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Central bank boards around the world: Why does membership size differ?

Helge Berger [a,d], Volker Nitsch [a,b,d,*], Tonny Lybek [c]

[a] Free University Berlin, Germany
[b] ETH Zurich, KOF Swiss Economic Institute, Switzerland
[c] International Monetary Fund, United States
[d] CESifo, Germany

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ABSTRACT

This paper analyzes empirically differences in the size of central bank boards (or monetary policy committees) across countries. We discuss the possible determinants of a board's size. The empirical relevance of these factors is examined using a new dataset that covers the de jure membership size of 84 central bank boards at the end of 2003. We find that larger and more heterogeneous countries, countries with stronger democratic institutions, countries with floating exchange rate regimes, and independent central banks with more staff tend to have larger boards.

1. Introduction

Size matters, in particular when it comes to central bank boards or monetary policy committees (MPCs).[1] While monetary policy may be a "science," it is hardly an exact one; it operates in an environment surrounded by considerable uncertainty. As a result, the way MPCs exploit information and agree on decisions may be critical for the quality and success of monetary policy. Current research has particularly emphasized the importance of central bank organization – and especially the size of central bank boards or MPCs – in this regard.[2]

Specifically, academics and policy makers have recently stressed the advantages of larger MPCs.[3] For instance, Blinder (2006) and Blinder and Morgan (2005) argue that multiple decision makers make fewer mistakes and better decisions when information

* Corresponding author. Weinbergstrasse 35, 8092 Zurich, Switzerland. Tel.: +41 44 632 25 53; fax: +41 44 632 12 18.
E-mail address: nitsch@kof.ethz.ch (V. Nitsch).

[1] To avoid confusion, we will hereinafter generally use the terms *MPC* or *central bank board*, instead of the various specific national terms describing the board, committee, council, or body in charge of deciding whether to change the monetary policy stance to achieve a specified target.

[2] Other features of central bank design may also have the potential to affect the quality of monetary policy decision-making; these include: meeting procedures (consensus decisions, voting arrangements, etc.), whether board members are full-time employees with the central bank or part-time external members, and if there are government representative(s), if any, with voting rights or the ability to temporarily postpone decisions. These factors, although important, are outside the scope of this paper.

[3] Our framework is related to the recent discussion on the size of boards of corporations. Reviewing the literature, Hermalin and Weisbach (2001, p. 31) note that: "Board composition [share of outside versus inside directors] is not related to corporate performance, while board size is negatively related to corporate performance. Both board composition and size do appear to be related to the quality of the board's decisions regarding CEO replacement, acquisitions, poison pills, and executive compensation." However, in the case of commercial corporations, the primary objective (e.g., to maximize shareholder wealth) is often clearer than for central banks. Furthermore, central bank boards typically have a smaller role, or none at all, in the appointment of the governor and in compensation decisions than commercial boards have.

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is incomplete—an argument that is loosely based on Condorcet's jury theorem. Gerling et al. (2005) summarize a larger literature from a game theoretic perspective; they argue that larger MPCs are particularly attractive if information is not public in nature. Auriol and Gary-Bobo (2007) note that, in general, true representation of a politically and economically diverse area will require a larger number of representatives. The surveys by Fujiki (2005), Sibert (2006), Vandenbussche (2006), and Berger (2006) provide a comprehensive overview over this rapidly expanding literature.[4]

As Goodfriend (2005, p. 85) remarks, however, "the efficient size of a policy committee might vary across countries." Countries differ along various economic, political, and institutional dimensions and (some of) these characteristics may also shape the advantages of larger MPCs. For instance, the argument to increase board size to achieve better information processing appears to be of particular relevance when an economy is large or characterized by considerable diversity across regions and industries. Similarly, a country's political institutions may matter for MPC size, with less democratic regimes perhaps preferring a smaller board (since a large MPC could effectively provide insulation from political pressures).[5,6] Finally, MPC size is probably also affected by other elements of central bank design such as the institutional functions performed by a central bank. For instance, if the central bank enjoys full autonomy over both policy targets and instruments, the MPC may be larger than when the central bank's autonomy is more limited.

