

Is Inequality a Side Effect of Central Bank Independence?

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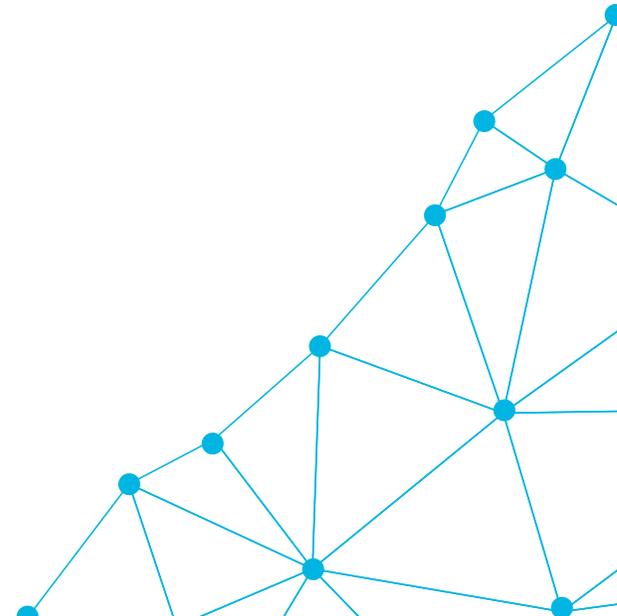
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The World Bank

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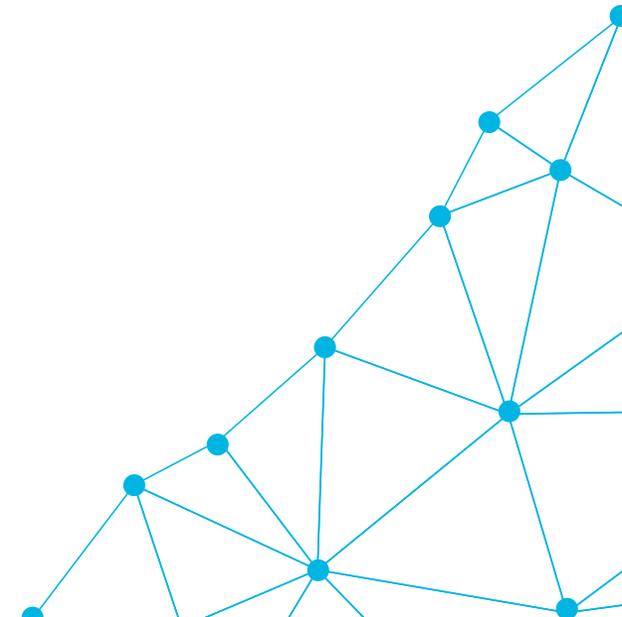
Introduction

- This paper is **not** about debunking the concept of CBI



Motivation

- Recent influential work in economics on income dynamics and inequality
- Literature analyzing the role of institutions for the rise of inequality
- The role of monetary policy to explain the rise in inequality
 - Monetary policy shocks
 - Macroprudential regulation
 - QE programs
 - **Consensus**
 - *“Inequality is not a long-run monetary phenomenon.” [Carstens, 2021]*



Motivation

- Central point of departure
 - Central bank independence takes away a powerful instrument to print money, distribute credit, and inflate the economy
- Central assumption in the literature
 - Policymakers' yield control over monetary policy and do not change their behavior. They are passive consumers to policy reform.



