁶¹ That is, section 2(a) imposes an internationally mandated obligation on member countries toward their own residents. They must permit their residents purchasing goods or services or making other international transactions with non-residents to acquire and use the needed currencies to make payments in settlement of those transactions.⁶² In fact, the IMF Executive Board has interpreted this obligation to mean that the government must not delay, limit, or prevent any of its residents from obtaining a foreign currency to settle a current international transaction.⁶³ The idea is that the payor should be able to obtain the currency needed in the amount required for the current payments without delay. Furthermore, the authorities are not to impose charges, such as taxes, on currency payments or

policies, or the exchange rates for their currencies, *apart from the constraints of Article VIII, Sections 2 and 3.*

Gold, *supra* note 10, at 345 (emphasis added).

57. The Fund Agreement explicitly permits the regulation of international capital movements. *See* IMF Agreement, *supra* note 10, art. VI, § 3. For a discussion of the distinction between capital controls and current account restrictions, see JOZEF SWIDROWSKI, EXCHANGE AND TRADE CONTROLS: PRINCIPLES AND PROCEDURES OF INTERNATIONAL ECONOMIC TRANSACTIONS AND SETTLEMENTS 43–50 (1975).

58. Executive Board Decision no. 1034 (60/27) June 1, 1960, para. 1, *reprinted in* 11 SELECTED DECISIONS OF THE INTERNATIONAL MONETARY FUND AND SELECTED DOCUMENTS 259 (IMF: Washington, D.C. 1986); *see also* 1 MARGARET GARRITSEN DE VRIES & JOHN KEITH HORSEFIELD, THE INTERNATIONAL MONETARY FUND, 1945–1965, at 260 (1969).

59. For the distinction, see SWIDROWSKI, *supra* note 57, at 1; *see also* Gianviti, *supra* note 9, at 7.

60. The “Bretton Woods Agreements” refers to agreements made at an international financial conference held at Bretton Woods, New Hampshire, in July 1944. *See* Michael D. Sandler, *Section Recommendation and Report*, 30 INT’L LAW. 441, 444 (1996). These agreements, including the IMF Agreement, created the IMF and the International Bank for Reconstruction and Development. *See id.*

61. *See* Klaus Boehlhoff & Axel Baumanns, *Extra-Territorial Recognition of Exchange Control Regulations—A German Viewpoint*, in 6 THE LAW OF INTERNATIONAL TRADE FINANCE 107, 108 (Norbert Horn ed., 1989).

62. *See* EDWARDS, *supra* note 46, at 391. Surrender requirements are not prohibited, because surrender in itself is not considered to be an impediment to making of payments. Just because a monetary authority requires residents to surrender foreign exchange does not necessarily mean that it would not provide this foreign exchange when needed to conduct an international transaction. *See* Gold, *supra* note 6, at 813.

63. *See* EDWARDS, *supra* note 46, at 391.

transfers that have the effect of inhibiting or increasing the costs of payments.⁶⁴

Multiple currency practices are prohibited in article VIII, section 3, which provides: "No member shall engage in or permit any of its fiscal agencies [e.g., the central bank, treasury, currency board, etc.] . . . to engage in any discriminatory currency arrangements or multiple currency practices except as authorized under this Agreement or approved by the Fund."⁶⁵ The Fund in 1981 defined "multiple currency practices" as policies that have the effect of producing rates of exchange that are independent of each other in circumstances in which the market would not have produced this independence.⁶⁶ Basically, members are required to refrain from extensive interference that leads to varying rates for different kinds of transactions or different trade partners, unless the Executive Board approves.⁶⁷

None of these obligations are binding upon joining the Fund, however. The IMF Articles of Agreement provided for a post-war transition period during which members could avoid undertaking the full obligations of IMF membership.⁶⁸ Upon joining the IMF, new members can avail themselves of the transitional arrangements, which in effect "grandfather" restrictions that were in place upon their accession to the Articles of Agreement. So-called "article XIV status" reserves the right for members to maintain restrictions that were in place when they joined the Fund, so an article XIV country does not need approval to continue practices that are inconsistent with article VIII, sections 2, 3, and 4. An article XIV country can also adapt its restrictions without Fund approval. But an article XIV country cannot introduce new restrictions, nor can it adapt multiple currency practices without Fund approval. Countries that choose transitional status under article XIV are expected to withdraw restrictions when they are no longer needed for balance of payments reasons,⁶⁹ and to consult annually with the Fund about the further retention of restrictions inconsistent with article VIII.

In other words, currency convertibility is not and never has been a requirement of Fund membership.⁷⁰ The Fund does try to persuade members gradually to remove transitional restrictions—multiple exchange rates, foreign exchange licensing systems—and then to adopt its traditional approach to economic adjustment: Devalue if necessary, reduce domestic inflation, make

64. *See id.*

65. IMF Agreement, *supra* note 10, art. VIII, § 3.

66. For a discussion of several examples of multiple currency practices, see SWIDROWSKI, *supra* note 57, at 71–84. For an in-depth examination of the case of China, see Chris Brown, *China's GATT Bid: Why All the Fuss over Currency Controls?*, 3 PAC. RIM L. & POL'Y J. 57 (1994).

67. *See* JOSEPH GOLD, EXCHANGE RATES IN INTERNATIONAL LAW AND ORGANIZATION 266 (1988).

68. *See* IMF Agreement, *supra* note 10, art. XIV. For a discussion of the transitional period, see Jeanne Asherman, *The International Monetary Fund: A History of Compromise*, 16 N.Y.U. J. INT'L L. & POL. 235, 259–63 (1984).

69. *See* IMF Agreement, *supra* note 10, art. XIV, § 2; *see also* 3 HORSEFIELD, *supra* note 52, at 248–56.

70. This point is discussed by Buck Wile, *Russian Membership in the IMF: A Look at the Problems, Past and Present*, 22 GA. J. INT'L & COMP. L. 469, 471–78 (1992).

comprehensive fiscal reforms, and simplify exchange restrictions to remove their tax and subsidy effects. Once these fundamentals are in place the Fund usually urges the article XIV country to remove its restrictions. Interestingly, however, the articles contain no time limit for the transition period, nor any criterion that mandates a formal shift to article VIII status.⁷¹

What can the IMF do to enforce the obligations contained in article VIII? To the extent that the Fund has tried to influence members' policies, the most common method is to use persuasion during the consultation process rather than to apply a remedy for continued non-compliance.⁷² Along with the publication of data on states' policies from which one can largely infer compliance,⁷³ this persuasion goes a long way toward a system of monitoring.⁷⁴ The Executive Board has the power to approve a particular arrangement, and this temporarily can bring an otherwise illegal restriction into technical compliance with a member's obligations. Fund approval of a country's restrictions may potentially have consequences in the domestic courts of Fund members. According to article VIII, section 2(b): "Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member."⁷⁵ Unapproved restrictions, for example, cannot be used as a

71. See I DE VRIES & HORSEFIELD, *supra* note 58, at 225.

72. See GOLD, *RULE OF LAW*, *supra* note 50, at 185.

73. See INTERNATIONAL MONETARY FUND, ANNUAL REPORT ON EXCHANGE ARRANGEMENTS AND RESTRICTIONS, analytical app.

74. Much of the compliance literature suggests that monitoring and verification can improve compliance. See, e.g., CHAYES & CHAYES, *supra* note 16, at 180; WOLFGANG FISCHER, THE VERIFICATION OF A GREENHOUSE GAS CONVENTION, VERIFICATION REPORT (1991); Jesse Ausubel and David Victor, *Verification of International Environmental Agreements*, 17 ANN. REV. ENERGY & ENV'T 1 (1992). Since the IMF collects data on restrictions for all countries for the entire time period examined in this Article, this is a condition for which I have controlled rather than tested.

75. IMF Agreement, *supra* note 10, art. VIII, § 2(b). Some legal research suggests, however, that there is a striking lack of uniformity in domestic courts' interpretations of article VIII, section 2(b). See Pierre Francotte, Comment, in CURRENT LEGAL ISSUES AFFECTING CENTRAL BANKS, *supra* note 9, at 14, 15-16; Allan T. Marks, *Exchange Control Regulations Within the Meaning of the Bretton Woods Agreement: A Comparison of Judicial Interpretation in the United States and Europe*, 8 INT'L TAX & BUS. LAW. 104 (1990); George B. Schwab, *The Unenforceability of International Contracts Violating Foreign Exchange Regulations: Article VIII, Section 2(b) of the International Monetary Fund Agreement*, 25 VA. J. INT'L L. 967 (1985). For an example involving a decision of the New York Court of Appeals, see Brian Trubitt, *International Monetary Fund Conditionality and Options for Aggrieved Fund Members*, 20 VAND. J. TRANSNAT'L L. 665, 669-70 (1987). For interpretations of article VIII, section 2(b) by German courts, see generally Werner F. Ebke, *Article VIII, Section 2(b) of the IMF Articles of Agreement and International Capital Transfers: Perspectives from the German Supreme Court*, 28 INT'L LAW. 761 (1994). For a discussion of the arbitrability of article VIII, section 2(b) under the law of the Federal Republic of Germany and U.S. arbitration law, see Otto Sandrock, *Are Disputes over the Application of Article VIII, Section 2(b) of the IMF Treaty Arbitrable?*, 23 INT'L LAW. 933 (1989).