A case in point is the recent discussion of the design of the European Central Bank's (ECB's) 19-member Governing Council, in which there is at least one representative from each member country of the monetary union (see, for instance, Baldwin et al., 2001; Berger et al., 2004). In light of the ongoing increase in euro area membership, the ECB has limited the (future) number of voting members to 21. Even with this restriction, however, the Council appears to be relatively large; most of the 82 central banks surveyed by Fry et al. (2000) have an MPC with about 5–10 members. It is still unclear, though, whether the ECB Governing Council is indeed exceptionally large or just a manifestation of a general pattern where larger countries tend to endow their central banks with larger MPCs.

Despite the considerable interest in MPC size, there is surprisingly little evidence about the cross-country variation in central bank boards and their determinants. Fry et al. (2000) document differences in MPC size across countries but provide no explanations. Erhart and Vasquez-Paz (2007) review a small number of potential determinants of MPC size. However, to the best of our knowledge, a systematic, broad-based empirical analysis of differences in MPC size is missing.

In this paper, we aim to fill this void by systematically characterizing differences in the membership size of decision-making bodies of central banks around the world. Since central banks often operate various boards, committees, and councils, we focus on the central bank's implementation board (or MPC) that makes decisions on whether and when to change policy instruments to achieve a given monetary policy target.[7]

Our results indicate that board size is indeed strongly and plausibly associated with a number of country-specific characteristics. We find, for instance, that board size is related to country size and country heterogeneity as well as to a country's political institutions. Also, MPC size is often associated with other central bank characteristics.

The remainder of the paper is organized as follows. In Section 2, we provide a detailed discussion of possible determinants of MPC size. Section 3 presents the data and the empirical results, and Section 4 provides a brief conclusion.

2. Possible determinants of central bank board size

The size of the central bank board is an important feature of central bank design. In practice, the decision on the number of board members appears to reflect various factors, including the political environment in which the decision on MPC size is made. In fact, one way to picture the decision process on board size is purely political. For instance, the number of central bank board members could be the result of a bargaining process that involves different interest groups (e.g., the financial sector, trade unions, or export industries) aiming at direct or indirect representation in the MPC.[8] Alternatively, the decision on MPC size could take the form of a conscious design decision of a decision-maker based on social or private preferences and subject to more or less binding political constraints.[9] Following the more recent literature, however, we will organize our discussion of the determinants of central bank board size around the trade-off of (some of the more obvious) costs and benefits of an increasing number of board members.[10]

[4] Schein (1999) is a related contribution from the business literature that looks at group-based decision making. Also see the helpful survey in Erhart and Vasquez-Paz (2007), who, like Sibert (2006) and Vandenbussche (2006), discuss contributions coming from outside economics proper.

[5] One argument along this line is that large board size combined with anonymous majority voting allows individual board members to claim to have been outvoted or otherwise dominated in the decision-making process.

[6] Related to size, it may in practice also make a difference if some of the MPC members are full-time employees of the central bank (i.e., "internal members") whose future careers may depend on the chairman of the MPC, typically the governor, or the members are "external" members. In the case of the former, the meeting dynamics may also be influenced by Keynes's "beauty contest factor," where these members may also be tempted to refine their own interventions in line with those they expect the chairman will favor. The special role of the chairman (see, for instance, Chappell et al., 2004) and the issue of internal and external members (see, for example, Tuladhar, 2005, who provides such information on MPCs in inflation-targeting countries) are indeed important, but lie outside the scope of this paper.

[7] Lybek and Morris (2004) provide a more detailed discussion of the various functions of central bank boards.

[8] A case in point are the recent amendments to the central bank law of Hungary in 2004, where the balance in the monetary policy committee was changed by increasing the number of members.

[9] Provided the central bank independence paradigm is acknowledged, the design-scenario may be more relevant for boards that primarily make decisions on whether to change monetary policy instruments to achieve a specified target (instrument autonomy) than for policy boards that are also involved in determining the target of the central bank (target autonomy) or even deciding on its primary objective (goal autonomy), which is much more normative.

[10] See, among others, Goodfriend (2005), Berger (2006), and Sibert (2006). It should be noted that the forces shaping any political process relevant for the decision on MPC size may be somewhat similar in nature to the forces considered in a cost-benefit approach.