Motivation

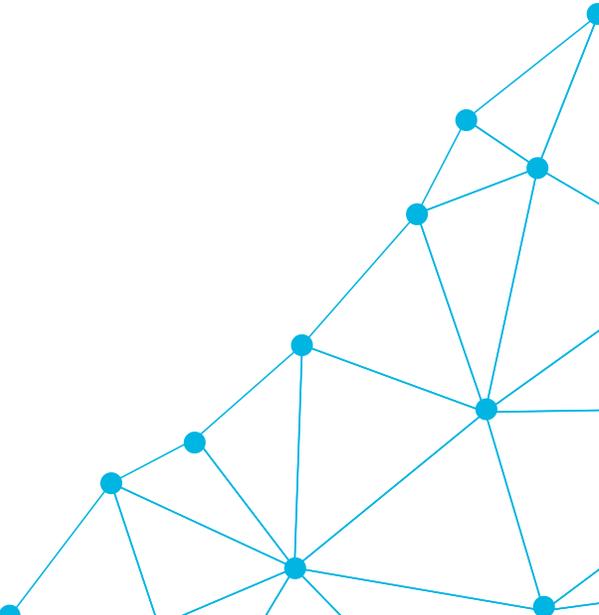
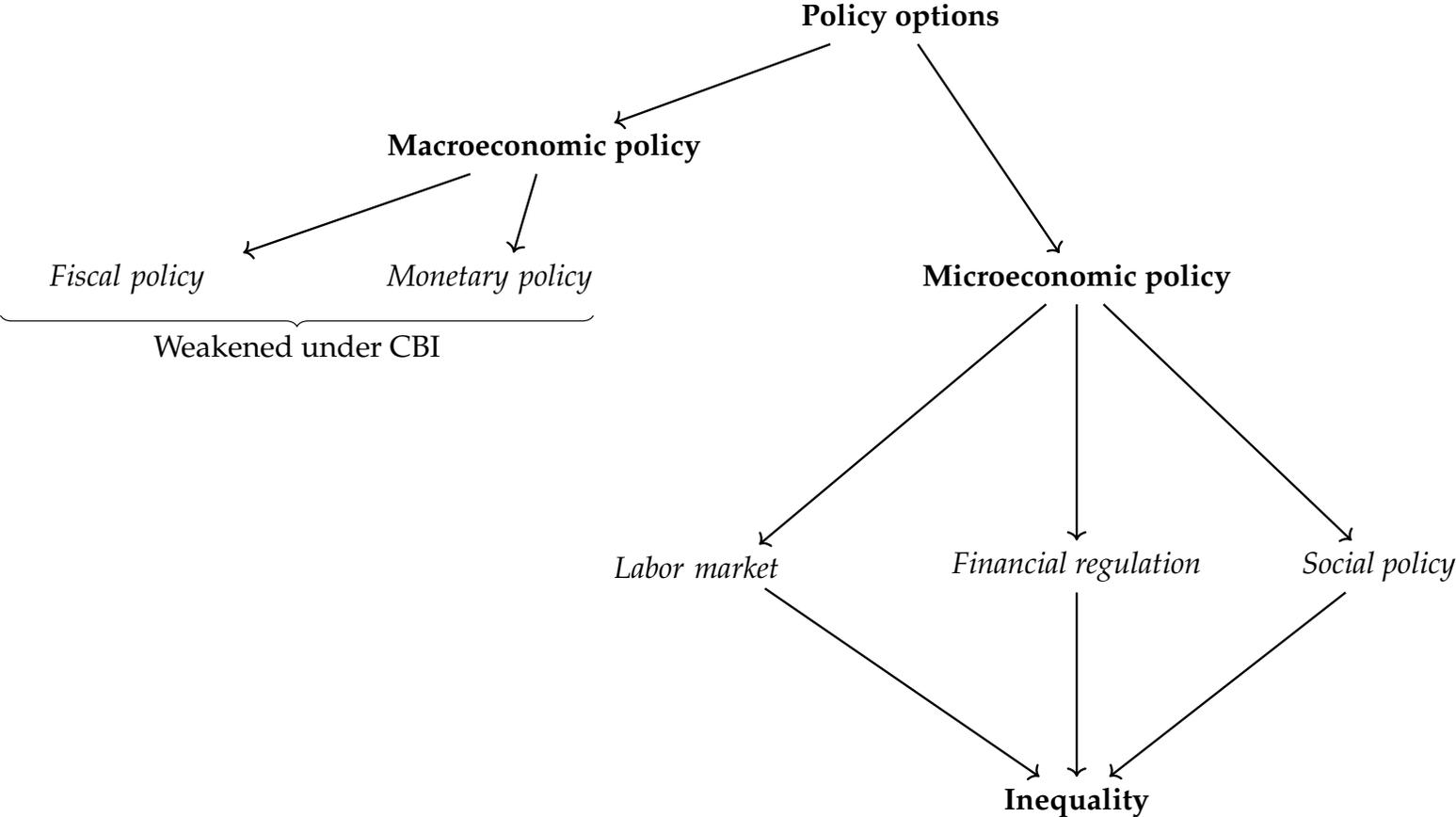


fensterln

[ˈfɛnstɛrn] to climb through one's sweetheart's bedroom window



Theoretical Argument



Theoretical Argument

Channel	Policy Response	Policy Outcome(s)
Financial Channel	Financial Deregulation	Financialization
Labor Channel	Labor Market Reforms	Wage Stagnation
Social Channel	Social Policy Reforms	Less Redistribution



