International Finance and CBI

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Background

- International economic outcomes (FDI, bond ratings)
  - BITs and PTAs credible commitment to investors (Kerner, Buthe and Milner)
  - Also can serve as a signal to investors (Gray)

- Same arguments for CBI’s effect on domestic outcomes (inflation, growth)
Real-world examples

- Brazil 2002 presidential election
  - Markets react to Lula taking substantial lead by fleeing country
  - Lula responds by promising central bank reform
- Myanmar central bank reform
  - CBI = seal of good housekeeping
  - Signal to associate Myanmar with Philippines and Thailand
International outcomes and CBI

• International pressures => CB reform
  ▫ CB reform more likely as similar countries reform

• CBI => better international economic outcomes
  ▫ More FDI, lower interest rates, better credit ratings
Intl pressure => CB reform

- Competition: CB reform driven by countries with similar economic positions
- Learning: CB reform driven by countries with similar political regime
- Norms: CB reform driven by regional/global trends
- Coercion: Exposure to FDI/financial openness leads to CB reform
3 hypotheses:

1) CBI itself increases FDI and lowers cost of borrowing
2) Effect of CBI depends on configuration of political institutions
3) CBI has strongest effect for early adopters and loses its effect if most countries have CBI
Data

• IVs:
  ▫ Central bank laws: Coded independence for 80 countries for 1973 to present
    • Collection of laws allows us to identify reform years
  ▫ Diffusion: average CBI or number of reforms in similar countries in past year
  ▫ Political configuration: Polity score

• DVs
  ▫ CB reform
  ▫ Intl Outcomes: FDI inflows, bond yields, sovereign credit ratings
## Diffusion results

<table>
<thead>
<tr>
<th></th>
<th>CBI average</th>
<th>Reform average</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P diffusion</td>
<td>5.15***</td>
<td>6.15***</td>
</tr>
<tr>
<td></td>
<td>(1.30)</td>
<td>(1.45)</td>
</tr>
<tr>
<td>Export similarity</td>
<td>4.03***</td>
<td>4.56***</td>
</tr>
<tr>
<td></td>
<td>(1.51)</td>
<td>(1.47)</td>
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<tr>
<td>Polity diffusion</td>
<td>3.61***</td>
<td>3.77***</td>
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<tr>
<td></td>
<td>(1.32)</td>
<td>(1.41)</td>
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<tr>
<td>Regional diffusion</td>
<td>4.69***</td>
<td>2.71**</td>
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<tr>
<td></td>
<td>(1.32)</td>
<td>(1.16)</td>
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</table>
## Outcome results

<table>
<thead>
<tr>
<th></th>
<th>FDI</th>
<th>FDI to 1997</th>
<th>FDI from 1997</th>
<th>3-month rates</th>
<th>10-year rates</th>
<th>S&amp;P ratings</th>
<th>Moody’s ratings</th>
</tr>
</thead>
<tbody>
<tr>
<td>CBI</td>
<td>1.199</td>
<td>4.506***</td>
<td>-3.063</td>
<td>-9.011</td>
<td>-10.428</td>
<td>0.366</td>
<td>0.022</td>
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<td></td>
<td>(1.406)</td>
<td>(1.131)</td>
<td>(2.425)</td>
<td>(7.292)</td>
<td>(6.495)</td>
<td>(0.623)</td>
<td>(0.484)</td>
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<tr>
<td>Polity</td>
<td>0.000</td>
<td>0.003</td>
<td>0.123</td>
<td>-0.537</td>
<td>0.127</td>
<td>0.037</td>
<td>0.032</td>
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<tr>
<td></td>
<td>(0.028)</td>
<td>(0.013)</td>
<td>(0.092)</td>
<td>(0.413)</td>
<td>(0.320)</td>
<td>(0.022)</td>
<td>(0.027)</td>
</tr>
</tbody>
</table>
Marginal Effect of CBI on FDI inflows/GDP
As Polity changes

Marginal Effect of CBI

10
0
-10
-20
-30
-10
-5
0
5
10

Polity

Marg Effect of CBI

90% CI
Marginal Effect of CBI on 10-year bond rates
As Polity changes

Marginal Effect of CBI

Polity

Marg Effect of CBI
90% CI
Marginal Effect of CBI on FDI inflows/GDP
As Polity and post 1997 Change
Marginal Effect of CBI on 10-year bond rates
As Polity and yrdum Change

Marginal Effect of CBI

Polity

1997 & before  After 1997
Conclusion

- Strong evidence of diffusion
  - Countries react to CB reforms in similar countries
- Mixed evidence of effect of CBI on international economic outcomes
  - Combination of democracy increases FDI inflows and lowers 10-year bond rates in non-OECD countries
  - Also, some evidence of temporal component to effect of CBI on FDI
  - Little evidence of effect of CBI on sovereign credit ratings
Additional slides
Marginal Effect of CBI on 3-month bond rates
As Polity changes

Marginal Effect of CBI on 3-month bond rates
As Polity changes

Marginal Effect of CBI

Polity

Marg Effect of CBI 90% CI
Marginal Effect of CBI on 3-month bond rates
As Polity and yrdum Change

Marginal Effect of CBI on 3-month bond rates
As Polity and yrdum Change
Marginal Effect of CBI on Moody rating
As Polity changes

Marginal Effect of CBI on Moody rating
As Polity changes
Marginal Effect of CBI on S&P rating
As Polity changes