Cooperation In the Global Village: Social Globalization and the Impact of International Law on Monetary Policy

by

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(Under the direction of Jeffrey Berejikian)

Abstract

This paper examines the micro-foundations of the domestic sources of compliance with international agreements, specifically Article 8 of the IMF Articles of Agreement. While global economic interdependence increases formalized cooperation between states, domestic resistance against negative impacts of international agreements may also raise the pressure on governments to not comply. Based on findings from experiments in behavioral economics, I argue that social global integration can alleviate this pressure towards non-compliance. More integrated domestic audiences develop a higher propensity toward cooperation and are less likely to tolerate non-compliant decisions by their governments. I test this hypothesis with a recent dataset that captures the social dimension of globalization and apply it to data from 27 years of Article 8 commitments. The analysis shows that democracies with higher levels of international interactions between domestic societies display significantly lower rates of non-compliance with Article 8, even in adversary conditions.

Index words: International law, compliance, globalization, cooperation, IMF, international institutions, domestic sources of foreign policy

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Chapter 1

Introduction

Scholars of international relations have increasingly focused on the influence of domestic actors when evaluating the stability and effectiveness of international law. Arguments differ as to whether this influence is positive or negative. In practice, constraints through international agreements have often sparked domestic dissent. Under the usual assumptions about leaders' responsiveness to domestic demands, such instances can pose a problem to international cooperation. This paper speaks directly to the theoretical and practical debates and provides a framework to evaluate several claims about the domestic sources of compliance. I argue that preference formation and the resulting impact of domestic actors on compliance can best be understood by applying the neoliberal perspective on cooperation between states to individuals. While this perspective originated from a game-theoretic background, recent psychological research has shown that *actual* individuals display more cooperative behavior within more personalized-integrated environments. This introduces a new aspect to the study of domestic determinants of compliance. I therefore examine the relationship between states' interdependence, domestic politics, and compliance with international law by utilizing the concept of *social globalization*. It expresses the degree to which individuals likely perceive the international environment as cooperative or anarchic, how favorable they view compliant policies, and thus eventually it affects the probability with which states comply with an agreement. Other theories on domestic determinants of compliance rely on interest-based explanations on the individual level that can be quite volatile in predicting state behavior. Against this background, it is argued and shown that the global social integration of citizens overall makes it less favorable for political leaders to defect from a commitment that formally

prevents them from pursuing certain policies. This argument also speaks to the literature that has been focusing on showing the impact of international norms on compliance, and highlights a potential way of uncovering the way norms work.

I test this and rival propositions examining states' compliance behavior with the prescriptions of Article 8 of the Agreements of the International Monetary Fund. If signed, Article 8 requires states to eliminate permanently any restrictions on payments through current capital accounts. This is meant to ensure full capital convertibility and, eventually, the free flow of money in the global economy. Policy tools such as capital controls have been viewed by the IMF "as dangerous substitutes for economic adjustment and as inhibitors to the development of free foreign exchange markets" (Simmons 2000) that can promote growth. Removing this tool as a policy option, however, can have destabilizing effects (for a thorough discussion, see Glick & Hutchison (2005)), particularly in the short term "during and after a balance of payments crisis" (Mathieson & Rojas-Suarez 1993, p. 12). This instance of international law[1] has been the subject of rigorous examination in recent studies by Simmons (2000), von Stein (2005), and Grieco, Gelpi & Warren (2009), and provides therefore an opportunity to evaluate the arguments in this paper against competing and previously tested explanations.

Building on the original dataset presented in Simmons (2000), I analyze under which conditions states imposed capital controls despite their previous commitment not to do so. Over the 27 years covered in the dataset used here, states showed non-compliant behavior in about 13 % of all cases. I then test several hypotheses on the domestic determinants of compliance with data collected from a new index of globalization (Dreher, Gaston & Martens 2008). The findings show that countries with higher social globalization and institutions that allow citizens' influence on policy are significantly less likely to defect from their obligations from Article 8 if rival explanations are controlled for.

[1]In the following pages, the terms *international law*, *international agreements*, *international obligations*, *international regimes*, and *international commitments* are used interchangeably unless noted otherwise.

These findings have implications for the theoretical and political-practical debates about international law. First, I suggest that linkages between domestic actors and the world impact the way international norms affect these domestic actors. This emphasizes the importance of studying the conditions and microfoundations under which domestic actors operate. Second, the paper also has practical implications for what we may expect for the future of international legal cooperation. Growing linkages not only in the form of economic interdependence but also interpersonal communication may reduce cheating and non-compliance with international law. Since the expansion of accessible communication technologies toward less developed countries is a current and profitable phenomenon, this implication lends itself to further interdisciplinary studies that may uncover causal mechanisms in more detail.

The paper is organized as follows. First, I describe the implications of the existing literature for studying the compliance with international regimes that constrain policies which affect domestic actors. Then, I present the argument that social global integration of their citizens furthers compliant behavior by states. A brief review of competing domestic explanations for compliance follows. Next, I develop a quantitative test of states' compliance with the IMF Article 8 regime. The discussion of the results is followed by an overview of qualitative evidence related to the core argument. I conclude with suggestions for the further direction of the empirical investigation of this theoretical debate.

Chapter 2

Literature: International obligations and domestic preferences

As the world has become more integrated economically (Friedman 2005), states have increasingly established international legal standards in different areas of policies (Simmons & Steinberg 2006). International relations theory has interpreted this legalization as a solution to fundamental cooperation dilemmas for rational unitary actors in an anarchic environment (Axelrod & Keohane 1985). Interdependence and legalization have also increased the influence of international institutions and obligations on domestic policies (Keohane & Milner 1996), resulting in what Drezner (2001) has termed "policy convergence." This phenomenon has often times been met with domestic skepticism and opposition (Auvinen 1996, Ayres 2001, Sen 2002).

Recent studies have picked up on the importance of studying the role of domestic society for the stability of international agreements: "Because international agreements have domestic distributional consequences, there exist domestic sources of enforcement." (Dai 2005, p. 363). The general impact of these domestic sources has been argued to be positive (Kelley 2007), negative (Gartzke & Gleditsch 2004), or conditionally both (Dai 2007). Much of this recent literature has, however, highlighted the importance of citizens' preferences in determining the success of international agreements, assuming that (democratic) governments are more likely to fail to comply with international obligations if this puts them at risk domestically. First, the work on cooperation between states as aggregate actors highlights the basic mechanisms of compliance and defection.

2.1 Cooperation between rational unitary actors

Theories building on the assumption of states as (rational) unitary actors generally lead to two models of cooperative state behavior. The first, grounded in the realist tradition, predicts little or no effect of formal agreements or institutions on actual policy choices. Both for realist (Morgenthau 1948) and neo-realist (Waltz 1979) theories, the significance of regimes is low. Power dynamics between states (Morgenthau) and structural effects (Waltz), i.e. the anarchic nature of the international system and states concern for security, make commitments temporary and short-lived. Although states may choose to cooperate within regimes (Mearsheimer 1994/95), the latter "cannot get states to stop behaving as short-term power maximizers" (Mearsheimer 1995, p. 82). For the context of low politics, Grieco (1990) cited support for the same argument.

Neoliberal institutionalists propose that regimes prompt states to digress from the course of pure relative gains maximization. Cooperative arrangements increase the shadow of the future. They provide the framework for iterated exchange and reduce the uncertainties that actors face whose choices are dependent upon those of others (Axelrod & Keohane 1985, Keohane 1984). Many multilateral agreements (such as account controls as discussed in Article 8) do not immediately resemble the classic case of a collaboration problem, the prisoner's dilemma. Unlike in a prisoner's dilemma, actors that cheat do not achieve significant, relative gains over opponents that comply. However, Simmons (2000, p. 820) for instance holds that there is a "market that 'enforces' the public international law of money." This market is based on states' reputation for property rights protection (ibid.), which in turn increases, on the long run, the perspectives for attracting trade and investment. Defection from the Article 8 obligations provides no gains in this domain. During monetary crises, however, capital account controls may be one tool to stabilize a country's economy (Mathieson & Rojas-Suarez 1993, p. 12) and prevent a domestic economic crisis – albeit risking the mid-term loss of trade and investment. Thus, the Article 8 commitment, viewed from a market perspective, indeed alleviates a collaboration problem by raising the cost of non-compliance.

The neoliberal institutionalist perspective then suggests higher compliance with regimes such as Article 8 under critical conditions than realists would predict.

However, both of these perspective fail to account for the diversity of preferences toward Article 8. While the concern for short-term gains might have prompted some states to defect, many states also complied with the obligations under harsh circumstances. Uncertainty through domestic interest-group competition and institutional variation (Downs & Rocke 1995) are two factors suggesting that variation on the domestic level accounts for the effect of the Article 8 regime on state behavior. Grieco, Gelpi & Warren (2009), for instance, capitalize on these assumptions, and present evidence for the relevance of domestic factors.

But for the question of this paper, neither realist nor neoliberal institutionalist arguments offer a concise answer. Domestic society is not necessarily a part of the equation in both schools. Borrowing the argument about the reputational effect of an Article 8 commitment, however, shows why the institution of Article 8 itself is important from a macro-economic perspective. The potential negative impact of domestic concerns on compliance is not directly reflected. This is problematic given the apparent lack of explanatory power of institutionalist and realist variables. While more countries have refrained from using current account controls after they signed Article 8 (Simmons 2000), non-compliance was still an issue during the Asian Financial Crisis about a decade ago. For the realist argument, concerns about relative gains and losses provide unclear predictions. For instance, if financial crises induce non-compliant behavior due to relative-gains seeking, one should expect more defectors across the board than we see in reality.

2.2 Reputation and the time horizon for gains and losses

For Simmons (2000), reputational interests of states are instrumental in explaining the constraining effect of international law on policy choice. This argument can be seen in the institutionalist context, as outlined above. If the primary purpose of committing to rules such as the provisions of Article 8 is to generate economic gains – absolute or relative – through

investment, then commitment and compliance are, as Simmons argues, market effects. In the context of debt default and repayment, Tomz (2007) expands the argument that reputational effects are crucial both to lenders and borrowers. Borrowers, in this case, are similar to Article 8 signatory states, as they are concerned about sending signals that increase their likelihood to establish gains – in the form of loans, external investment, or others.