For a discussion of the relationship between article VIII, section 2(b) and letters of credit (interpreted as "exchange contracts"), see David Kalson, *The International Monetary Fund Agreement and Letters of Credit: A Balancing of Purposes*, 44 U. PITT. L. REV. 1061 (1983). Article VIII, section 2(b) has been used unsuccessfully as a defense in the case of sovereign bond default in American courts. See Philip J. Power, *Sovereign Debt: The Rise of the Secondary Market and Its Implications for Future Restructurings*, 64 FORDHAM L. REV. 2701, 2724-26 (1996); Ettore A. Santucci, *Sovereign Debt*

defense when non-performance of a contract is alleged.⁷⁶ While the original intent of this provision was to protect the ability of governments to maintain approved restrictions, especially in an effort to defend their currency's par value,⁷⁷ it may also create disincentives to enter into exchange contracts with private or public entities that operate under national rules that do not comply with international obligations.⁷⁸ However, in the absence of litigation, the Executive Board's formal decision as to whether or not it has approved a particular restriction is not made public.⁷⁹ It is not clear, therefore, how much impact such decisions have on the decision to implement restrictions.

The Executive Board has other ways to sanction non-compliers, but, in fact, the Fund has used these formal remedies very sparingly.⁸⁰ The Board can declare a member ineligible to use the resources of the Fund if the member "fails to fulfill any of its obligations" under the Articles,⁸¹ and non-compliance sometimes does interrupt drawings under stand-by and extended

Resolution Through the International Monetary Fund: An Alternative to the Allied Bank Decision, 14 DENV. J. OF INT'L L. & POL'Y 1 (1985).

For a discussion on the relationship between article VIII, section 2(b) and the imposition of economic sanctions, see Cynthia C. Lichtenstein, *The Battle for International Bank Accounts: Restrictions on International Payments for Political Ends and Article VIII of the Fund Agreement*, 19 N.Y.U. J. INT'L L. & POL. 981 (1987). Relatedly, a few cases handled by the Iran-U.S. Claims Tribunal have touched upon the consistency of Iran's currency controls with article VIII. See John R. Crook, *Applicable Law in International Arbitration: The Iran-U.S. Claims Tribunal Experience*, 83 AM. J. INT'L L. 278, 307-08 (1989).

76. 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. Unenforceability does not mean invalidity or illegality. The provision establishes a defense rather than a condition for the institution of proceedings." Joseph Gold, *Article VIII Section 2(b) of the IMF Articles in its Institutional Setting*, in 6 THE LAW OF INTERNATIONAL TRADE FINANCE, *supra* note 61, at 90. Furthermore:

The provision has displaced some principles of private international law. Contracts must be treated as unenforceable even though the exchange control regulations that have been neglected are not part of the law that governs the contract or its performance under the private international law of the forum. Similarly, the provision applies even if the *lex fori* governs the contract under the private international law of the forum. Courts must not refuse to treat contracts as unenforceable on the ground that the exchange control regulations that have not been observed are contrary to the public policy (*ordre public*) of the forum or because the regulations are 'revenue' laws . . . [P]rivate international law will not apply if the *lex fori* imposes exchange control regulations as mandatory norms.

Id. at 92.

77. See DAM, *supra* note 6, at 98-101; see also Gold, *supra* note 76, at 73.

78. In practice, many domestic courts have been reluctant to refuse to enforce such contracts. If an open international economy is construed as a public good, this must be juxtaposed with the particular national interests courts may have in supporting the interests of the contracting parties, often national firms or major financial institutions. See Gold, *supra* note 76, at 6-7 ("Not everyone deduces from this argument that it is desirable to commit to the process by a broad application of Article VIII section 2(b) whenever the opportunity occurs, particularly if private interests would suffer for the time being").

79. Like most Board Decisions, however, decisions on approval of restrictions are generally made available to the public through the IMF's archives after twenty years.

80. This is consistent with the domestic regulatory literature that emphasizes the importance of coaxing and persuasion, and de-emphasizes the role of enforcement. See, e.g., IAN AYRES & JOHN BRAITHWAITE, *RESPONSIVE REGULATION: TRANSCENDING THE DEREGULATION DEBATE* 35-40 (1992). See generally ENFORCING REGULATION (Keith Hawkins & John M. Thomas eds., 1984).

81. IMF Agreement, *supra* note 10, art. XXVI, § 2(a). Expulsion from the Fund, or "compulsory withdrawal" are theoretical possibilities as well. *Id.*

arrangements.⁸² A member's voting rights may be suspended by a seventy percent majority of the Fund's total weighted voting power, if the member had previously been declared ineligible to use Fund resources and persists in its failure to fulfill its obligations under the Articles of Agreement.⁸³ It is also theoretically possible for a member that is consistently in breach of its obligations to be expelled from the Fund,⁸⁴ though this has never happened. Realistically, however, non-compliers rarely have to worry about retaliation directly from the Fund, since members that vote for some kind of punishment may be concerned about drawing a retaliatory vote in the future. And unlike the decentralized enforcement permitted in international trade, direct state-to-state reciprocity is basically incompatible with the overall intent of the Fund's articles.⁸⁵

To summarize, after World War II, governments established for the first time in history a public international law of money, which required adherents to keep their current account free from restriction and to maintain unified exchange rate systems. Put most simply, this means that if a bill for imports or for an external interest payment comes due, national monetary authorities should make foreign exchange available to pay it. They should also refrain from adopting currency policies that cause the emergence or maintenance of more than one exchange rate. This obligation is assumed voluntarily, but once made the commitment is legally binding and permanent as long as a country remains a Fund member. There are a number of mechanisms that are theoretically available to enforce members' obligations, but sanctions have rarely, if ever, been used. Why, then, do governments commit to and comply with article VIII? The next part examines whether legal rules influence economic policy choice even when governments facing unanticipated

82. According to Joseph 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 Article VIII, or imposes [or intensifies] import restrictions for balance of payments reasons.'

JOSEPH GOLD, *EXCHANGE RATES IN INTERNATIONAL LAW AND ORGANIZATION* 466 (1988).

83. See IMF Agreement, *supra* note 10, art. XXVI, § 2(b); see also Richard W. Edwards Jr., *Introductory Note*, 31 I.L.M. 1307 (1992) (discussing the addition of this provision in the Third Amendment to the IMF Agreement).

84. This is also known as "compulsory withdrawal." IMF Agreement, *supra* note 10, art. XXVI, § 2(c).

85. According to Gianviti, "[t]he imposition of certain exchange restrictions by one member, in violation of the Fund's Articles, would not justify the imposition of similar restrictions by other members." Francois P. Gianviti, *Developments at the International Monetary Fund*, in 3 *CURRENT LEGAL ISSUES AFFECTING CENTRAL BANKS* 1, 12 (Robert C. Effros ed., 1995). There is only one circumstance in which individual retaliation is authorized: when a member has put in place policies that render its currency "scarce" as determined by the Fund. See GOLD, *RULE OF LAW*, *supra* note 50, at 163. This is an exception that is strictly controlled by the articles and by the Fund.

circumstances may find it inconvenient or even costly in the short run to comply.

III. MARKETS AND INTERNATIONAL MONETARY LAW: EXPECTATIONS REGARDING COMMITMENT AND COMPLIANCE

Under what conditions should we expect governments to live comfortably with their currency obligations, and when should we expect tension between the rule and governments' behavior? In order to answer this question it is important to understand not only the legal framework, but the incentives governments have to break the law. This section reviews the reasons governments might wish to place restrictions on foreign exchange available to settle current account transactions. The analysis that follows relies on "enforcement" mechanisms that flow from market rather than official sources. In tension with a desire to retain their policy flexibility, governments face market incentives to commit and comply with their article VIII obligations. A credible commitment to maintain a current account free from restriction provides information for investors and suppliers that a country will be a reliable trade partner and a desirable investment venue. In the presence of uncertainty regarding actual risk, economic agents will prefer to conduct business with entities in jurisdictions that have pledged not to interfere with current account payments or to discriminate with respect to exchange rates.⁸⁶

The first expectation is that we should see policy convergence, especially among countries that are "near substitutes" for one another. Governments that lag significantly behind the policies of their more liberal competitors place their businesses at a competitive disadvantage. On the other hand, economic agents are likely to tolerate non-compliance if it is rampant among similar states; deviant non-compliance is more likely to be punished than non-compliance that has become the norm.⁸⁷ Thus, the decision to liberalize the foreign exchange market will be strongly influenced by the policies adopted by international competitors.

