Populism and Central Bank Independence

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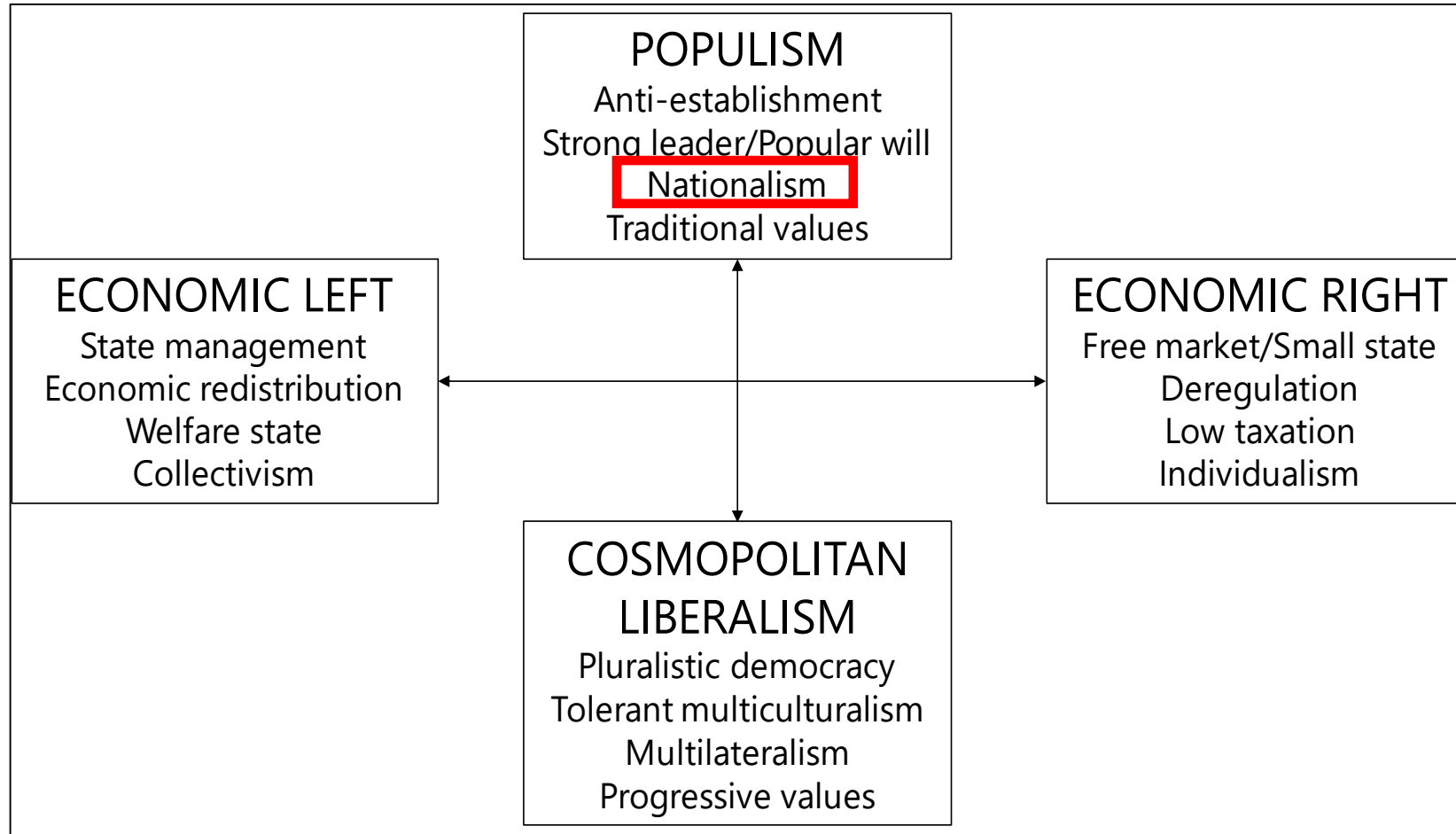
Central bank independence under stress

- The potential for populist political movements to affect central bank independence (CBI) discussed in press, policy debates, and academic literature (e.g., Goodhart and Lastra, 2018)

- Empirically, we can see that average global CBI has indeed plateaued since GFC (e.g., Masciandaro and Romelli, 2015, 2018)

- But can we empirically tie CBI to populism? Can we go beyond individual case studies and have broad, cross-country evidence on this relationship?

