

Political Regimes and Currency Crises*

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Abstract: This paper shows that political regime type influences the risk of currency crises. We hypothesize that currency crises are less likely in regimes where rulers are insulated from broad-based political pressures; have long time horizons; and are unable to deflect blame for crises. Currency crises should therefore be most frequent in democratic regimes and least frequent in monarchic regimes. Analyses of a time-series—cross-sectional dataset indicate that monarchies significantly reduce the probability of a currency crisis compared to other types of political systems. We demonstrate that this effect is driven primarily by the fact that monarchies adopt more prudent financial policies than other types of political systems. These findings suggest that perverse political incentives help explain why currency crises are so common, and that certain regime characteristics encourage leaders to adopt policies that prevent financial catastrophe.

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I. Introduction

Dictators are widely believed to be poor stewards of the economy. Compared to democracies, authoritarian governments tend to have weaker protection of property rights (Leblang 1996); higher levels of government indebtedness (Oatley 2010); more protectionist trade policies (Mansfield et al. 2002); greater state interference with market mechanisms (Giuliano et al. 2013); and more rampant corruption (Sandholtz and Koetzle 2000). These tendencies hardly inspire confidence in the economic abilities of autocrats. This paper explores how authoritarian regimes perform with respect to one crucial aspect of economic performance: the frequency of currency crises.

Understanding how political regimes affect currency crises is important because such events are both frequent and economically devastating. A currency crisis, which is defined as a rapid loss in a currency's external value, is typically associated with large declines in wealth (Hutchison & Noy 2002; Bussiere et al. 2012; Gupta et al. 2007; Bordo et al. 2001). Yet in spite of these tremendous economic costs, the world experienced 465 currency crises over the past four decades – an average of more than twelve per year.¹ Moreover, countries from all geographic regions and income levels have been affected by currency crises (Laeven & Valencia 2008; Glick & Hutchison 2001). However, some countries are at far greater risk than others. For instance, whereas Turkey had 9 currency crises between 1973 and 2010, Jordan experienced

¹ These figures are calculated from the authors' dataset.

only one. This paper shows that a country's vulnerability to currency crises depends in large part upon their political regime. Contrary to conventional wisdom, we demonstrate that certain types of authoritarian regimes actually outperform their democratic counterparts when it comes to avoiding currency crises.

In this paper, we elaborate a theoretical logic as to how and why political regimes influence the risk of currency crises. We posit that political systems shape the incentives of leaders to adopt financial policies that prevent currency crises. More specifically, we argue that currency crises are less likely in political contexts where: (1) leaders are insulated from broad-based pressures; (2) leaders have long time horizons; and (3) leaders are easily blamed for the crises. These traits encourage policymakers to implement policies that reduce the likelihood of a currency crisis, such as building up a large stockpiles of foreign reserves, maintaining competitive exchange rates, and adopting anti-inflationary monetary policies.

We argue that democratic and authoritarian regimes differ markedly with respect to each of these three attributes, and therefore expect these differences to influence financial stability. However, in this paper, we move beyond simple comparisons between democracy and dictatorship, and take seriously the important variations within the authoritarian world.² Although insulation, time horizons, and clarity of responsibility tend to be higher in autocracies than in democracies, these features also vary greatly across monarchic, military, and civilian dictatorships. Specifically, we hypothesize that currency crises are rarest in monarchic dictatorships because, when compared to other types of autocrats, monarchs are especially insulated from societal pressures, have longer time horizons, and have greater difficulties

² Recent scholarship has demonstrated that the type of authoritarian regime has a profound effect on diverse outcomes, including regime survival (Geddes 1999), strikes and protests (Kim and Gandhi 2010), civil war (Fjelde 2010), international conflict (Lai and Slater 2006; Weeks 2010), and economic policies (Hankla and Kuthy 2013; Steinberg and Malhotra 2014).

blaming others for crises. Following this logic, the risk of a currency crisis should be higher in civilian and military dictatorships than in monarchic regimes, but this risk should be highest in democracies.

To ground these expectations, Table 1 provides some preliminary data that reveals the plausibility of our argument. Between 1973 and 2010, a currency crisis took place in about 7% of all “country-years” for democracies. That proportion is quite similar, though slightly larger, for civilian and military dictatorships (0.09 and 0.11, respectively). In contrast, monarchies experienced currency crises in less than 2% of all observations and less than a quarter as often as democracies. Table 1 further reveals that monarchies stand out in a number of other respects: they maintain noticeably larger stockpiles of foreign reserves, have less overvalued exchange rates, and have lower inflation rates than each of the other major types of political regimes. This preliminary evidence indicates that one type of autocracy—monarchies—adopts more prudent macroeconomic policies and experiences fewer currency crises than democratic regimes.

We subject this finding to a battery of more rigorous empirical tests below, and find strong evidence that the risk of a currency crisis is substantially lower in monarchies than in other types of political regimes. In fact, monarchy continues to exert a large negative effect on the probability of a currency crisis after controlling for a country’s level of development, its natural resource wealth, and many other potential confounders. This relationship also holds using various measures of regime type and currency crisis, and it is robust to a variety of different estimation techniques, including fixed-effects and matching. Finally, we demonstrate that the low risk of currency crises in monarchies is driven primarily by the fact that monarchic regimes adopt more prudent macroeconomic and financial policies than other regime types.

Our findings suggest that political regimes have an important effect on the risk of currency crisis. They also indicate that differences across authoritarian regimes can be as consequential as differences between democracy and dictatorship. Finally, these results show that macroeconomic fundamentals are an important, yet largely overlooked, mechanism through which political institutions contribute to financial crises.

II. The Economics of Currency Crises

Currency crises are largely preventable events. Policymakers that want to ensure that their country avoids a currency crisis have the means for doing so. In the words of Eichengreen et al. (1995: 294), “governments bring currency crises on themselves through the reckless pursuit of excessively expansionary policies.” Scholarship has repeatedly shown that prudent macroeconomic and financial policies can substantially reduce the risk of a currency crisis.³ To be sure, no politician has a complete ability to prevent currency crises, but currency crises are extremely rare in countries with “immaculate fundamentals” (Kaminsky 2006).⁴

Three macroeconomic policies have a particularly strong influence on the risk of a currency crisis: low levels of international reserves; overvalued real exchange rates; and inflationary domestic monetary policy.⁵ Countries with strong fundamentals in these three areas

³ For excellent overviews of empirical studies on this topic, see Abiad (2003), Frankel and Saravelos (2012), Hawkins and Klau (2000), and Kaminsky et al. (1998).

⁴ Even models of self-fulfilling crises recognize that countries with very strong fundamentals are unlikely to experience currency crises (Obstfeld 1996).

⁵ Frankel and Saravelos (2012) summarize the findings of 83 studies on financial crises, and find that foreign reserve levels and real exchange rate overvaluation are the two most important determinants of crises. They also report that many studies find that domestic credit growth and inflation, two indicators of inflationary monetary policies, are significant predictors of financial crises. Earlier surveys by Kaminsky et al. (1998) and Hawkins and Klau (2000) highlight these three policies as key determinants of currency crises. Frankel and Rose (1996), Sachs et al. (1996), Bussiere (2013), Bussiere and Fratzscher (2006), Falcetti and Tudela (2006), and

are more likely to avoid crises, while those that adopt more reckless policies face a much greater risk of crisis. The typical sequence through which this set of policies results in a currency crisis is as follows. The government adopts low interest rates to increase individuals' and firms' access to credit, and the resulting increase in consumption and investment pushes up inflation rates. If the exchange rate is relatively stable, domestic inflation results in an appreciation of the real exchange rate, meaning that the price of domestic goods rises relative to the price of foreign goods. Real exchange rate appreciation causes exports to fall and imports to increase. When imports exceed exports, the government must start using its foreign reserves to pay for these excessive imports. Finally, as foreign reserves fall, investors realize that the government cannot maintain the overvalued exchange rate indefinitely, causing them to quickly liquidate their holdings of local currency—an action that further drains foreign reserves and helps bring about a currency crisis. The currency crises in the United Kingdom in 1967, Chile in 1982, Mexico in 1994, Russia in 1998, and Turkey in 2001 all illustrate this established pattern (Bordo and Schwartz 1996; Desai 2000; Ozkan 2005).