86. This perspective is consistent with a growing research program in political economy that suggests that national economic policies and domestic institutions must be understood in the context of the international market. Examples of this research program include GEOFFREY GARRETT, *PARTISAN POLITICS IN THE GLOBAL ECONOMY* (1998); SYLVIA MAXFIELD, *GATEKEEPERS OF GROWTH: THE INTERNATIONAL POLITICAL ECONOMY OF CENTRAL BANKING IN DEVELOPING COUNTRIES* (1997); and ANDREW C. SOBEL, *STATE INSTITUTIONS, PRIVATE INCENTIVES, GLOBAL CAPITAL* (1999).

87. Note that this argument is distinct from the claim that "normative concerns" underlie law compliance. See THOMAS M. FRANCK, *THE POWER OF LEGITIMACY AMONG NATIONS* (1990); Thomas Franck, *Legitimacy in the International System*, 82 AM. J. INT'L L. 1705 (1988). Indeed, most normative theories emphasize that states comply with their obligations for reasons that do not have to do with the incursion of direct costs and benefits. See, for example, the discussion of the socializing role of rules in FRIEDRICH V. KRATOCHWIL, *RULES, NORMS, AND DECISIONS* (1989). The primary difference is that the mechanism I propose here for imitative behavior does not require altruism, empathy, ideational commitment, legitimacy, or esteem. See Martha Finnemore & Kathryn Sikkink, *International Norm Dynamics and Political Change*, 52 INT'L ORG. 887, 898 (1998). I expect compliance to be encouraged through reputational mechanisms, burnished by international competition, with direct material consequences.

The second expectation is that a reputation for the rule of law should correlate with compliance. One implication of viewing market pressures as the primary enforcement mechanism for international monetary rules is that governments should be very concerned to develop a reputation for openness and, especially, predictability. Such a reputation is unlikely to be divisible: Governments that have invested in and rest on a stable legal framework at home are unlikely to jeopardize this reputation by lightly flouting international legal obligations. In this way, compliance is influenced by a decentralized system in which competition and concern for reputation motivate behavior.

This part explores three questions. First, what factors influence governments to commit themselves to article VIII? Second, do countries that commit actually comply? And third, what difference does commitment make to actual behavior?

A. *Why Commit to Article VIII? Explaining the Duration of the "Transitional Regime"*

In order to understand the decision to commit to and comply with article VIII, it is essential to understand why governments *may not* wish to maintain an open current account.⁸⁸ One reason may be to support developmental objectives that favor certain kinds of transactions (exports, capital inflows) over others (imports, capital outflows) based on established state priorities.⁸⁹ Another may be to affect the structure and operation of the banking system or to distribute exchange controls operations to particular domestic banks.⁹⁰ The primary reason, however, is likely to be to ameliorate balance of payments problems.⁹¹ Under these conditions, governments usually want to retain the flexibility of intervening to conserve foreign exchange in whatever ways they consider appropriate.

If the decentralized enforcement mechanism outlined above is correct, then the decision to commit to article VIII should be strongly influenced by markets that value certainty and policy liberalism. We therefore expect a commitment to liberalization to be highly influenced by the choices of economic competitors. Two variables are used here to test this hypothesis empirically: first, the proportion of IMF members that have committed to

88. Current account restrictions are one example of economic controls that governments may use to attempt to achieve certain policy objectives. For a discussion of general aspects of controls, see SCHUSTER, *supra* note 6, at 27–37, 140–56; JOZEF SWIDROWSKI, EXCHANGE AND TRADE CONTROLS: PRINCIPLES AND PROCEDURES OF INTERNATIONAL ECONOMIC TRANSACTIONS AND SETTLEMENTS 1–14 (1975).

89. See EDWARDS, *supra* note 46, at 386–87.

90. See generally SWIDROWSKI, *supra* note 90, at 61–69.

91. See EDWARDS, *supra* note 46, at 381–82. See generally GILBERT P. VERBIT, INTERNATIONAL MONETARY REFORM AND DEVELOPING COUNTRIES: THE RULE OF LAW PROBLEM 45–92 (1975). Verbit argues that “it is the perception of the balance of payments as ‘negative’ that normally leads to the implementation of an exchange distribution system.” VERBIT, *supra*, at 48. Verbit also emphasizes that to many developing countries, exchange restrictions are preferable to currency depreciation and can also generate revenue. See *id.* at 63–69, 74. On the balance-of-payments reason for controls, see Gianviti, *supra* note 9, at 7.

article VIII, and second, the proportion of jurisdictions within a given region that has made such a commitment. The expectation is that, as this proportion increases, so does the likelihood that any given country will also make such a commitment.

A serious test of this proposition requires a battery of economic, institutional, and domestic political controls that minimize the possibility that any regional correlation is spurious. Control variables allow us to draw inferences about the variables of primary theoretical concern, while taking into account the possibility that other influences are driving the commitment and compliance decisions as well. Their inclusion lessens the possibility of wrongly attributing causation to the variables of greatest theoretical interest by allowing for plausible alternative explanations. For example, we would certainly expect balance of payments difficulties to influence the commitment decision (primarily because they are likely to have a significant impact on a government's ability to comply).⁹² But if economic conditions *alone* can account for the pattern of commitment, or if they completely wash out the effects of policy choices made in other countries, then we do not have a very compelling story about competitive reputational concerns.

Economic conditions should certainly be included as control variables in this analysis. We should expect countries with economies that are vulnerable to highly volatile swings in their external position to find it difficult to comply; similarly, susceptibility to balance of payments pressures is expected to make a government less likely to accept article VIII obligations in the first place. Developmental level and the direction of the business cycle could also conceivably influence the decision to make a legal commitment with respect to economic policy, since restrictions are a potential policy lever for influencing imports and raising public revenues. The following analysis therefore controls for reserves as a proportion of GDP, volatility in this proportion, GDP per capita, and GDP growth.

It is also critical to consider the broader institutional context of the commitment decision.⁹³ Three controls relate to the IMF's potential role in this regard. First, the Fund may have policy leverage through the distribution of its resources. If the Fund applies leverage in order to persuade governments to commit to liberalization, then the use of Fund credits should be associated with a greater propensity to commit to article VIII.

Second, institutional changes ushered in by the Second Amendment could be expected to affect the decision to commit to article VIII. Prior to that

92. Downs and Locke argue persuasively that commitments are endogenous to expectations about future compliance. See GEORGE DOWNS & DAVID M. LOCKE, *OPTIMAL IMPERFECTION? DOMESTIC UNCERTAINTY AND INSTITUTIONS IN INTERNATIONAL RELATIONS* (1995).

93. Many critics of highly analytical work note the fallacy of artificially separating a particular rule from the broader institutional framework in which it is nested. "Precisely because rules operate in broader networks, their isolation threatens to be artificial. Both within and across issue areas, other rules and institutions can contribute to, or detract from, the effectiveness of any single rule." André Nollkaemper, *On the Effectiveness of International Rules*, 27 *ACTA POLITICA* 49, 63 (1992). Thus it is important to control for the effects of other institutional arrangements that could be expected to impact the commitment and compliance decision. See Kingsbury, *supra* note 27, at 363.

time, governments willing to announce acceptance of article VIII obligations could actually *avoid* multilateral surveillance.⁹⁴ Article XIV countries, on the other hand, were subject to wide-ranging, even invasive “consultations,” during which the staff broadly reviewed, and the Executive Board passed judgment on, the member’s balance of payments position. Additionally, the Second Amendment decoupled article VIII status from the determination as to whether or not a currency was defined as convertible and therefore acceptable for use in Fund operations. This change further lessened the institutionally granted incentive to declare one’s country to be bound by article VIII.⁹⁵ Other things being equal, these institutional changes should be expected to render the commitment rate much higher before 1977 than after.

Third, exchange rate regimes can be expected to have a systematic impact on the decision to commit to article VIII. The degree of exchange rate flexibility varies by country and over time. Flexible exchange rates absorb some of the burden of balance of payments adjustment and mitigate the need for large reserves to defend the currency. Since it then becomes much less necessary to reserve the right to restrict in order to maintain a large pool of reserves, flexibility should be associated with a higher propensity to commit.