- Key constraint: how do measure populism across countries, and over time?

Measuring the link to populism

What we need from a populism measure

- Central bank independence measures are relatively short-lived, but have a wide cross-section.

- To study the link to populism, we need a measure of populism that is available for a wide array of countries, unlike political spectrum variable

- This also allows us to study the linkage where it may have been most prominently visible historically: among developing countries

- Take a step back to a definition of populism:

Defining characteristics of populism

POPULISM
Anti-establishment
Strong leader/Popular will
Nationalism
Traditional values

ECONOMIC LEFT
State management
Economic redistribution
Welfare state
Collectivism

ECONOMIC RIGHT
Free market/Small state
Deregulation
Low taxation
Individualism

COSMOPOLITAN LIBERALISM
Pluralistic democracy
Tolerant multiculturalism
Multilateralism
Progressive values

Source: Inglehart and Norris (2016)

Data on nationalism

- World Bank's Database of Political Institutions (DPI) has data on nationalism in politics since 1975 for 178 countries

- Party counted as nationalist if "a primary component of its platform is the creation or defense of a national or ethnic identity"

- Applied to: chief executive, largest government party, largest opposition party
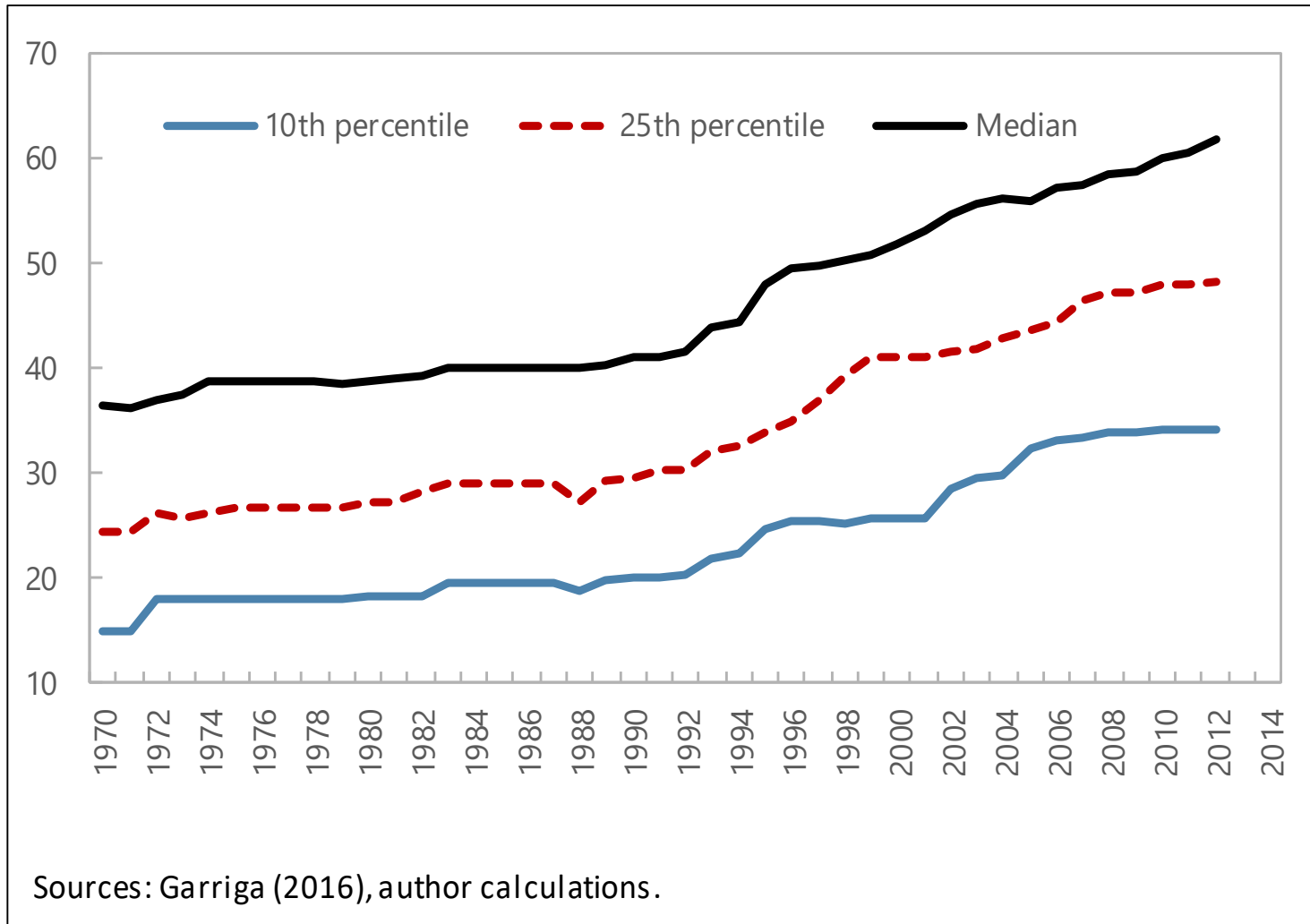
Match to CBI data