In contrast, political elites intent on avoiding a currency crisis can follow the opposite set of policies. Governments can actively accumulate foreign reserves to build up a large enough stockpile to defend against, and deter, speculators from attacking their currency. The accumulation of foreign reserves reduces the supply of foreign currency relative to domestic currency, which prevents the local currency from appreciating in value. When this strategy is combined with conservative domestic macroeconomic policies, which keep a lid on inflation, a

Gourinchas and Obstfeld (2012) all find that these three policies influence the risk of currency crisis. Perhaps surprisingly, budget deficits do not appear to have much impact on the risk of a currency crisis. Frankel and Saravelos (2012) report that few studies find that the budget balance influences financial crises, and Frankel and Rose (1996), Kaminsky and Reinhart (1999), Sachs et al. (1996) find that fiscal policy does not influence the incidence of currency crises.

country's goods remain competitive on world markets. These policies give local firms a competitive advantage that increases a country's net exports, and increases foreign exchange reserves even further. Several countries have adopted this prudent policy mix, and have been highly successful in preventing currency crises as a result, including Botswana, China, and Saudi Arabia (Corsetti et al. 1999; Acemoglu et al. 2003; Enders and Williams 2008). The lesson is clear: to avoid a currency crisis, political elites should adopt restrictive monetary policies, keep their exchange rate undervalued, and accumulate foreign reserves.

III. The Politics of Currency Crises

If policymakers can adopt policies that make their economies less vulnerable to a currency crisis, why are some decision-makers more inclined to do so than others? We argue that domestic politics plays a key role in answering this puzzle. In many types of political systems, national leaders lack strong incentives to prevent currency crises. Despite the tremendous economic and political costs of these events, political elites often find that currency crises are less problematic than the alternative—that is, adopting prudent, but unpopular, policies that are required to reduce a country's vulnerability to a currency crisis. This section explains how three features of domestic political systems—namely, insulation, time horizons, and blame attribution—influence leaders' incentives to prevent currency crises.

a. Insulation from Domestic Pressures

Political elites that are exposed to broad-based social pressures face strong incentives to implement imprudent macroeconomic and financial policies that increase the risk of currency crises. Leaders that are more insulated from societal pressures are less inclined to do so. Even

though inflationary monetary policies, overvalued real exchange rates, and low levels of foreign reserves make future currency crises more likely, most domestic constituents benefit from these policies in the short term.

Policymakers are often under intense pressure to maintain loose and inflationary monetary policies. Businesses benefit from low interest rates because it makes it less expensive for them to invest, thus raising their profits. Indeed, high interest rates and difficulty obtaining loans are among the most common concerns expressed by firms in developing countries (Batra et al. 2003; Bigsten and Soderbom 2006). Banks are another domestic constituency that benefit from loose monetary policies because it increases the demand for loans as well as the difference between lending and deposit interest rates, which fattens banks' profit margins (Chinn and Frieden 2011: 61-62; Copelovitch and Singer 2008: 667; Posen 1995: 258). Since cheap credit inflates asset values, asset-holders also favor cheap credit (Ansell 2012; Broz 2013: 75). Lastly, consumers favor easy access to low-cost credit because it makes it easier for them to afford large purchases, such as cars and houses. Rajan (2010: 31) aptly summarizes the political incentives for inflationary monetary policies: "Easy credit has large, positive, immediate, and widely distributed benefits, whereas the costs all lie in the future. It has a payoff structure that is precisely the one desired by politicians, which is why so many countries have succumbed to its lure." Only political elites that are highly insulated from societal demands should have much success in resisting the lure of cheap credit.

Similarly, most domestic groups find the short-term effects of an overvalued exchange rate to be highly attractive. Political leaders seeking the support of organized labor often attempt to appreciate their exchange rates because this lowers the cost of food, clothing, and other consumer items, which increases workers' real wages (Kaufman and Stallings 1991; Krugman

and Taylor 1978). An overvalued exchange rate also increases the profitability of many businesses because it lowers the costs of their imported inputs and their foreign-currency debts (Pepinsky 2009; Walter 2008).⁶ Due to its popularity among multiple domestic constituencies, exchange rates tend to appreciate in the run-up to elections, when democratic rulers are most concerned with societal pressures (Frieden et al. 2001). Broad-based support for overvalued exchange rates makes it hard for leaders to resist, especially when they feel the need to quickly bolster their popularity.

Finally, amassing a large stockpile of foreign reserves is also politically costly. Central banks earn very low rates of return on their foreign reserve holdings. As a result of these low returns, holding large quantities of foreign reserves imposes large fiscal costs on governments, and, by extension, the population. Rodrik (2006), for example, estimates that maintaining preventative stockpiles of foreign reserves reduces the revenues of many developing countries by around 1% of GDP annually. This means that large holdings of foreign reserves prevent the government from investing in public goods, development projects, and other popular policies (Aizenman and Marion 2004; Rodrik 2006; Cruz and Walters 2008). Instead, politicians that are concerned with maintaining the support of societal interest groups face strong temptations to “reduce international reserve holdings...in order to maximise the current consumption of special interest groups” (Aizenman and Marion 2004: 570). Policymakers seeking to increase their popularity would rather spend their foreign currency on the population today, rather than keep it stockpiled in the central bank to prevent potential future catastrophes.

⁶ Even though an overvalued exchange rate reduces the international competitiveness of tradable firms, the tradable sector often supports an overvalued rate because the benefit of lower imported inputs and foreign debt burdens are often large (Walter 2008).

Taken together, politicians often face pressure from key domestic constituencies to adopt inflationary monetary policies, overvalued exchange rates, and maintain small foreign reserve holdings—three policies that increase the risk of a currency crisis. Political regimes that insulate leaders from societal pressures weaken their incentives to adopt imprudent macroeconomic policies, which should reduce the risk of a currency crisis.

b. Leaders' Time Horizons

National leaders are often unconcerned about the prospects of a currency crisis because many have short time horizons. Politicians frequently care much more about the very near future than about the state of the economy in several years' time. In other words, most national leaders heavily discount the future costs of their policies.

Short time horizons lead those in power to care less about the costs of a currency crisis. Imprudent policies do not bring about currency crises overnight. Instead, there are often relatively long time lags, of at least several years, before imprudent policies culminate in a financial crisis (Keefer 2007: 617; Schamis and Way 2003). As a result of term limits or other regularized mechanisms of succession, there is a strong possibility that the regime incumbent may not be in office when a currency crisis materializes. For example, President Carlos Menem of Argentina adopted expansionary monetary policies and an overvalued exchange rate, but the resulting currency crisis did not materialize until his successor's tenure. Leaders like Menem that do not expect to remain in office far into the future steeply discount the costs of future crises. Hence, leaders with short time horizons lack incentives to adopt policies that prevent

crises from arising in the future (Chiu and Willett 2009: 1005).⁷ The costs of future currency crises are more salient for leaders that expect to reign for long periods of time. Political regimes that lengthen leaders' tenures and time horizons should, therefore, reduce the frequency of currency crises.

c. Blame Attribution

Leaders' ability to escape blame and punishment for crisis is a third political factor that influences the likelihood of currency crises. The public and organized interest groups often lack knowledge about why currency crises occur. This makes it difficult for citizens to determine who is responsible for such events (Keefer 2007). These groups may fail to accurately connect a currency crisis to a specific government policy or leader. Moreover, citizens may not believe that government economic policy is to blame for a nation's economic problems, and instead place the blame on outside forces like greedy foreign capital holders or the IMF (Crespo-Tenorio et al., Forthcoming; Alcañiz and Hellwig 2011). As we discuss in more detail below, some leaders can also convince their constituents that crises are the fault of a previous leader or other governmental institutions, such as the legislature.

Politicians' ability to deflect blame for currency crises lowers their incentives to prevent such crises from arising. When the population is unsure as to whether political elites are to blame for their problems, they are less likely to punish them accordingly (Arceneaux 2003; Javeline 2003; Tillman 2008). In political contexts where it is unclear who is responsible for bad economic performance, leaders have little incentive to prevent currency crises because they

⁷ This logic is consistent with a large literature in political economy, which suggests that politicians with short time horizons lack incentives to adopt policies that increase long-term economic growth. See, for example, Haggard and Kaufman (1995), Olson (1993), and Przeworski (1991).

recognize that they will not be held accountable. By contrast, in political contexts with a high degree of clarity of responsibility, political leaders realize that they will be blamed (and punished) for a currency crisis. The easier it is for the public to attribute blame for crises, the greater are leaders' incentives to prevent currency crises.

In sum, currency crises are common events because political leaders often lack incentives to prevent them from occurring. The structure of a country's domestic political system determines whether or not leaders have incentives to prevent currency crises. We have argued that three attributes of political regimes are particularly important in this regard. Currency crises should be less common when leaders are more insulated from popular pressures, their time horizons are relatively long, and clarity of responsibility is high. The next section examines how these three factors vary across four types of political regimes.