Domestic political conditions are also a likely source of influence on the decision to commit to article VIII.⁹⁶ Most obviously, a government may choose to commit to liberal policies because that is what the polity demands. Article VIII provides a right of access to foreign exchange for residents and non-residents, and such a guarantee is valuable to residents that engage in foreign trade or depend economically on foreign imports or capital. For importers, it provides a signal to foreign firms that the government is not likely to interfere in the foreign exchange market or to intervene in international business transactions.⁹⁷ Article VIII is also likely to be favored by export groups, which recent research has shown to be concerned with issues of reciprocity and retaliation.⁹⁸ Hence, trade dependence should positively influence the legal commitment to free and open foreign exchange

94. See IMF Agreement, *supra* note 10. Consultations with article VIII countries were established in 1960 but were completely voluntary. See 1 DE VRIES AND HORSEFIELD, *supra* note 58, at 246–47; Joseph Gold, *Strengthening the Soft International Law of Exchange Arrangements*, 77 AM. J. INT’L L. 443, 474–75 (1983). On the significance of the Second Amendment for mandatory surveillance, see Harold James, *The Historical Development of the Principle of Surveillance*, 42 INT’L MONETARY FUND STAFF PAPERS 762, 770–79 (1995).

95. See James M. Broughton, *Silent Revolution: The International Monetary Fund, 1979–1989* (unpublished manuscript) (on file with author).

96. See Edward D. Mansfield & Marc L. Busch, *The Political Economy of Nontariff Barriers: A Cross-National Analysis*, 49 INT’L ORG. 723 (1995) (arguing that non-tariff barriers can generally best be understood as the result of societal demands for protection); see also Kal Raustiala, *Domestic Politics and International Regulatory Cooperation*, 49 WORLD POL. 482 (1997) (using a variant of liberal theory to explain divergent approaches to international regulatory cooperation). See generally Andrew Moravcsik, *Taking Preferences Seriously: A Liberal Theory of International Politics*, 51 INT’L ORG. 513 (1997).

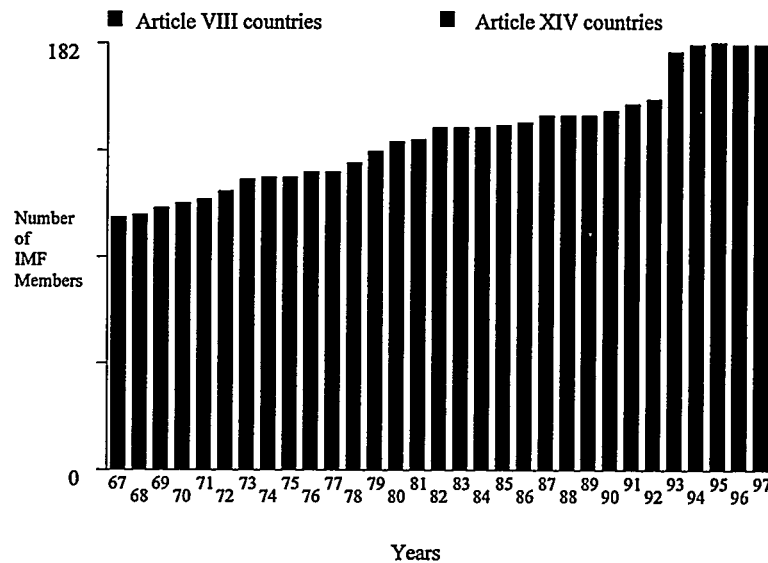
97. See 1 DE VRIES & HORSEFIELD, *supra* note 58, at 285–86 (“Article VIII status had come to signify over the years either that a country had a sound international balance of payments position or that if its payments position was threatened, it would avoid the use of exchange restrictions.”).

98. See MICHAEL GILLIGAN, *EMPOWERING EXPORTERS* 17–89 (1997).

markets. Finally, one might expect that civil society's demand for guaranteed foreign exchange access is most likely to be addressed by a democratic regime. The political organization around this issue is likely to be that of private interests versus the state, with concentrated rents going to the latter as the dispenser of limited access to hard currency. If so, then democratic governance should contribute to a higher rate of article VIII acceptance.

Before proceeding to more complicated analyses, it is useful to examine trends in IMF membership and article VIII commitment for the period under examination. As can be seen in Figure 1, both IMF membership and the number of article VIII countries have grown over time.

FIGURE 1: GROWTH IN MEMBERSHIP OF THE INTERNATIONAL MONETARY FUND, 1967-1997



By 1995 a clear majority of members had given up their transitional article XIV status and obligated themselves to openness.⁹⁹ Many countries, however, have taken a very long time to do so. What Figure 1 does not show is that *any given country* has about a twenty-five percent chance of accepting article VIII status in the first five years of IMF membership, a fifty percent

99. Data on whether or not the country has accepted article VIII status is taken from INTERNATIONAL MONETARY FUND, *supra* note 73.

chance within thirty-one years, and about a seventy-five percent chance after having been a member for forty years.¹⁰⁰ For many countries, the “transitional” regime could in fact last a long period of time.

What factors affect the rate of country acceptance of obligations for current account openness? Note that an article VIII obligation is a *uni-directional* decision: Once the obligation is made it cannot be formally rescinded if the country wishes to remain a member, although the country can fail to comply with its commitment, as discussed below. I use techniques of survival analysis that focus on the spell of time until the event of interest occurs (in this case, the making of an article VIII commitment). Widely used in epidemiological studies that seek to understand factors that affect mortality rates, this technique can be used analogously to test for the conditions associated with a greater “risk” of commitment (given that a commitment has not yet been made up to this point).¹⁰¹ I am interested in demonstrating that there are systematic influences on the rate of acceptance that can be characterized as a desire to establish a credible reputation for economic openness.

100. These rates of acceptance are estimated using the Kaplan-Meier estimator, in this case for maintaining article XIV status beyond time t . The probability of maintaining article XIV status in any given year is the product of the probability of maintaining this status in time t and the preceding periods:

$$S(t) = \prod_{j=t_0}^t [(n_j - d_j)/n_j]$$

where n represents those cases which neither accepted article VIII status, nor were censored, and d represents the number of acceptances during the time period. Subscript j designates the particular country, and Π is a symbol for taking the product of the probability of maintaining article XIV status at any given point in time (i.e., time t) and the preceding periods.

101. Specifically, I employ a Cox proportional hazard model to examine the effects of a number of continuous and categorical predictors, and because some of these vary over time, the tests presented here use time varying co-variables. The Cox model estimates a “hazard rate” which is defined as:

$$h(t) = \frac{\text{probability of accepting art. VIII between times } t \text{ and } t+1}{(t+1) (\text{probability of accepting art. VIII after time } t)}$$

The hazard rate is then modeled as a function of the baseline hazard (h_0) at time t —which is simply the hazard for an observation with all explanatory variables set to zero—as well as a number of explanatory variables, the estimates of which indicate proportional changes relative to this baseline hazard. The null hypothesis is that the proportionate hazard rate for any given explanatory variable of interest is 1 (it has no effect on the baseline hazard rate).

TABLE 1: INFLUENCES ON THE RATE OF ARTICLE VIII COMMITMENT
RESULTS OF A COX PROPORTIONATE HAZARD MODEL WITH TIME
VARYING CO-VARIATES

Explanatory Variables	Proportionate Effect on the Commitment Rate (Hazard Ratio)	Robust Standard Errors
Universality	1.247***	.089
Regional Norm	1.038***	.010
Use of Fund Credits	.577	.241
Flexible Exchange Rates	2.659**	1.286
Second Amendment	.046	.053
Openness (Trade Dependence)	1.019***	.004
Democracy	1.028	.034
Wealth (GNP/capita)	1.00009**	.00004
GDP Growth	1.021	.041
Reserves/GDP	.950	1.192
Reserve Volatility	.883	.300

Number of Subjects: 106
 Number of Commitments: 36
 Time "at risk": 2177.96
 Log Likelihood: - 88.305
 $\chi^2 =$ 80.20
 Probability > χ^2 0.00

* $P > |Z| = .10$

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

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

Table 1 presents the findings of the Cox proportional hazard estimation for the explanatory variables discussed above.¹⁰² Note that ratios of more than one indicate an increase in the rate of article VIII acceptance, while ratios of less than one indicate a reduction in the rate of acceptance. We are interested in whether these ratios are significantly different from one, which represents the basic acceptance rate.

The first two variables, "universality"¹⁰³ and "regional norm,"¹⁰⁴ test the proposition that taking on an obligation is likely to be related to similar

102. The dependent variable, commitment, is coded 1 if the country has accepted article VIII status, and is coded 0 if the country remains subject to article XIV transitional arrangements. Acceptance indicates the end of a "spell" for purposes of the Cox proportional hazard model.

Statistical significance is defined as any result for which there is at least 90% confidence.

103. "Universality" is measured as the proportion of current IMF members, calculated yearly, who have accepted article VIII status. See INTERNATIONAL MONETARY FUND, *supra* note 73.