Reputation plays a crucial role in Tomz' argument because of two key features of the international (economic or political) system: "incomplete information and political change" (Tomz 2007, p. 4). In a world with these characteristics, the Article 8 commitment provides information about a state's intention, and, through its legal character, it does so regardless of political change. This perspective is biased toward long-term gains. Long-term gains materialize, for instance, through external investment. They become more likely if commitment and compliance concur, i.e. if a state's words and actions are the same, holding all others constant. What if a country's domestic environment does not succumb to this mechanism? In Tomz' study, two actors play the reputation game: creditors and borrowers. Were one to use the same framework for Article 8, a similar situation could be construed. However, the domestic resistance against some of the IMF's prescriptions cited earlier in this paper calls for an additional perspective on compliance. Political leaders face two levels of concern: international negotiations and domestic competition (Putnam 1988). Reputational concerns on the international level are thus to be separated from other short-term interests in the domestic context. This affects the discussion of reputational effects, but at the same time offers a way of applying parsimonious arguments to domestic actors.

2.3 Domestic roots of compliance and defection

Previous work has treated the impact of domestic factors on compliance with international law mainly from three perspectives: interests, norms, and capacities. All three perspectives are considered here for their implications for compliance behavior, that is: policy choices *after* a state commits to an international obligation.

The management perspective on compliance highlights the crucial role of domestic *capacities* in fulfilling the obligations from international law. Despite commitments, states might display non-compliant behavior due to insufficient bureaucratic, economic, or political capabilities (Chayes & Chayes 1993, Chayes & Chayes 1995). This is related to the clash between international law and domestic demand for a wider array of policy choices, because low capabilities can be endogenous to domestic demands for non-compliance. As Chayes and Chayes' studies of environmental collaboration and disarmament indicate, though, it may be more relevant for instances of international law that involve more complex and proactive efforts than the "simple" commitment to deregulate capital accounts or to refrain from human rights abuse.

In such cases, domestic demands as an outcome of a domestic *interest competition* can explain the political decision for or against compliance. Political economists in particular have developed specific models of this competition within institutional structures and its impact on international negotiation (Rogowski 1987, Simmons 1994, Milner 1997, Frieden 2002) and compliance behavior (Downs & Rocke 1995, Dai 2005, Tomz 2005, Dai 2006, Dai 2007). Compliance in this case is determined by domestic institutional rules and power politics that regulate the influence of different domestic actors on policy. These approaches dissect the original interest of the state into its subcomponents on a domestic level. While the competition of different interest groups or segments of the electorate often shows clear categories, the political process complicates the utility of this analysis. Not all interest groups always have a constant influence on a political executive. Particularly conditions of crisis that make non-compliance a salient policy choice (Gartzke & Gleditsch 2004) might upset the previous dynamics of domestic interest formation. This can add uncertainty to the analysis of domestic sources of compliance and may reduce the eventual explanatory power of this perspective.

The study of *norms* and compliance addresses this uncertainty by focusing on the broader "policy space" that constrains the range of policy options. This argument holds that "inter-

national norms work their effects in the domestic arena" (Checkel 1997) and, if strong, promote compliance. These effects have been hypothesized and empirically studied in various areas: landmine bans (Price 1998); trade (Cortell & Davis 1996); the International Criminal Court (Kelley 2007); women's rights (Gray, Kittilson & Sandholtz 2006); human rights (Hafner-Burton & Tsutsui 2005); election monitoring (Kelley 2008); and environmental regimes (Payne 1995, Zürn 1998, Neumayer 2002). All of these studies provided support for the argument about a positive effect of international norms on the domestic determinants of compliance. Yet, the operationalization of norms and norm strength is often restricted to the assumption that democracies are generally more likely to respect international obligations. Democracies also present a fertile environment for interest group competition, which may make compliance less likely if leaders give in to competitive pressure.

This paper therefore adds an important and previously understudied aspect to this debate by showing that the impact of norms and written international law also depends on the environment in which domestic actors perceive cooperation. The next section develops this argument further.

Chapter 3

Theory: Why social globalization reduces non-compliance

This section presents the argument that compliance with international obligations is more likely when domestic actors within a country are more integrated into the global system. It builds on two gaps in the literature: uncertainty in the evaluation of domestic interest group competition, and the limited availability of tools to measure how international norms affect domestic sources of compliance. Applying microfoundations from neoliberal arguments about cooperation shows that reciprocity and reputational concerns drive the compliance behavior of domestic societies. Unlike the rational unitary actor approach, this argument incorporates the two levels of international politics (Putnam 1988).

3.1 Liberal assumptions

Three assumptions of liberal international relations theory, formulated by Moravcsik (1997), specify the role of domestic actors for the study of compliance with international law. First, "the fundamental actors in international politics are individuals and private groups [...]." Second, "states [...] represent some subset of domestic society, on the basis of whose interests state officials define state preferences and act purposively in world politics." Third, the "configuration of interdependent state preferences determines state behavior." These assumptions imply that political decisions are influenced by "domestic society." Thus, domestic society implicitly plays a central role in models of cooperative behavior between states. Cooperation in a largely anarchic system can occur within an institutional (Axelrod & Keohane 1985) or interdependent (Keohane & Nye 1989) context. Institutions (and interdependence) constitute

an environment that increases the shadow of the future, enabling reciprocity as an enforcement for states not to cheat. Recognizing the conjectural character of the as-if assumption (Friedman 1953) that is instrumental to this type of behavior prompts the question how much it can be applied to domestic actors. Many issue areas in the political environment affect different domestic groups differently. Institutional effects alone – as proposed by liberal institutional theory – cannot be simply transferred to domestic actors. In other words: To determine the positive impact of regimes on cooperation between states as "subsets of domestic society," one must consider the impact of regimes on domestic society itself.

3.2 Individuals and personalized interaction

Recent findings from psychology and neuroeconomics provide information to answer this question. Neuroeconomic studies have expanded on the hypothesis that institutions alleviate cooperation problems. Their results provide support to the notion that institutions lend impersonal interactions a personal character. Personalized interactions have been shown to allow cooperative behavior: only in environments that make actors identifiable to each other can reciprocity and reputation work their mechanisms (Axelrod & Keohane 1985). Reciprocity and reputation, on the other hand, are crucial for actors' compliance with their commitments. If a commitment is broken and an actor defects, further interactions with other actors will be costlier, and the defector may be punished — simply because the defector can be identified by others. Inversely though, cooperation (and compliance) is more likely in personalized interactions, where actors can build trusting relationships. Chorvat & McCabe (2004) note, for instance, that soldiers behave more cooperatively when grouped in platoon-sized units, where reciprocity occurs between mutually identifiable actors. Brain-imaging studies (McCabe, Houser, Ryan, Smith & Trouard 2001) cite physical evidence for a difference in cognitive processes between pairs of human subjects and anonymous computer players versus humans and identifiable human counterparts. Hoffman, McCabe & Smith (2005) present results from laboratory experiments supporting the notion that cooperative

behavior is distinctly more likely in personal exchange environments. Common to these studies is the notion that individuals act more cooperatively, that is, are less pursuant of short-term gains when they operate in a non-anonymous environment.

My argument is that domestic society, i.e. citizens and groups, is comparable to the subjects in such studies. Its members and parts can be cognizant of international interdependence and the transnational links of economic processes. Such actors are like individuals in a personalized environment, operating under the perception of reciprocity and identifiability. From their position within a transnational environment that is recognizable to them, these actors understand that international regimes optimize processes that involve multiple actors. Consequently, defection from a regime produces at least long-term disadvantages for the defector and its position within the global system. On the other hand, domestic actors that are less integrated are more like individuals in anonymous environments. Because they are less perceptive of reciprocal mechanisms, they discount long-term gains from cooperation and may favor short-term gains. Regime commitments constitute little obligation to these individuals because the other regime members affected negatively by defection are not identifiable and not expected to reciprocate positively or negatively in either case.

This implies that the benefits of compliance – i.e. cooperative behavior – are most discernible to actors in personalized, integrated environments. These are the actors that, in relative terms, tend to display more compliant behavior in order to reap the regime's long-term benefits, even when the regime prescriptions and political short-term interests may clash. Because models of cooperation and compliance are also grounded in the assumption that *issues* are interdependent, compliance in one area can impact reputation in another. Thus, the effect of integration and "personalization" on compliance should eventually be similar across issues.

Consider an example from the human rights literature. In *Human Rights and Gender Violence* (2006), Sally Engle Merry provides a detailed account of how international human rights laws are "translated" into local law and practice. This is a classic subject of compliance

problem in human rights cases. While many states have signed on to human rights treaties on the international stage, the local implementation often lags behind the stipulations of the international agreement. To improve this situation, international pressure is not the only tool that has shown to be more or less effective. As Merry shows in her observations, what matters equally is "the process of localizing transnational knowledge of rights" (p. 179); this does tell us something about the domestic sources of compliance. Citizens and domestic groups must be aware of the implications and ramifications to act as domestic "enforcers" of international human rights laws. Social globalization, i.e. the individual exposure to international processes, plays a key role in this process. The same can be said for those issues that are more standard cases of international cooperation, such as monetary law, where social globalization emphasizes the transnational processes that create the need for cooperation.

This proposition is also an expansion of previous arguments about global interdependence (Keohane & Nye 1989). Keohane and Nye, for instance, acknowledge some effects of interdependence on domestic society: "The attitudes and policy stands of domestic groups are likely to be affected by communications, organized or not, between them and their counterparts abroad." (p. 34). This study goes one step further and hypothesizes a directional effect of interdependence on domestic society. So far the psychological and economic research on personalized interactions has not fully uncovered the *cause* of cooperation; both changes in individual calculations of short- and long-term gains as well as empathy and moral concerns can make cooperative choices more likely.

In both cases, the causal mechanism and prediction of this argument contribute to the discussion about the domestic sources of cooperation. By introducing the factor of personalized interaction and social integration, institutionalist arguments are refined in order to take into account the effect of domestic individuals and groups on policy cooperation. The same applies to more interest-based accounts of cooperation. Finally, it qualifies arguments about the impact of norms on cooperation and compliance by using a tangible concept for the environment in which norms operate. Norms on cooperation and compliance thus do

not only work differently depending on polity and rule of law, for instance, but are also contingent on the level of social integration of domestic society.

