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COMMENT

Populism and Central Bank Independence: Comment

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Abstract Goodhart and Lastra (Open Econ Rev 29:49–68, 2018) lay out the mechanisms through which populist political movements may affect central bank independence. This paper provides the first empirical evidence that one aspect commonly attributed to populism, namely national identity politics, has indeed negatively impacted on central bank independence in developing countries. Combining existing datasets on central bank independence and political variables in developing countries, panel regressions are run for a sample of 113 countries during 1975–2012. Results prove robust to various specifications and macroeconomic as well as institutional control variables.

Central bank independence (CBI) is often regarded as a pillar of effective monetary reform, particularly in developing countries (Heenan et al. 2006). However, granting independence of policy determination to a central bank is not merely an economic policy decision. It is a choice that is deeply intertwined with political preferences, and therefore granting (or rescinding) independence can relate to political cycles. Goodhart and Lastra (2018) argue that the electoral success of populist political movements in various countries may result in pressures on the independence of central banks. They observe a tension between the expanded mandates of central banks, and the electoral discontent with the prevailing status quo since the Global Financial Crisis.

The relationship between political populism and CBI that Goodhart and Lastra (2018) lay out, contains elements that are testable. The challenge is to define what

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constitutes a populist movement, and to find an empirical representation for such a definition. While there is no consensus on the meaning of populism, national identity politics is one aspect that is commonly associated with it. For example, Fig. 1 depicts the categorization of contemporary politics by Inglehart and Norris (2016), where nationalism is identified as one facet of populism.

Political nationalism is a variable on which data is available from the World Bank's Database of Political Institutions (DPI). DPI counts a party as nationalist if "a primary component of its platform is the creation or defense of a national or ethnic identity." DPI records several 0–1 dummy variables relating to nationalism, namely "nationalist chief executive", "nationalist largest government party" and "nationalist largest opposition party". DPI covers 178 countries between 1975 and 2012. However, among advanced economies very few leading parties or chief executives have been included in DPI's "nationalist" category during the sample period. We focus, therefore, on the experience of developing countries.

Political variables tend to change infrequently, and we require a CBI dataset of maximum scope (time and countries) to fully exploit the variation in the political data. This guides our choice for *de jure* measures of CBI, which offer much wider scope than de facto measures. We consider *de jure* CBI as a measure of policy intent. Legal independence of the central bank does not guarantee de facto independence, and the relationship between *de jure* CBI and inflation outcomes is not always clear-cut (Cukierman 2008). 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 (Freedman and Ötker-Robe 2010).

The best known *de jure* CBI index was developed by Cukierman et al. (1992). This metric consists of 4 components: financial independence, policy independence, personnel independence, and central bank objectives. Each of these in turn is created out of several sub-components that are ranked by looking at central bank legislation and statutory reforms. Garriga (2016) applies this method to 182 countries between 1970 and 2012. Her dataset includes 382 identified instances of monetary reforms, of which 276, 50 and 56 instances, respectively, resulted in higher, unchanged, and lower CBI.
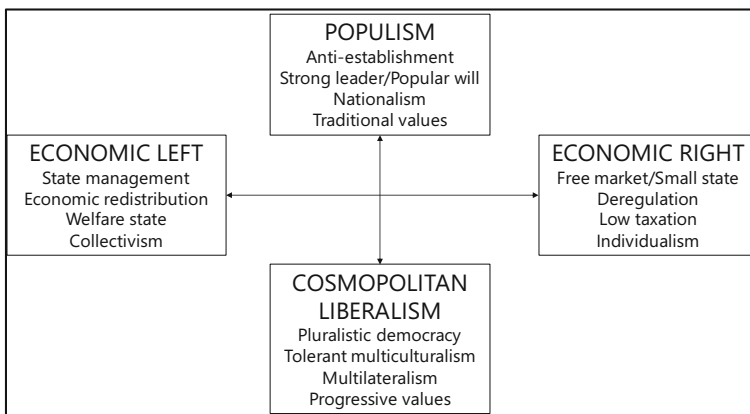

Fig. 1 Inglehart and Norris' (2016) Categorization of contemporary politics

We combine the *de jure* CBI data of Garriga (2016) with DPI data to gauge the link between nationalism and CBI. Figure 2 provides a first glance at this type of link. It shows that countries with a nationalist chief executive (president or prime minister in DPI, depending on the political system) generally lag other countries in CBI, a gap that has been widening since the late 1990s. One might suspect that this is easily explained by a selection bias, whereby less developed countries have both lower CBI and a greater fraction of nationalist governments. However, all economic development strata have on average witnessed a gradual rise of CBI since the late 1990s (Fig. 3). The move towards increased CBI is not concentrated in specific types of economies, but seen in a wide cross-section of development stages. The relationship hinted at by Fig. 2, merits a deeper investigation, therefore.