104. "Regional norm" is measured as the proportion of current IMF members within each region who have accepted article VIII status. Classification of economies by region (East and Southern

actions by others. Both of these variables have a large and positive influence on the acceptance rate. According to these results, every one-percentage-point increase in the proportion of IMF members accepting article VIII increases the likelihood of acceptance by 24.7%. Similarly, a one-point increase in the regional proportion of article VIII adherents increases a country's "risk" of acceptance by 3.8%. This translates into a 45% increase for every 10% increase in regional accession, which is calculated by raising the estimated hazard ratio to the tenth power. Clearly, as the number of countries who accept article VIII increases, there is a greatly increased chance that an uncommitted government will do so. This impact is significant even if we control for time (not statistically significant; not reported here), which reduces the likelihood that the universality and regional norms variables evaluated here are simply a reflection of the fact that adherents increase over time.

There is also evidence that institutional incentives have made some difference in article VIII acceptance. "Second Amendment" (a dummy variable that takes on a value of 0 prior to 1977 and 1 thereafter)¹⁰⁵ has the expected negative effect, though it is not statistically significant for this sample of countries, many of which joined the IMF after surveillance was mandatory for all members.¹⁰⁶ Flexible exchange rates¹⁰⁷ have probably increased the likelihood of making an article VIII commitment, since it becomes much less necessary with flexible rates to maintain large foreign exchange reserves in order to defend a beleaguered currency. Perhaps the most interesting of the institutional influences, however, is the fairly strong and consistent negative effect of the use of fund credits¹⁰⁸ on the article VIII decision. This provides evidence that the IMF is not simply using resources as leverage to pressure borrowers into making a legal commitment they are not prepared to make. In fact, use of fund credits reduced the proportional hazard rate by about 42.3%.¹⁰⁹

Africa, West Africa, East Asia and Pacific, Eastern Europe and Central Asia, Rest of Europe, Middle East, North Africa, and Americas) are based on World Bank categories. See INTERNATIONAL MONETARY FUND, *supra* note 73.

105. This distinction is meant to capture the change in incentives that governments faced to accept article VIII after the Second Amendment to IMF Agreement, especially the surveillance regime and the convertibility regime for purposes of Fund transactions. See *supra* text accompanying notes 94–95.

106. Research shows that for those countries that had joined the Fund by 1980, the change in the surveillance regime had a very strong negative effect on the decision to commit to article VIII, indicative of a rather perverse incentive to commit. Mandatory surveillance for all countries drastically reduced the probability of accepting article VIII for those countries who were members during the regime change. See Beth A. Simmons, *The Legalization of International Monetary Affairs*, 54 INT'L ORG. (forthcoming 2000).

107. "Flexibility" is coded 1 if a country's exchange rate regime was flexible in a given year, and 0 if it was relatively inflexible. See INTERNATIONAL MONETARY FUND, *supra* note 73.

108. This variable is coded 1 if a country had made use of IMF credits during a given year and 0 otherwise. See WORLD BANK, WORLD DATA 1995 (Retrieval of World Bank Indicators on CD Rom using STARS Retrieval System 1995) [hereinafter STARS]; WORLD BANK, WORLD DEVELOPMENT INDICATORS (1998).

109. This percentage is arrived at by subtracting the hazard ratio from unity. This substantive interpretation seems consistent with the claims of the IMF staff:

[T]he acceptance of the obligations of Article VIII had been a matter for the member,

Domestic political demands that flow from trade openness also appear to have an important impact on the acceptance rate. Openness¹¹⁰ to the international trade system raises the proportional hazard rate significantly. According to these results, every one-point increase in imports plus exports as a proportion of GDP increases the likelihood of article VIII acceptance by 1.9%. This could account for a 72.6% difference in acceptance probability for countries with trade profiles as different as, say, Malaysia (imports plus exports approximately 80% of GDP for the spell under consideration) and the Philippines (where the corresponding ratio is a little over 50%).¹¹¹ The presence of a democratic regime,¹¹² on the other hand, had no independent effect on the propensity to commit to openness.

Finally, with a few exceptions, the remaining economic controls basically fit expectations: Making a commitment for external liberalization is more likely under good and improving economic conditions. Wealth and GDP growth make it more likely a government will commit, though in this model the latter does not reach traditional standards of statistical significance. As expected, reserve volatility (though not statistically significant) reduces the rate of commitment.¹¹³ What is interesting, however, is the apparent strength of the influence of external behavior on the commitment decision, even when controlling for economic conditions to which governments obviously feel pressures to respond. This seems to suggest that something like “peer pressure” in a competitive market context, rather than either Fund pressure or economic conditions alone, is in part driving the willingness of governments to make a legal commitment to a liberal international monetary policy.

with the Executive Board approving the member's decision to change its status once it had been shown to have no restrictions. The Executive Board had not taken a strong position on the termination of transitional arrangements of Article XIV, either in general or specific cases.

Broughton, *supra* note 95 (quoting minutes of EBM/87/39, Mar. 4, 1978, at 45). Gianviti notes that the Fund may in fact have at times viewed current account restrictions as an alternative to fund assistance: “The Fund is a cooperative institution designed to help its members, but its resources are made up of taxpayers' money and are not unlimited: hence the desire to find other—even distasteful—remedies to limit the amount of financial assistance from the Fund.” Francois Gianviti, *The Fund Agreement in the Courts*, in 1 CURRENT LEGAL ISSUES AFFECTING CENTRAL BANKS 1, 8 (Robert C. Effros ed., 1992). Broughton argues that it was not until 1993 that the Fund made major effort to persuade members to accept obligations of article VIII. *See* Broughton, *supra* note 95.

110. Openness is defined as imports plus exports as a proportion of GDP. Imports are comprised of total value of goods and services: the sum of merchandise f.o.b., imports of non-factor services, and factor payments at market prices in current U.S. dollars. Exports consist of the total value of goods and services: the sum of merchandise f.o.b., exports of non-factor services, and factor receipts at market prices in current U.S. dollars. *See* STARS, *supra* note 108, indicators (210 + 119)/38.

111. The difference in acceptance probability is calculated in this case by raising the estimated hazard ratio to the 29th power.

112. Domestic political regimes are scored according to how democratic they are, ranging from a low of 0 (nondemocratic) to a high of 10 (highly democratic). *See* POLITY III Data set, ICPSR Study No. 6695, available at <<http://www.icpsr.umich.edu>> (visited Apr. 14, 2000). For a complete discussion of the conceptualization and coverage of this data set and comparisons with other measures of democracy, see Keith Jagers & Ted Robert Gurr, *Tracking Democracy's Third Wave with the Polity III Data*, 32 J. PEACE RES. 469 (1995).

113. Current account balance and volatility, as well as terms of trade volatility were also analyzed, but because the results were insignificant they are not reported here.

B. *Why Comply with an Article VIII Commitment? Explaining the Decision To Comply*

Members of the IMF are legally required to comply with their commitments to keep the current accounts free from restrictions and to maintain unified exchange rates, and thirty-seven members have perfect compliance records on both counts.¹¹⁴ However, a number of article VIII countries have a far from perfect record, as shown in Table 2. Most of the long-term non-compliers are concentrated in Latin America, although there is a marked trend toward liberalization in this region during the mid-to-late 1990s. The global financial crisis of 1997 elicited foreign exchange restrictions in a number of article VIII countries that otherwise had exemplary records of compliance (e.g., Singapore and Korea).

Why do some countries comply, while others do not? The strategy in this section is to examine *only* cases in which governments have committed to article VIII and then to explain the decision nevertheless to implement restrictions on current account.¹¹⁵ The first and most obvious explanation for non-compliance is once again economic pressures that make the maintenance of an open current account and unified exchange rates very difficult. Certainly economic conditions are likely to have influenced Latin American countries in the 1980s and Asian countries in recent years. Thus, in the tests that follow, I control for the current account balance,¹¹⁶ current account volatility,¹¹⁷ and reserves,¹¹⁸ all standardized over GDP.

114. As of 1997, Armenia, Bahrain, Canada, Denmark, Djibouti, Estonia, Finland, Gambia, Germany, Hungary, Indonesia, Kiribati, the Kyrgyz Republic, Latvia, Lebanon, Malaysia, the Marshall Islands, Mauritius, Micronesia, Mongolia, New Zealand, Norway, Panama, Portugal, Qatar, Russia, San Marino, Saudi Arabia, Seychelles, Spain, Sweden, Switzerland, Thailand, Trinidad and Tobago, the United Arab Emirates, the United States, Vanuatu, and the Yemen Arab Republic all had perfect records of compliance with their article VIII status. However, there are very few yearly observations on several of these cases. See INTERNATIONAL MONETARY FUND, *supra* note 73.