- Political variables change infrequently: need CBI dataset of maximum scope (countries & time) to fully exploit the variation in the political data. Implies choice for *de jure* measures of CBI

- De jure CBI does not guarantee de facto CBI. However, statutory reforms towards increased CBI are a policy statement, a desire to untie the central bank and the government. In the practice of monetary reform, *de jure* CBI is often a prerequisite for *de facto* CBI and successful monetary reform more broadly

- Use Garriga (2016) CBI index, 182 countries since 1970. Includes 382 instances of CBI reform, including 56 cases of CBI reduction

CBI & nationalism: a first glance at the data

Sources: Garriga (2016), World Bank DPI, author calculations
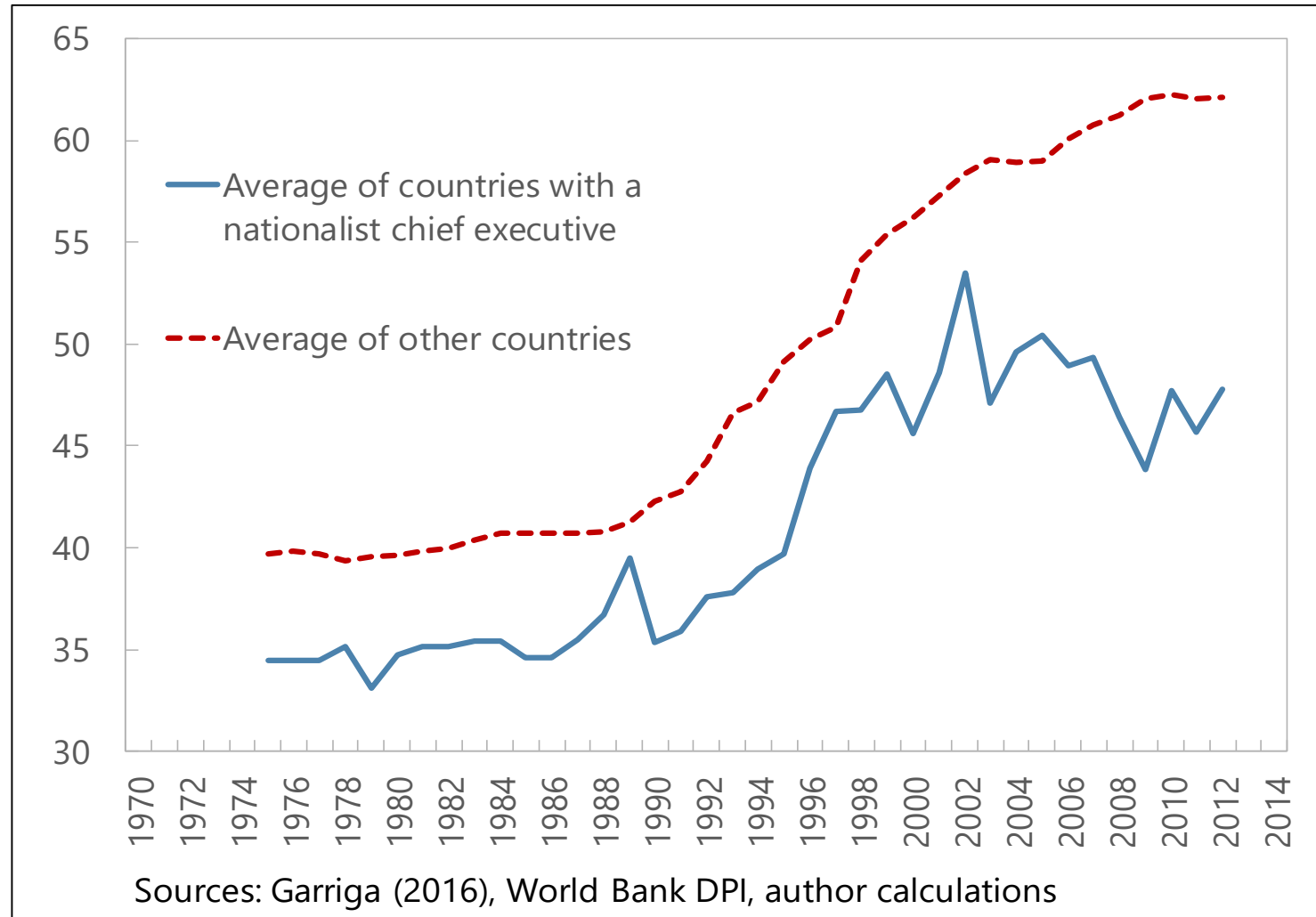
Country development effect? Maybe not

Sources: Garriga (2016), author calculations.

Panel regression methodology

- Panel with country fixed effects, 113 developing countries, 1975-2012

- 4 macro variables: trade openness, GDP per capita, financial depth and lagged inflation. Approach follows Dincer and Eichengreen (2014), but with longer sample & added nationalism variables

- Nationalism variables: as single index, and one-by-one, in separate specifications

- Other institutional control variables added (shortens sample, as based on ICRG, available for fewer countries, and since 1984).

