



Does high inflation cause central bankers to lose their job? Evidence based on a new data set

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ARTICLE INFO

Article history:

Received 17 December 2007

Received in revised form 30 March 2008

Accepted 1 April 2008

Available online 9 April 2008

JEL code:

E5

Keywords:

Central bank governors

Central bank independence

Inflation

ABSTRACT

This paper introduces new data on the term in office of central bank governors in 137 countries for 1970–2004. Our panel models show that the probability that a central bank governor is replaced in a particular year is positively related to the share of the term in office elapsed, political and regime instability, the occurrence of elections, and inflation. The latter result suggests that the turnover rate of central bank governors (TOR) is a poor indicator of central bank independence. This is confirmed in models for cross-section inflation in which TOR becomes insignificant once its endogeneity is taken into account.

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1. Introduction

In this paper we examine which political and economic factors affect the likelihood that a central bank governor will be replaced. We present new data on the term in office of central bank governors for 137 countries covering the period 1970–2004, thereby substantially extending previous datasets by Cukierman, Webb and Neyapti (1992) and De Haan and Kooi (2000), both regarding the number of countries and the number of years covered. We estimate conditional Logit models of the probability that the central bank governor will be replaced. Our results show that the share of the current term in office elapsed, high levels of political and regime instability, the occurrence of elections, and inflation increase the probability of a turnover.

Our main contribution is that we criticize the use of the so-called turnover rate of central bank governors (TOR) as an indicator of central bank independence (CBI). To examine whether there is any relationship between CBI and inflation, one needs an indicator measuring the extent to which the monetary authorities are independent from politicians. Most empirical studies use an indicator based on central bank laws in place.¹ However, legal measures of CBI may not reflect the true relationship between the central bank and the government (Forder, 1996 and Mangano, 1998). Especially in countries where the rule of law is less strongly embedded in the political culture, there can be wide gaps between the formal, legal institutional arrangements and their practical impact (Walsh, 2005). This is particularly likely in many developing economies. Cukierman et al. (1992) argue that the TOR may therefore be a better proxy for CBI in these countries than measures based on central bank laws. The TOR is based on the presumption that, at least above some threshold, a higher turnover of central bank governors indicates a lower level of independence. Various studies report that countries experiencing rapid turnover among their central bank CEOs also tend to experience high rates of inflation (see, for instance, Cukierman et al., 1992). This is a case, however, in which causality is difficult to

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¹ See Berger et al. (2001) for a survey of the literature on central bank independence.

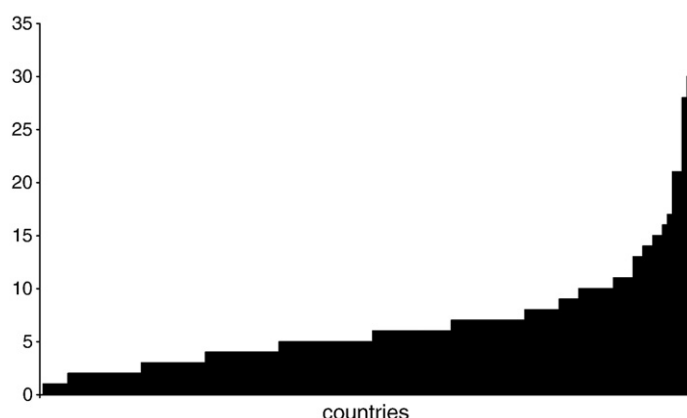


Fig. 1. Frequency distribution of number of governor changes (# countries).

evaluate; is inflation high because of political interference that leads to rapid turnover of central bank officials? Or are central bank officials tossed out because they can't keep inflation down? (Walsh, 2005).² In the latter case, the TOR is a poor indicator of CBI.

Our empirical results suggest that using the TOR as a proxy for CBI is problematic when it comes to measuring the impact of central bank independence on inflation. Since we find inflation to increase the likelihood that the central bank governor will be replaced, turnovers are endogenous to inflation. This is confirmed in models estimating inflation in which the TOR becomes insignificant once its endogeneity is taken into account.

The remainder of the paper is structured as follows. Section 2 describes our data and Section 3 discusses the methodology used. Section 4 presents our estimation results for the likelihood that a central bank governor will be replaced, while Section 5 contains the models for inflation. The final section offers some concluding comments.

2. Data

The database contains information on the term in office of the central bank governor for 137 countries covering the period 1970–2004.³ Most information was received directly from central banks. Some central banks provide data on previous governors on their homepage, while for many other central banks we got the information by writing emails and letters. Additional sources are Morgan Stanley Dean Witter's *Central Bank Directory* and the databases introduced by Cukierman et al. (1992) and Sturm and De Haan (2001).⁴ Our exact sources are listed in Table A1 in the Appendix. Our data cover all geographic regions fairly well. While we tried to get data going back as far as 1970, we did not always succeed either because data were not available for the entire period or because countries came into existence after 1970. Table A1 in the Appendix shows the countries and periods for which we have information, as well as the number of times the central bank governor was replaced during those periods and the average TOR.

Fig. 1 shows the frequency distribution of the number of governor changes during the time period for which we have information. According to our dataset, on average a central bank governor remained in office for 3.6 years. On average, a turnover occurred in 22 percent of the country-years. Argentina (with an average TOR of 0.86) and Ecuador (average 0.80) have the highest turnover rates of the countries in our sample.

Fig. 2 shows the yearly average turnover for our full sample. It is interesting that after 1995, when many countries increased the legal independence of their central bank, the average number of turnovers decreased.⁵

Our dataset also includes information on the legal term in office of the central bank governor. Unfortunately, data is not available for all country-years in our sample. We obtained data on regular office terms for 91 countries, for an average of 30 years, ranging between 7 and 35 years. In some cases the governor's term in office is unlimited, and the most likely reason for a turnover is retirement due to age.

3. Methodology

According to Cukierman (1992), high and sustained inflation leads to the evolution of automatic or semi-automatic accommodative mechanisms, like indexation of contracts in the labour and capital markets that may undermine central bank independence. Alternatively, it may be argued that a high inflation rate may cause the replacement of the central bank governor due to dissatisfaction with this policy outcome (Walsh, 2005). Both arguments, although fundamentally different in their

² Using Granger causality tests, Cukierman et al. (1992) report that causality runs in both directions. De Haan and Kooi (2000) and Sturm and De Haan (2001) report that the TOR indicator only becomes significant if high inflation countries are added to the sample, suggesting that causality may run from inflation to turnovers rather than the other way round.

³ The database is available at <http://www.kof.ethz.ch/centralbankgovernors> and will be updated over time.

⁴ The correlation between our data and those provided by Cukierman et al. (1992) is 0.89, those with the data in Sturm and De Haan (2001) is 0.90. The data of Cukierman et al. is available for 69 countries over the period 1950–89, the data of Sturm and De Haan cover 114 countries over 1975–98.

⁵ This result is not driven by the increasing number of countries in our sample in more recent years. When restricting the sample to countries with at least 30 observations, the overall picture looks very much alike.

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