3.3 Compliance with Article 8

The nature of this argument is also applicable to explore states' compliance with the obligation to maintain unrestricted current accounts once this commitment has been made. A global regime that aims to create a system of freely flowing capital beyond borders, Article 8 is conceived as one of the IMF's tool to generate aggregate economic growth (Edwards 1985, Simmons 2000).[1] The exact provisions of the Article are explained in more detail in a legal commentary:

> Section 2(a) imposes an internationally mandated obligation on member countries toward their own residents. They must permit their residents purchasing goods or services from non-residents, or engaging in other current international transactions with IMF members, to acquire and use the needed currencies to make payments in settlement of those transactions. The purpose of the rule is to ensure that currency restrictions in the purchaser's (payor's) state do not prevent or delay receipt of payment by the foreign seller or creditor (payee). [...] The country must not delay, limit, or prevent any of its residents from obtaining a foreign currency issued by an IMF member that the resident needs for making payments to nonresidents in settlement of current international transactions.[2] (Edwards 1985, pp. 390-391)

Reputation through good compliant behavior is important for states to attract the capital that is supposed to promote parts of the fundament for growth (Simmons 2000). Long-term benefits thus exist in the attraction of investment and economic development. In the short-term, compliance can create adjustment problems and, during crises, economic problems through unrestricted capital flight. Domestic individuals and groups in the "anonymous"

[1] The full text of the Article is cited in the appendix.

[2] It must be noted that *current account restrictions*, as prohibited in Article 8, are not the same as *capital controls*. A number of papers on monetary policies, e.g. Edison et al. (2002) and Prasad et al. (2004), use measurements for capital controls as an indicator of financial integration. While current account controls are also capital controls in a wider sense, the provisions of Article 8 do not ban all types of capital controls, but are limited to restrictions on current payments alone (Edwards 1985, pp. 394-395)

international environment then have higher incentives to defect as they expect others to do the same, and are not cognizant of the long-term reputational loss of defection. In the more integrated, or personalized context, individuals to a large extent will not push for defection in crises, as the reputational compliance mechanism applies to them. In both instances, the general orientation toward cooperation among the domestic actors translates into policy because, following Moravcsik (1997, p. 513), "societal ideas, interests, and institutions influence state behavior by shaping state preferences." Hence, it is expected that the trans-national integration of domestic societies is empirically associated with a higher probability of that state to comply with the laws of Article 8. Although this expectation should be valid regardless of polity, the link between domestic societies and policy must be considered. In democracies, a certain level of policy responsiveness to domestic groups is generally assumed (Page & Shapiro 1983). For non-democratic governments, the threshold for the impact of domestic society on such policies might be higher. Therefore, democracies should be much more likely to display the expected impact of trans-national integration on policy toward the Article 8 regime. The degree of personalization of societies' interactions with other actors, i.e. other states, can be interpreted as the level of social globalization of this society, that is the physical and communicational links to the outside world. This expectation is formalized in

Hypothesis 1: States with higher levels of social globalization are less likely to break with their Article 8 obligation. This expectation is conditional on some institutionalized influence of domestic societies on political leaders.

Chapter 4

Alternative explanations

Theories about domestic interest competition and international norms provide alternative predictions that are explored to contextualize the central theme of this paper. They are added to the key causal variable *social globalization* as control variables, which is advisable in both qualitative and quantitative analyses (King, Keohane & Verba 1994, p. 77). Therefore, I briefly discuss and state, in Table 4.1, rival predictions 2 through 7 that can be derived from the literature reviewed above.

First, the realist or interest-based argument (Downs, Rocke & Barsoom 1996) predicts that states will comply only when it is in their interest, and defect equally. International law itself has no or little effect on state behavior.The same argument can also be made by observing related policy choices that indicate a common preference for liberal financial and monetary policies. The introduction of flexible exchange rate regimes is a key case of such policies (Simmons 2000) and has been argued to "permit [states] to relax capital controls" (Bordo & Eichengreen 1993, p. 517).

Without yearly polling data, the direction of domestic interests is hard to examine over time. For the case of Article 8, however, Grieco, Gelpi & Warren (2009) point to relatively strong links between regime-related preferences and political ideology. Article 8 constrains the ability of governments to pursue more statist monetary policies, a preference that some associate with left governments' tendency to pursue more protectionist policies (Dutt & Mitra 2005). Secondly, domestic interests can be expressed by proxies that indicate the potential consequences of reputation loss through non-compliance. The primary goal of Article 8 is to (eventually) promote economic growth through easing the flow of capital. Therefore, states

more dependent on foreign capital and external economic actors would aggregately have less interest in defection that curtails reputation for external economic actors.

More comprehensively, one would then also expect that reputation losses hurt most for these states that are most integrated in the global economy. This is an abstraction of early arguments about interdependence (Keohane & Nye 1989). While economic integration as a concept is applicable to rational unitary actors, it fails to capture the mechanisms specified for domestic societies previously in this paper. Regardless, reputational arguments and one variant of interdependence theory would suggest a negative impact of economic integration on non-compliance.

The measurement of the existence and impact of norms has also been disputed. The literature reviewed above displays, however, one common tendency: polities that respect the rule of law are often hypothesized to make up the cases where international law is adhered to precisely because of a domestic tradition of abiding by legal provisions (Kelley 2007). Finally, Simmons (e.g. 2000; 2009) and others have made the argument that norms can also be captured simply by examining global or regional behavior. Higher compliance rates within one region, for example, denote a "higher" norm of the international regime in discussion. Consequently, I also examine this claim following Simmons' practice.

Table 4.1: Alternative hypotheses

	Expectation	*Mechanism*	*Examples*
2	States are more likely to defect from Article 8 under conditions of economic crisis.	Exogenous pressure, primary state interest	Downs et al. (1996)
3	States that employ flexible exchange rate regimes are also less likely to defect from Article 8.	Capacity	Chayes & Chayes (1995)
4	States are more likely to defect from Article 8 when left governments are in power.	Domestic policy preferences, ideology	Grieco et al. (2009)
5a	States that are more dependent on trade with external actors are less likely to break Article 8.	Reputation, competition	Simmons (2000), Tomz (2007)
5b	Stronger presences of foreign investors are associated with lower probabilities of defection.		
5c	The more countries are integrated in the global economy, the less likely they are to defect from their Article 8 obligation.		
6	States with a lower degree of domestic rule of law are more likely to defect from Article 8.	Norms, domestic socialization	Kelley (2007)
7	When compliance in the environment of a state is good, this state is also less likely to defect from Article 8.	Regional competition	Simmons (2000, 2009)

Chapter 5

Data and statistical model

These hypotheses are tested examining states' policies toward current account restrictions over 27 years, from 1970 to 1997.[1]

5.1 Response variable: Defection

I use Simmons' (2000) data to obtain the dependent variable. Every country-year is coded for its Article 8 signatory status, and then, independently, for its use of current account restrictions. The original source for these data are the IMF's *Annual Reports on Exchange Arrangements and Exchange Restrictions* (AREAER; International Monetary Fund, various years).[2] From these two variables I construct the variable "defection" which takes the value 1 for all country-years of non-compliant behavior, i.e. restricting current accounts as Article 8 signatories. All other years in which countries did *not* restrict their current accounts are coded as 0. The commitment to Article 8 is a matter of signing and does not require ratification through national parliaments. Non-compliance is not finite, i.e. countries can return to a compliant status if they lift the restrictions on their current accounts. Due to constraints from unavailable data for other variables, the number of observations in the estimated models drops less 2,000, of which about 15% are coded as defection (see Tables 5.2 and 5.3; summary statistics for the full dataset can be found in the appendix). Recent efforts at the IMF have

[1] The Appendix provides a bivariate correlation table for all variables in the dataset.

[2] To verify that these variables are coded adequately for the purposes of this paper, I compared about 50 randomly selected observations from the years 1979 and 1980 with the assessment in the respective volumes of AREAER. Every year, the reports feature an appendix with tables that indicate open or restricted current accounts. I found no discrepancies between Simmons' data and the reports.

been directed towards creating a more nuanced measure of account restrictions (Miniane 2004), but the proposed new measures are not yet available for a greater set of countries over a longer time.

5.2 Explanatory variables

Operationalizing social integration, or globalization, requires a tangible measurement. As specified in the argument above, physical and communicational links to the rest of the world capture this concept. The World Development Indicators (World Bank 2008) provide these data as separate measures. Dreher, Gaston & Martens (2008) developed an aggregated and weighted measure of *social globalization* that contains several different measurements over time. These data are adjusted so that meaningful comparison through a continuous score is possible. Table 5.1 lists the components of this ranking.

Table 5.1: Components of the social globalization variable

Personal contact	*30%*
Outgoing telephone traffic	13%
Transfers (percent of GDP)	6%
International tourism	28%
Foreign population (of total pop.)	26%
International letters (per capita)	28%
Information flows	*35%*
Internet users (per 1000 people)	25%
Cable TV (per 1000 people)	25%
Trade in newspapers (per GDP)	21%
Radios (per 1000 people)	29%
Cultural proximity	*35%*
McDonald's restaurants (per capita)	40%
Ikea stores (per capita)	41%
Trade in books (per GDP)	19%

The resulting score ranks from about 2 to about 90, and shifts toward higher values over time. Figure 5.1 shows that between 1970 and 1997, the mean value almost doubled. It is also important to note that this variable for social globalization is conceptually and empirically different from standard measures of economic globalization, or integration as