115. Restrictions on current account are coded 1; absence of restrictions is coded 0. Since this section analyzes only the policies of article VIII countries, restrictions are interpreted as non-compliance. See INTERNATIONAL MONETARY FUND, *supra* note 73. At this point I do not examine the technical question of whether the Executive Board of the IMF has approved of the restrictions in place, thus rendering them "legal" temporarily.

116. The current account balance is defined as the sum of net exports of goods and non-factor 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. See STARS, *supra* note 108, indicators 223/38.

117. Current account volatility is defined as the log of the standard deviation of current account balance as a proportion of GDP. See STARS, *supra* note 108, indicators 223/38.

118. Reserves are defined as central monetary authority reserves, including official holdings of gold valued at London market prices, SDR holdings, reserve position at the IMF, in current U.S. dollars. Reserves are standardized as a proportion of GDP. See STARS database, *supra* note 108, indicators 397/38.

TABLE 2: NON-COMPLIERS*: RATES AND YEARS OF NON-COMPLIANCE:
RESTRICTIONS 1967-1997

Country	Rate of non-compliance (1967-1997)	Years committed: (1967-1997)	Dates of restrictions
Dominican Republic	1.00	31	1967-1997
El Salvador	.87	31	1967-1993
Jamaica	.81	31	1968-1969, 1973-1995
Guyana	.77	31	1967, 1971-1993
Chile	.75	20	1983-1995, 1996-1997
South Africa	.71	24	1979-1993, 1996-1997
Cyprus	.71	7	1991-1993, 1996-1997
Iceland	.64	14	1984-1992
Morocco	.60	5	1993, 1996-1997
Argentina	.59	29	1972-1977, 1983-1993
Costa Rica	.55	31	1972-73, 1975, 1982-95
Peru	.55	31	1971-78, 1985-92, 1996
St. Lucia	.53	15	1981-1986, 1996-1997
Guatemala	.52	31	1967-1973, 1981-1989
St. Vincent	.50	14	1982-1986, 1996-1997
Barbados	.50	4	1996-1997
Israel	.50	4	1996-1997
Nicaragua	.48	31	1979-1993
Ecuador	.41	27	1983-1993
Greece	.40	5	1996-1997
Tunisia	.40	5	1996-1997
Honduras	.39	31	1982-1993
Fiji	.28	25	1989-1992, 1996-1997
Italy	.26	31	1975-1982
Swaziland	.25	8	1996-1997
Turkey	.25	8	1996-1997
Grenada	.25	4	1997
Austria	.23	31	1967-1973
Bolivia	.23	30	1982-1986, 1996-1997
Korea	.22	9	1996-1997
Belize	.21	14	1982, 1996-1997
St. Kitts & Nevis	.18	11	1996-1997
Mexico	.16	31	1983-1987
Antigua & Barbuda	.14	14	1996-1997
France	.13	31	1969-1971, 1983
Haiti	.13	31	1968-1971
Dominica	.11	18	1996-1997
Japan	.10	30	1968-1970
Oman	.09	23	1996-1997
Papua New Guinea	.09	22	1996-1997

Bahamas	.08	24	1996–1997
Netherlands Antilles	.06	31	1996–1997
Solomon Islands	.06	18	1997
Singapore	.05	21	1997

*Non-compliers with three or fewer years of article VIII commitment (1995–1997):

Algeria, Bangladesh, Benin, Botswana, Burkina-Faso, Cameroon, Central African Republic, Chad, China, Comoro, Congo, Croatia, Czechoslovakia, Gabon, Georgia, Ghana, Guinea, Guinea-Bissau, India, Ivory Coast, Jordan, Kazakhstan, Kenya, Madagascar, Malawi, Mali, Malta, Moldova, Namibia, Nepal, Niger, Pakistan, Paraguay, Philippines, Poland, Senegal, Sierra Leone, Slovak Republic, Slovenia, Sri Lanka, Tanzania, Togo, Tonga, Ukraine, Western Samoa, and Zimbabwe

The central concern of the analysis, however, is the pressure that the behavior of other similarly situated countries places on the decision to comply. Investors and suppliers seeking opportunities for international commerce, would prefer to do business with firms in countries with a legal framework that provides greater certainty that international contracts will not be fulfilled arbitrarily or discriminatorily. “Regional non-compliance”¹¹⁹ reflects the extent to which other countries within each region have implemented restrictions on their current accounts, as shown in Table 3. The expectation is that if it is common for article VIII countries in the region to disregard their commitments to keep their current accounts free from restrictions, this should increase the probability that any given country in that region will decide against compliance. On the other 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.

Institutional context may also be important for the compliance question. First, if the IMF is “enforcing” liberal legal obligations through the conditional distribution of resources, then we would expect the use of these credits to be associated with compliance. Second, compliance may be more palatable if it is not essential to maintain reserves in order to defend a fixed value of the currency. Flexible rates should be associated with greater compliance.

Finally, it is important to consider characteristics of the domestic polity itself. Several authors 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.¹²⁰ In this view,

119. Regional non-compliance is defined as the proportion, calculated yearly, of current IMF members within each region who place restrictions on their current accounts. World Bank regional classifications are used. *See supra* note 104. Since this explanatory variable is used only to analyze policies of article VIII countries, it is interpreted as non-compliance. *See INTERNATIONAL MONETARY FUND, supra* note 73.

120. *See* the discussion of the Partial Test Ban Treaty and Fisheries agreements in ORAN YOUNG, *supra* note 16, at 51–66 (1979); and OSCAR SCHACHTER, *INTERNATIONAL LAW IN THEORY AND PRACTICE* 7 (1991). *See generally* Moravcsik, *supra* note 96. Edith Brown Weiss has commented that

participatory politics might put pressure on the government to comply, especially in this case where non-compliance involves curtailing the rights of residents to foreign exchange. Others have argued that the most important characteristic of liberal democracy when it comes to international compliance is a 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 law¹²¹ to a more general argument that domestic systems that value rule-based decision-making and dispute resolution are also likely to respect rules internationally.¹²² In essence, these are affinity arguments: They argue that domestic norms regarding limited government, respect for judicial processes, and regard for constitutional constraints “carry over” into the realm of international politics.¹²³ They rest on an intuitively appealing assumption that policymakers and lawmakers are not able to park their normative perspectives at the water’s edge.¹²⁴

“the more adherence to democratic norms, the more [we might expect] implementation and compliance.” Edith Brown Weiss, *Remarks*, 89 AM. SOC’Y INT’L L. PROC. 206, 211 (1995). She recognizes, however, that there are some cases under which democratic institutions could undermine compliance. *See id.* For an examination of the impact of domestic appeals to implement international norms, see Andrew P. Cortell & James W. Davis, Jr., *How Do International Institutions Matter? The Domestic Impact of International Rules and Norms*, 40 INT’L STUD. Q. 451 (1996).

121. *See* Anne-Marie Slaughter, *International Law in a World of Liberal State*, 6 EUR. J. INT’L L. 503 (1995).

122. This captures the flavor of some of the democratic peace literature that has flourished in political science. *See, e.g.*, William J. Dixon, *Democracy and the Management of International Conflict*, 37 J. CONFLICT RES. 42 (1993); Michael W. Doyle, *Liberalism and World Politics*, 80 AM. POL. SCI. REV. 1151 (1986); Gregory A. Raymond, *Democracies, Disputes, and Third-Party Intermediaries*, 38 J. CONFLICT RES. 24 (1994). Liberal states may agree to and comply with decisions by international tribunals more readily than illiberal states. *See generally* Laurence R. Helfer & Anne-Marie Slaughter, *Toward a Theory of Effective Supranational Adjudication*, 107 YALE L.J. 273 (1997) (applying liberal theory); Ernst-Ulrich Petersmann, *Constitutionalism and International Adjudication: How To Constitutionalize the UN Dispute Settlement System*, 31 N.Y.U. J. INT’L L. & POL. 4 (1999); Ernst Ulrich Petersmann, *How To Constitutionalize International Law and Foreign Policy for the Benefit of Civil Society*, 20 MICH. J. INT’L L. 1 (1999); Anne-Marie Slaughter & Alec Stone, *Assessing the Effectiveness of International Adjudication*, 89 AM. SOC’Y INT’L L. PROC. 91 (1995); Fernando R. Teson, *The Kantian Theory of International Law*, 92 COLUM. L. REV. 53 (1992).

123. “International law is not unlike constitutional law in that it imposes legal obligations upon a government that in theory the government is not free to ignore or change.” FISHER, *supra* note 21, at 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. The proposition that constitutionally constrained governments are more likely to observe legal obligations seems to dovetail with that strand of the democratic peace literature that argues that regard for domestic constitutional constraints carries over into the conduct of foreign policy. *See generally* THOMAS RISSE-KAPPEN, *COOPERATION AMONG DEMOCRACIES: THE EUROPEAN INFLUENCE ON U.S. FOREIGN POLICY* (1995); Dixon, *supra* note 122.