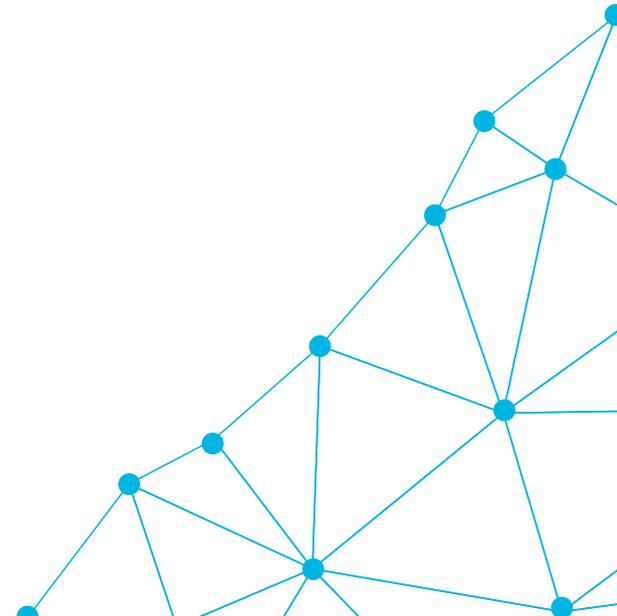
Theoretical Argument

- **Hypothesis**

- Central bank independence is associated with greater income inequality

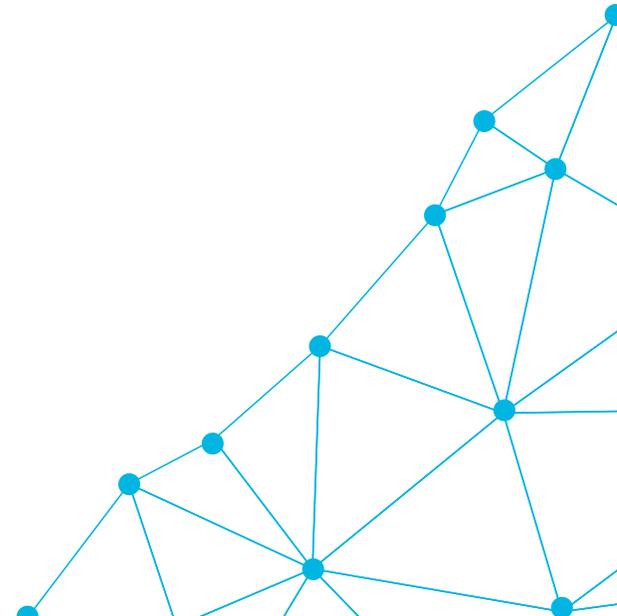
- **Note**

- **Central bank does not do anything >>> it is the policy responses by governments**



Empirical Analysis

- Quantitative analysis
 - CBI and its effect on income inequality
 - CBI and its effect on main mechanisms
- Qualitative analysis
 - selected case studies to illustrate mechanisms

