ELSEVIER

Journal of Banking & Finance 24 (2000) 643–664

Journal of BANKING & FINANCE

www.elsevier.com/locate/econbase

Does central bank independence really matter? New evidence for developing countries using a new indicator

Jakob de Haan *, Willem J. Kooi

Department of Economics, University of Groningen, P.O. Box 800, 9700 AV Groningen, Netherlands

Abstract

This paper provides a new indicator for central bank independence (CBI) based on the turnover rate of central bank governors for 82 developing countries over the period 1980–1989. Using this new indicator it is concluded that this proxy for CBI is related to inflation, only if the high inflation countries are included in the sample. The view that both CBI and inflation are caused by effective opposition towards inflation is not supported. Using both the extreme bound analysis and Sala-i-Martin's method we do not find evidence that CBI is robustly related to economic growth. © 2000 Elsevier Science B.V. All rights reserved.

JEL classification: E42; E58

Keywords: Central bank independence; Turnover rate; Developing countries; Inflation; Economic growth

"Economists and practitioners in the area of monetary policy generally believe that the degree of independence of the central bank from other parts of government affects the rates of expansion of money and credit and, through them, important macroeconomic variables, such as inflation and the size of the budget deficit." (Cukierman et al., 1992, pp. 353–354).

* Corresponding author. Tel.: +31-50-3633706; fax: +31-50-3637337.
E-mail address: j.de.haan@eco.rug.nl (J. de Haan).

PII: S 0 3 7 8 - 4 2 6 6 (9 9) 0 0 0 8 4 - 9

1. Introduction

As follows from the citation above, nowadays is it widely believed that regulation resulting in a high level of central bank independence (CBI) coupled with some explicit mandate for the bank to restrain inflation are important institutional devices to assure price stability. An independent central bank can give full priority to low levels of inflation, whereas in countries with a more dependent central bank other considerations (notably, re-election perspectives of politicians and a low level of unemployment) may interfere with the objective of price stability. Indeed, there is quite some evidence for a negative relationship between central bank independence and inflation (see Eijffinger and De Haan (1996) for a review). This evidence generally consists of cross-country regressions using proxies for CBI based on the statutes of the central bank (e.g., Eijffinger and Van Keulen, 1995). Popular as the view referred to above may be, the empirical literature on the effects of central bank independence recently came under attack.

First, the relevance of independence measures which are based on regulations on the position of the central bank is disputed if it comes to testing whether central bank independence is conducive to lower inflation. For instance, Forder (1996, pp. 43–44) argues that "a central bank may be independent by statute, and it is nevertheless accepted – on all sides – that the government will have its wishes implemented. ... it is quite clear that the reading of statutes is not a measure of independence in the sense required by the theory ... There is no theory that says it matters what the rules say. There is only a theory that says it matters what the behaviour is". Of course, one could conjecture that regulations concerning the position of the central bank may (at least partially) shape the options for the central bank to pursue the kind of policies that it deems necessary. Still, existing indices of central bank independence are often incomplete and noisy indicators of actual independence. For example, laws cannot specify explicitly the limits of authority between central banks and the political authorities under all contingencies. And even when the laws are quite explicit, actual practice may deviate from them (Cukierman et al., 1992; Walsh, 1997). However, this does not mean that legal indicators are uninformative. But, as Cukierman (1995) points out, it does imply that their use should be supplemented by judgement in the light of the problem under consideration. In particular some indices are more appropriate for some purposes than for others. For instance, legal independence measures may be a better proxy for actual independence in industrial countries than in developing countries. Cukierman (1992) and Cukierman et al. (1992) therefore developed a yardstick for central bank autonomy which is not based on regulation but on the actual average term of office of central bank governors in different countries during the period 1950–1989. This indicator is based on the presumption that, at least above some threshold, a higher turnover of central bank governors indicates a