

International Finance and CBI

Cristina Bodea (Michigan State)

Raymond Hicks (Princeton)

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

CBI => Intl Economics

- 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

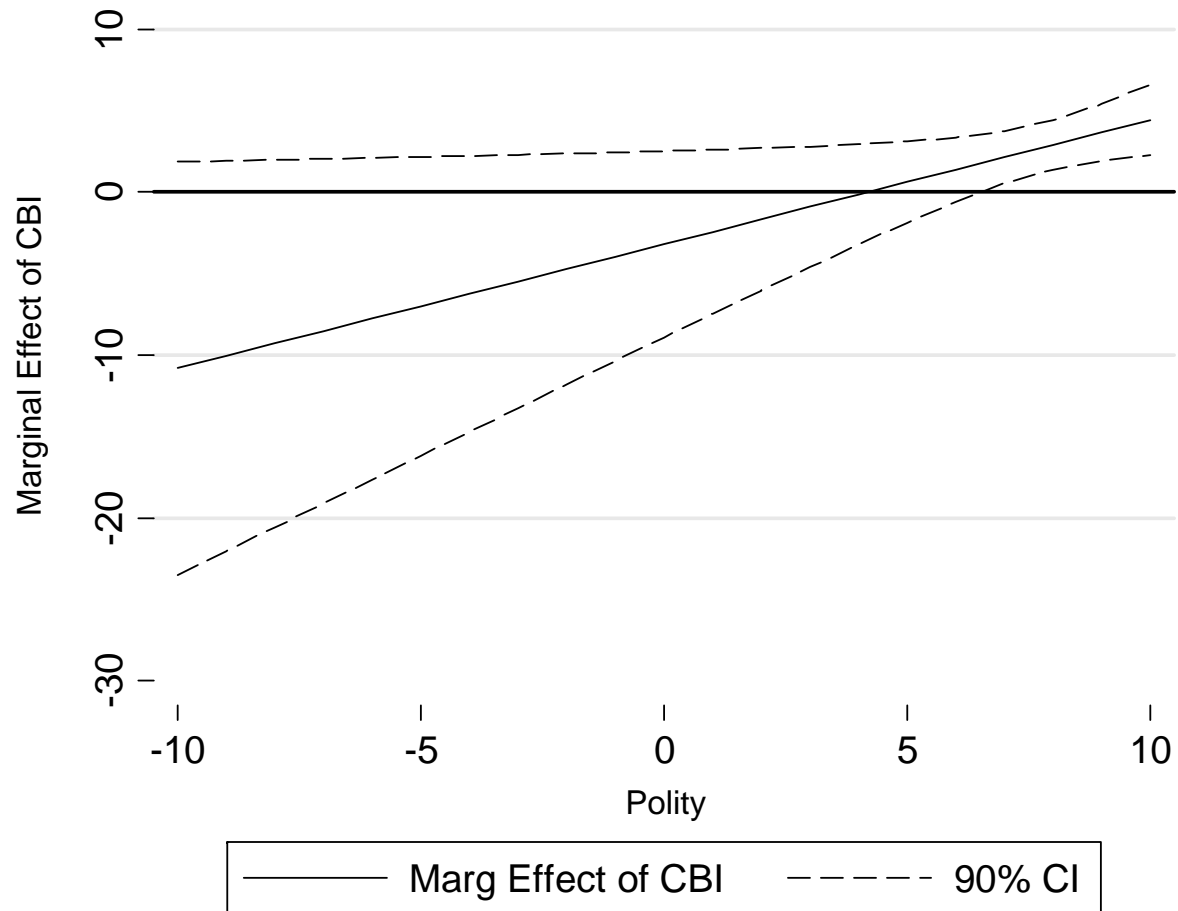
Diffusion results

	CBI average	Reform average
S&P diffusion	5.15***	6.15***
	(1.30)	(1.45)
Export similarity	4.03***	4.56***
	(1.51)	(1.47)
Polity diffusion	3.61***	3.77***
	(1.32)	(1.41)
Regional diffusion	4.69***	2.71**
	(1.32)	(1.16)