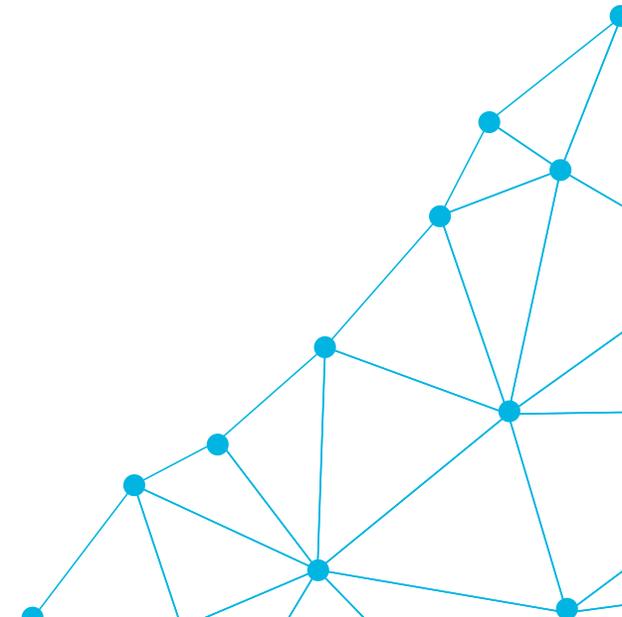


Research Design

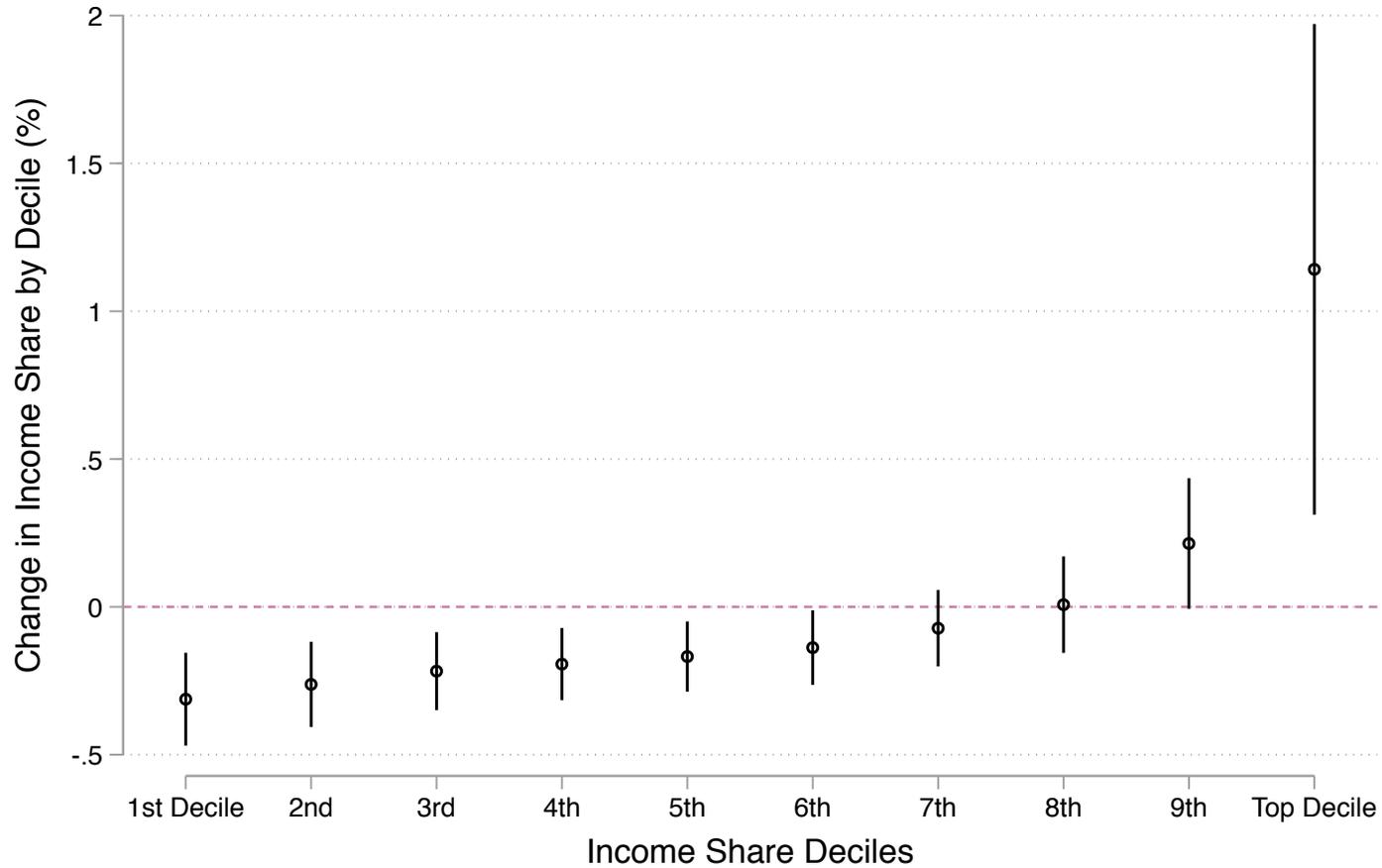
- A series of simple models

$$y_{i,t+1} = \beta CBI_{i,t} + \lambda' X_{i,t} + \alpha_i + \mu_t + \varepsilon_{i,t}$$

