

Comment on Susanne Lohmann

"Federalism and Central Bank Independence: The Politics of German Monetary Policy, 1957-92" (World Politics 50, April 1998: 401-46)

Lohmann's analysis is very useful in many respects but it is not well suited to test my "party preference hypothesis" or, as McGregor has aptly called it, the "party loyalty hypothesis" ^[1]. The hypothesis states that, if the federal government has a partisan majority in the central bank council at the beginning of the pre-election period or if the partisan regime at the council changes in favor of the government during the pre-election period, monetary expansion accelerates and that monetary expansion decelerates if the opposite is the case. My empirical analysis for Germany in 1949-94 revealed that 13 out of 15 observations favor the hypothesis (which is significant at the 1 percent level). As McGregor has shown, my hypothesis also significantly explains the voting behavior of Federal Reserve Board members in the U.S. Federal Open Market Committee.

While I used a non-parametric test, Lohmann presents a regression analysis which controls for more than a dozen variables simultaneously even though only very few take significant coefficients. She also restricts the sample to the period 1960-89 even though, over this subperiod, I report a much lower share of favorable observations (7/9) ^[2]. It turns out that, in this framework, the party preference effect - even though clearly positive - is no longer fully significant ^[3]. But the same would be true if my non-parametric test had been confined to 1960-89.

Before analyzing her results, two more comments on her test design are in order:

- First, Lohmann's dependent variable is the growth rate of central bank money as defined by the Bundesbank. This is not the monetary base

but an aggregate derived from M3 using the reserve ratios as weights. I had chosen the growth rate of M1 because it has been shown to be the best predictor of output ^[4].

- Second, Lohmann uses quarterly data. Since the partisan regime in the Bundesbank council has frequently changed during pre-election quarters, the regime shifts are not well identified in Lohmann's analysis. In my non-parametric test each period of observation is defined by a uniform partisan regime in the council. In a regression containing lagged variables, periods of unequal length cannot easily be handled. Thus, a non-parametric test need not be inferior to a regression analysis.

Lohmann's results reveal a serious identification problem which is common to all her tests. The problem is indicated by the striking fact that her shift dummies for the Bretton Woods and the EMS periods take significantly negative coefficients. As the 1994 version of her paper shows, this would also be the case if the various slope dummies for Bretton Woods and the EMS had been omitted. However, probably all observers of German post-war monetary policy would agree that the Bretton Woods System and the European Monetary System (especially during its first four years) have forced the Bundesbank to raise rather than lower monetary expansion. Lohmann concedes that the results for the exchange rate dummies may reflect the inflationary effects of the two oil price shocks (p. 429). But, if this is the explanation, she should have used a specific variable capturing these shocks - preferably a quantitative variable. The timing of the oil price shocks is not coextensive with the interval between the Bretton Woods System and the EMS. Accounting for the oil price shocks requires some difficult decisions. My non-parametric test is less sensitive to this problem because it merely looks at (qualitative) changes before elections, analyzing each pre-election period separately. It does not attempt to explain the rate of monetary expansion over thirty years. Once more, a non-parametric test is not necessarily inferior to a regression analysis.

Finally, I turn to the champion of Lohmann's horse race, the Bundesrat support model (hypothesis 4). I am afraid that it has to be disqualified for two reasons. First, the number of supporting votes in the Bundesrat is not a median voter variable. This is inconsistent with her hypothesis and with the remainder of her analysis. (For the Bundesbank Council, she correctly uses a median voter dummy.) Lohmann is aware of the problem and presents a median-voter estimate as a "robustness check" (H4). But as her F-tests show, the correctly specified model has less explanatory power than the simple Nordhaus model (H1). If, alternatively, her Bundesrat support variable reflects the popularity of the government, the use of opinion poll data, as in H4, is preferable. But once more, the F-statistic is no better than in the Nordhaus model. It is true that the median voter variable and the

popularity variable might usefully be combined. As they seem to be highly collinear, there may also be a case for constructing a weighted index of the two variables. But Lohmann's Bundesrat support variable is not such an index. It cannot usefully be interpreted.

The second problem of the Bundesrat support model is that even a correctly specified version would be historically implausible. Probably most, if not all, observers of German monetary policy would agree that, in the period under consideration, no German government would have dared to abolish the legal independence of the Bundesbank if the latter had pursued a less expansionary monetary policy at election time ^[5]. The electoral consequences would have been strongly negative, if not disastrous.