III. The Effect of Political Regime Type on the Risk of Currency Crisis

Political regimes structure how leaders acquire and maintain power. The type of regime in which a leader operates should influence the risk of currency crises because regime characteristics shape each of the considerations outlined in our political explanation of currency crises. Political regimes that encourage their leaders to heavily discount future outcomes, help them deflect blame for crises, and leave them exposed to societal distributional pressures should experience more currency crises than regimes with the opposite features.

Most previous studies on the politics of financial crises have focused on the distinction between democratic and authoritarian regimes.⁸ However, “different kinds of authoritarianism

⁸ For example, Lipsy (2011) shows that banking crises are more common in democratic regimes than in authoritarian ones. Keefer (2007) finds that democracies respond differently to banking

differ from each other as much as they differ from democracy” (Geddes 1999: 121). Indeed, recent research shows that authoritarian institutions influence many aspects of economic policy, including trade policy (Hankla and Kuthy 2013), monetary policy (Steinberg and Malhotra 2014), labor policy (Kim and Gandhi 2010), corporate governance regulations (Jensen et al. 2013), and foreign aid (Wright 2008). Differences among different types of authoritarian regimes should be equally important for financial stability. Hence, our theory considers the politics of currency crises across the four main types of political regimes: democracies, monarchic dictatorships, military dictatorships, and civilian dictatorships (Cheibub et al. 2010).⁹ We expect the distinctive characteristics of each regime type to influence the preferences of ruling elites to adopt risky or prudent financial policies.

Political regime type influences whether leaders are insulated from societal pressures, the first element in our political theory of currency crises. Political regimes that concentrate decision-making authority very narrowly tend to reduce the influence of societal interest groups. By contrast, in regimes where political authority is more fragmented, interest groups have more avenues through which they can lobby for favorable policies, which makes it harder for leaders to ignore pressures from business, labor, and other interest groups (Brownlee 2009; Gandhi 2008; Jensen et al. 2013; Steinberg and Malhotra 2014; Wright 2008). The way in which a regime justifies and legitimates its rule should also influence the degree to which leaders are insulated from societal pressures over economic policy. Regimes that are able to justify their rule based on God-given, historical, or traditional forms of authority are under less pressure to

crises than non-democracies. Sattler and Walter (2010) show that responses to speculative attacks on the currency differ across democratic and authoritarian regimes.

⁹ While we find this to be the most useful typology of political regimes, it is surely not the only one. O’Donnell (1973), Geddes (1999), Kailitz (2013), Linz (2007), Hadenius and Teorell (2007), and Levitsky and Way (2010) all provide alternative classifications of authoritarian regimes. The empirical analyses examine several of these alternatives.

respond to the demands of interest groups than leaders of regimes that must justify their rule upon their economic performance (Kailitz 2013).

Regime type also determines the length of a ruler's time horizon, the second component of our theory. Leaders have longer time horizons in regimes that permit incumbents to remain in office for extended periods of time than in regimes that enforce term limits or those that regularly hold competitive elections.

Lastly, political regime type influences the "clarity of responsibility" for crises, and thus citizens' ability to blame and punish leaders for poor economic performance. Two regime characteristics, the centralization of authority and leader turnover rates, influence the clarity of responsibility. Leaders have more difficulty deflecting blame when decision-making authority is highly centralized than when decision-making is plural or fragmented (Powell and Whitten 1993; DeVries et al. 2001; Anderson 1995; Brooks and Kurtz 2007; Powell 2000; Tavits 2007). Leaders with long tenures also find it more difficult to blame others for economic problems that occur under their watch. The more frequent is leader turnover, the easier it is for national leaders to blame their predecessors for crises (Powell 2000; Tavits 2007). The remainder of this section compares how these three dimensions vary across different political regime types, and how this, in turn, should influence the frequency of currency crises.

a. Democracy

Democracies are political systems where the chief executive is routinely elected in competitive, free, and fair elections. This means that political elites are highly accountable to domestic constituents and sensitive to the preferences of a wide array of domestic groups (Milner and Kubota 2005; Bueno de Mesquita et al. 2003). Democracies typically have numerous

avenues through which interest groups can press their interests and agendas. Consider the Thai democracy in the 1990s. The fragmented and weak party system gave financial and industrial interests easy access to the state—an influence they used, in the years leading up to the 1997 crisis, to push for rapid increases in credit (Haggard 2000).

A second characteristic of democratic regimes is that the tenure of leaders tends to be far shorter than in other political systems. The average democratic leader in our sample lasted less than 4 years in office.¹⁰ Term limits and electoral cycles routinely and peacefully remove politicians from power. Since national leaders recognize that they are unlikely to remain in office in five or ten years' time, they lack incentives to adopt the kind of prudent financial policies that minimize the risk of an economic crisis far into the future.

Finally, democratic regimes leave ample room for leaders to deflect blame and find scapegoats for currency crises. Due to the decentralization of political power, national leaders can plausibly pin the blame for poor economic performance on minority parties in coalition governments or on the legislature. Moreover, high executive turnover rates make it easier for democrats to blame their predecessors for any problems. These regime features make it more difficult for citizens and interest groups to figure out who is to blame for their economic problems. Anticipating that they will be able to avoid punishment for economic catastrophes further reduces democrats' incentives to prevent currency crises.

b. Monarchic Dictatorship

Monarchies are regimes in which national leaders are selected solely on the basis of hereditary succession. The attributes of monarchies that influence currency crises could hardly

¹⁰ Data on leader tenure are from Cheibub et al (2010).

look more different from democracies. First, monarchic regimes are far more insulated from societal pressures than most other regime types. Monarchs appeal to traditional forms of legitimacy to justify their rule, and claim to have an established historical right to rule regardless of the outcomes of their rule (Herb 1999; Kailitz 2013). Furthermore, in monarchic regimes, political decision-making is highly concentrated within one family or a small consultative council, and this type of extreme centralization of power means that societal groups have less influence than in other types of dictatorship (Cheibub et al. 2010; Brownlee 2009; Gandhi 2008; Hadenius and Teorell 2007; Lucas 2004; Bueno de Mesquita et al. 2003; Herb 1999; Anderson 1991; Hertog 2010; Wright 2009; Magaloni 2008). For example, in the Saudi Kingdom, there is “no space for the emergence of powerful organized groups in society that could throw around their weight in the policy-making process” (Hertog 2010: 11).¹¹ This type of insulation from domestic pressure groups means that there are few incentives for monarchs to adopt perverse economic policies that generate rapid, but unsustainable, growth and move their country toward crisis. Monarchs, in short, are rarely beholden to their subjects.

Monarchs also tend to have far longer time horizons than other types of rulers. The average monarch lasts in office thirty years—far longer than leaders in other regime types. Moreover, since monarchs tend to be succeeded by family members, their time horizons are more likely to extend beyond their own tenures. Kings and queens are concerned not only with perpetuating their personal rule, but also that of their children and grandchildren. As Lisa Anderson writes, “presumably no king wants himself or his successor to be the end of the

¹¹ Hertog (2010: 11) notes that certain segments of business may be a “partial exception.” Even here, however, Hertog notes that “private sector lobbying consist[s] of little more than ad hoc pleas” (2010: 193).

dynasty” (1991: 15). The imperative of “dynastic succession...give[s] monarchs more concern for the long run and the productivity of their societies” (Olson 1993: 572).

Finally, the centralization of authority and long-term rule of a single family also means that it is difficult for the royal family to deflect the blame for a currency crisis. For instance, even if a king is no longer in power, it is likely that his son or grandson is. Thus, monarchs have strong incentives to prevent future currency crises because blame will be tied to the family and they face serious difficulties convincing the public that they are not responsible.

c. Military Dictatorship

Military dictatorships arise when a professional military overthrows a civilian government. This regime type has far more mixed incentives than democratic and monarchic regimes. The average tenure of military leaders is about 9 years, suggesting that their time horizons are far shorter than the tenure of monarchs, but longer than democrats. Military rulers have shorter tenures than monarchs because factional splits in the armed forces often bring about their downfall. Militaries also occasionally choose to return to the barracks on their own accord after they have restored political order (Huntington 1968; Nordlinger 1977; Geddes 1999).