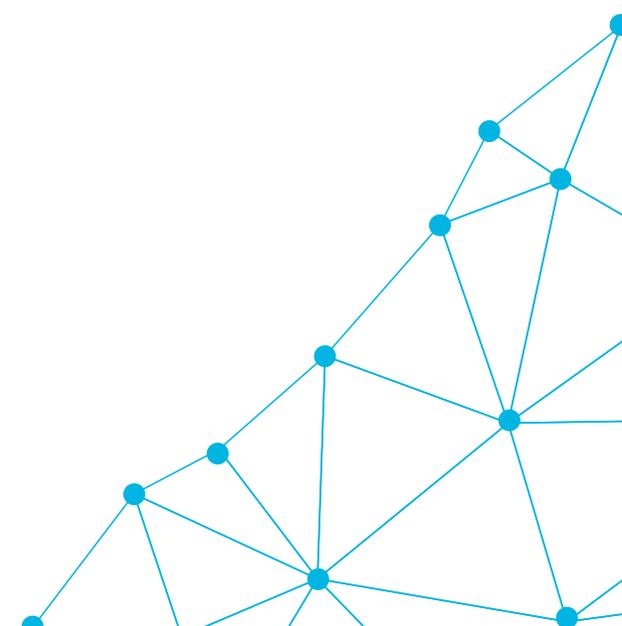
- Dependent variable
 - Income deciles from the World Bank's PovcalNet Database
 - Income deciles are estimated based on individual surveys.
 - Data covers up to 164 countries between 1981 and 2015.
- Independent variable
 - CBI Index measures the level of *de jure* central bank independence.
 - CBI Index is a continuous variable that ranges from 0 to 1.
 - Data covers up to covers up to 144 countries between 1972 and 2014.
- Control Variables
 - GDP per capita (log), Population (log), year and country fixed effects



Research Design

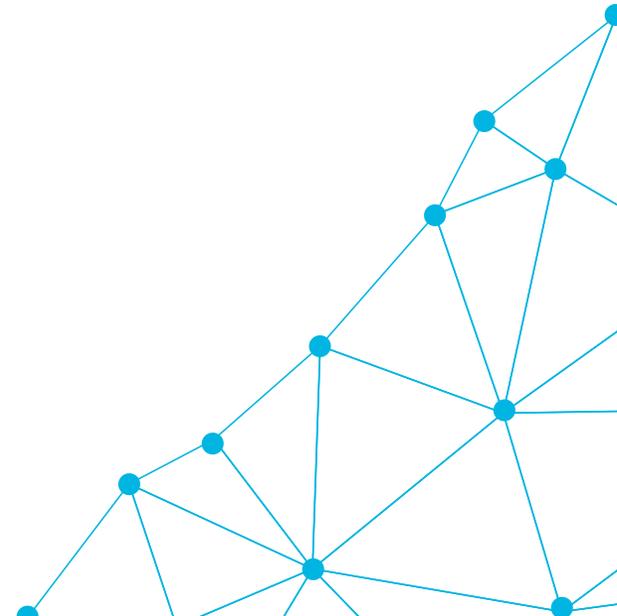


→ A one-standard deviation increase in CBI leads to a decline – about 0.3 percentage points – in the share of income of all income groups up to the 6th decile.



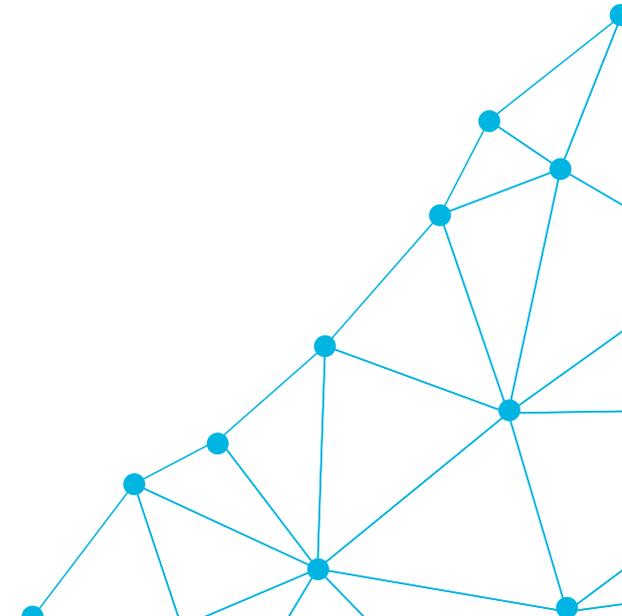
Robustness Checks

- Robustness checks
 - Inclusion of additional control variables
 - *Economic variables: Trade Openness, TFP growth, Financial Crisis*
 - *Policy variables: Democracy, Financial Interests, IMF programs*
 - *Political controls: Government ideology*
 - Different econometric modeling techniques
 - *GMM model to check for the long-run relationship*
 - *IV models to mitigate concerns about endogeneity*
 - ...
- Testing additional empirical implications of our theory



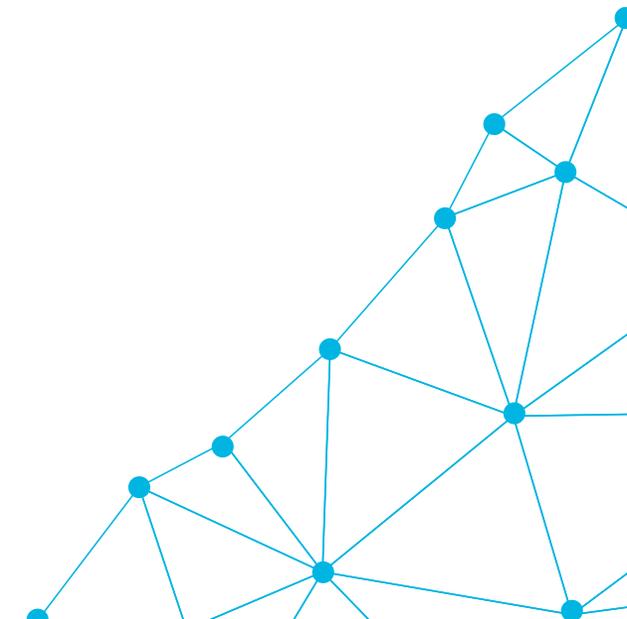
Mechanisms – Finance Channel

- Dependent Variable(s) – Financial Channel
 - Financial Reform Index (Abiad et al., 2010)
 - Entry Barriers into the Banking System (Abiad et al., 2010)
 - M2 growth rate (WDI, 2019)
 - Credit growth rate (WDI, 2019)
- Controls Variable(s)
 - GDP per capita (WDI, 2019), Population (WDI, 2019)



Mechanisms – Finance Channel

	Policy Reform		Policy Outcome	
	Fin. Reform	Bank Reform	M2	Credit
CBI	1.66 (1.07)	0.92*** (0.34)	-15.40** (6.96)	0.13** (0.06)
Controls	√	√	√	√
Country FE	√	√	√	√
Time FE	√	√	√	√
Observations	2132	2132	3149	3518



Mechanisms – Labor Channel

- Dependent Variable(s) – Labor Channel
 - Social Pact (Visser, 2015)
 - Part-time employment legislation index (Reinsberg et al., 2019)
 - Inflation (WDI, 2019)
 - Part-time employment as share of total employment (WDI, 2019)

- Controls Variable(s)
 - GDP per capita (WDI, 2019), Population (WDI, 2019)



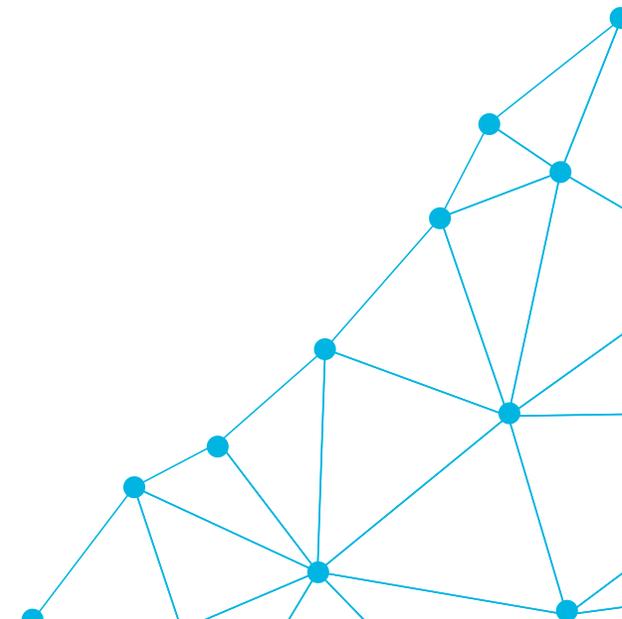
Mechanisms – Labor Channel

	Policy Reform		Policy Outcome	
	Social Pact	PT Index	Inflation	PT Employment
CBI	0.39** (0.17)	19.32*** (7.18)	-9.75*** (3.49)	5.04*** (1.50)
Controls	√	√	√	√
Country FE	√	√	√	√
Time FE	√	√	√	√
Observations	2132	1199	3197	827



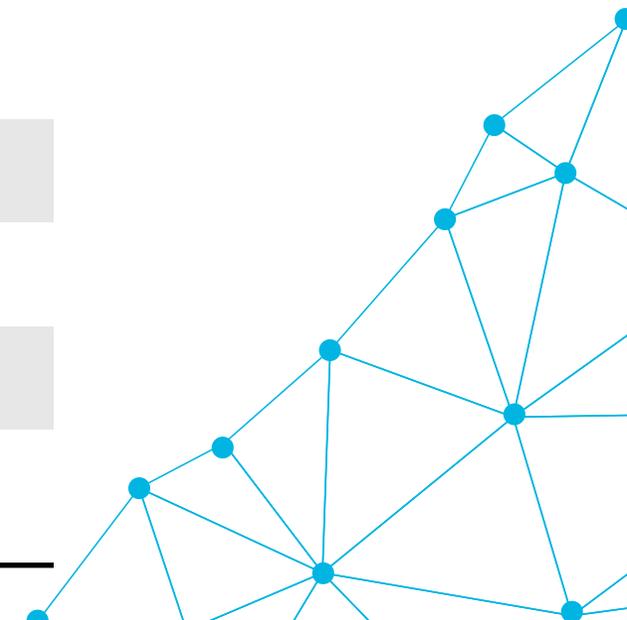
Mechanisms – Social Channel

- Dependent Variable(s) – Social channel
 - Social reform (Visser, 2015)
 - Pension reform (Visser, 2015)
 - Social security benefits (Berg et al., 2018)
 - Household transfers (Berg et al., 2018)
- Controls Variable(s)
 - GDP per capita (WDI, 2019), Population (WDI, 2019)



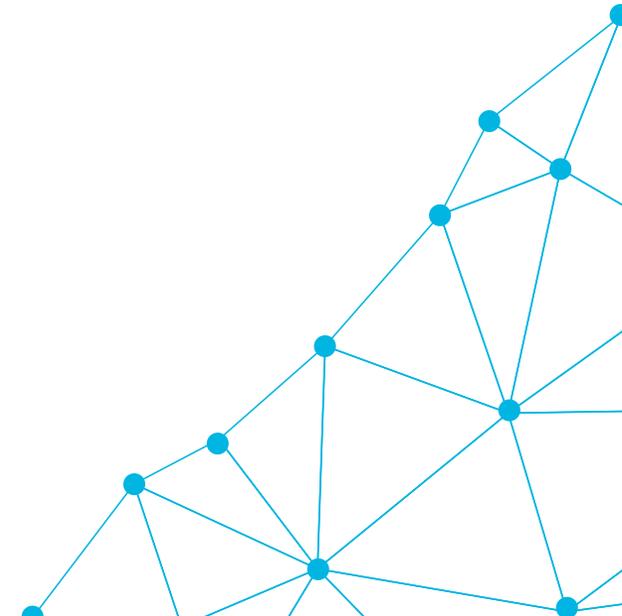
Mechanisms – Social Channel

	Policy Reform		Policy Outcome	
	Social Reform	Pension Reform	SSA Benefits	HH Transfers
CBI	0.11 (0.08)	0.11*** (0.03)	-0.12* (0.06)	-0.15*** (0.05)
Controls	✓	✓	✓	✓
Country FE	✓	✓	✓	✓
Time FE	✓	✓	✓	✓
Observations	1168	1167	850	828



Concluding Thoughts

- Should we go back to the old days?
 - Should governments control their central banks?
- **No**, but
 - Understand institutional reforms are part of broader political games.



Thank you!

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