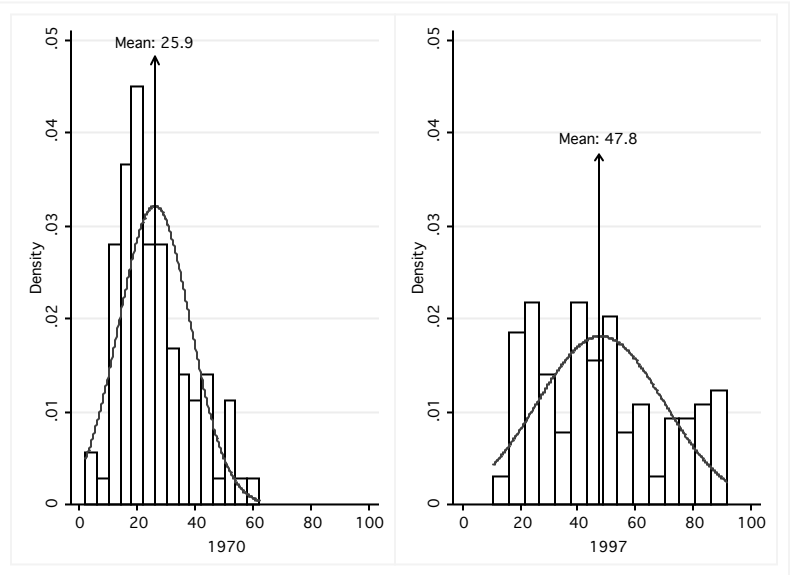

Figure 5.1: Social globalization in 1970 and 1997

specified in Hypothesis 5c (see Table 4.1). Figure 5.2 plots the distribution of the values for social globalization in 1980 (approximately in the middle of the covered time period) against the values for Dreher et al.'s *economic globalization* score from the same study. Economic globalization entails trade flows and investments (50%) as well as economic barriers (50%). Their correlation coefficient of 0.8046 for the whole dataset is high, but not so high as to raise strong concerns about collinearity of the two variables. Theoretically, economic integration covers a different concept and has a much weaker – if any at all – effect on societies' perception of the international environment. This implies that observations with comparatively low values of social globalization, but comparatively high values of social globalization may be more likely to defect. In 1980, the year represented in Fig. 5.2, six out of seven countries that defected had a considerably lower score of social globalization than economic globalization. All of these six cases are more than two studentized residuals away from the regression line. Although only a snapshot of one year, this observations supports the notion of a significant

empirical difference between economic and social globalization, given the different theoretical implications of the two concepts.

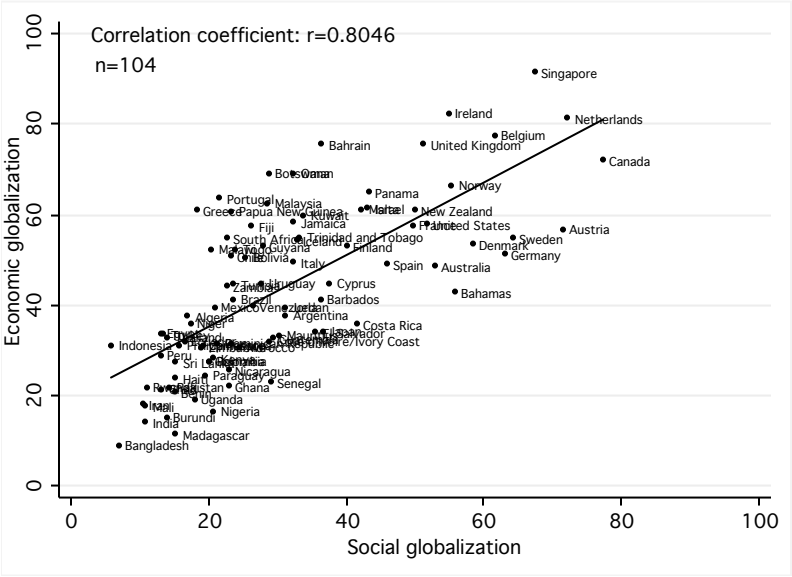

Figure 5.2: Social and economic globalization in 1980

A Spearman test for rank correlation for each year from 1970 to 1997 shows, however, that the ranking resulting from the two scores does not fulfill the null hypothesis of independence. Values for the corresponding rank correlation coefficient, Spearman's ρ, varies between about 0.75 and 0.82. This also indicates that the empirical similarity of the two variables cannot be denied. Consequently, one would expect similar results for both variables in empirical models. I offer two responses to this problem. First, because my theory proclaims a significant difference between the two concepts of social and economic globalization, I focus on the former and do not prioritize competitive testing of the two concepts against each other. Second, I do examine one model that includes both variables. I would also expect that a better measurement of social globalization would solve the problem of both concepts being empirically indistinguishable.

Economic crisis, discussed in the arguments leading to Hypothesis 2, is operationalized following Simmons (2000) in two ways. World interest rate shocks constitute events that could trigger capital withdrawal, which in turn can be a prime motivator for governments

to restrict current accounts. Interest rate development is measured using the annual squared change interest rates from U.S. federal treasury bonds,[3] and then interacted with a dummy variable for non-OECD countries. Stronger movements of this interest rate denote stronger changes on the financial markets. Secondly, movements in the ratio of balance-of-payments to GDP similarly express economic crisis. This variable is calculated by dividing countries' account balance (from the World Bank) by their GDP. Flexible exchange rate regimes, an indicator for capacity and general interest in liberal market policies, are coded as a binary variable. Years in which countries employed flexible exchange rates are coded as 1, and all others as 0. These data are also taken from Simmons (2000).

Left governments are included as a dummy variable. The Database of Political Institutions (Beck, Clarke, Groff, Keefer & Walsh 2001) provides the party ideology of the executive in power for every year from 1975 to 2005. This variable is recoded as 1 for every year in my dataset (1970/75 to 1997) when a state's executive is listed as leftist. All other country-years are coded as 0.

Trade dependence is an important factor for reputation and dependence on foreign economic actors. I gather this variable from the Penn World Tables (Heston, Summers & Aten 2006), where it is calculated as the ratio of exports and imports over GDP. This is equivalent to Simmons' operationalization; using the PWT data, however, slightly reduces the number of missing observations. The presence of foreign investors is captured by the volume of foreign direct investment (FDI) in a country. I obtain these data from the World Bank (World Bank 2007). Additionally, the standard economic controls of GDP per capita and growth rate of aggregate GDP are included to account for economic development. Both variables are drawn from the Penn World Tables (Heston, Summers & Aten 2006).

Domestic rule of law requires a more differentiating approach in terms of operationalization. The most popular measurement, the various components of the International Country Risk Guide, are only available for years after 1984 and for selected countries, which would

[3]These rates, *Treasury Bills/Secondary Markets*, are available on the Federal Reserve's website, http://www.federalreserve.gov/releases/h15/data.htm (accessed 9/18/2008).

significantly reduce the number of observations. Another is to use the Political Rights variable from the Freedom House data, which begin in 1972. Political rights, in this definition, encompass competition for public office and representatives that are accountable to the electorate (Teorell, Holmberg & Rothstein 2008, Codebook p. 39). This definition comes close to the concept of interest here: domestic norms about the validity of institutions. I therefore include a recoded version of this variable (higher scores mean higher degrees of political rights) in my dataset. Using these data causes the number of observations in my models to deviate from these in Simmons (2000), who restricted her analysis to the years 1982-1995.

Simmons identifies regional norms as the percentage of states behaving compliant with Article 8. I follow this notion and calculate the inverse ratio, using the World Bank's categorization of seven world regions (East Asia & Pacific, Europe & Central Asia, Latin America & Caribbean, Middle East & North Africa, North America, South Asia, Sub-Saharan Africa). The resulting percentages denote the percentage of states defection from Article 8 within a region in a year. The regional factor is important because following Simmons, competition occurs mainly within regions, i.e. states' concern for reputation works around the behavior of regional competitors.

Finally, a dummy variable for democracy is included in all estimations to control for the assumption that only in democracies mechanisms of electoral control assure the transmission of societal preferences to political decision-makers. I follow the widely cited example of Fearon & Laitin (2003) and recode the Polity IV score (Marshall & Jaggers 2007) into a dummy variable with a cutoff of +5, based on a scale ranging from -10 to +10. That is, all country-years with a Polity score higher than 5 are coded as democracies, all others as non-democracies. Alternatively, Bueno de Mesquita, Smith, Siverson & Morrow (2003) have suggested to measure the role of domestic actors. Domestic selectorates denote the size of the part of the population that has a voice in the political process, i.e. that is eligible to vote. Winning coalitions are the share of the selectorate that make up the necessary support base for leaders to be chosen for office. Consequently, the ratio of winning coalitions

Table 5.2: Summary statistics for continuous variables

Variable	**Mean**	**Std. Dev.**	**Min.**	**Max.**	**N**	**Source**
Social globalization	35.86	19.84	6.13	90.37	1780	Dreher et al.
Economic globalization	48.42	19.19	8.49	94.03	1638	Dreher et al.
Winning coalition	.773	.255	0	1	1124	BdM et al.
Winning coalition / select.	.775	.254	0	1	1124	BdM et al.
Bal. of payment / GDP	-10.632	27.483	-238.35	59.45	1780	World Bank
Interest rate shock (sq)	1.412	1.783	0	5.3361	1780	Fed. Res.
Trade dependence	61.312	38.137	9.116	341.028	1780	Penn WT
FDI (in 1000 US$)	1670.192	6059.15	-1038.1	105590	1780	IMF
Political rights	4.593	2.1401	1	7	1780	FH
Regional norm	26.685	23.722	0	100	1780	(own calc.)
GDP per capita in US$	6405.99	5827.766	335.09	26051.60	1780	Penn WT
GDP growth	1.396	4.974	-47	37.5	1780	Penn WT

Table 5.3: Summary statistics for binary variables

Variable	**0**	**1**	**N**	**Source**
Defection	1510	299	1780	Simmons
Democracy	856	924	1780	Polity
Flexible exchange rates	1060	720	1780	Simmons
Left government	606	518	1124	DPI

and selectorates denotes the influence of domestic societies on their leaders. Ratios close to 1 imply that this influence is high, as leaders are dependent upon the support of the highest possible part of the population. The size of the winning coalition and the winning coalition—selectorate ratio, collected from the dataset accompanying Bueno de Mesquita et al. (2003), are employed as an alternative to the dummy variable for democracy.

