



ELSEVIER

Contents lists available at ScienceDirect

Journal of International Money and Finance

journal homepage: www.elsevier.com/locate/jimf



Political monetary cycles and a *de facto* ranking of central bank independence

Sami Alpanda, Adam Honig*

Amherst College, Department of Economics, 315 Converse Hall, Amherst, MA 01002-5000, United States

A B S T R A C T

Political monetary cycles are less likely to occur in countries with independent central banks. Independent central banks can withstand political pressure to stimulate the economy before elections or finance election-related increases in government spending. Based on this logic and supporting evidence, we construct a *de facto* ranking of central bank independence derived from the extent to which monetary policy varies with the electoral cycle. The ranking avoids well-known problems with existing measures of central bank independence and provides independent information about average inflation and inflation volatility differences across countries.

© 2010 Elsevier Ltd. All rights reserved.

JEL classification:

E52

E58

Keywords:

Political monetary cycles

Central bank independence

1. Introduction

There is a growing consensus on the importance of central bank independence (CBI) in ensuring low and stable inflation rates. Existing measures of CBI have been shown to predict variation in both the level and the volatility of inflation across countries (c.f. Cukierman et al., 1992; Alesina and Summers, 1993). There are, however, well-known problems with these measures. For example, many of the rankings are based on measures of legal independence from the fiscal authorities (c.f. Arnone et al., 2007; Bade and Parkin, 1978; Cukierman et al., 1992; Eijffinger and Schaling, 1993; Grilli et al., 1991; Jácome and Vázquez, 2005).¹ These rankings may be problematic because what is written down in law can be vastly different from actual practice (c.f. Mishkin, 2004). In light of this problem, the

* Corresponding author. Tel.: +1 413 542 5032; fax: +1 413 542 2090.

E-mail address: ahonig@amherst.edu (A. Honig).

¹ For a thorough review of the literature on measures of CBI, see Arnone et al. (2006), Berger et al. (2001), Cargill (2009), Crowe and Meade (2007), and Eijffinger and de Haan (1996).

literature has also considered *de facto* measures of independence. For example, Cukierman et al. (1992) and Sturm and de Haan (2001) rank independence using the average turnover rate of central bank governors. One problem with this measure, however, is that central banks that are not independent could still display little turnover if the central bank governor acts subserviently to the fiscal authority to avoid being forced to resign. Subservient governors will therefore exhibit lower turnover.²

Measuring CBI based on actual monetary policy decisions is also problematic. Specifically, it is difficult to infer the effect that politicians have on monetary policy because many other factors, not necessarily related to CBI, determine policy. Some of these factors are observable and can be controlled for, such as the output gap; countries that grow faster relative to trend might have greater inflation concerns and therefore lower money growth rates. Other factors, however, are unobservable (or difficult to measure) and can therefore be confounded with CBI. For example, countries with dependent central banks could conceivably experience lower average inflation rates than those with independent central banks if there is a cultural aversion to inflation (Hayo and Hefeker, 2002). Measuring relative CBI based on cross-country differences in average inflation or money growth rates would therefore be problematic, even though cross-country differences in average inflation rates are partly due to differences in CBI.³

We search instead for *within*-country variation in monetary policy that reflects CBI and then rank CBI accordingly. We propose election cycles as a source of this variation. Before elections, politicians may place extra pressure on the central bank to expand the economy by loosening monetary policy, creating a political monetary cycle.⁴ This is the first channel through which political manipulation of monetary policy might operate before or during election years, which we refer to as the Phillips curve channel. Second, political monetary cycles might be caused by political *budget* cycles, in which governments use expansionary fiscal policy to expand the economy and/or increase government handouts and transfers to certain constituencies.⁵ These fiscal expansions can in principle be financed through borrowing. In cases where the government's borrowing capacity is limited, however, central banks may be called in to monetize instead. We refer to this as the fiscal-financing channel.⁶

Both channels are less likely to exist, and therefore political monetary cycles are less likely to occur, in countries with independent central banks. Independent central banks can withstand political pressure to stimulate the economy before elections or finance election-related increases in government spending (or tax cuts). Fig. 1 plots the ratio of average money growth during election periods to non-election periods vs. central bank governor turnover for the 52 countries in our ranking.⁷ The graph indicates that countries with high turnover (low CBI) tend to experience larger changes in money growth during election periods. The regression results in Alpanda and Honig (2009) tell a similar story.

² Cukierman et al. (1992) also introduce a second *de facto* measure based on responses from central banks to a questionnaire focusing on central bank practices. The main drawbacks of this measure are that the responses may be biased and the sample size is quite limited.

³ Similarly, using a cross-country regression to estimate the effect of existing measures of CBI on average inflation does not control for unobservable country-specific factors (Walsh, 1997).

⁴ In the political business cycle model of Nordhaus (1975), politicians attempt to lower the unemployment rate before elections to raise their chances of reelection. Implicit in this idea is first, that macroeconomic policy is not neutral (at least in the short-run) and therefore can alter economic outcomes; second, voters reward politicians for higher growth during election years; third, voters value growth more than other economic objectives such as low inflation; and fourth, politicians are willing and able to manipulate policy in order to exploit this short-run non-neutrality for their own benefit. In this paper, we concentrate on the last issue, in particular the presence of political monetary cycles as an indicator of CBI.

⁵ Implicit in this idea is that voters reward politicians for higher overall spending during election years, as opposed to the composition of spending (Drazen and Eslava, 2007), and that they value the fiscal expansion more than low inflation or fiscal discipline. Brender and Drazen (2005) find evidence for political budget cycles, but only in new democracies where voters are inexperienced with electoral politics. De Haan and Zelhorst (1990) find that there is a link between budget deficits and money growth in high inflation years.

⁶ In Alpanda and Honig (2009), we do not find evidence for the fiscal-financing channel and conclude that political monetary cycles are most likely caused by attempts to stimulate the economy by exploiting the Phillips curve. Note that the absence of a fiscal-financing channel is still consistent with the presence of political budget cycles since election-related fiscal expansions may be financed through other means rather than monetization.

⁷ The sample of countries and the data including the definition of election periods are discussed in Section 2.

متن کامل مقاله

دریافت فوری ←

ISIArticles

مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات