World Academy of Science, Engineering and Technology
International Journal of Economics and Management Engineering
Vol:8, No:12, 2014

The Relationship between Central Bank Independence and Inflation: Evidence from Africa

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Abstract : The past decades have witnessed a considerable institutional shift towards Central Bank Independence across economies of the world. The motivation behind such a change is the acceptance that increased central bank autonomy has the power of alleviating inflation bias. Hence, studying whether Central Bank Independence acts as a significant factor behind the price stability in the African economies or whether this macroeconomic aim in these countries result from other economic, political or social factors is a pertinent issue. The main research objective of this paper is to assess the relationship between central bank autonomy and inflation in African economies where inflation has proved to be a serious problem. In this optic, we shall measure the degree of CBI in Africa by computing the turnover rates of central banks governors thereby studying whether decisions made by African central banks are affected by external forces. The purpose of this study is to investigate empirically the association between Central Bank Independence (CBI) and inflation for 10 African economies over a period of 17 years, from 1995 to 2012. The sample includes Botswana, Egypt, Ghana, Kenya, Madagascar, Mauritius, Mozambique, Nigeria, South Africa, and Uganda. In contrast to empirical research, we have not been using the usual static panel model for it is associated with potential mis specification arising from the absence of dynamics. To this issue a dynamic panel data model which integrates several control variables has been used. Firstly, the analysis includes dynamic terms to explain the tenacity of inflation. Given the confirmation of inflation inertia, that is very likely in African countries there exists the need for including lagged inflation in the empirical model. Secondly, due to known reverse causality between Central Bank Independence and inflation, the system generalized method of moments (GMM) is employed. With GMM estimators, the presence of unknown forms of heteroskedasticity is admissible as well as auto correlation in the error term. Thirdly, control variables have been used to enhance the efficiency of the model. The main finding of this paper is that central bank independence is negatively associated with inflation even after including control variables.

Keywords : central bank independence, inflation, macroeconomic variables, price stability
Conference Title : ICBEFM 2014 : International Conference on Business, Economics, Finance, and Management
Conference Location : Bangkok, Thailand
Conference Dates : December 18-19, 2014