5.3 Statistical model

All hypotheses are examined using logistic regression because the response variable is binary.[4] Since the dataset covers a time period of 27 consecutive years, time dependence of the examined associations is a concern for the statistical analysis (Stimson 1985, Beck & Katz 1995, Beck, Katz & Tucker 1998). I cluster standard errors to account for unit exchangeability, following the suggestions in Beck & Katz (1995).[5] Regarding time, I use two different techniques: a specific time-series estimator, i.e. the `-xtlogit-` command in Stata, and control dummy variables for time dependence in the models presented in the main text. All the hypotheses are directional, hence I use one-tailed tests to assess the significance of the results, following Gill (1999). The central hypothesis 1 specifies a conditional effect of social globalization, dependent on polity. To model this prediction, I interact the social globalization variable with a dummy variable for democracy (and, later, the variables for the size of the domestic winning coalition). This interaction term calculates the effect of social globalization within a democratic polity. The resulting model is expressed in the following equation:

$$
\begin{aligned}
&logit(\text{Defection})_{it} = \\
&\alpha_{it} + \beta_1(\text{Social globalization} \times \text{Democracy})_{it} + \beta_2(\text{Social globalization})_{it} + \beta_3(\text{Democracy})_{it} + \\
&\beta_4(\text{Trade dependence})_{it} + \beta_5(\text{FDI})_{it} + \beta_6(\text{Regional norm})_{it} + \beta_7(\text{Interest rate shock})_{it} + \\
&\beta_8(\frac{\text{Balance-of-Payment}}{\text{GDP}})_{it} + \beta_9(\text{Exchange rate})_{it} + \beta_{10}(\text{Development})_{it} + \epsilon_{it}
\end{aligned}
$$

[4] Estimations are performed using Stata Version 10 (StataCorp 2007). I construct graphs to aid the interpretation of interaction terms using the `-inteff-` command (Norton, Wang & Ai 2004).

[5] To be sure, treating each country as a different unit in fixed-effects models as proposed by Green, Kim & Yoon (2001) did not result in significant differences among the variables of interest in exploratory analysis; hence I treat country-units as exchangeable.

Chapter 6

Findings

The results of my analysis suggest that the effect of social globalization on the probability of defection is indeed negative, but also strongly dependent on the institutional role of domestic societies.

Instead of coefficients, I present odds ratios to interpret the strength of association between the explanatory variables and the probability of defection. Coefficients in logistic models cannot be meaningfully compared (Liao 1994). By definition, non-linear models do not produce coefficients that express a linear increase or decrease of the likelihood of the dependent variable. Odds ratios instead denote the change in the ratio of risks of the two possible outcomes (1 or 0), based on variation in the respective explanatory variable. Thus, odds ratios larger than 1 express an increase in probability of the response variable to occur, and odds ratios smaller than one express the opposite.

6.1 Social globalization

First, I present a reduced Model 1, only including one proxy each for social globalization, reputational concerns (trade dependence), regional norm, capacity, and crisis. I account for the link between integration (social globalization) and the presumed impact of domestic societies on policy by including a variable for polity. Then, *social globalization* and different versions of polity characteristics are interacted. Interaction variables serve exactly the purpose called for in Hypothesis 1: they calculate the effect of a first explanatory variable *considering the variation* of a second right-hand side variable. Interpreting interaction effects requires graphical representation though, which follows below. First, Models 1, 2, 3, and 4 introduce

a dummy variable for democracy following the same practice as Fearon & Laitin (2003).[1] This dummy is interacted with the social globalization score, incorporating the second element of Hypothesis 1 that expected conditionality upon "some institutionalized influence of domestic societies on political leaders." Models 2a and 2b use Bueno de Mesquita's *winning coalition* variable and are discussed further below.

Within Model 1, a one-point increase in the social globalization score in democracies, ranging from about 7 (e.g. Bangladesh in the 1970s) to the high 80s (most European states in the 1990s), decreases the odds of defection by about 7.5 %, holding all other variables constant. Although this change seems small, it is considerable given the range of the social globalization score. It also appears that there is support for the initial assertion about policy responsiveness in democracies. At the onset of this paper, I note that the rising competitive demands in a globalized economy might raise domestic resistance toward agreements that constrain the leeway for national policies. This proposition seems drastically supported by all statistical models. In Model 1, democracies are 16 times more likely to defect from their Article 8 obligation than non-democracies. All other models show similar results for the democracy dummy variables. However, these results need to be interpreted with care. Braumoeller (2004) points out that in the presence of interaction terms, main effects can rarely be interpreted meaningfully. In this case, the odds ratio of the democracy dummy only takes on meaning when the value of social globalization is zero, which is not the case in any of the observations (see 5.2). Models 2 through 4 control for all rival hypotheses from the literature that I discuss above. In each model, the interaction term performs at nearly the same value at the 5%-significance level. The control variables, if significant, perform as expected (see the discussion in the next section).

Nonlinear models do not allow for the standard interpretation of coefficients or odds ratios especially when it comes to interaction effects. For interacted variables, the coefficient (or

[1] To reflect other practices, I also run alternative model specifications, using a Polity score of 6 and 7 as the cut-off. The results are essentially similar. Also, Models 2a and 2b employ a different concept for polity, and provide equal evidence for the core hypothesis.

Table 6.1: Results of the logit regression, using *Democracy*

Explanatory variables	**Model 1**	**Model 2**	**Model 3**	**Model 4**
Social globalization × Democracy	.924*	.934*	.953*	.962*
	(.036)	(.039)	(.023)	(.019)
Social globalization	1.127*	1.119*	1.092*	1.069*
	(.046)	(.051)	(.037)	(.037)
Democracy	16.358*	10.216*	5.417*	4.528*
	(19.051)	(13.371)	(5.261)	(3.979)
Trade dependence	.992	.997	.992	
	(.008)	(.007)	(.006)	
Foreign direct investment		.999	.999	
		(.000)	(.000)	
Economic globalization				.997
				(.022)
Political rights		.994	1.288	1.179
		(.194)	(.209)	(.186)
Regional norm	1.083*	1.084*	1.077*	1.076*
	(.013)	(.013)	(.011)	(.011)
Interest rate shock	.852	.861	.907	.925
	(.206)	(.197)	(.181)	(.179)
Balance of Payments/GDP		1.006	.998	.996
		(.006)	(.004)	(.004)
Flexible exchange rate		1.973*	1.499	1.779
		(.777)	(.59)	(.697)
Left government		.967		
		(.932)		
GDP per capita	.999*	.999*	.999*	.999*
	(.000)	(.000)	(.000)	(.000)
GDP growth	.977	.976	.993	.991
	(.034)	(.034)	(.729)	(.028)
Country-years	1,241	1,124	1,780	1,736
Countries	81	80	101	95
Pseudo – R^2	.35	.37	.34	.31
Log likelihood	-395.33	-354.68	-502.88	-499.28
Probability > χ^2	.000	.000	.000	.0000

Dependent variable is *Defection*. Odds ratios are displayed with clustered standard errors in parentheses below.
* indicates significance at the 5% level in one-tailed tests.
All models control for time dependence using year dummies. See the appendix for models with identical findings resulting from using the **-xtlogit-** command.

Table 6.2: Values of the Interaction effect

	Mean	Std. Dev.	Min.	Max.
Social globalization × Democracy	-.11	.008	-.026	.003

odds ratio) of the interaction term can change with different values of the covariates.[2] Even the significance of the interaction term can vary with different covariates. Thus, due to the variation of the interaction term across the range of the independent variable, only graphical display of the interaction term allows for correct interpretation. I follow the suggestions from Norton, Wang & Ai (2004) to display the interaction term of *social globalization* and *democracy*. Model 2 is used for the calculations underlying these graphs. Of all models using the democracy dummy, Model 2 explains the most variation in the data (indicated by the highest R^2 in the four nested models). Interaction terms are graphed because we should be interested not only in sign and significance, but in the variation in effect *and* explanatory power across predicted probabilities. Therefore, the operation designed by Norton, Wang & Ai (2004) first computes predicted probabilities for every observation in the logit model. This shows that the mean interaction effect is smaller than the coefficient in the logit model (-.01 compared to -.06), and more importantly, that its 95% confidence interval varies between negative (-.026) and positive (.003) values. This exemplifies why reading solely the coefficients or odds ratios does not provide the full picture in this case. In the second step, I show the graphs for the interaction effects for individual observations and their value (Figure 6.1) and their z-scores (Figure 6.2).[3]

Figure 6.1 shows that at most predicted probabilities, the interaction effect is indeed negative, although it varies strongly for many of the observations with very low probability

[2]See Norton, Wang & Ai (2004) for an extended discussion.

[3]This command operates only with standard logit models. Although I argue that time dependence plays a role in modeling the probability of non-compliance over time, Table B.5 in the appendix shows that the standard logit performs similar. Thus, it is permissive to generate the graphs based on the standard logit model for illustrative purposes.

