REVISITING MONETARY POLICY EFFECTS ON INCOME INEQUALITY AND WEALTH IN AFRICA: Fresh Empirical Lessons based on Monetarist versus Keynesian Approach

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CHRISTIAN LAMBERT NGUENA
UNIVERSITY OF DSCHANG
FACULTY OF ECONOMICS AND MANAGEMENT (FSEG)
EMAIL: lambert.nguena@univ-dschang.org
The relative positive economic growth experienced by most African countries in the recent decade has come with insufficient demand stimulation.

The concern of poverty at the forefront of economic policy, the need for inclusive growth and sustainable development, inter alia, brings forward the inevitable question of the monetary policy responsibility.

Accordingly, at the contrary of the Keynesian theory, the monetarist theory that focuses on price stability inherently neglects the demand stimulation aspect of economic prosperity.

To this effect, while good results in terms of inflation targeting has been achieved in many African countries; performances in terms of wealth improvement and inequality reduction are low.
**Figure 2:** Sub Saharan Africa’s inflation rate and economic growth evolution.

Source: Author calculation based on World Bank data base (2008) and International Monetary Fund data base (2010 estimation).
MOTIVATION

LOW AFRICAN PERFORMANCE IN TERMS OF WEALTH & INEQUALITY

GROWTH lower than its potential; Poverty and inequality remain a big concern.

GOOD RESULTS IN TERMS OF PRICE STABILITY

INFLATION maintained at a stable and low level for almost all SSA

MONETARY POLICY RESPONSIBILITY IN AFRICA

PRICE stability Low demand stimulation
Problem

Observation
Low wealth & inequality performances + Good performance of CMP in terms of price stability

Solution
Potential macroeconomic solutions
(Men, Money, Material, Management, Machine ... etc.)

Proposed solution
Monetary policy solution
Promote pro growth monetary policy in Africa

Research question
What is the effect of CMP on Wealth and income inequality in Africa?

Assess & quantify the effect on wealth
Assess & quantify the effect on income inequality
CONCEPTS & THEORETICAL LINK

- CMP = monetary policy is credible when it guarantees the continuity of Central Bank action in pursuing its objective of price stability, and managed to stop monetary funding of budget deficits;

- Demand stimulation = providing means to economic agent to act in the market and thus permit to move to an equilibrium close to the highest production level;

- Income inequality = Extreme concentration of wealth /income in the hands of small percentage of a population; gap between the richest and the poor;

- Wealth= at a country level means stock of asset held by a country at a single point of time;

- Economic growth= Increase in the production of economic goods and services, compared from one period of time to another.
CONCEPTS & THEORETICAL LINK
“Le paradoxe de la crédibilité” [Mésonnier (2004)] with author modification
CONFRONTATION OF THEORETICAL EVOLUTION TO PRACTICAL RESULTS IN THE CONTEXT OF APPLICATION:

1. Monetarist versus Keynesian Approach: the old-new debate in the African context;
   - The neoclassical orthodoxy argues in favor of money neutrality in the short and long term. This consensus based on life cycles theory orients the role of the monetary authority to the absolute pursuit of price stability over the medium and long term;
   - The New Keynesian Economics, with the assumption of sticky prices and wages, price rigidity is the cause of distortions in consumption that cause the economy to not realize its growth potential.
LITERATURE REVIEW

CONFRONTATION OF THEORETICAL EVOLUTION TO PRACTICAL RESULTS IN THE CONTEXT OF APPLICATION:

2. Which real goal for pro-growth monetary policy in Africa?

- Price stability is very important to maintain a good economic environment and thus unleash activities and economic development;

- The theory of divine coincidence which argues that by only stabilizing inflation as an objective, the monetary authority also stabilizes the economy does not seem to be applicable in practice.
GENERAL INFORMATION

- **SAMPLE**: 46 AFRICAN COUNTRIES
- **PERIOD**: 1990 - 2014
- **INSTRUMENTS**:
  - Graphical & statistical analysis
  - Econometric analysis
- **DATA source**: World Development Indicator database;
- **METHODOLOGY**: PCM; GMM; Dummy variable technics ... etc.