Moreover, even if anybody had doubts on this point, it is highly improbable that such a government could have been hindered by the Bundesrat. As I have pointed out to Lohmann, the Federal Constitutional Court has declared in another context that the Bundestag may alter the Bundesbank Law without the assent of the Bundesrat ^[6]. It is, of course, true that the Bundesrat does not have to accept this obiter dictum and that the Court is always free to reverse its decisions. But as Lohmann notes (p. 421), the Bundesrat has never dared to challenge the Bundestag's exclusive monetary competence in Court even though it clearly disagreed with the latter's legislation.

The autonomy of the Bundesbank does not depend on the composition of the Bundesrat but there is good reason to believe that its monetary stance is affected by the popularity of the government. An independent central bank is a bureaucracy, and the modern theory of bureaucracy tends to assume that bureaucrats have a strong interest in raising their prestige - indeed, more so than entrepreneurs or lobbyists ^[7]. Milton Friedman even suspects that

"by far and away the two most important variables in the central banker's loss function are avoiding accountability on the one hand and achieving public prestige on the other. ^[8]"

If the members of the Bundesbank Council want to be popular, they will not wish to be seen at loggerheads with a popular government - not even outside election periods. This hypothesis deserves to be tested.

Comments:	For statements of the hypothesis and tests of it see Roland Vaubel, "Eine Public-Choice-Analyse der Deutschen Bundesbank und ihre Implikationen für die Europäische Währungsunion", in Dieter Duwendag und Jürgen Siebke, eds., Europa vor dem Eintritt in die Wirtschafts- und Währungsunion (Berlin: Duncker und Humblot); Rob R. McGregor, "FOMC Voting Behavior and Electoral Cycles: Partisan Ideology and Partisan Loyalty," Economics and Politics 8 (1996); Roland Vaubel, "The Bureaucratic and Partisan Behavior of Independent Central Banks," European Journal of Political Economy 13 (1997). Lohmann - misleadingly - calls it "the obstructionist hypothesis" which describes only one of two possibilities. -Back to
1)	

	text -
2)	Another difference is that her test of the party preference hypothesis includes the two early elections of 1972 and 1983 which neither the government nor the central bank can have anticipated. Only in testing the Nordhaus hypothesis (p. 432) does she report an estimate excluding these elections. -Back to text -
3)	Lohmann does not indicate the precise t-statistic of the party preference variable for my partisan coding but she reports that it is "indeed better" than the $t = 1.20$ for her partisan coding (p. 433). Her partisan coding of Bundesbankers ignores the fact (which she expressly admits) that the federal government has sometimes nominated a supporter of the opposition for the Bundesbank council (notably Helmut Schlesinger and Edgar Meister whom she mentions). -Back to text -
4)	Peter Trapp, Geldmenge, Ausgaben und Preisanstieg in der Bundesrepublik Deutschland (Tübingen: Mohr/Siebeck, 1976); Joachim Scheide, Geldpolitik, Konjunktur und Rationale Erwartungen (Tübingen: Siebeck/Mohr, 1984); Jürgen von Hagen, "The Causal Role of Money in West Germany - Some Contradicting Comments and Evidence," <i>Weltwirtschaftliches Archiv</i> 120 (1984). -Back to text -
5)	Helmut Schmidt in 1979 was merely bluffing, and almost everybody knew it. -Back to text -
6)	Bundesverfassungsgericht (07/18/1962), Nr. 24, p. 215. -Back to text -
7)	For a detailed application of the prestige motive to the Bundesbank see my 1993 article (fn.1), pp. 26-31. -Back to text -
8)	Quoted from S. Fischer, "Rules versus Discretion in Monetary Policy," in B.M. Friedman, F.H. Hahn, eds., <i>Handbook of Monetary Economics</i> , Vol. 2 (Amsterdam: North Holland, 1990), p. 1181. -Back to text -

[☰ \[Lehrstuhl\]](#)
[\[Lehre\]](#)
[\[Mitarbeiter\]](#)
[\[Stellenangebot\]](#)
[\[Publikationen\]](#)
[\[Drittmittelprojekte\]](#)



[\[Universität Mannheim\]](#)



[\[Fakultät für VWL\]](#)



[\[Uni-Bibliothek\]](#)



Stand: 1. Oktober 1999