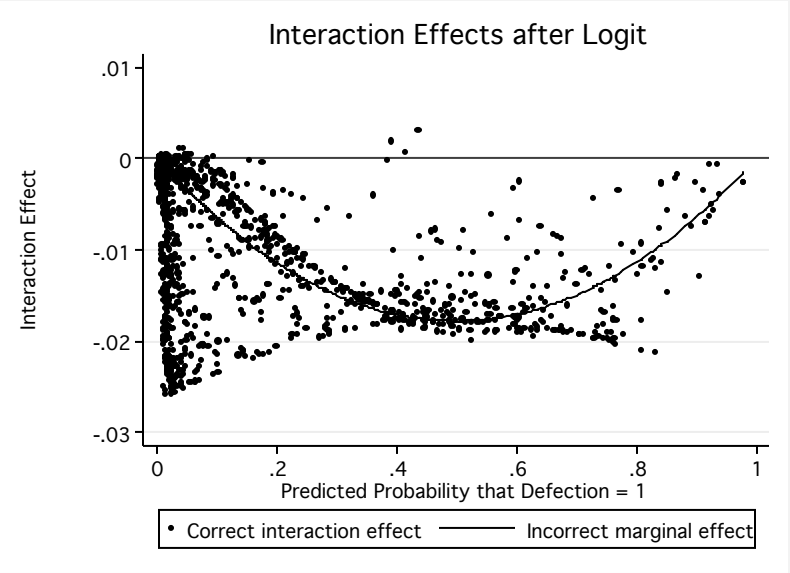

Figure 6.1: Distribution of the interaction term

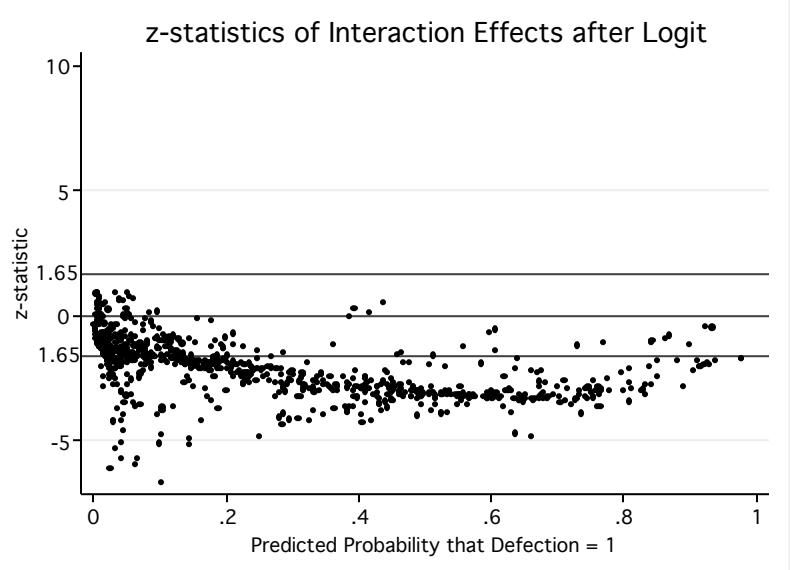

Figure 6.2: Significance of the interaction term

of defection (keep in mind that 85-90% of the actual observations were indeed 0s). The x-axis denotes predicted probabilities while the y-axis shows the values of the interaction term, i.e. its effect on the risk of defection. That way, Figure 6.1 plots the exact effect of the interaction term for every observation in the dataset at its respective predicted probability. The distinction between individual observations and the marginal effect curve (proposed by Norton, Wang & Ai (2004) shows the considerable difference of the interaction term across observations. For low probabilities of defection, the interaction term varies considerably between 0 and -.025. For higher probabilities, it is closer to its mean, and becomes more spread out at high probabilities. Because of this variation, the odds ratio alone does not show the full picture.

Secondly, Figure 6.2 reveals the degree to which I can evaluate the interaction effect with confidence. The y-axis here denotes the z-statistic (i.e. the statistical significance) of the interaction term for every individual observation. For many of the cases that are least likely to defect (with predicted probabilities below .05 in one-tailed tests – below z-values of -1.65), the interaction effect does *not* deliver a statistically significant explanation. Most observations above that probability, however, are significantly related to negative values of the interaction term: they are strongly associated with lower levels of social globalization in democracies. Once observations increase in predicted probability of defection beyond .15, one can make a comfortable assertion about the negative association between social globalization (in democracies) and the risk of defection. In other words: Democracies in the dataset are more likely to break their Article 8 commitment the less integrated their domestic societies are. Conversely, most democracies with high levels of social globalization are also least likely to defect, but social globalization is not a robust predictor in these cases. The spread of the values of the interaction term in 6.1 illustrates this interpretation.

6.2 Rival explanations

Table 4.1 presented alternative hypotheses that predicted different levels of non-compliance. Among these predictors, only two are supported across all models presented in this paper. First, Hypothesis 3 specified that low capacities to implement Article 8 obligations leads to higher rates of non-compliance. If we use economic development as a proxy for this concept, this effect is present in the data. With higher GDP, the likelihood of defection increases. The odds ratio, .999, is very close to 1 because of the scale of the right-hand side variable: it is measured in US dollars. This means that a 100-dollar increase in GDP per capita is associated with a decrease of 10% in the odds ratio, which is meaningful considering the range of GDP per capita from about $267 to more than $30,000. The presence of this variable is crucial to the model because economic development may itself cover quite a few latent influences on compliance and defection. The performance of the interaction term of social globalization thus gains in relevance when the proxy for economic development is present in the statistical model.

The same observation can be made for Hypothesis 7 regarding regional norms. This argument predicts regional dynamics of non-compliance. If more countries in the vicinity of one country defect, the competitive pressure for this country to refrain from defection declines (Simmons 2000, p. 828). This trend is observable in the empirical analysis as well, where a one-percent increase in the ratio of regional defectors increases the odds of defection of the respective country by about 8 %. This finding is akin to Simmons' study.

Describing the data revealed the strong correlation between the two variables for economic integration and social globalization. Models 3 and 4 use two different ways of operationalizing the former concept. In Model 3, two conventional measures of economic globalization, trade dependence (i.e. imports and exports divided by GDP) and the volume of foreign direct investment are used. Model 4 employs the aggregate index of economic globalization. Surprisingly, despite the correlation, the variable does not perform at a significant level. While it is apparent that the correlation between the two variables might be responsible for

insufficient findings in this regard, it appears that controlling for time dependence might wash out the effect of economic integration. Since both separate alternative measurements show similar results - negative, but not significant -, I find no strong support for arguments about reputational concerns preventing non-compliance. Only the findings about regional competitive dynamics point in this direction, but are based on a more specific argument.

None of the other control variables allow for confident interpretation at the conventional significance level. However, most of them display the hypothesized direction, namely trade dependence (5a), FDI (5b), and growth of GDP (3). Other indicators point in both directions. These aberrations are not discussed as they are not significant at conventional levels. Direct domestic interests, measured by the dummy variable for left executives, are not associated with higher risks of defection in my models. On this aspect though, studies that are more geared toward a sophisticated analysis of ideology produce different results – see Grieco, Gelpi & Warren (2009), who also examine a larger sample and do not focus on compliance as much as current account controls in all countries, regardless of Article 8 status.

One reason for the poor performance of most control variables is most likely the expansion of the time covered in my dataset. Simmons' analysis, for instance, is restricted to 14 years in which better data on, for instance, role of law and governance were available. For my purpose, however, the longer time span had the advantage of better capturing the dynamics of increasing social globalization and interdependence over time, which was one of the points raised in the theory.

6.3 Winning coalitions and selectorate

Models 2a and 2b partially address the criticisms of the Polity data as biased (Pemstein, Meserve & Melton 2008, Treier & Jackman 2008). Particularly because I use a cut-off within a variable that ranges across 20 ordinal numbers, I have reason to be concerned about arbitrariness and the validity of this measurement. Instead of using a variation of the Polity data, I turn to the work of Bueno de Mesquita et al. (2003) and tap into the concept of

Table 6.3: Results of the logit regression, using *Winning coalition*

Explanatory variables	**Model 2a**	**Model 2b**
Social globalization × Winning coalition	.814*	
	(.062)	
Social globalization × $\frac{\text{Winning coalition}}{\text{Selectorate}}$		.816*
		(.062)
Social globalization	1.254*	1.254*
	(.082)	(.082)
Winning coalition	456.598*	
	(1448.049)	
$\frac{\text{Winning coalition}}{\text{Selectorate}}$		437.201*
		(1383.671)
Trade dependence	.996	.997
	(.007)	(.007)
FDI	.999	.999
	(.000)	(.000)
Political rights	1.021	1.024
	(.287)	(.287)
Regional norm	1.085*	1.085*
	(.013)	(.013)
Interest rate shock	.801	.801
	(.187)	(.187)
Balance of Payment/GDP	1.007	1.007
	(.006)	(.006)
Flexible exchange rate	1.958*	1.962*
	(.758)	(.759)
Left government	1.056	1.057
	(.38)	(.38)
GDP per capita	.999*	.999*
	(.000)	(.000)
GDP growth	.969	.969
	(.036)	(.035)
Country-years	1,124	1,124
Countries	80	80
Pseudo – R^2	.38	.38
Log likelihood	-347.41	-347.5
Probability > χ^2	.0000	.0000

Dependent variable is *Defection*. Odds ratios are displayed with clustered standard errors in parentheses below.
* indicates significance at the 5% level in one-tailed tests.
All models control for time dependence using year dummies. See the appendix for models with identical findings resulting from using the **-xtlogit-** command.

selectorates and winning coalitions. These two concepts provide an alternative assessment of the society-policy link, and are therefore utilized for the construction of the interaction term with social globalization. The findings are strikingly similar to those in the previous models (see Table 6.3). Again, social globalization regardless of the representation of societal groups makes defection more likely. When depending on representation, i.e. in the interaction term, the effect is reversed. If one were to interpret the interaction coefficient across the board of observations, a one-point increase in social globalization of a polity with a large winning coalition would be associated with decrease of the odds of non-compliance by 20%. All other control variables perform as in Models 1 through 4.

6.4 Time dependence and model fit

Because the data in this study are time-series and cross-sectional, time dependence and autocorrelation over time are a natural concern (Stimson 1985, Beck & Katz 1995, Beck, Katz & Tucker 1998). One could imagine that once a state has defected from Article 8, the occurrence in the following year is no longer an independent observation. In fact, some countries in the dataset have non-compliant status over a considerable number of years. Two methods are available to deal with this problem. First, one can control for time dependence by adding dummy variables for every year in the dataset. All models in the text use this solution. Second, I employ the specific time-series logit estimator `-xtlogit-`, represented in Table B.4. Also in this specification, the variables of interest perform essentially the same as in the other estimations, at the conventional significance level. This lets me conclude that the underlying assumption to treat every country-year as exchangeable, even over time, is justified and does not introduce severe problems when the interaction effect is evaluated in Figures 6.1 and 6.2, based on a standard logit model.