124. Charles Kupchan and Clifford Kupchan argue, for example, that states “willing to submit to the rule of law and civil society are more likely to submit to their analogues internationally.” Charles Kupchan & Clifford Kupchan, *Concerts, Collective Security, and the Future of Europe*, 16 INT’L SECURITY 114, 115–16 (1991). Volker Rittberger and Frank Schimmelfennig also test an “idealistic-liberal expectation” that “due to societally anchored norms operating as constraints on foreign policy behavior, the growth of German power will not be followed by a foreign policy change which is characterized by an increased projection or use of power.” VOLKER RITTBERGER & FRANK SCHIMMELFENNIG, *GERMAN FOREIGN POLICY AFTER UNIFICATION: A RE-EXAMINATION OF REALIST*

There are other reasons, however, to expect the rule of law to be associated with article VIII compliance. Rule of law countries 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 non-compliance; 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.¹²⁵ The scale represents the willingness of citizens to implement law and adjudicate disputes peacefully 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 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. There is no 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. It is true that these two variables are positively correlated, but they are certainly conceptually distinct, and may have very different impacts on the decision to comply with article VIII obligations. Thus, we are able to directly 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. A control for bureaucratic quality¹²⁶ is also included to control for the differential capacity of various states to intervene in foreign exchange markets.

In this case the compliance decision is modeled using a logistical regression (logit) model, with the dependent variable taking on a value of 1 for the presence of restrictions and 0 for their absence. (Since we are analyzing only article VIII countries, each restriction is also a case of apparent non-compliance.) Because the data consist of observations across countries and over time, with a strong probability of temporal dependence among

PROGNOSES 16–17 (Tübinger Arbeitspapiere zur internationalen Politik und Friedensforschung Number 28a, 1997). See generally RISSE-KAPPEN, *supra* note 123.

125. Rule of Law is measured along a one-to-six point scale measuring the extent to which a country's domestic polity is based on practices that respect the rule of law. Data collected by Country Risk Guide (on file with author). For a full discussion of the conceptualization of this variable, see Stephen Knack & Philip Keefer, *Institutions and Economic Performance: Cross-Country Tests Using Alternative Institutional Measures*, 7 *ECON. & POL.* 207, 225 (1995).

126. Bureaucratic quality is measured by a one-to-six scale measuring the extent to which a country's bureaucracy is capable of carrying out a range of administrative tasks. For a full discussion of the conceptualization of this variable, see Knack & Keefer, *supra* note 125.

observations, a logit specification is used that takes explicit account of the non-independence of observations.¹²⁷ The results are reported in Table 3.

TABLE 3: INFLUENCES ON THE DECISION TO COMPLY WITH
ARTICLE VIII OBLIGATIONS

Dependent Variable: Current Account Restrictions
Range of Analysis: Article VIII Countries Only, 1982–1995
Results of a Logit Model with Correction for Time Dependence of Observations

Explanatory Variables	Logit Coefficients	Robust Standard Errors
Constant	-2.84***	.784
Regional Non-Compliance	5.94***	.982
Rule of Law	-.288**	.135
Bureaucratic Quality	.417***	.146
Democratic Regime	.003	.008
Use of Fund Credits	.723*	.386
Average Balance of Payments/GDP	-.083**	.034
Current Account Volatility	.400*	.242
Average Reserves/GDP	-2.71	2.09

Number of observations: 620
Probability > χ^2 0.00
Log Likelihood: -139.35
Pseudo R² 0.63

* P > |Z| = .10

** P > |Z| = .05

*** P > |Z| = .01

One of the most important findings is again the clustering of compliance behavior across regions. Article VIII countries are much more likely to put illegal restrictions on current accounts if other countries in the region are doing so. Could this be due to 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 that were included in the specification. The inclusion of various measures of reserves, current account, wealth, and growth failed to wash out apparent regional mimicry. Compliance decisions are apparently not being made on the basis of economic conditions alone, but with an eye to standards of regional behavior. The most obvious

127. I use a method described fully in Nathaniel Beck et al., *Taking Time Seriously: Time-Series-Cross-Section Analysis with a Binary Dependent Variable*, 42 AM. J. POL. SCI. 1260 (1998). A counter-vector was created and three splines were included in the analysis, but their coefficients are not reported here.

reason for this concern would be reputational consequences in a competitive international economic environment.

The domestic political variables tell an interesting story with respect to regime characteristics. The evidence is strong that states must have the developmental capacity to renege on their commitments. The strong positive relationship between bureaucratic quality and restrictions implies that these choices are more likely to be made where the capacity exists to implement them. Trade dependence may have an influence on restrictions, but the standard errors raise some doubts. By contrast to theories of international behavior that concentrate on the law-consciousness of democracies, the evidence presented here suggests that the quality of being democratic actually contributes little or nothing when other factors are held constant.¹²⁸ On the other hand, a strong domestic commitment to the rule of law contributes positively to compliance.

When the IMF is the enforcer of compliance, we should see a strong negative effect on the dependent variable. Yet the coefficient is positive and statistically significant. The Fund is tolerating a good deal of non-compliance when it comes to restricting access to foreign exchange,¹²⁹ a finding that is inconsistent with the effective use of its leverage.

C. *To Commit or Not To Commit: What Is the Difference?*

This final section of analysis considers whether the law matters: Specifically, does making an article VIII commitment have an independent effect on behavior, once we take into account the obvious economic factors that are likely to lead to restrictions on current accounts? Certainly, those who have labored long and hard in the study and practice of international law are apt to emphasize the uniquely constraining qualities of legal institutions on governmental decision making. Louis Henkin, for example, has argued that "there is an influence for law observance in the very quality of law, in the sense of obligation which it implies."¹³⁰ Is there something about making a legal commitment that enhances the prospects of behavior required by the rule?

In order to answer this question, I analyze the entire data set (133 countries, including article VIII *and* article XIV cases, with observations over time averaging twenty years) using logit analysis to explain the existence of restrictions.¹³¹ Article VIII status is forced to compete with a broad range of economic conditions that one would clearly expect to be associated with

128. On a subset of countries that were IMF members by 1980, earlier research has shown a strong negative correlation between democracy and compliance with respect to restrictions on current accounts. See Simmons, *supra* note 106.

129. This result is completely consistent with archival research, which has uncovered evidence that stand-by arrangements are often accompanied by the temporary approval of restrictions in order to conserve foreign exchange. See EDWARDS, *supra* note 46, at 413.

130. HENKIN, *supra* note 1, at 60.

131. I used the same technique for time-dependence of observations as that described *supra* note 127.

restrictions: volatility in the terms of trade,¹³² reserves,¹³³ and the balance of payments;¹³⁴ economic growth rates;¹³⁵ and per capita GNP.

TABLE 4: DOES ARTICLE VIII MATTER?

Results of a Time Series Cross Section Logit Model
Dependent Variable: Restrictions on Current Account

Explanatory Variables	Logit Coefficients	Robust Standard Errors
Constant	.845**	.355
Article VIII Commitment	-1.151***	.141
Terms of Trade Volatility	.405***	.100
Balance of Payments/GDP	-.021**	.010
GNP/Capita	-.00001	.00002
Reserves/GDP	1.99***	.551
Change in GDP	-.031***	.012
Openness	-.005**	.002
Use of Fund Credits	.821***	.138
Flexible Exchange Rates	.160	.158
Years Since Last Restriction	-1.30***	.114

Number of observations: 2973
 $\chi^2 =$ (12) 527.58
 Probability > χ^2 0.00
 Log Likelihood: -772.25

* $P > |Z| = .10$
 ** $P > |Z| = .05$
 *** $P > |Z| = .01$

Table 4 presents the results of this analysis. Most of the economic variables do indeed have the expected effects, and many are in fact significant. The strongest effects are, as expected, those associated with balance of payments difficulties and low and/or volatile reserves. Income per capita and GDP growth also contribute to an economic explanation of a liberal policy orientation with respect to restrictions. As seen in the earlier analysis, openness is also associated with liberal policy choice. Another interesting

132. Terms of Trade Volatility is measured as the log of the standard deviation of the terms of trade index. The terms of trade index is the relative level of export prices compared with import prices, calculated as the ratio of a country's index of average export price to the average import price (1987=100). See STARS, *supra* note 108, indicator 275.

133. Reserve volatility is measured as the log of the standard deviation of reserves/GDP for each country over the observed time period. Thus, this measure varies by country, not over time. See *id.*, indicator 397.

134. See *id.*, indicator 397. Balance of payments is a yearly observation of the ratio of the current account balance as a proportion of GDP. Volatility measures the extent of variation over time.