The susceptibility of military regimes to societal pressures also lies in between monarchies and democracies. In military dictatorships, political decision-making rests with the armed forces and is generally organized around one or more military juntas—generals who rely on the organizational resources and standard operating procedures of the armed forces to rule (Bueno de Mesquita et al. 2003, 71; Wright 2009). A key difference between military and monarchic regimes is that the latter justify their rule according to their superior ability to provide political order and deliver economic growth. Accordingly, military regimes are more vulnerable

to economic pressures from below compared to monarchic regimes. Argentina under military rule in the late 1970s illustrates the ways in which interest group lobbying can induce military leaders to adopt risky financial policies. Argentina's economic minister during this time admitted that he was unable to reduce government spending, which contributed to persistently high inflation, an overvalued exchange rate, and ultimately a currency crisis, because "resistance came from private sectors interested in the maintenance of certain works – being the suppliers, contractors or beneficiaries" (Martínez de Hoz 1990: 167). However, since interest groups have far fewer access points in military regimes than in democratic ones, they are less vulnerable to societal pressures than their democratic counterparts.

Lastly, the ability of military leaders to deflect blame for currency crises also lies in between democrats and monarchs. According to our theory, the capacity to evade blame and punishment for crises depends upon centralization and leadership turnover—two features that are at intermediate levels in military regimes.

d. Civilian Dictatorship

Civilian dictatorships are authoritarian regimes that do not use a ruling family or the military to retain power. Instead, most civilian dictatorships rely upon a dominant party or personal ruler to retain a grip on power. Civilian dictatorships use diverse sources of legitimacy to support and defend their rule, though promises of economic growth and modernization are among the most common (Kailitz 2013). Under civilian dictatorship, political decision-making tends to be far more fragmented than under other authoritarian systems. For instance, it is common for single-party regimes to have legislatures and elections (though not competitive), which expands the number of actors with input into the policymaking process (Gandhi 2008;

Bueno de Mesquita et al. 2003; Hankla and Kuthy 2013; Steinberg and Malhotra 2014; Wright 2009). Mexico prior to its 1995 currency crisis provides a striking example of this. Mexican President Carlos Salinas kept interest rates low and the exchange rate overvalued in the early 1990s because “virtually all of the economic interests that exercised influence over the PRI’s political future” favored these policies (Kessler 1998: 60). In short, civilian dictatorships are less insulated from societal demands than other types of authoritarian regimes, especially monarchies.

Civilian dictators also tend to have moderately long time horizons. Their average tenure in office of a national leader is ten years, similar to those of military leaders. Although civilian dictatorships tend to be highly durable, their national leaders often rotate in office frequently. In Mexico, for example, the PRI ruled for decades, but presidents were restricted to a single six-year term in office. Similarly, China’s Communist Party, which has ruled since 1949, has come to develop regularized leadership successions in the post-Deng era. Civilian dictators, therefore, have only moderately strong incentives to promote stable long-term growth rates.

Finally, civilian dictatorships’ ability to deflect blame also lies in between those of democratic and monarchic regimes. A civilian dictator should have some ability to convince the public that other political actors, such as minor opposition parties or low-ranking party members, bear the responsibility for an economic downturn. By way of example, in the wake of domestic scandals, top officials of China’s Communist Party have made it a habit of firing provincial and other lower-ranking party leaders to convince the public that they are not to blame (Li 2006). But, longer tenures and more centralized political systems make responsibility clearer and blame attribution more difficult than in democracies.

e. Summary: Political Regimes and Currency Crises

Our theory suggests that currency crises should be more frequent in some political regime types than others. As summarized in Table 2, we anticipate that currency crises should be least common in monarchic regimes and most frequent in democratic regimes. Civilian and military dictatorships are expected to experience more currency crises than monarchies but fewer crises than democratic regimes. We hypothesize that democratic (monarchic) regimes have more (fewer) crises than other regime types because they adopt less (more) prudent macroeconomic policies. This implies that political regimes should no longer have much influence on currency crises once these macroeconomic policies are accounted for. We now turn to testing these hypotheses.

IV. Data & Methods

We constructed a time-series—cross-sectional dataset that includes annual data for 178 countries over the period of 1973-2010. Our sample period begins in 1973 because this was the beginning of the “post-Bretton Woods” international monetary system, characterized by flexible exchange rates, rising international capital mobility, and frequent currency crises. The sample period ends in 2010 because this is the most recent year with data available on all the major variables of interest.

The dependent variable in our models is the presence or absence of a currency crisis in a “country-year.” We define currency crises based upon changes in a country’s actual foreign exchange rate.¹² In particular, we adopt Frankel and Rose’s (1996) widely used definition of

¹² By contrast, an alternative approach is to define currency crises more broadly to include speculative attacks on the currency even if no devaluation occurs. These “exchange market pressure” indices, however, are less consistent with our theory, which focuses on outcomes in

currency crisis, which is an annual depreciation of the exchange rate that is greater than 25% if that depreciation is also at least a 10% increase in the rate of depreciation from the previous year.¹³ The importance of the first part of the definition, a 25% devaluation, is straightforward. However, it is also important to exclude cases where devaluations have not increased in size to avoid identifying countries with crawling peg exchange rate regimes as experiencing persistent currency crises.

Political regime type is our main independent variable of interest. We focus on Cheibub, Gandhi, and Vreeland's (2010) dataset, which classifies political regimes into four main categories: democratic, monarchic, military, and civilian dictatorships. Cheibub et al. classify a regime as monarchic if the effective head of government bears the title of king and the king has a hereditary successor and/or predecessor. Importantly, their definition excludes constitutional monarchies, such as the United Kingdom, where the monarch is not the *effective* head of government. It also excludes father-son duos like Syria under the Assads and the three generations of Kims ruling North Korea (Gandhi 2008: 29). According to this classification, seventeen different countries are monarchies in our sample period, a total of 501 country-year observations representing eight percent of our sample.¹⁴ Cheibub et al. classify countries as democratic if each of the following conditions is fulfilled: the chief executive is either selected through direct elections or an elected legislature; the legislature is elected; more than one party

foreign exchange markets. Another important advantage of focusing on actual exchange rate outcomes rather than exchange market pressure is that we can gather data on a much larger sample of countries.

¹³ Berg and Pattillo (1999), Frankel (2005), and Gourinchas and Obstfeld (2012) also use this measure. Data on exchange rates are obtained from Heston et al. (2012). As discussed below, we obtain similar results using alternative measures of currency crises.

¹⁴ Monarchies include: Afghanistan, Bahrain, Bhutan, Brunei, Ethiopia, Iran, Jordan, Kuwait, Morocco, Nepal, Oman, Qatar, Samoa, Saudi Arabia, Swaziland, Tonga, and United Arab Emirates.

competes in elections; and power has alternated in a manner consistent with the rule of law. Military regimes are defined as regimes that are neither democratic nor monarchic (as defined above) and in which the effective head of state is a current or past member of the armed forces. The remaining regimes are classified as civilian dictatorships, a category that consists primarily of single-party regimes (e.g. China) and “electoral authoritarian” regimes (Schedler 2006) such as Malaysia and Zimbabwe that employ highly compromised elections. Our statistical models include variables for each of the three main types of dictatorship and treat democracies as our baseline category. The regression coefficients therefore indicate the effect of each authoritarian regime type vis-à-vis democratic regimes.

Testing our theory, which posits that political regimes shape the incentives of ruling elites to adopt risky or prudent macroeconomic and financial policies, requires careful attention to which control variables are included in our statistical models. Our hypotheses imply that the estimated effect of political regimes on the risk of currency crisis should vary greatly depending upon whether or not our statistical models control for macroeconomic fundamentals. We expect monarchies to be associated with a lower risk of currency crisis when holding constant only those factors that are outside of policymakers’ control. Since we argue that macroeconomic fundamentals are the mechanism through which political regimes influence the risk of currency crisis, it is imperative to not control for macroeconomic fundamentals; doing so would result in “post-treatment bias” (King 2010). In fact, our theory implies that regime type should *not* have large or statistically significant effects on crisis-risk after controlling for macroeconomic fundamentals, such as inflation, exchange rate misalignments, and the level of foreign reserves. As Leblang and Satyanath (2006: 247) point out, arguments that assert that institutions influence currency crises exclusively via macroeconomic fundamentals—as our does—“imply that the

relationship between institutional variables and currency crises should become statistically insignificant once economic fundamentals are included as controls in regressions accounting for crises.”

Our empirical analyses, therefore, focus on a sparse model specification that does not include any macroeconomic policy indicators. Afterwards, we add variables to capture the macroeconomic fundamentals we hypothesize to mediate the effect of regime type on crises. Comparing the results of these two specifications allows us to understand whether political regimes affect the probability of currency crises and the degree to which prudent macroeconomic policies account for this effect.