All of these estimations are also drawn from the same data and differ only in a limited number of explanatory variables used. Thus, Models 1 through 4 can directly be compared to each other in terms of model fit. The log-likelihood shows some changes between the models,

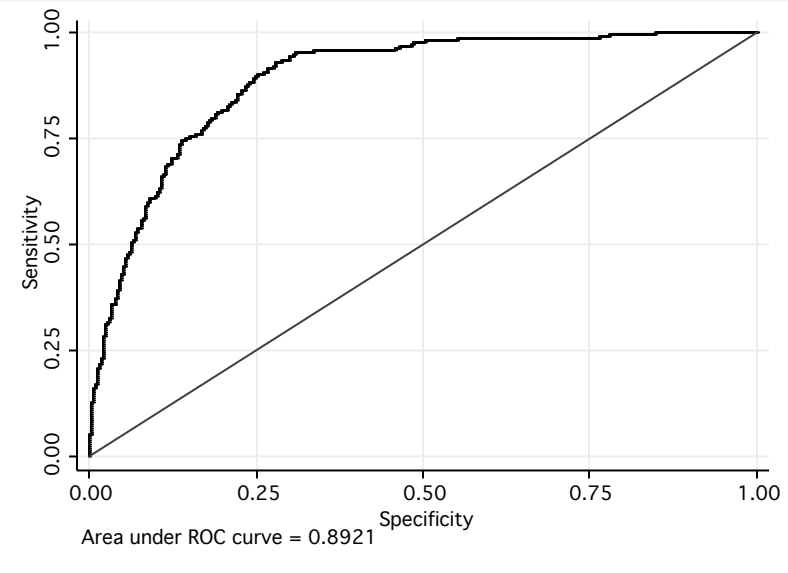

Figure 6.3: ROC-curve for Model 2

but none of them drastic. Specificity and sensitivity of the models are more interesting in that regard. How much of the variation in the data can these models explain? Although purely predictive modeling is not the primary purpose if this study, it is worth considering how much better these models fare compared to a naive guess. One way to explore this is to examine the "receiver operating characteristic" of the models. This statistical technique calculates (and graphs) the probability of *positive predictions of positive cases* ("sensitivity") as well as of *negative predictions of negative cases* ("specificity"). In other words, it tells us how many outcomes the model predicted correctly. In many studies with binary response variables, the naive guess would be to assume that half of the cases have a positive and half of them a negative outcome. In the case of Article 8 and compliance with international law, however, the common null hypothesis is that "almost all nations observe almost all principles of international law and almost all of their obligations almost all of the time" (Henkin 1979, p. 47). Therefore, the best guess would be to assume exactly that, namely that there are zero

cases of defection. The small ratio of observations of defection (about 13-15%) support this hint. The ROC-classification is a standard method to evaluate the model fit across different models, and serves thus at least as a helpful tool to do so. Overall, Models 1 through 4 classify almost 85% of all observations correctly. Compared to the actual ratio of positive and negative outcomes of the response variable (about 15% and 85%), this is acceptable. Under general standards, a value in the high 80s is considered "good." Figure 6.3 illustrates this. This is acceptable. The null model is denoted by the diagonal. Every improvement over the diagonal is an improvement in model fit. More importantly, in Model 2, 113 of 170 cases of defection (66.5%) were predicted correctly.[4] Given the character of the data and the relative scarce occurrence of positive outcomes (i.e. defection), I consider the statistical evidence as sufficient to provide support for the core hypothesis about social globalization.

[4]Table B.6 in the Appendix lists the exact classification values for Model 2.

Chapter 7

Additional evidence

This paper explores the impact of more isolated societies on governments' decision to violate a commitment to international law. Because social globalization offers a fitting quantitative measure of isolation and integration, the quantitative empirical analysis contributes to the debate about cooperation and compliance. Yet, it is limited in its ability to provide observations of causality as described in the theoretical argument. A stronger causal point can be made by studying "social globalization at work." Ideally, one should be able to observe domestic societies that are lowly integrated internationally exert pressure on their governments to disregard international obligations under critical conditions. Inversely, highly integrated societies would exert the opposite pressure.

Unfortunately, the study of Article and current account restrictions provides little tangible material to use as evidence. So far, I have not been able to access survey data or parliamentary debates that deal directly with account restrictions in the context of violating Article 8. Yet, this does not undermine the causal argument per se, since leaders can well respond to general public moods even in decision areas that might not be fully discussed because they might be too fine grained as a tool to raise sufficient debate. I point out potential avenues of inquiry to triangulate the causal aspect better in the last section of this paper below. However, I also offer some evidence from other subjects of study that hint at a causal relationship between social global integration and the domestic treatment of international law.

7.1 Capital controls

First, some characteristics of capital controls and account restrictions offer evidence on why the global integration of domestic societies can be related to less non-compliant behavior. For example, one case study of British capital controls (Bordo & Eichengreen 1993, Ch. 11, p. 519) points out that under restricted accounts, residents "could invest abroad only by using foreign exchange obtained from the sale of existing securities or from foreign currency borrowing." With controls being removed, domestic individual actors are enabled to a wider range of global economic transactions. When this is the case, it may also be assumed that these actors have a vested interest in the continued opportunity to operate freely in this way. Non-compliance in the form of reintroduced capital controls presents an obstacle in this regard. Domestic societies are thus directly affected by non-compliance, and it becomes the more relevant for them the more transnational inter-actions they engage in. Non-compliance has more negative effects on their personal interests the more they are acting across borders. Thus, social integration may eventually have positive effects on compliance. These effects are not covered by aggregate measures of *economic* integration or globalization, which does not exactly capture the exposure of domestic societies to transnational inter-actions. Social globalization as operationalized in this paper presents a slight improval in this aspect. This notion is also supported by another collection of case studies of account restrictions in the context of IMF Article 8. According to Ishii (2003, p. 36), the

> "tendency [reluctance to remove illegal account restrictions] may reflect these authorities' reliance on direct controls in managing their economies [...]. In many cases, such members have also experienced internal or external conflict for extended periods, and *some have been isolated form the international community, limiting incentives to pursue economic openness through measures such as acceptance of the obligations of Article 8.*" (emphasis added)

In the same volume, one also finds a hint that particularly in less developed countries, capital exchange restrictions are often related to transactions such as "binding limits on foreign exchange allowances for remittances and travel" (p. 38). Additionally, capital account

liberalization also typically leads to more investment abroad not just by corporate actors, but also by individuals (Johnston 1999). This highlights again how domestic societies are affected by capital controls and how increasing social globalization could induce an increased interest in compliance with Article 8. Of course, these anecdotal observations are so tightly tied to Article 8 and monetary policy that it might be hard to separate individual material interest from a preference for compliance. Domestic actors that would be negatively affected by governments' non-compliant restriction of current accounts need not have a strong respect for international law to display positive attitudes to Article 8. On the other hand, the core hypothesis of this paper does not specifically differentiate between economic interest and norm-based, "ethical" respect for international law as such. Thus, the power of Article 8 as international law may well be high in integrated societies (and low in isolated societies) because of material interests of domestic societies. It is important to note, however, that this relationship is substantially moderated by the degree of social integration.

7.2 Other areas of international law

The role of social globalization can be further illustrated by reviewing recent explorations of other issue areas of international law. I briefly consider recent contributions from the human rights literature to expand on this picture. There is a separate debate on the dynamics of states' decisions to join human rights regimes and sign to treaties (Hathaway 2007), but even once governments do so, the effect on human rights practice can be ambiguous (Hathaway 2002, Cardenas 2004, Hafner-Burton & Tsutsui 2005, Neumayer 2005). Aside from the study of compliance levels and government practice, however, the role of domestic actors in the global setting is an important subject of interest (Graubart 2004, Carpenter 2007). In that respect, scholars have begun to look at how domestic non-government actors both influence *creation*, *adoption*, and *implementation* of international law. Merry's (2006) in-depth qualitative account of gender-related human rights advocacy provides some hints on the role that personalized interaction frameworks for actors may play here. To restate the initial

argument of this paper, personalized interaction frames for domestic actors facilitate can cooperation and reduce the rate of non-compliance with international law. This argument seems applicable to the practice of human rights advocates as well. What becomes clear from Merry's study is that transnational interactions of current and potential activists play a key role in international efforts to cooperate on human rights issues. This ranges from information provision to representatives at the United Nations and other IGOs to monitoring of government practice and to transnational lobbying for a better performance of states on these issues (Price 1998, Cardenas 2004). Stronger links across borders can facilitate the provision of information about opportunities for activism to domestic actors, which in turn can raise pressure on non-compliant governments or those that have not yet committed to legal standards. More specifically related to the argument of this paper though, personal interaction may also induce slow norm shifts among domestic societies in terms of human rights practices, as some of Merry's study suggests. By building transnational linkages between domestic advocacy groups, information provision and external support can enhance the domestic activism for compliance with international standards. Social globalization, in this context, is physically enabling this exchange and making it more likely at the same time. However, such implicit evidence still bears the further study of human rights advocacy and the role of global social integration.

Chapter 8

Implications and conclusion

8.1 Broader theoretical implications

Quantitative evidence has supported the notion that those democracies were more likely to break with their Article 8 obligation that rank lower in terms of social globalization. This finding holds in the presence of standard controls. The scholarly debate about compliance and international relations in general has recently turned toward domestic determinants of the stability of international agreements. My argument about the relevance of the integration of domestic audiences adds to this debate. It has been challenging to quantify and conceptualize the impact of (international) norms on (domestic) interests, and a rising number of scholars have focused on this task. Among these, some have pointed out the utility of two concepts for international relations theory: network effects (Hafner-Burton, Kahler & Montgomery 2008) and social capital (Dorussen & Ward 2008).

Theories on networks point out that network structures affect information dissemination, depending on the position of actors within the system. Although most research so far has not extensively focused on compliance, the reputational mechanisms put forward by Tomz (2007) can especially be applied within a structure of information provision. In many aspects, more isolated domestic societies are less likely to obtain information that could be used to influence their governments; this argument also follows from Dai's (2007) studies on the positive impact of information on the success of activists lobbying for compliance with international environmental law. It may be fruitful to further pursue this thought of network effects of *domestic societies* besides the study of network structures containing states as aggregate actors. One current research project (Tomz 2008) has been exploring the role of information

on the preferences and beliefs toward international law. Information again showed to be an important individual-level predictor for attitudes toward compliance with, in this case, debt repayment. Certainly, pursuing this idea would require more polished methods and would involve a multi-step analysis of integration, attitudes, policy debate, and policy outcome. But given the practical puzzle of this paper – what prevails when international law and short-term domestic interests clash? – such research would capitalize nicely on current work on networks.

Secondly, the topics of *trust* and *social capital*, pressing issues in the field of comparative politics (Crepaz 2008), begin to spill over into the study of international relations. Dorussen & Ward (2008, p. 190) explicitly refer to "social capital" between states. For domestic actors, Brewer, Gross, Aday & Willnat (2004) have explored "international trust" and attitudes toward key foreign policy issues. In the context of political science, Putnam, Leonardi & Nanetti (1993) provide the most relevant conceptualization of social capital for this context. Their study of governance in Northern Italy meant to show that social capital can create both positive (e.g. good governance) and negative (e.g. corruption) outcomes, depending on the linkages between communities, amongst other things. Essentially, this paper performs a related analysis on the global stage by examining the impact of transnational linkages between domestic actors on the performance of states in regard to international law. Given the institutional mechanisms that enable domestic societies to influence policy, this impact has been found to be positive. This encourages the further development of a theoretical research agenda that studies social capital in the global environment. Particularly for inter-disciplinary attempts that study sub-state level cooperation between states this should be of relevance. For instance, initiatives studying forms of the impact of information provision and -creation through online tools, such as blogs and network platforms, should be interested in and relevant for the impact of such potential new forms of social capital on government behavior. Returning to the subjects of human rights (Merry 2006) and environmental politics (Dai 2007) for instance, there is reason to believe that the increased access to and exchange

of information can create increasing pressures on governments to comply with their international commitments.