	(1) Baseline	(2) Institutional controls 1	(3) Institutional controls 2	(4) Nationalist government	(5) Nationalist chief exec.	(6) Nationalist opposition
Trade openness	0.156***	0.0874***	0.127***	0.0981***	0.0920***	0.0924***
	(0.0239)	(0.0311)	(0.0311)	(0.0298)	(0.0302)	(0.0309)
GDP per capita	0.159***	0.149***	0.182***	0.148***	0.154***	0.149***
	(0.0105)	(0.0129)	(0.0136)	(0.0121)	(0.0123)	(0.0127)
Lagged inflation	-0.116***	-0.0305	-0.0764***	-0.0333	-0.0311	-0.0316
	(0.0149)	(0.0208)	(0.0190)	(0.0205)	(0.0207)	(0.0207)
Financial depth	0.0780***	0.0450***	0.0454**	0.0404**	0.0416***	0.0448***
	(0.0152)	(0.0160)	(0.0176)	(0.0158)	(0.0159)	(0.0159)
Nationalism index	-0.0482**	-0.0762***	-0.0826***			
	(0.0215)	(0.0238)	(0.0253)			
Ethnic tension index (up = lower tension)		0.0352*		0.0307	0.0296	0.0324
		(0.0208)		(0.0199)	(0.0202)	(0.0205)
Political risk index (up = lower risk)		0.219***	0.130*	0.179**	0.169**	0.221***
		(0.0797)	(0.0680)	(0.0748)	(0.0754)	(0.0796)
Government stability index (up = higher stability)		0.00154	0.0459	0.0154	0.0158	-0.000288
		(0.0285)	(0.0299)	(0.0274)	(0.0276)	(0.0283)
Bureaucracy quality index (up = higher quality)		0.0175		0.0132	0.0136	0.0158
		(0.0238)		(0.0225)	(0.0227)	(0.0237)
Politcal fragmentation index (up = more fragmented)		0.0568***	0.0602***	-0.000738	-0.000975	0.0564***
		(0.0185)	(0.0194)	(0.00203)	(0.00205)	(0.0184)
Nationalist largest government party				-0.0793**		
				(0.0401)		
Nationalist chief executive					-0.0862**	
					(0.0409)	
Nationalist largest opposition party						-0.0560*
						(0.0330)
Constant	1.775***	1.188***	1.136***	1.264***	1.277***	1.183***
	(0.113)	(0.308)	(0.220)	(0.293)	(0.297)	(0.307)
Observations	2,145	1,294	1,563	1,380	1,357	1,313
R-squared	0.266	0.239	0.281	0.218	0.221	0.231
Number of countries	113	77	84	80	80	77

Standard errors in parentheses

*** $p<0.01$, ** $p<0.05$, * $p<0.1$

A different angle: institutional quality & CBI

Institutional quality

- A different approach is to take as given that populist forces are capable of influencing institutional quality, and ask how clear the evidence is that institutional quality matters for CBI

- Might seem obvious, but actually: largest previous study on a broad set of institutional determinants, Dincer and Eichengreen (2014), found *negative* relation:

  "there is no evidence that countries with more robust institutions strengthened the independence of their central banks, perhaps because the level of central bank independence was already high. If anything, the opposite is true."

- Rule of law, political stability, government efficiency, voice & accountability, and regulatory quality *negatively* affect CBI, according to their results

Re-examining the relationship

- However, behind "perhaps because the level of central bank independence was already high" lies a clue: their sample length, starting in 1998, may be too late to fully capture a slow-moving interaction between institutions and CBI

- Re-examine with our longer and broader sample. In previous regression various institutional variables added simultaneously, to give nationalism hardest "hurdle" to be significant

- Now add institutional quality variables one by one, to investigate individual significance. Sample 114 countries since 1984

	(1) Baseline	(2) Bureaucracy quality	(3) Corruption	(4) Democratic accountability	(5) Ethnic tension	(6) External conflict	(7) Govt. stability	(8) Internal conflict
Trade openness	0.141***	0.131***	0.128***	0.128***	0.140***	0.138***	0.126***	0.135***
	(0.0127)	(0.0126)	(0.0128)	(0.0127)	(0.0127)	(0.0128)	(0.0127)	(0.0127)
GDP per capita	0.513***	0.504***	0.472***	0.502***	0.524***	0.524***	0.519***	0.524***
	(0.0351)	(0.0346)	(0.0354)	(0.0348)	(0.0353)	(0.0352)	(0.0347)	(0.0350)
Lagged inflation	-7.965***	-7.706***	-7.549***	-7.396***	-7.963***	-7.981***	-6.676***	-7.514***
	(0.677)	(0.668)	(0.675)	(0.675)	(0.676)	(0.676)	(0.687)	(0.679)
Financial depth	0.130	0.132	0.0170	0.121	0.133	0.158	0.183	0.220
	(0.411)	(0.405)	(0.408)	(0.407)	(0.410)	(0.410)	(0.406)	(0.409)
Bureaucracy quality index		3.410***						
		(0.402)						
Corruption index			-1.853***					
			(0.292)					
Democratic accountability index				1.742***				
				(0.242)				
Ethnic tensions index					0.846***			
					(0.283)			
External conflict index						0.479***		
						(0.148)		
Government stability index							0.928***	
							(0.115)	
Internal conflict index								0.694***
								(0.135)
Constant	38.91***	32.55***	45.43***	33.22***	35.58***	34.39***	32.52***	33.10***
	(0.959)	(1.207)	(1.400)	(1.236)	(1.471)	(1.694)	(1.233)	(1.483)
Observations	2,578	2,578	2,578	2,578	2,578	2,578	2,578	2,578
R-squared	0.202	0.224	0.214	0.218	0.204	0.205	0.222	0.210
Number of countries	114	114	114	114	114	114	114	114