Since our dependent variable is binary, we use a probit estimator. The models include one-year lags of the dependent variable because turmoil in currency markets often persists from one year to the next. To mitigate the potential for simultaneity or reverse causality bias, the explanatory variables are always lagged by one year. We use robust standard errors clustered by country because it is unlikely that observations within individual countries are independent.

V. Results

a. Estimating the Effect of Political Regimes on the Risk of Currency Crisis

Table 3 presents our first set of regression results. These first model only controls for variables that are largely out of policymakers’ control (except, perhaps, over the very long-run) to estimate the overall effect of political regimes on currency crises through a variety of potential channels. Our baseline model includes real per capita GDP and real GDP since we expect richer and larger economies to have a lower risk of currency crisis. We also control for the number of currency crises in other countries in the previous year to capture “contagion” effects. Finally, we

include a country's trade-to-GDP ratio. Trade openness might increase a country's susceptibility to contagious currency crises (Glick and Rose 1999). Alternatively, trade openness might reduce the risk of currency crises by helping countries maintain access to international capital markets (Cavallo and Frankel 2008).

The results confirm that political regimes influence currency crises. The coefficient for monarchies is negative and statistically significant in model 1. The military and civilian dictatorship variables return positive coefficients, though they are much smaller in absolute value than the monarchy variable, and they are not statistically significant. Figure 1 presents the marginal effects of these three regime variables when holding the other variables at their means (medians for non-continuous variables).¹⁵ Monarchies reduce the risk of crisis by three percentage points, from a predicted probability of crisis of 4.6% in democracies to a predicted probability of crisis of 1.6% in monarchies. When holding these other factors constant, the risk of a currency crisis is almost three times higher under democratic rule than under monarchic rule. Relative to democracies, civilian dictatorships are estimated to increase the probability of a crisis by 0.9 percentage points and military regimes increase the risk of crisis by 0.3 percentage points; neither of these effects is statistically significant, however. On the other hand, the probability of a currency crisis is significantly greater in military and civilian dictatorships than in monarchies, which implies that not all authoritarian regimes are equally effective at preventing currency crises.¹⁶ The evidence indicates that monarchies are far less likely to experience crises than all

¹⁵ Predicted values and first-differences were calculated with Clarify software (Tomz et al. 2003).

¹⁶ The difference in crisis-probability between monarchies and military regimes is -0.033, with a 95% confidence interval of -0.01 to -0.05. This difference between monarchies and civilian dictatorships is -0.039, and has a 95% confidence interval of -0.02 to -0.06.

other types of political regimes, but there appears to be surprisingly little difference in crisis-risk between democracies, military dictatorships, and civilian dictatorships.

b. Robustness

These results are also highly robust to different measures of the main independent and dependent variables.¹⁷ Following Reinhart and Rogoff (2009), we defined currency crises as any depreciation that is greater than 25% regardless of the rate of change in depreciation. We also used Laeven and Valencia's (2008) criterion for a currency crisis: a depreciation in excess of 30% that is also an increase in the rate of depreciation by at least 10%. Monarchic regimes continued to have negative and statistically significant coefficients when using these alternative measures of currency crisis. We also estimated the models using three alternative classifications of political regimes: Hadenius and Teorell's (2007) typology, which distinguishes between single-party and multi-party dictatorships; Geddes et al.'s (2012) dataset, which treats personalist dictatorships as a fifth major regime type; and Kailitz's (2013) seven-fold classification of political regimes. The results were very similar using these alternative measures: in each case, monarchic regimes stand alone as the only political regime that returned a statistically significant coefficient.

The main results were also similar when alternative estimation strategies and samples were employed. Since currency crises are a relatively uncommon occurrence, we estimated the model using King and Zeng's (2001) rare-events logistic regression. We also modeled temporal interdependencies in different ways, such as including a natural cubic spline (as suggested by Beck, Katz and Tucker 1998) and adding a cubic polynomial of the time since the last crisis (as

¹⁷ These results are not included for reasons of space, but are available upon request.

proposed by Carter and Signorino 2010). We also examined the results when we excluded the 23 advanced industrial democracies from the sample. Finally, we used multiple imputation techniques to generate complete datasets of 7166 observations from 204 countries.¹⁸ In all cases, the results were substantively similar.

This finding that monarchic regimes stand out as far less likely to experience currency crises than other types of political regimes is striking, particularly because monarchies are comparatively understudied among authoritarian regimes and generally assumed to be highly anachronistic (Davidson 2012). The next three models in Table 3 seek to address the possibility that it is not monarchy itself, but other factors associated with monarchy, that reduce the risk of currency crises. One might worry, for instance, that the monarchy variable is capturing the effect of some other omitted variables. Many monarchies are oil producers, and it is possible that it is resource wealth that reduces the risk of currency crisis. Another possibility is that monarchies are capturing some dynamic of the Middle East, and that there may be some important omitted regional effect. Third, religion may be important. Many monarchic regimes have large, observant Muslim populations, and one might wonder if Islam, perhaps because of the prohibition on interest-bearing assets, accounts for the low risk of currency crisis in monarchic regimes. Finally, many monarchies are former British colonies, and it is possible that their British legal systems contribute to stronger economic performance (e.g. La Porta et al. 1999). To address these concerns, the second model in Table 3 includes four variables that control for these alternative explanations: a dummy for Middle Eastern and North African countries; oil and gas production per capita (logged); the percentage of the population that is Muslim; and a dummy

¹⁸ Multiple imputation was conducted with Amelia II (Honaker et al. 2011).

denoting whether countries have a British legal system.¹⁹ None of these additional controls is statistically significant. Most important for our purposes, monarchy remains negative and statistically significant after controlling for the effects of these variables. In this model, monarchies are estimated to reduce the probability of a currency crisis by 3.3 percentage points relative to democracies when holding all other variables at their means/medians.

We also examined whether oil wealth and monarchies have an interactive effect on currency crises. Figure 2 presents the main results from an interactive specification, where we added multiplicative interaction terms between oil production and each authoritarian regime type to the basic model. This figure shows that, irrespective of their oil wealth, monarchies are less susceptible to currency crises than all other types of political regimes (though the negative effect of monarchy falls slightly short of statistical significance, with $p = 0.14$, when there is zero oil). However, oil appears to help monarchies further insulate themselves from the risk of currency crises: monarchies with oil wealth have extremely low risks of currency crises. By contrast, other regimes receive no such benefits from oil, and may even become more prone to crises as their oil wealth increases. Thus, oil does not alter the relationship between political regimes and currency crises, but it does magnify these differences considerably.

Next, to further address the concern that there are some other unmeasured factors that coincide with monarchies that are responsible for their low crisis risk, model 3 adds a fixed effect for each unit to the previous specification.²⁰ The fixed-effect estimator has one limitation

¹⁹ The classification of Middle Eastern and North African countries is based upon the World Bank (2012). Oil data are from Ross (2012), and data on Muslim share of population and legal origin are from La Porta et al. (1999). We also tried including oil per capita and its square in the model to test for a quadratic relationship. Neither variable was statistically significant in this specification, and they did not alter the effect of monarchy.

²⁰ Several of the time-invariant explanatory variables are dropped due to perfect collinearity with the country fixed-effects. A random-effects probit estimator produced similar results.

in this application: since it estimates the effect of political regime type on crisis using only over-time variation, it relies solely on the small number of monarchies who experienced a regime change in the sample period. In spite of this limitation, it is potentially useful since it controls for all constant but unmeasured sources of variation in countries' crisis-risk. The results indicate that monarchy is negative and statistically significant in the fixed-effects specification. This reflects the fact that several countries, including Ethiopia, Iran, and Nepal, experienced far fewer currency crises when they were monarchies than when they were other regime types.

For additional tests of robustness, we also used matching statistical techniques to assess the causal effect of monarchic regimes on currency crises. Here, we used a nearest-neighbor matching technique to compile a dataset of 572 observations, which consists of 286 monarchic country-years and the 286 non-monarchies that are most similar to the monarchic observations on the basis of the covariates used in model 2.²¹ Although the matching process provided reasonably good covariate balance, we use parametric estimation on the matched dataset in order to control for any remaining differences between the treatment and control groups (Ho et al. 2007). Model 4 presents our probit estimates based upon this sample of 572 observations, which reveal that monarchic regimes again reduce the probability of a currency crisis. Based on the estimates from model 4, the average marginal effect of monarchy is -0.05, an effect that is similar in magnitude to those obtained in the previous models.