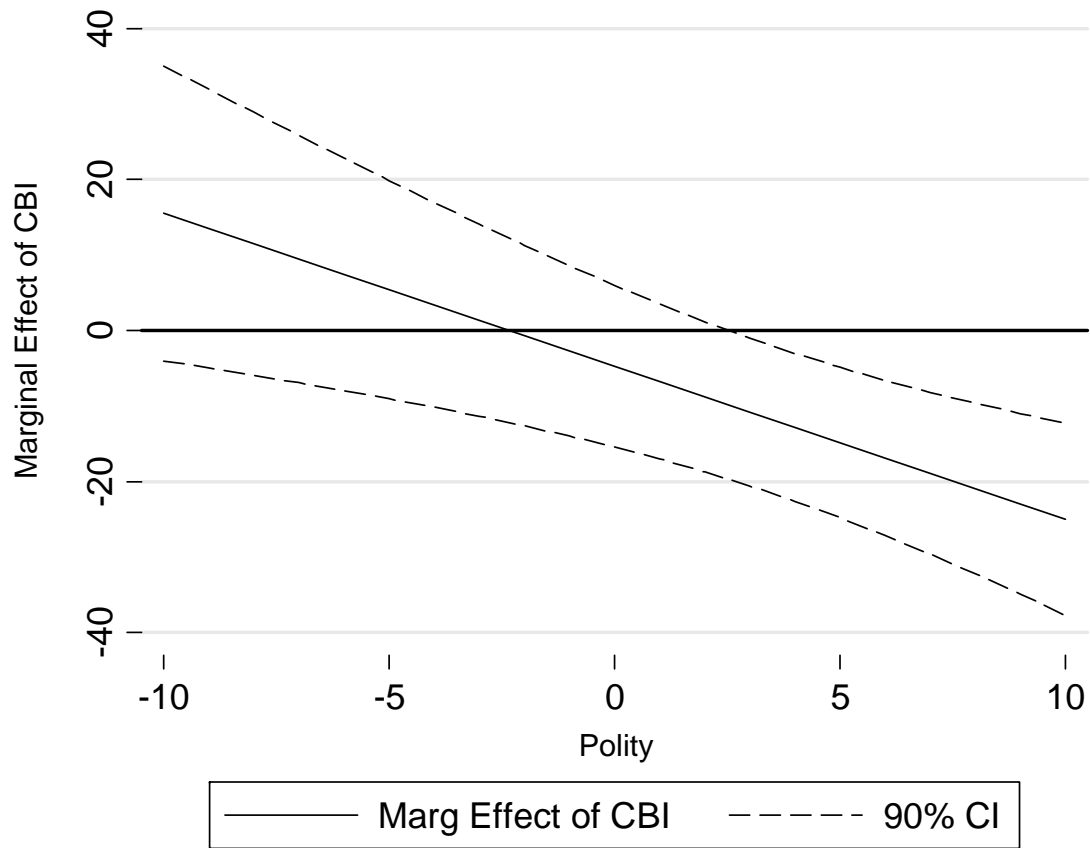
Outcome results

	FDI	FDI to 1997	FDI from 1997	3-month rates	10-year rates	S&P ratings	Moody's ratings
CBI	1.199	4.506***	-3.063	-9.011	-10.428	0.366	0.022
	(1.406)	(1.131)	(2.425)	(7.292)	(6.495)	(0.623)	(0.484)
Polity	0.000	0.003	0.123	-0.537	0.127	0.037	0.032
	(0.028)	(0.013)	(0.092)	(0.413)	(0.320)	(0.022)	(0.027)