Standard errors in parentheses; *** p<0.01, ** p<0.05, * p<0.1; Both financial depth and GDP per capita are divided by 1000 for ease of coefficient reading;

The institutional variables are all defined such that an increase is an improvement in institutional quality.

	(9) Investment profile	(10) Law & order	(11) Religious tensions	(12) Socioeconomic conditions	(13) Economic risk	(14) Financial risk	(15) Political risk	(16) Composite risk rating
Trade openness	0.110***	0.142***	0.141***	0.141***	0.125***	0.122***	0.124***	0.113***
	(0.0127)	(0.0127)	(0.0127)	(0.0127)	(0.0129)	(0.0128)	(0.0127)	(0.0128)
GDP per capita	0.367***	0.513***	0.512***	0.518***	0.484***	0.518***	0.493***	0.492***
	(0.0366)	(0.0351)	(0.0351)	(0.0361)	(0.0352)	(0.0347)	(0.0347)	(0.0345)
Lagged inflation	-6.164***	-7.844***	-8.017***	-7.995***	-6.396***	-6.458***	-6.766***	-5.720***
	(0.680)	(0.679)	(0.679)	(0.679)	(0.722)	(0.692)	(0.681)	(0.701)
Financial depth	0.123	0.127	0.120	0.130	0.203	0.241	0.216	0.275
	(0.401)	(0.411)	(0.411)	(0.411)	(0.409)	(0.406)	(0.405)	(0.404)
Investment profile index	1.381***							
	(0.123)							
Law & order index		0.663**						
		(0.296)						
Religious tensions index			-0.320					
			(0.330)					
Socioeconomic conditions index				-0.106				
				(0.170)				
Economic risk index					0.331***			
					(0.0553)			
Financial risk index						0.296***		
						(0.0354)		
Political risk index							0.274***	
							(0.0311)	
Composite risk rating								0.318***
								(0.0318)
Constant	31.80***	36.48***	40.40***	39.48***	28.84***	29.68***	22.66***	19.67***
	(1.131)	(1.449)	(1.804)	(1.317)	(1.933)	(1.454)	(2.070)	(2.142)
Observations	2,578	2,578	2,578	2,578	2,575	2,575	2,575	2,575
R-squared	0.240	0.203	0.202	0.202	0.213	0.224	0.226	0.233
Number of countries	114	114	114	114	114	114	114	114

Standard errors in parentheses; *** $p<0.01$, ** $p<0.05$, * $p<0.1$; Both financial depth and GDP per capita are divided by 1000 for ease of coefficient reading;
The institutional variables are all defined such that an increase is an improvement in institutional quality.