135. Economic growth rates are measured as GDP average annual growth rate, at factor cost plus indirect taxes, less subsidies. See *id.*, indicator 181.

finding is that use of fund credits is consistently associated with illiberal policy choice, once again providing evidence that these choices cannot convincingly be explained by Fund pressure in the context of extending loans.

Most important for our purposes, however, is that, controlling for the likely macroeconomic influences on the decision to implement current account restrictions, having made a formal declaration of adherence to article VIII obligations consistently has a strong negative effect on the probability of imposing restrictions. In fact, controlling for all other economic variables as well as for policy inertia,¹³⁶ countries that continue to live under the "transitional" article XIV regime have an estimated probability of .55 of implementing restrictions, while the corresponding probability for an identically situated article VIII country is only .46.¹³⁷ Thus, commitment accounts for just about a nine-percentage-point difference in the probability of imposing restrictions on current accounts for the sample of cases as a whole.

These findings provide fairly strong evidence that legal commitments have a systematic effect on state behavior. It should be underscored that the legal commitment was shown to affect the propensity to restrict the current account, controlling for a wide range of economic conditions and the time dependence of observations (policy inertia). It is difficult to counter that these results merely reflect the actions that governments had intended to take regardless of a formal commitment. Recall that adherence to article VIII is a *one-way commitment*, and that in a thirty- to fifty-year time span after making such a commitment there are certainly likely to be unanticipated occasions in which eschewing restrictions on current accounts is an inconvenient commitment to have made. Nonetheless, in a significant number of these cases, governments appear to have decided that their best interests lay in sticking with their commitment to refrain from implementing restrictive policies.

IV. CONCLUSIONS

The effect of international law on states' behavior should be a central concern of international relations scholarship, but few studies have systematically examined this question. International legal scholars tend to view law compliance as the norm,¹³⁸ while political scientists are far more skeptical.¹³⁹ In the face of daunting conceptual and methodological issues,¹⁴⁰ very little systematic evidence has accumulated to assess basic propositions about why governments commit to and comply with international legal

136. Here I report the predicted probabilities as generated by a set of simulation algorithms developed by Gary King et al., *Making the Most of Statistical Analyses: Improving Interpretation and Presentation*, 44 AM. J. POL. SCI. 341 (2000).

137. This is the result of holding all other variables at their mean and calculating the probability from the raw logit coefficients in Table 4.

138. See, e.g., HENKIN, *supra* note 1; Chayes & Chayes, *supra* note 1.

139. See, e.g., Downs et al., *supra* note 2; Mearsheimer, *supra* note 8.

140. See, e.g., Simmons, *supra* note 27, at 91.

obligations and whether this makes any difference to outcomes in which we are interested.

The legalization of some central aspects of the international monetary regime after World War II provides an opportunity to inquire into the conditions under which law can influence the behavior of governments in the choice of their international monetary policies. Using the IMF's own data to examine this issue, we can be fairly precise about what constitutes obligation and compliance. The strategy of this Article has been to model the factors that contribute to the rate of article VIII acceptance, to test a set of hypotheses regarding compliance with this commitment, and finally, to assess the impact that commitment has on behavior.

One of the most interesting findings is that the behavior of other countries, especially in one's own region, has far more impact on commitment and compliance decisions than has generally been recognized. Indeed, there was more evidence of competitive policy convergence than of overt pressure from the Fund on borrowing countries. Especially compelling is the finding that governments are positively influenced by the choices of other governments in their own region. They are more likely both to make and to honor a legal commitment if others in the region are doing so. This provides evidence that norms are set and reputations are assessed among groups of roughly comparable countries, likely through international market channels rather than international organizational channels. Although the Fund undoubtedly has a significant impact on some countries at certain points in time, much more decentralized forces seem largely to be at play.

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, participatory democracy had little to do with the compliance question. 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 indicates that rules and popular pressures can, and apparently sometimes do, pull in opposite directions when it comes to international law compliance. It seems clear that governments that provide for a stable framework of law and system of property rights domestically are more likely to do the same for the purposes of facilitating international economic transactions. One interpretation is that a credible commitment to a stable system of law is not divisible in the eye of the investor. A rule-of-law government may have even more to lose from non-compliance with an international legal obligation than a more capricious regime.

Perhaps no question has plagued scholars of international institutions as persistently as the challenge to demonstrate that such institutions directly affect state behavior. Does international law order state action? How can we know that governments have not simply committed to do things that they would have done even in the absence of rules? How can we be sure that the rules are not epiphenomenal of behavior rather than a constraint on future behavior? "Proof" of such propositions is probably not possible, but evidence

has been presented here that addresses such skepticism. Once we control for most of the obvious reasons a government might choose to restrict its current account, article VIII status still emerges as a truly significant influence on the probability of choosing to restrict. An article VIII country facing external economic pressures and business cycle conditions matching those of a similarly situated article XIV country manages much more often to avoid implementing restrictions to cope with these pressures. This is not simply due to Fund pressure attached to credits, nor is it an artifact of the exchange rate regime. We should continue to entertain alternative explanations, but these tests indicate that a legal commitment may carry decisive weight in determining some states' international monetary policy.

These results also have broader implications for international law compliance. They seem to point to a conclusion that international law matters because legal obligations systematically raise and focus public and private actors' expectations about governmental behavior. The making of legal commitments may not be the only way to do this, but it is a broadly recognized, socially interpretable effort to signal a government's policy intentions. Once made, such commitments are honored, but not because governments have an inherent respect for legal institutions (least of all international ones). Rather, the results presented here suggest that governments are keenly aware of the impact that non-compliance will have on their reputation, affecting their appeal as a venue for conducting international transactions within a reasonably stable legal framework that protects property rights.

It is straightforward to think about international economic law as an example of market-enforced rule compliance. It is not hard to imagine how the basic mechanism described here could be at play in a study of the effects of bilateral investment agreements, preferential trade arrangements, or trade dispute settlement. But the work here suggests that the basic mechanism may have broader applicability. It is useful to begin thinking about why and to what extent governments may expect to encounter various kinds of costs associated with non-compliance. In some cases, market-related costs should be the focus of attention, as is obviously appropriate in the case of international monetary law. Yet there may be market-related costs in less obvious policy areas. Human rights may provide an example, as long as information on governmental activities is available and a public norm that does not tolerate clear abuses exists. There are, however, many regulatory areas in which market forces are the problem rather than the solution, as in international drug trafficking and money laundering. It would be the height of naïveté to assume that market actors can be counted upon to boycott governments that ignore their international legal commitments. The extent to which markets can be used to achieve broader social purposes depends on the extent to which the objective purposes and the objective of a narrow range of private interests are compatible.

Further research should focus on even broader conceptualizations of reputational costs that can flow from non-compliance with international legal

obligations. Much more attention should be given to domestic audience costs, or the domestic political fallout a government might experience should it decide to renege on an international legal commitment. Certainly, some cases will call for an analysis of domestic groups opposing the substantive policy stand represented by breach of an obligation (e.g., free traders will oppose protectionism, environmentalists will oppose unabated pollution, pacifists will oppose the use of force). But beyond this, it may be fruitful to think about the conditions under which a government's disregard for internationally principled constraints might be opposed by a polity worried about a similar disregard for (equally unenforceable) constitutional constraints at home. What does international law violation do to a government's domestic legitimacy? Does it spur nationalist support in the short run, but damage its credibility at home in the long run?

The role of reputational considerations has long been central to our impressions of why international law is generally obeyed, despite the lack of centralized enforcement. This research suggests that reputations are situational. In some sense this is obvious; a reputation has no meaning outside of a specific social context. But it is surprising how little attention researchers have given to the clustering of legal commitments in time and space. Where do governments pick up their cues on appropriate behavior? How do they decide the time is right to commit themselves to a multilateral treaty? How do they decide when non-compliance will be tolerated, and when it will not? It is impossible to deny that national decision makers are looking for external cues of what is expected of them. But to date, little work has been done to understand the various channels or networks that might help to explain the "momentum"¹⁴¹ or the apparently "contingent compliance"¹⁴² that this and other studies have uncovered.

It is evident that scholarship has only begun to scratch the surface of the broader explanations for sovereign governments' willingness to make legally binding, potentially politically costly commitments. This study has gone some distance toward testing a particular conception of international law as a commitment device enforced through decentralized market forces that loath legal uncertainty. Viewed in this way, the evidence points to international legal commitment as an important influence on state behavior.

141. Michael J. Glennon & Alison L. Stewart, *The United States: Taking Environmental Treaties Seriously*, in ENGAGING COUNTRIES, *supra* note 16, at 173, 189, 203.

142. MARGARET LEVI, CONSENT, DISSSENT, AND PATRIOTISM 17-27 (1997).