THE MODEL BACKGROUND

- **FINANCIAL FACTORS**
- **INSTITUTIONAL FACTORS**
- **HUMAN CAPITAL FACTORS**
- **MARKET ACCESS FACTORS**

IMPproved WEALTH / INEQUALITY

Mésonnier (2004)


**METHOD AND DATA**

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<td>Dummy variable based on the decomposition of (lower=0, lower middle=1, upper=2) wealth level</td>
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WDI: World Bank Development Indicators. FDSD: Financial Development and Structure Database.

Source: Authors construction. WDI: World Bank Development Indicators.
METHOD AND DATA

BASIC MODEL

\[
\ln\left( y_{i,t} \right) - \ln\left( y_{i,t-1} \right) = \alpha X_{i,t} + \omega_i + \xi_{i,t}
\]

\( y_{i,t} \) being the explained variable for each country and year (economic growth/wealth dummy or income inequality);

\( X_{i,t} \) the matrix of explanatory variables (credible monetary policy, nominal cash rates per capita, human capital, openness rate and investment rate along with interactions variables);

\( \omega_i \) the specific effect of controlling unobservable differences between statistical units; and random disturbances.

Therefore, the basic dynamic panel regression model is expressed as follows:

\[
\ln(y)_{i,t} = \sigma_0 + \sigma_1 \ln(y)_{i,t-1} + \sigma_2 \ln(CMP)_{i,t} + \sigma_3 \ln(TXO)_{i,t} + \sigma_4 \ln(CAH)_{i,t} + \sigma_5 \ln(OUV)_{i,t}
\]

\[+ \sigma_6 \ln(TIV)_{i,t} + \sigma_y W_{i,t} + \eta_i + \xi_i + \epsilon_{i,t} \]
**METHOD AND DATA**

**CMP index construction**

Laxton and N’Diaye (2002) proposed in their work a simple measure of CMP in the light of a transformation of long-term interest rates that compares the current rate ($R_{i,t}$) with its higher ($R_{i,max}$) and lower ($R_{i,min}$) historical levels over the selected period. It is formalized as follows:

$$Cr_{i,t} = \frac{\left( R_{i,t} - R_{i,max} \right)^2}{\left( R_{i,t} - R_{i,max} \right)^2 + \left( R_{i,t} - R_{i,min} \right)^2}$$

Eyal Argov et al. (2007) will rewrite this formulation by replacing the long-term nominal interest rate with the inflation rate. Thus, we have:

$$Cr_{i,t} = \frac{\left( \pi_{i,max} - \pi_{i,t} \right)^2}{\left( \pi_{i,max} - \pi_{i,t} \right)^2 + \left( \pi_{i,min} - \pi_{i,t} \right)^2}$$

This calculation made it possible to have PMC values between 0 and 1 (corresponding to absence and perfect credibility thresholds) by country and by year.
RESULTS

IMPACT OF CMP ON WEALTH (WEALTH DUMMY & GDP GROWTH)

POPULATION; INVESTMENT; HUMAN CAPITAL; TRADE OPENNESS

CMP

NEGATIVE EFFECT

NOMINAL CASH RATE; CMP*Trade; CMP*Investment; CMP*Human

POSITIVE EFFECT

NO EFFECT
RESULTS

IMPACT OF CMP ON INCOME INEQUALITY (GINI INDEX)

- CMP → POSITIVE EFFECT
  - INVESTMENT; CMP*Trade; CMP*GDP Capita → NEGATIVE EFFECT
  - CMP*Interest → POSITIVE EFFECT
  - GDP PER CAPITA; TRADE OPENNESS; INTEREST RATE; CMP*Investment → NO EFFECT
CONCLUSION AND RECOMMENDATIONS

- **THEORETICALLY**, CMP as it is implemented is not useful in terms of economic development objectives.

- **PRACTICALLY**, African present good performance for CMP in terms of price stability and less performance in terms of wealth creation and inequality reduction due to insufficient demand.

- **EMPIRICALLY**, our results show that the paradox of CMP is traceable in Africa with a bad performance in terms of wealth creation and income inequality reduction.
  - The implementation of CMP is to be reviewed;
  - Price stability does not absolutely matter
  - **Wealth creation** and **income inequality reduction** should be the main pet subjects

With a promising economic environment mainly characterized by a low inflation, we recommend the promotion of a monetary policy oriented toward primarily improving wealth creation and inequality reduction under the constraint of price stability in Africa.
THANK YOU