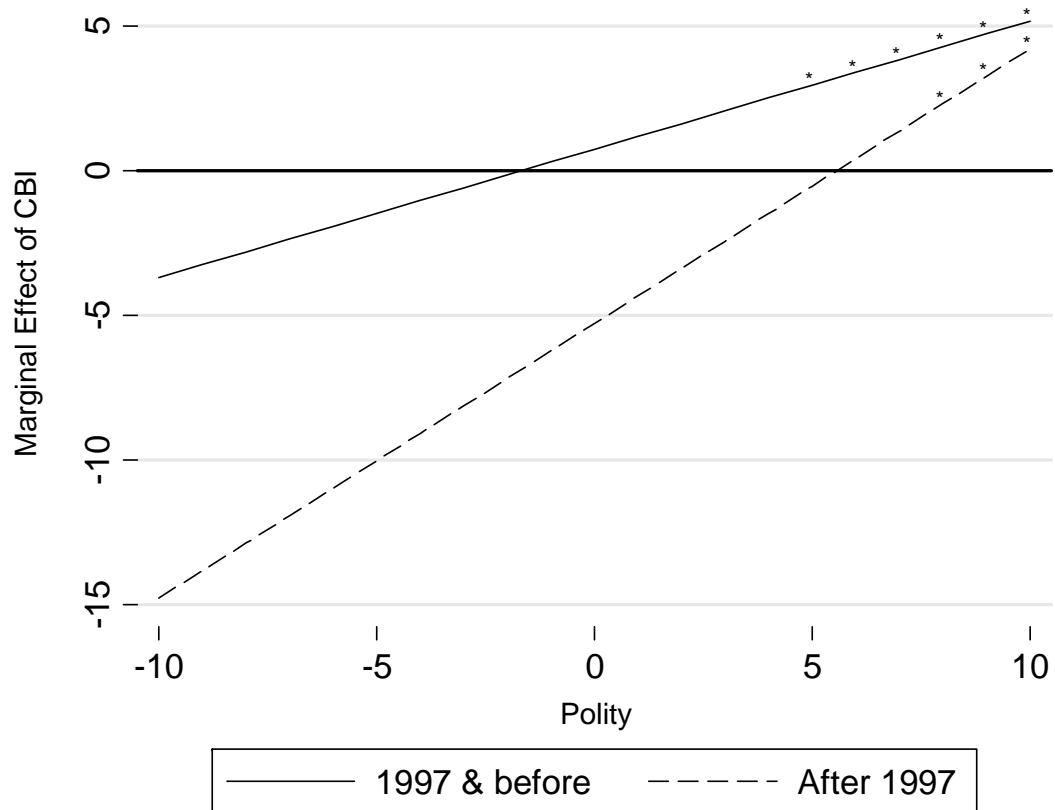
Marginal Effect of CBI on FDI inflows/GDP As Polity changes



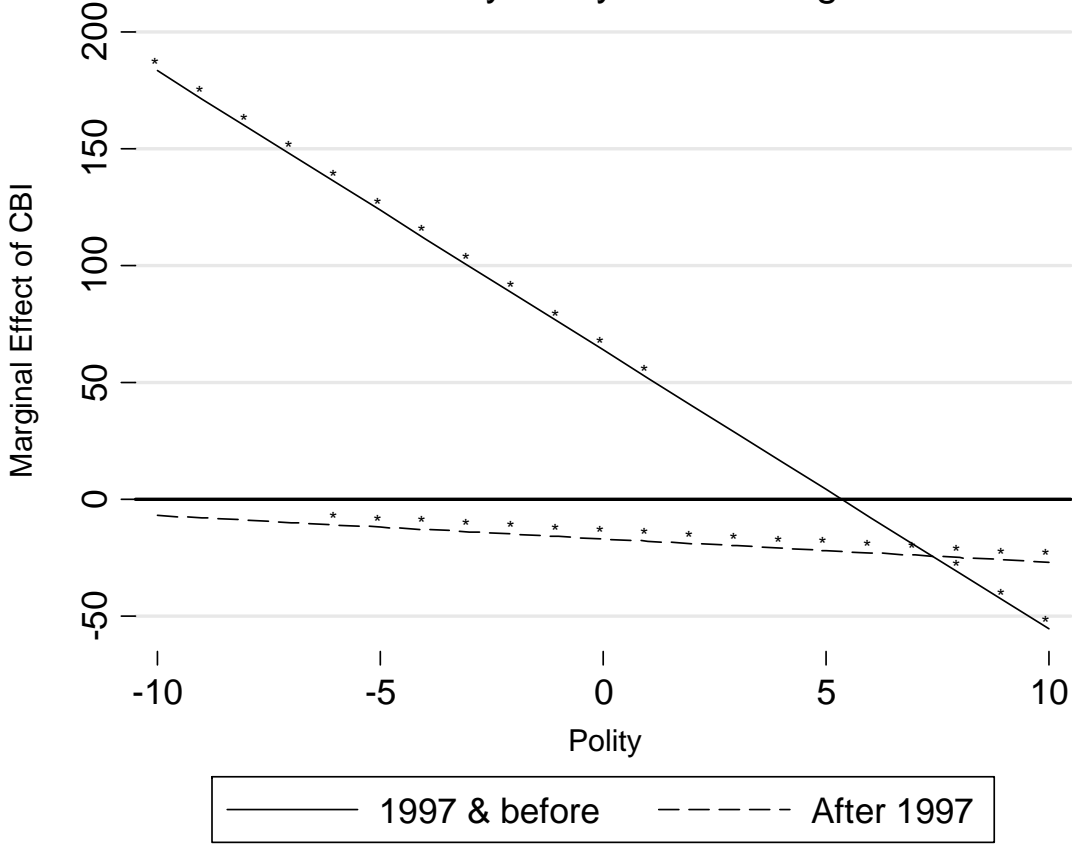
Marginal Effect of CBI on 10-year bond rates
As Polity changes



