Simmons 2000, "The Legalization of International Monetary Affairs."

Brief Summary:

Based on the premise that legalization of international monetary relations helps governments make credible commitments to market actors, Simmons tries to show that the monetary system needs to be governed by rules that enhance hard commitments. The soft arrangements during the interwar period proved to be useless. Despite an imperfect compliance, commitment to the rules contained in the IMF's Articles of Agreement, including maintaining an open current account and unified exchange rates, are instead quite effective. Reputation costs prevent countries from violating the rules, especially if those countries have a strong reputation of respect for the rule of law and other comparable countries are at the same times complying.

Main Puzzle:
Why is it that, given a choice, governments commit to and comply with the IMF's monetary rules? Since commitment to these rules is voluntary, why do governments obligate themselves to abide by them?

Main Answer:
- The stability of the gold standard in the nineteenth century, though had a clear legal basis, has nothing to do with international legal structure and arrangements. It was, at most, a decentralized system of regulatory harmonization. This decentralized system seemed to work because investors were confident in its stability. Although those countries tried to legalize the international monetary system; it was mainly dependent upon national law. Later, however, that system failed during the interwar years. After World War II, we see the first time the emergence of a public international law of money embedded in the IMF.
- The IMF's Articles of Agreement set forth two primary regulatory goals that reflected lessons drawn from the interwar years: governments should be obligated to peg exchange rates and remove exchange controls and discriminatory practices that affected current transactions, and legalization was designed to help facilitate the international exchange of goods and services by providing for currency convertibility in open, free, and legal markets.
- The international community thus explicitly recognized for the first time that exchange rates were properly a matter of international concern. 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 is not to say that all members complied with the obligation to peg. Some were able to do so only by maintain other undesirable or illegal practices. However, this "par value" rule was abolished in 1977.
- Despite the softening of legal obligations with respect to the system of par value, governments who members of the IMF do retain two important obligations in the conduct of their external monetary policy: prohibiting restrictions on the making of payments and transfers for current international transactions, and prohibiting multiple currency without the approval of the Fund itself.
- Due to the unwillingness of the Fund's founding members, these two aspects of obligations contained in Article VIII are only made voluntarily.
- While the IMF encourages countries they believe are in a position to do so to make an Article VIII commitment, the Fund does not provide direct positive or negative incentives to do so. Nor does the Fund directly 'enforce' these obligations; it only publishes data on state's policies from which one can infer compliance. 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.
- Hypotheses about why countries commit and whether they comply relate to the function that international legal commitments play in international monetary relations. Governments commit themselves in order to send a costly signal to market actors as well as other governments that they plan to maintain a stable, open, and non-discriminatory stance. A legal commitment helps make this signal more credible. An Article VIII commitment is more costly to breach than are other kinds of policies. It has consequences in domestic courts because any exchange contracts that reflect illegal or unapproved restrictions are required by the Articles to be unenforceable in the courts of any member state. This should, in theory, create disincentives to make exchange contracts with private or public entities that operate under national rules that do not comply with international obligations.

- More important than the prospect of actually being enforced in a court, however, is the signal that an Article VIII commitment sends to markets. It is a signal of a serious intention not to interfere in free exchange. Hence, only countries that are certain about their insusceptibility of the balance of payments pressures will be more likely to Accept VIII obligations.
- Furthermore, it is likely that one influence on the decision to accept Article VIII status is that others are doing so. A country's firms may find themselves at a competitive disadvantage in international transactions if competitors make commitments to refrain from foreign exchange restrictions while the home government does not.

Under what conditions do countries decide to comply?

- Based on a logistical regression (logit) model, Simmons test independent variables that impact the presence or absence of restrictions and/or multiple exchange rates.
- Her first hypothesis is that costs are greatest when a violator is an outlier among comparable countries.
- Also, it is likely to believe that compliance with international legal commitments will be much more prevalent among liberal democracies because we might expect that the demand for guaranteed foreign exchange access is most likely to be addressed by a democratic regime.
- Economies that depend on trade are likely to be among the most willing make the legal commitment to free and open foreign exchange markets.
- There are also the institutional incentives the IMF has provided for those who commit because Article VIII obligations, up to 1977, gave them the ability to avoid discriminatory and potentially humiliating surveillance and formal Board review.
- One important reason is that countries may have been reluctant to commit to Article VIII in the early years of the Fund because it was unclear just how the Executive Board would interpret the obligation. As time went on, this kind of uncertainty could be expected to wane through approval decisions and Executive Board. So, the passage of time may count.
- In sum, the variables that Simmons look for their statistical significance include
    - Compliance by other countries
    - More democracy in domestic politics
    - Positive economic conditions
    - Flexible exchange rates
    - Use of Fund resources
    - Membership in the GATT
    - The passage of time

The results

- One of the most important findings is the clustering of compliance behavior within regions. This finding shows that a country is more likely to comply if other countries in the region are doing so.
- The domestic political variables tell an interesting story tell an interesting story with respect to regime characteristics. The evidence here suggests that democracy may be associated with a greater tendency to violate the country's international monetary obligations. On the other hand, a strong domestic commitment to the rule of law contributed positively Article VIII compliance. This difference is understandable in light of the argument about uncertainty and reputation: with much to lose, governments that have invested heavily in a reputation for the rule of law have a lot to lose by reneging on their international obligations.
- None of other control variables has an impact on these findings. Flexible exchange rates, GATT membership, and the use of Fund resources may be important institutional contexts for international economic relations, but they do not systematically impact the compliance decision.