The control variables included in this model also influence the risk of currency crisis. As expected, the lagged dependent variable consistently returns a positive and statistically significant coefficient, which indicates that a currency crisis in the recent past increases the risk

²¹ Matching was conducted using MatchIt (Ho et al. 2007).

of a currency crisis in the current year. Currency crises are also more likely in poorer countries, smaller countries, and in years where many other countries experience currency crises.

In sum, the results show that military and civilian dictatorships do not reduce the likelihood of a currency crisis. Monarchic regimes, though, are less likely than other regime types to suffer from a currency crisis. These results hold across a variety of measures, model specifications, and estimation strategies. Holding constant some exogenous features of national and global economies, monarchies consistently have a substantially lower risk of currency crisis than other types of political regimes.

c. How Monarchies Prevent Crises: The Mediating Effect of Macroeconomic Policy

Our first set of analyses established that monarchies decrease the likelihood of currency crises. This next set of analyses seeks to shed light on why monarchic regimes have such an effect. Our theory suggested that political regime type matters primarily because it affects leaders' incentives to adopt prudent macroeconomic policies. If, as we posit, variation in macroeconomic fundamentals accounts for differences in crisis-risk across political regimes, monarchies should have little effect on currency crises when macroeconomic fundamentals are held constant.

We focus on the three policies that have received the most attention in the economics literature on currency crises: overvalued exchange rates, foreign reserves, and inflationary monetary policies. Exchange rate overvaluation is measured here, following Rodrik (2008), as the difference between the real exchange rate and the equilibrium real exchange rate, where the latter is estimated as the real exchange rate that is predicted based upon a country's (logged) GDP per capita and a set of year dummies. The ratio of non-gold foreign reserves to GDP is to

capture the size of a country's reserve holdings. The logged inflation rate is used as an indicator of loose and inflationary monetary policies.²² Although governments do not have perfect control over their inflation rates, their policies are a leading determinant of whether inflation is at a low rate, consistent with currency stability, or if inflation is high enough that problems in the foreign exchange market become likely. We focus on inflation because it has a much stronger relationship with currency crises than alternative indicators of this concept, such as domestic credit growth and money supply growth.²³

To test this hypothesis, our next set of analyses adds these variables to our baseline model. These results are presented in Table 4. All five models in Table 4 focus on an identical sample of 4413 observations to make it easier to compare the results of each model. The first model in Table 4 is our benchmark specification that does not include any indicators of macroeconomic policy. Each of the next three models includes a different indicator of macroeconomic policy. The final model includes all three measures of macroeconomic fundamentals.

These results largely support our argument that macroeconomic fundamentals are responsible for the relationship between monarchies and low crisis-risk. First, each of these macroeconomic fundamentals influences the risk of currency crisis in the manner expected: overvalued exchange rates, low quantities of foreign reserves, and high inflation rates all

²² Heston et al.'s (2012) data were used to construct the real exchange rate index. Data on inflation and foreign reserves are from World Bank (2012). To preserve all observations, we recoded all countries with negative inflation rates as having zero inflation, and then added one to all countries' inflation rates prior to taking the log transformation.

²³ The pairwise correlation between currency crisis and inflation ($r = 0.25$) is far stronger than the correlation between currency crisis and either domestic credit growth ($r = -0.003$) and money supply growth ($r = 0.05$). We also compared the pseudo R-squared statistic, a measure of goodness-of-fit, when using each of these three variables in the model. Using identical samples, the pseudo R-squared was 0.14 when inflation was used in the model, but 0.10 in the other two cases.

increase the risk of currency crisis. The results of the first model, which does not include any indicators of macroeconomic fundamentals, are nearly identical to the earlier model. As shown in Figure 3, when we do not control for any macroeconomic fundamentals, monarchies reduce the probability of a currency crisis by about 2.5 percentage points, and this effect is statistically significant.²⁴

Model 2 and the second row of Figure 3 demonstrate that monarchies retain their negative and statistically significant impact on the likelihood of currency crises when controlling for exchange rate overvaluation. This suggests that exchange rate policy does not account for much of the negative effect of monarchies on currency crises. High foreign reserve holdings appear to be a much more important part of the reason why monarchies have a low risk of currency crisis. The inclusion of foreign reserve holdings in model 3 decreases the size of the effect of monarchies, and renders monarchies statistically insignificant. In model 4, we find that the effect of monarchies on currency crises is smaller, and no longer statistically significant, when holding inflation rates constant. Monarchies have an even smaller effect in model 5, which controls for all three macroeconomic variables. When holding all three of these macroeconomic variables constant, monarchies are estimated to reduce the probability of a currency crisis by only 1.2 percentage points—less than half the size of the estimated effect from the original model—and this effect is not statistically significant. Overall, Table 4 and Figure 3 indicate that the risk of a currency crisis in monarchies differs little from other regime types when macroeconomic fundamentals are held constant.²⁵ These results suggest that prudent

²⁴ To generate these first-differences, we again hold the control variables at their mean or median values.

²⁵ We reach similar conclusions when utilizing more formal statistical techniques to decompose the effect of monarchy into a direct effect and an indirect effect. Results available upon request.

macroeconomic policies play a large, perhaps even dominant, role in explaining why monarchies experience fewer currency crises than other political regime types.

VI. Conclusion

A country's political regime type influences whether its financial system is stable or whether it suffers recurring currency crises. However, the evidence suggests that, when it comes to currency crises, the common distinction between democratic and dictatorship may be less important many would expect. In fact, the results suggest that currency crises are no more or less likely in democracies than in civilian or military dictatorships. Our counterintuitive findings indicate that one political regime stands alone for its superior ability to prevent currency crises: monarchies. Monarchic regimes have a lower risk of currency crisis than all three other major types of political regimes. The results also showed that the primary reason why this is the case is that monarchies adopt more prudent monetary and foreign reserve policies.

These findings offer new insights about the comparative study of political regimes and financial crises. One important implication is that regime type strongly influences the incidence of currency crises. A second insight is that authoritarian contexts matter and vary in dramatic ways. Along with a burgeoning literature on comparative authoritarianism, our research shows that the differences among monarchic, civilian, and military dictatorships are often as great as those between dictatorship and democracy.

It is somewhat surprising that democratic regimes are no more likely to experience currency crises than civilian or military dictatorships. This finding stands at odds with the expectations of our theory, which anticipated that democratic regimes should be the most crisis-

prone regime type because of high degrees of political decentralization, short tenures for national leaders, and low clarity of responsibility. Why might the frequency of currency crises be no higher in democratic regimes than in certain authoritarian sub-types? Possible reasons include the existence of an independent and critical media that makes it more difficult for democratic leaders to deflect blame; leaders' concern with the party brand, causing them to care more about future economic performance than we expected; or the ability of elections to weaken the influence of special interest groups that prefer imprudent policies. This suggests some refinement of our theory may be in order, and leave this as an area for future research.

Another implication of this study is that macroeconomic fundamentals represent an important mechanism through which political regimes influence the risk of currency crises. Leblang and Satyanath (2006: 247) suggest that macroeconomic imbalances are an “obvious way” that institutions can influence the risk of currency crises. While this may be the case, the existent literature has largely overlooked this supposedly obvious mechanism. Most large-N research on currency crises neglects the role of macroeconomic fundamentals, and focuses instead on how institutions shape investors' expectations (e.g. Block 2003; Leblang 2002; Leblang and Bernhard 2000; Leblang and Satyanath 2006), or how governments respond after speculators have already put tremendous pressure on the currency (e.g. Chiu and Willett 2009; Leblang 2003; Sattler and Walter 2010). Our results suggest that macroeconomic fundamentals are one of the most important reasons why institutions influence the risk of financial crises.

Building on this last point, one final implication from this study is the inescapable influence of domestic politics upon financial stability. No explanation of currency crises is complete without reference to politics and political incentives. Perverse political incentives bear

much of the responsibility for why the global economy has witnessed so many financial crises over the last generation.