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 yrdrum Change

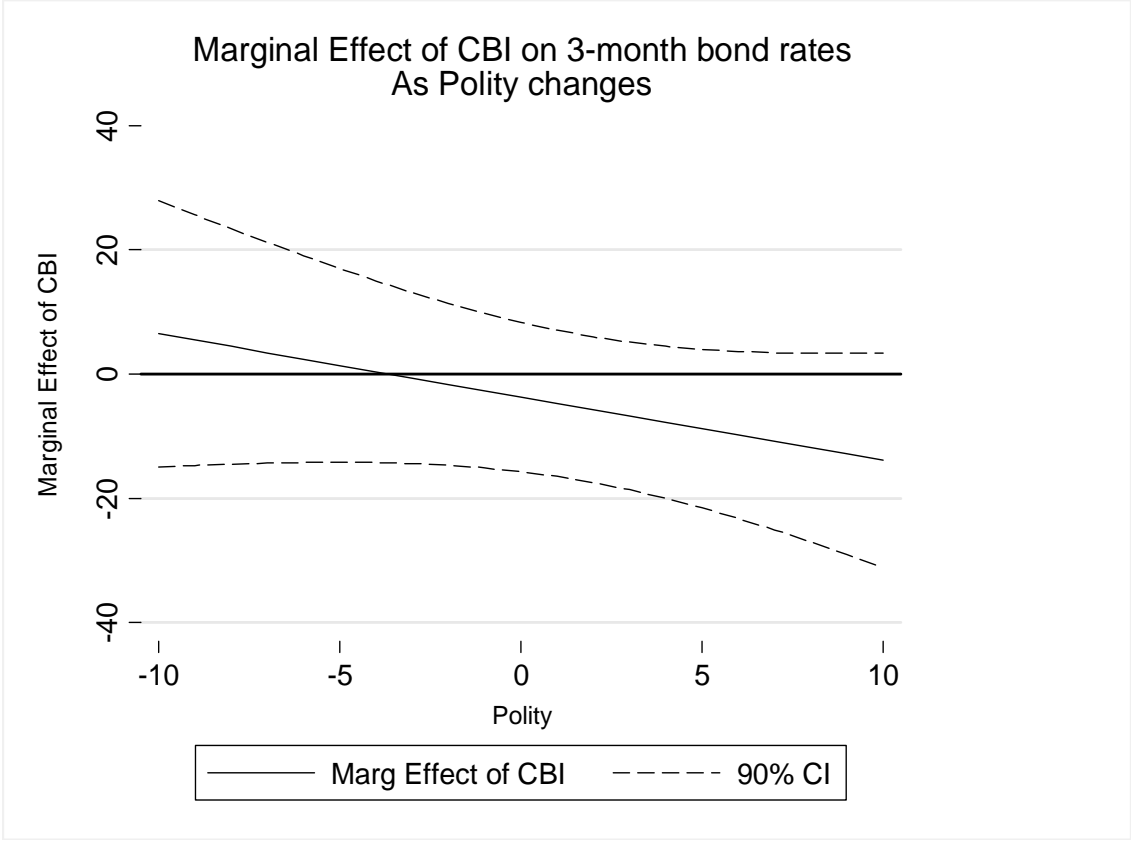


Conclusion

- 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 and yrdum Change

