Determinants and Effects of Central Bank Independence Reforms

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Abstract
This thesis consists of four empirically oriented papers on central bank independence (CBI) reforms.

Paper [1] is an investigation of why politicians around the world have chosen to give up power to independent central banks, thereby reducing their ability to control the economy. A new data-set, including the possible occurrence of CBI-reforms in 132 countries during 1980-2005, was collected. Politicians in non-OECD countries were more likely to delegate power to independent central banks if their country had been characterized by high variability in inflation and if they faced a high probability of being replaced. No such effects were found for OECD countries.

Paper [2], using a difference-in-difference approach, studies whether CBI reform matters for inflation performance. The analysis is based on a dataset including the possible occurrence of CBI-reforms in 132 countries during the period of 1980-2005. CBI reform is found to have contributed to bringing down inflation in high-inflation countries, but it seems unrelated to inflation performance in low-inflation countries.

Paper [3] investigates whether CBI-reforms are important in reducing inflation and maintaining price stability, using a random-effects random-coefficients model to account for heterogeneity in the effects of CBI-reforms on inflation. CBI-reforms are found to have reduced inflation on average by 3.31 percent, but the effect is only present when countries with historically high inflation rates are included in the sample. Countries with more modest inflation rates have achieved low inflation without institutional reforms that grant central banks more independence, thus undermining the time-inconsistency theory case for CBI. There is furthermore no evidence that CBI-reforms have contributed to lower inflation variability.

Paper [4] studies the relationship between CBI and a suggested trade-off between price variability and output variability using data on CBI-levels, and data the on implementation dates of CBI-reforms. The results question the existence of such a trade-off, but indicate that there may still be potential gains in stabilization policy from CBI-reforms.

Keywords: Monetary policy; institutional reform; central banking; price stability; political economy; delegation; institutional economics; inflation; time-inconsistency; accountability.