Table 1: Summary Statistics for Four Political Regimes

	All Countries	Democracy	Civilian Dictatorship	Military Dictatorship	Monarchy
Currency Crisis	0.07 [0.06, 0.08]	0.07 [0.06, 0.08]	0.09 [0.08, 0.10]	0.11 [0.09, 0.13]	0.02 [0.01, 0.03]
Reserves/GDP	0.15 [0.14, 0.15]	0.12 [0.11, 0.12]	0.15 [0.14, 0.16]	0.11 [0.09, 0.12]	0.20 [0.18, 0.22]
Overvaluation	0.00 [-0.01, 0.01]	0.01 [-0.001, 0.03]	-0.02 [-0.05, 0.01]	0.03 [0.002, 0.06]	-0.12 [-0.15, -0.08]
Inflation	34.93 [23.66, 46.20]	32.41 [20.41, 44.42]	48.13 [28.51, 67.75]	54.17 [0.40, 107.93]	6.42 [5.70, 7.04]

Note: Cell entries are the mean and 95% confidence interval of the mean values for each political regime type. The coding of political regimes is from Cheibub et al. (2010). Currency crisis was constructed by the authors following the definition of Frankel and Rose (1996), using data from Heston et al. (2012). Reserves/GDP is defined as central bank foreign reserves divided by GDP (Source: World Bank 2012). Overvaluation indicates the degree of real exchange rate over/undervaluation, and is constructed by the authors following the approach of Rodrik (2008) using data from Heston et al. (2012). Inflation is the percentage change in the consumer price index (Source: World Bank 2012).

Table 2: The Expected Effect of Political Regimes on Currency Crises

Political Regime Type	Insulation From Domestic Pressures	Ability to Attribute Blame	Time Horizons	Expected Risk of Crisis
<i>Democracy</i>	Low	Low	Low	HIGH
<i>Monarchy</i>	High	High	High	LOW
<i>Military</i>	Medium	Medium	Medium	MEDIUM
<i>Civilian</i>	Medium	Medium	Medium	MEDIUM

Table 3: The Estimated Effect of Political Regimes on Currency Crises

	(1)	(2)	(3)	(4)
Monarchy	-0.48*** [0.17]	-0.48** [0.24]	-4.12*** [0.18]	-0.63** [0.28]
Civilian Dictatorship	0.08 [0.09]	0.02 [0.10]	-0.15 [0.17]	
Military Dictatorship	0.02 [0.08]	-0.02 [0.10]	-0.10 [0.10]	
Lagged Currency Crisis	0.64*** [0.09]	0.61*** [0.08]	0.21** [0.09]	0.87*** [0.30]
GDP Per Capita	-8.4e-6 [7.8e-6]	-0.00002* [9.6e-6]	-0.0001*** [0.00003]	-0.00004 [0.00006]
Real GDP	-4.0e-13** [2.0e-13]	-4.5e-13** [2.3e-13]	4.5e-14 [3.8e-13]	-1.6e-11** [8.0e-12]
Contagion	0.02*** [0.003]	0.02*** [0.003]	0.02*** [0.003]	0.02 [0.01]
Trade/GDP	-0.01*** [0.001]	-0.01*** [0.001]	-0.01*** [0.003]	-0.01* [0.004]
Oil Per Capita		0.02 [0.02]	0.06 [0.06]	-0.01 [0.05]
Muslim Population		-0.002 [0.002]		-0.004 [0.003]
British Legal System		-0.09 [0.10]		1.64* [0.91]
Mid East & N. Africa		0.13 [0.21]		1.70* [0.97]
Constant	-1.14*** [0.12]	-1.05*** [0.13]	-0.64** [0.26]	-2.20** [0.87]
Countries	178	164	117	54
Years	37	35	35	35
Observations	5262	4623	3514	572
Pseudo R ²	0.11	0.11	0.16	0.21

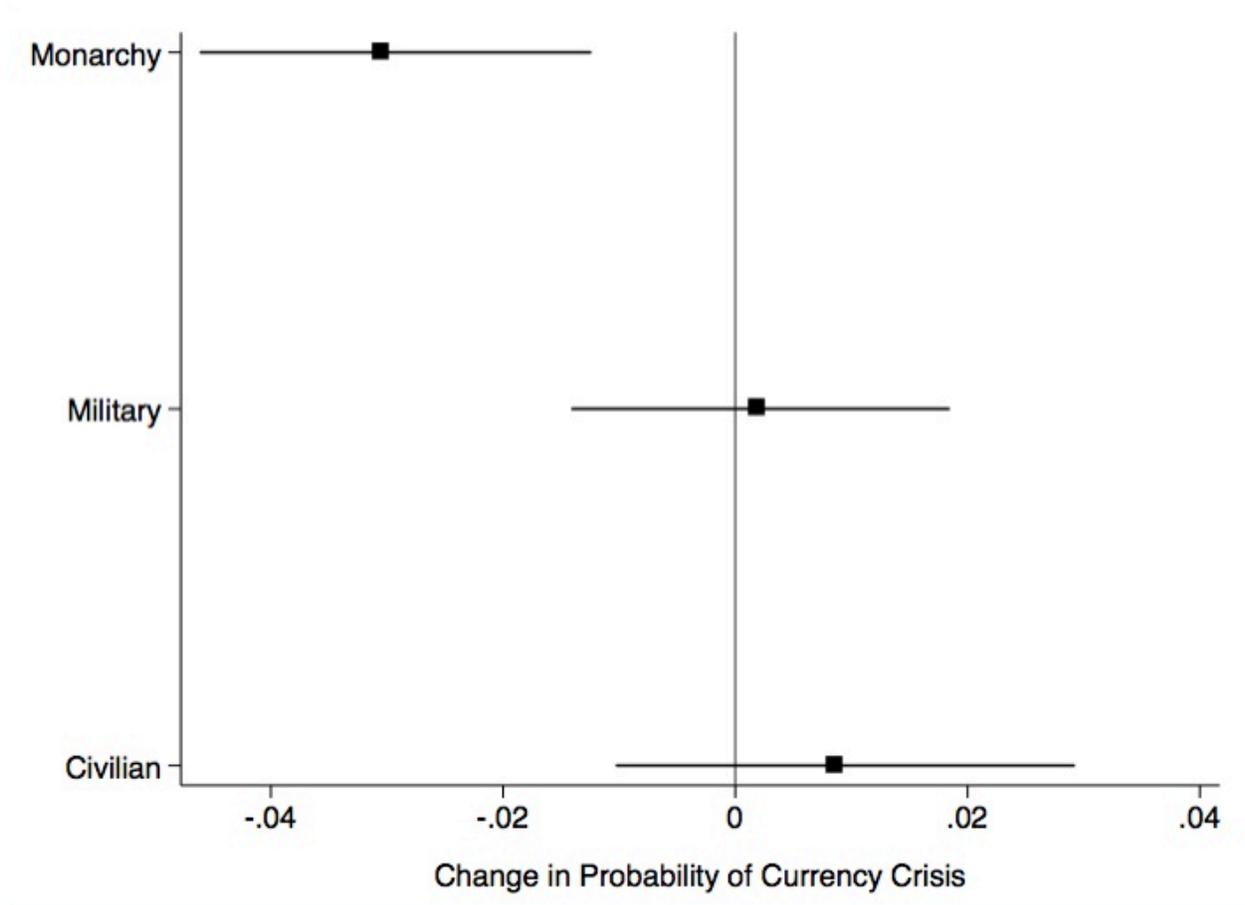
Note: Democratic regimes are the omitted regime category. Clustered standard errors are in parentheses. *p< .1 **p< .05 ***p< .01.

Table 4: The Estimated Effect of Macroeconomic Fundamentals on Currency Crises

	(1)	(2)	(3)	(4)	(5)
Monarchy	-0.40** [0.18]	-0.40** [0.18]	-0.32 [0.20]	-0.26 [0.16]	-0.19 [0.17]
Civilian Dictatorship	0.01 [0.10]	-0.02 [0.11]	-0.01 [0.11]	0.01 [0.09]	-0.05 [0.10]
Military Dictatorship	0.02 [0.09]	-0.02 [0.09]	0.005 [0.09]	0.07 [0.08]	0.02 [0.08]
Lagged Currency Crisis	0.50*** [0.10]	0.62*** [0.10]	0.55*** [0.10]	0.18* [0.10]	0.20* [0.10]
GDP Per Capita	-7.9e-6 [8.3e-6]	-0.00001 [8.8e-6]	-9.8e-6 [8.6e-6]	-3.3e-6 [7.7e-6]	-8.5e-6 [8.3e-6]
Real GDP	-3.8e-13** [1.9e-13]	-3.8e-13** [1.9e-13]	-3.7e-13** [1.9e-13]	-3.3e-6** [1.6e-13]	-3.2e-13** [1.6e-13]
Contagion	0.01*** [0.003]	0.01*** [0.003]	0.01*** [0.003]	0.01*** [0.003]	0.01*** [0.003]
Trade/GDP	-0.01*** [0.001]	-0.01*** [0.001]	-0.01*** [0.002]	-0.01*** [0.001]	-0.005*** [0.001]
Overvaluation		0.20* [0.13]			0.26** [0.13]
Reserves/GDP			-1.50** [0.68]		-1.01* [0.52]
Inflation (Logged)				0.27*** [0.030]	0.27*** [0.03]
Constant	-1.11*** [0.13]	-1.09*** [0.13]	-1.02*** [0.14]	-1.90*** [0.14]	-1.82*** [0.15]
Countries	169	169	169	169	169
Years	37	37	37	37	37
Observations	4413	4413	4413	4413	4413
Pseudo R ²	0.10	0.11	0.11	0.15	0.16

Note: Democratic regimes are the omitted regime category. Clustered standard errors are in parentheses. *p< .1 **p< .05 ***p< .01.

Figure 1: Marginal Effects



Note: Squares indicate the difference in the predicted probability of currency crisis compared to democratic regimes. Lines indicate 95% confidence intervals of these first-differences.

Figure 2: Oil Wealth, Political Regimes and Currency Crises

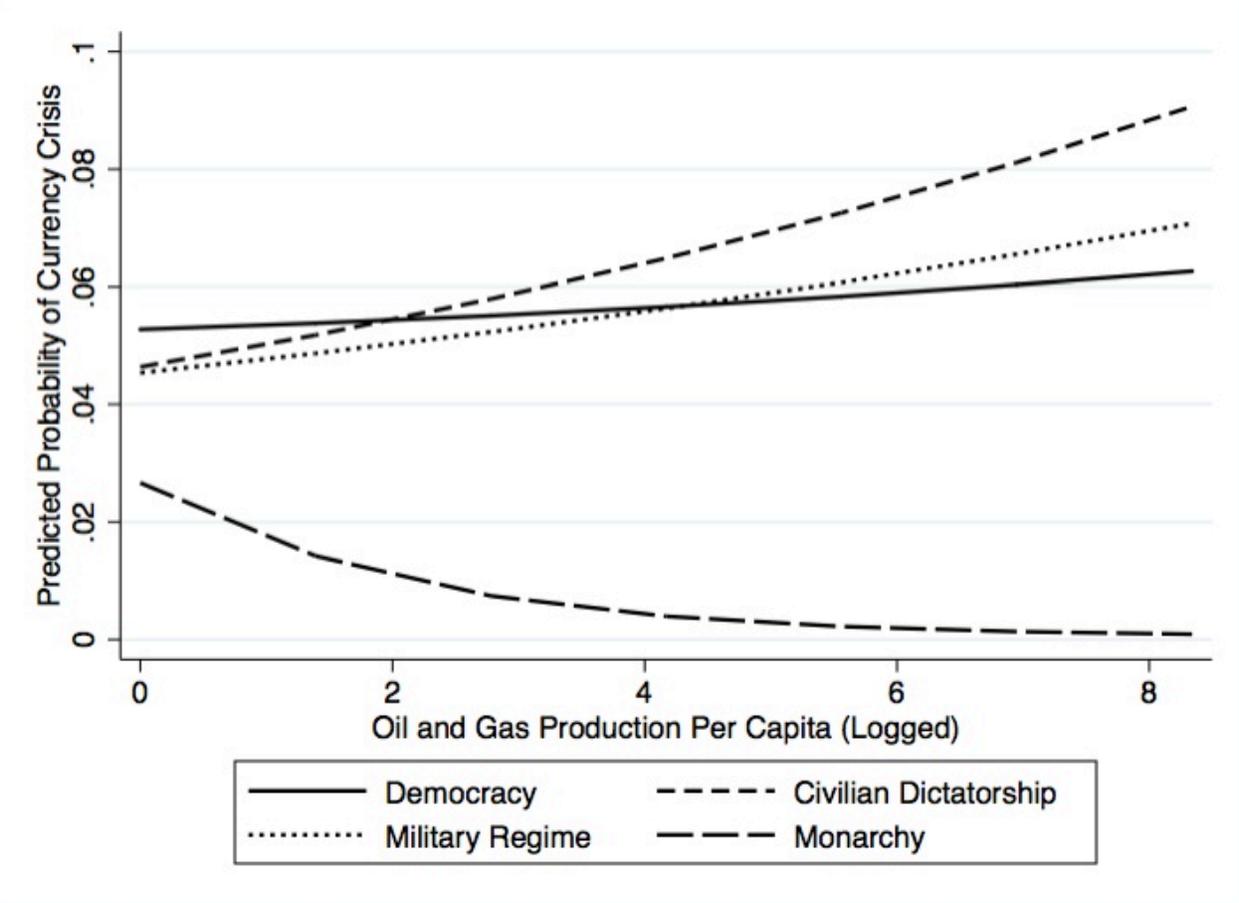
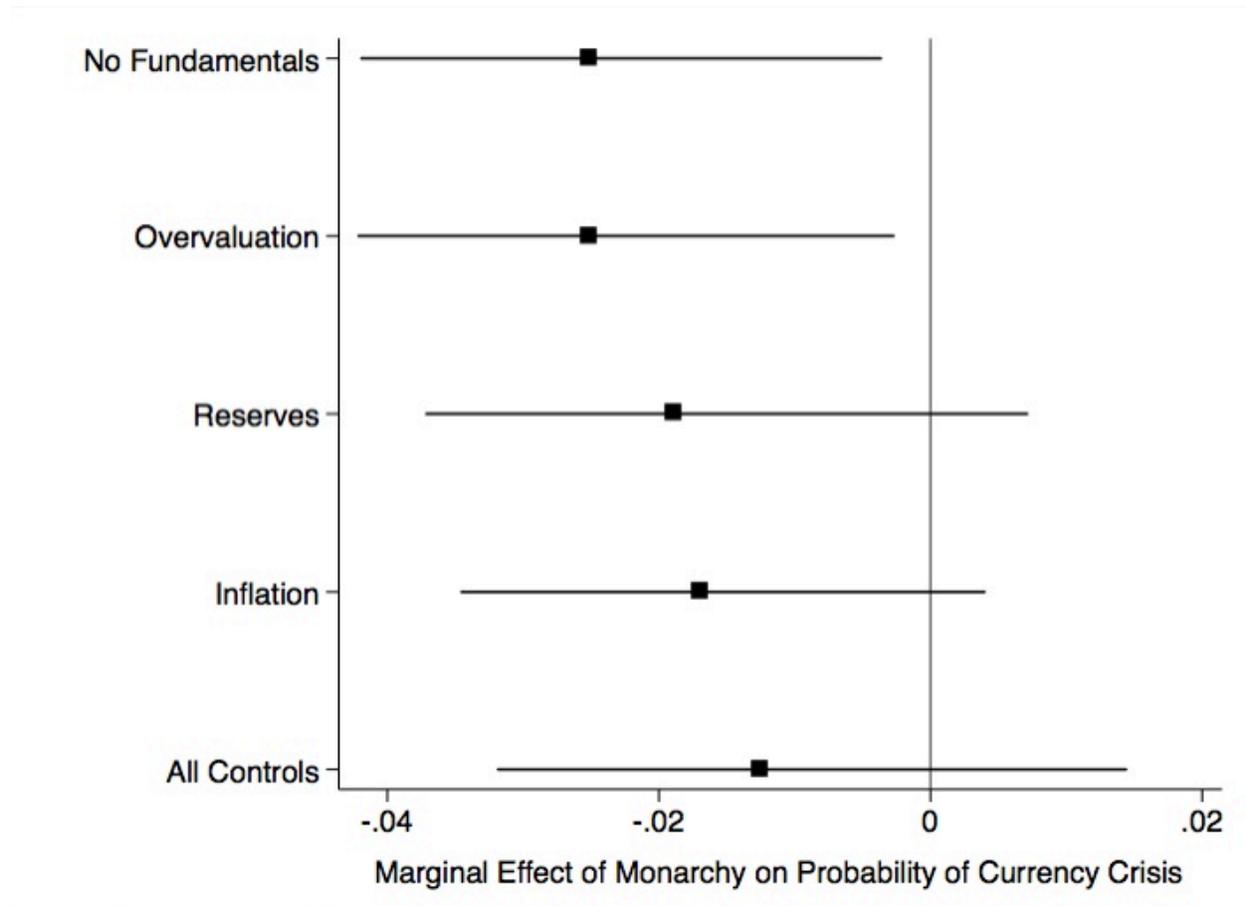


Figure 3: The Mediating Effect of Macroeconomic Fundamentals



Note: Squares indicate the predicted probability of a currency crisis in monarchies minus the predicted probability of a currency crisis in democratic regimes. Lines indicate 95% confidence intervals of these first-differences. The row labels indicate which, if any, macroeconomic fundamentals are included as controls in the model specification.

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