8.2 Conclusion and suggestions for further research

This paper presents support for the hypothesis that personal interaction frameworks of domestic societies affect cooperation between states positively when institutional mechanisms allow for the influence of domestic actors on policy. For the compliance literature, this finding further explored the role of the domestic sources of international cooperation. For the practical political context, I concluded that citizens seem to be receptive and supporting of international law when they sufficiently perceive international relations in a personalized framework. Besides the theoretical implications of this research mentioned above, the empirical limitations of this paper call for further examination of the role of transnational linkages between domestic societies and the resulting attitudes and, eventually, policies. Clearly, the social globalization ranking used in this paper is a more than imperfect measure of the concepts of social interdependence and international integration of domestic societies. Ideally, one would not have to infer levels of integration from aggregate scores of transnational communication; it would be preferable to, for instance, assess the spread of integration. Urban-rural discrepancies, as an example, can distort aggregate scores. Besides measurement problems, two other issues offer an immediate research agenda that is complementary to this paper's argument and that would contribute to a better understanding of the impact of social interdependence on cooperation between states:

Public opinion research. A question worth asking is to what extent social globalization directly and observably affects attitudes of individuals toward other states, international organizations, international law, and compliance. Some attempts in that direction have already been made. To my knowledge they usually require original surveys, since few or none of the available cross-country survey programs explicitly ask questions that could be used to this end. Torgler (2008) used the World Values Survey to explore the individual-

and country-level determinants of *trust in the United Nations*, also making use of the social globalization variable used in this paper. Such research could be driven further by gathering survey material that is more directly related to the effects of international law.

The link between individuals and national policy. This paper is built on strong assumptions about the transmission of domestic preferences and norms to policy, and used an interaction term in the statistical model to this end. For further consideration, the wealth of debate on this link implies a need for more careful consideration and specification. Is it permissive to assume an "automatic transmission belt" between domestic attitudes and international policies? More careful case studies can tell a better answer to this question. One potential project related to this paper could examine the link between attitudes to the United Nations and governments' compliance with their obligations of membership fee payment. But more nuanced approaches using qualitative evidence would clearly benefit this debate.

Finally, it is worth noting that while monetary policy provided a good case for the test of a newly derived argument, other areas of international law and institutions equally lend themselves to the study of the role of domestic actors. The brief references to research outside the field of political science also illustrate another avenue. To produce the evidence necessary for further theoretical development, interdisciplinary research would be particularly useful. The institutional perspective of political scientists would match well with the expertise of sociologists and anthropologists on network effects between individual actors. By bringing together arguments from early institutionalist theory and current neuroeconomic research, this paper attempts an early step in this direction.

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Appendix A

Article 8

Articles of Agreement of the International Monetary Fund
Article VIII – General Obligations of Members[1]

Section 1. Introduction

In addition to the obligations assumed under other articles of this Agreement, each member undertakes the obligations set out in this Article.

Section 2. Avoidance of restrictions on current payments

(a) Subject to the provisions of Article VII, Section 3(b) and Article XIV, Section 2, no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions.

(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. In addition, members may, by mutual accord, cooperate in measures for the purpose of making the exchange control regulations of either member more effective, provided that such measures and regulations are consistent with this Agreement.

Section 3. Avoidance of discriminatory currency practices

No member shall engage in, or permit any of its fiscal agencies referred to in Article V, Section 1 to engage in, any discriminatory currency arrangements or multiple currency practices, whether within or outside margins under Article IV or prescribed by or under Schedule C, except as authorized under this Agreement or approved by the Fund. If such arrangements and practices are engaged in at the date when this Agreement enters into force, the member concerned shall consult with the Fund as to their progressive removal unless they are maintained or imposed under Article XIV, Section 2, in which case the provisions of Section 3 of that Article shall apply.

[1]Source: http://www.imf.org/external/pubs/ft/aa/aa08.htm (accessed 9/18/2008).

Appendix B

Statistical appendix

Table B.1: Summary statistics for continuous variables, full dataset

Variable	**Mean**	**Std. Dev.**	**Min.**	**Max.**	**N**
Social globalization	33.099	18.719	1.93	91.290	2972
Economic globalization	46.156	18.77	7.84	94.03	2621
Balance-of-payment / GDP	-4.011	10.863	-240.521	59.45	3539
World interest rate shock	-0.032	1.458	-2.728	8.643	3326
Trade dependence	67.460	45.616	2.644	370.557	3416
FDI (in 1000 US$)	902.077	4346.549	-2117.2	105590	3625
Political rights	4.055	2.216	1	7	3461
ICRG Quality of government	0.551	0.247	0.042	1	1558
Regional norm	3.431	5.317	0	23	4242
Winning coalition	0.567	0.32	0	1	4112
Winning coalition / selectorate	0.579	0.316	0	1.001	4028
GDP per capita in US$	5008.904	5266.703	267.315	30929.916	3618
GDP growth	4.025	14.502	-76.822	699.902	3701

Table B.2: Summary statistics for binary variables, full dataset

Variable	**0**	**1**	**N**
Defection	3,764	473	4,237
Democracy	2,303	1,382	3,685
Flexible exchange rates	3,095	1,127	4,222
Left government	937	949	1,886

Table B.3: Bivariate correlation table

Variables	Def.	@Soc.glob.	Demo.	Econ.glob.	FDI	Tradedep.	Pol.R.	Reg.norm	Shock	$\frac{\text{BoP}}{\text{GDP}}$	Flex.ER	GDPpC	GDPch.	Win.C.	$\frac{\text{Win.C.}}{\text{Selec.}}$
Defection	1.0000														
Social globalization	0.0003	1.0000													
Democracy	0.1238	0.5359	1.0000												
Economic glob.	-0.0379	0.8046	0.4364	1.0000											
FDI	-0.0339	0.3486	0.1786	0.2811	1.0000										
Trade dependence	0.0176	0.2093	-0.0733	0.3435	-0.0816	1.0000									
Political rights	0.1375	0.6063	0.8625	0.5168	0.1837	0.0149	1.0000								
Regional norm	0.3663	-0.2167	-0.0501	-0.2951	-0.1246	0.0514	-0.0593	1.0000							
Interest rate shock	-0.0344	-0.3468	-0.2696	-0.3101	-0.1513	0.0600	-0.2189	0.0841	1.0000						
$\frac{\text{BoP}}{\text{GDP}}$	-0.0475	0.1509	0.0614	0.1501	0.0463	-0.0044	0.0811	-0.1308	-0.0985	1.0000					
Flexible ER	0.0963	0.1048	0.2238	0.1039	0.1757	-0.1373	0.1707	0.0236	-0.1373	0.0276	1.0000				
GDP per Capita	-0.0530	0.7887	0.5430	0.7230	0.4206	-0.0379	0.6041	-0.3613	-0.3183	0.2539	0.1194	1.0000			
GDP change	-0.0239	0.0722	0.0784	0.1250	0.0468	0.0985	0.1165	-0.0376	-0.0971	0.0144	0.0095	0.0693	1.0000		
Winning Coalition	0.1047	0.5729	0.7843	0.5365	0.2005	0.0566	0.8205	-0.0821	-0.2403	0.0316	0.1877	0.5241	0.1217	1.0000	
$\frac{\text{Winning coalition}}{\text{Selectorate}}$	0.0974	0.5968	0.7784	0.5448	0.2004	0.0594	0.8198	-0.1047	-0.2417	0.0371	0.1851	0.5766	0.1163	0.9970	1.0000

Table B.4: Results for Model 2, using `-xtlogit-`

Variable	**Coefficient** (Std. Err.)
Social globalization × Democracy	-0.100*
	(0.050)
Social globalization	0.116*
	(0.049)
Democracy	2.832*
	(1.599)
FDI	0.000
	(0.000)
Trade dependence	-0.013
	(0.012)
Political rights	0.196
	(0.219)
Regional norm	0.130*
	(0.014)
Interest rate shock	-0.054
	(0.101)
Balance of payment/GDP	0.006
	(0.009)
Flexible exchange rate	0.222
	(0.384)
Left government	0.267
	(0.440)
GDP per Capita	-0.0002*
	(0.000)
GDP change	-0.006
	(0.038)
N	1124
Log likelihood	-230.173
χ^2	99.993

Dependent variable is *Defection*. Coefficients are displayed with clustered standard errors in parentheses below.
* indicates significance at the 5% level in one-tailed tests.

Table B.5: Results for Model 2, using standard logit estimator

Variable	**Coefficient** (Std. Err.)
Social globalization × Democracy	-0.071*
	(0.040)
Social globalization	0.106*
	(0.044)
Democracy	2.331*
	(1.259)
FDI	0.000
	(0.000)
Trade dependence	-0.005
	(0.007)
Political rights	0.012
	(0.189)
Regional norm	0.063*
	(0.011)
Interest rate shock	-0.061
	(0.060)
Balance of payment/GDP	0.006
	(0.006)
Flexible exchange rate	0.455
	(0.374)
Left government	-0.071
	(0.386)
GDP per Capita	-0.0002*
	(0.000)
GDP change	-0.014
	(0.034)
N	1124
Log likelihood	-362.07
χ^2	104.254

Dependent variable is *Defection*. Coefficients are displayed with clustered standard errors in parentheses below.
* indicates significance at the 5% level in one-tailed tests.

Table B.6: Classification table for Model 2

	True values		
Classified	Defection	No defection	Total
+	113	57	170
–	112	842	954
Total	225	899	1124

Classified + if pr(Defection) > 0.5
True Defection defined as *Defection* $\neq 0$

Sensitivity	Pr(+|D)	50.22%
Specificity	Pr(–|No D)	93.66%
Positive predictive value	Pr(D|+)	66.47%
Negative predictive value	Pr(No D|–)	88.26%
False + rate for true No D		6.34%
False – rate for true D		49.78%
False + rate for classified +		33.53%
False – rate for classified –		11.74%
Correctly classified		84.96%