We follow the regression analysis of Dincer and Eichengreen (2014), who run fixed effects panels to identify the determinants of *de jure* CBI. Dincer and Eichengreen (2014) compile an extensive *de jure* CBI dataset, and analyze its determinants. While their dataset has a broad cross-country dimension (100 countries), its time-series is too short for our purposes, from 1998 till 2014 in their latest data update posted online.[1] We therefore replicate their approach for determinants, but with the dataset of Garriga (2016). Following Dincer and Eichengreen (2014), we employ as macroeconomic control variables: GDP per capita, lagged inflation, trade openness, and financial depth as measured by M2/GDP (all from IMF WEO).

Like Dincer and Eichengreen (2014), we also add a variety of institutional quality variables from the International Country Risk Guide (ICRG). Including institutional controls is important to address the risk that a significant result for nationalism variables masquerades for other institutional variables. However, the ICRG data are available for only part of the countries in our sample, and only begin in 1984. We will therefore show both regressions including and excluding these institutional controls.

Our contribution compared to Dincer and Eichengreen (2014) is the introduction of the nationalism variables from DPI. As each of the three nationalism variables (chief executive, largest government party, largest opposition party) has only limited variation over time, we combine these three variables into a single (unweighted sum) nationalism index, which can take values between 0 and 3. In addition, we also check the significance of each separate variable, in separate specifications. Our rationale for including the "largest opposition party" variable is that opposition parties can sometimes influence the direction of policy. Governing politicians may wish to placate the opposition party's voters by showing sensitivity to the opposition's political platform.

Table 1 summarizes our empirical results in eight different specifications. The first three specifications use only CBI, the macroeconomic variables and the nationalism index. Because these specifications exclude the ICRG data, they have the largest number of observations (2145 over 113 countries). The first specification, the "baseline", includes only country fixed effects. The second specification adds in time fixed effects. The third applies random effects instead of country fixed effects.

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[1] https://eml.berkeley.edu/~eichengr/Dincer-Eichengreen_figures&tables_2014_9-4-15.pdf

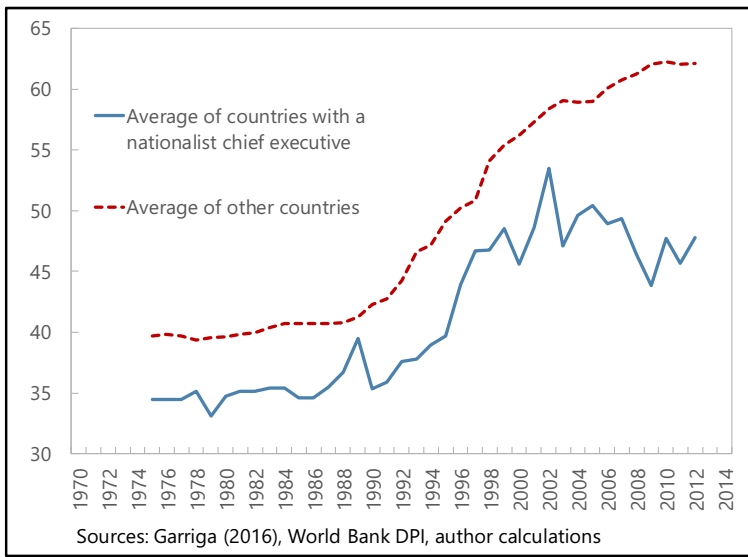Sources: Garriga (2016), World Bank DPI, author calculations

Fig. 2 CBI and nationalism

In all three specifications the macroeconomic variables are highly significant and have the expected signs. In all three specifications, moreover, the nationalism index has a negative impact on CBI, which is significant at 5% (baseline) or 10% (specifications (2) and (3)).

Specifications (4)–(8) add in the institutional control variables. With institutional controls the regression sample becomes smaller. Specification (4), which includes the full set of institutional controls, has 1294 observations over 77 countries. As such, the
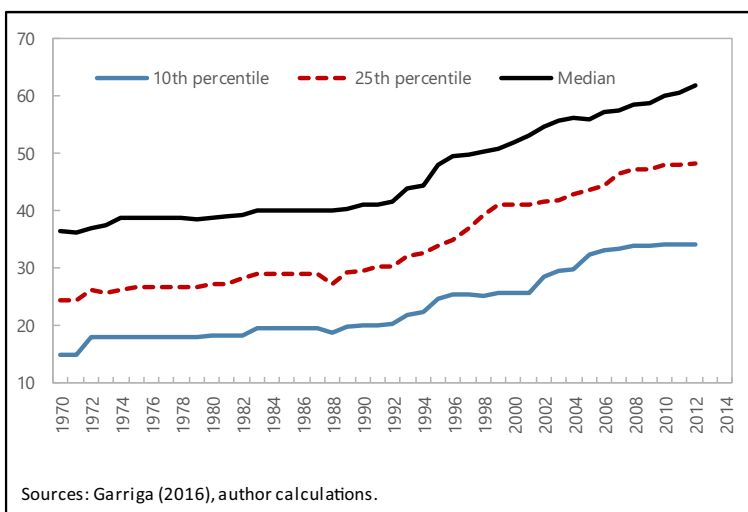