Conclusions

- First cross-country empirical evidence that one aspect of populism – national identity politics – is indeed associated with lower central bank independence

- Holds up in large sample of countries since 1975. Moreover, result remains true when controlling for other institutional variables

- Looking at the potential impact of populism through an alternate angle, the results also confirm that institutional quality in general matters for central bank independence

Backup slide: The political spectrum

Mean of far left and far right vote share
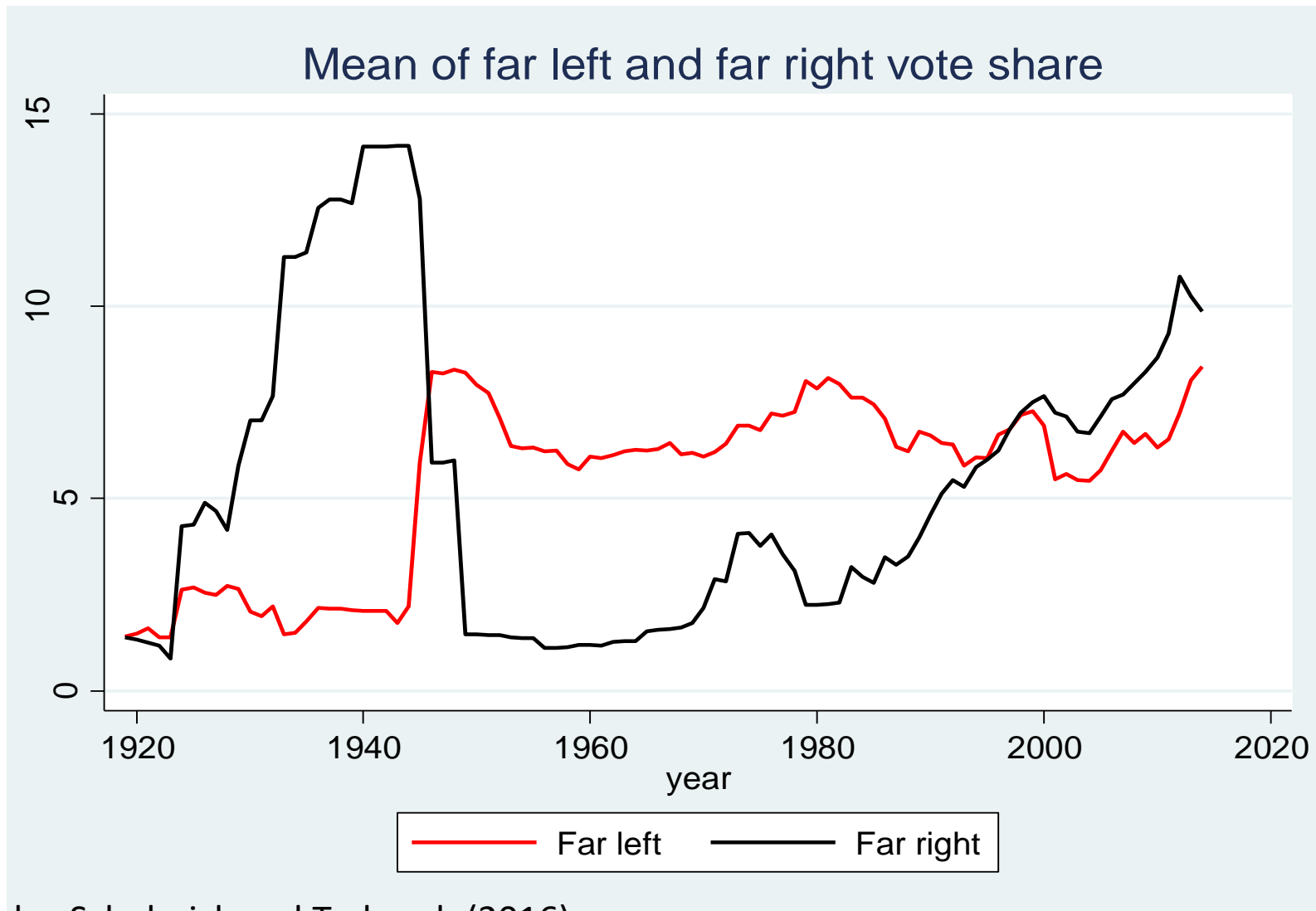
Source: Funke, Schularick and Trebesch (2016)