Sources: Garriga (2016), author calculations.

Fig. 3 CBI percentiles

Table 1 Panel regressions for Central Bank Independence (country fixed effects, unless otherwise specified; variables in logs; sample period: 1984–2012 for specifications (4)–(8), 1975–2012 for specifications (1)–(3))

	(1) Baseline	(2) Time fixed effects	(3) Random effects	(4) Institutional controls 1	(5) Institutional controls 2	(6) Nationalist government	(7) Nationalist chief exec.	(8) Nationalist opposition
Trade openness	0.156***	0.0919***	0.139***	0.0874***	0.127***	0.0981***	0.0920***	0.0924***
	(0.0239)	(0.0254)	(0.0231)	(0.0311)	(0.0311)	(0.0298)	(0.0302)	(0.0309)
GDP per capita	0.159***	0.111***	0.139***	0.149***	0.182***	0.148***	0.154***	0.149***
	(0.0105)	(0.0184)	(0.0103)	(0.0129)	(0.0136)	(0.0121)	(0.0123)	(0.0127)
Lagged inflation	−0.116***	−0.0872***	−0.125***	−0.0305	−0.0764***	−0.0333	−0.0311	−0.0316
	(0.0149)	(0.0151)	(0.0151)	(0.0208)	(0.0190)	(0.0205)	(0.0207)	(0.0207)
Financial depth	0.0780***	0.0557***	0.0658***	0.0450***	0.0454***	0.0404**	0.0416***	0.0448***
	(0.0152)	(0.0155)	(0.0151)	(0.0160)	(0.0176)	(0.0158)	(0.0159)	(0.0159)
Nationalism index	−0.0482**	−0.0392*	−0.0542**	−0.0762***	−0.0826***			
	(0.0215)	(0.0210)	(0.0213)	(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)
Political 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)

Table 1 (continued)

	(1) Baseline	(2) Time fixed effects	(3) Random effects	(4) Institutional controls 1	(5) Institutional controls 2	(6) Nationalist government	(7) Nationalist chief exec.	(8) Nationalist opposition
Nationalist largest government party								
Nationalist chief executive						−0.0793** (0.0401)	−0.0862** (0.0409)	
Nationalist largest opposition party								−0.0560* (0.0330)
Constant	1.775*** (0.113)	2.343*** (0.189)	2.098*** (0.113)	1.188*** (0.308)	1.136*** (0.220)	1.264*** (0.293)	1.277*** (0.297)	1.183*** (0.307)
Observations	2145	2145	2145	1294	1563	1380	1357	1313
R-squared	0.266	0.324		0.239	0.281	0.218	0.221	0.231
Number of countries	113	113	113	77	84	80	80	77

Standard errors in parentheses

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

results between the first three specifications and the rest are not directly comparable.[2] Significance of the institutional controls varies, but they do tend to have the expected signs: CBI falls as ethnic tension and political risk rise, and CBI rises as government stability, bureaucracy quality and political fragmentation rise (increased fragmentation in parliament being an indication of active multi-party democracy).

The nationalism variables remain significant and negative throughout all institutional control specifications. Specification (4) includes the full set of institutional controls, while specification (5) takes out the two institutional variables that are most costly in terms of lost sample observations. In both cases, the nationalism index is significant at 1%. Specifications (6)–(8) replace the nationalism index with its individual components. The nationalist largest government party and nationalist chief executive variables are significant at 5%, while the nationalist largest opposition party variable is significant at 10%.

Overall, our results provide support for the notion that one aspect of political populism is indeed related to CBI, in line with Goodhart and Lastra (2018). The relation between politics (and, in particular, fiscal policy) and CBI has been discussed extensively (de Haan and Eijffinger 2018). However, to our knowledge, this is the first empirical piece to connect CBI and nationalism.

Compliance with Ethical Standards

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[2] The significance of lagged inflation varies particularly much across the specifications. This is in line with Garriga (2016), who finds that the explanatory power of inflation for CBI is very sensitive to sample choice.