Policymakers' economics backgrounds vary substantially across EU and OECD countries

Blog Admin

The appointments of Lucas Papademos in Greece and Mario Monti in Italy in 2011 are examples of leadership changes intended to bring more competent figures into government. But why do governments sometimes appoint economic policymakers with economics training, whilst others do not? Using new research, **Mark Hallerberg** *and* **Joachim Wehner** *suggest that levels of economics education among finance ministers are substantially higher in new democracies than in old ones, and that the appointment of an economics PhD as a central bank president is 22 per cent more likely during a banking crisis.*

The following quotations suggest that ministers who lack technical competence make bad policy decisions.

> *"I don't know what George Osborne's degree was in. It was certainly not economics." – Alex Salmond, First Minister of Scotland.*
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> *"In case you are wondering, George Osborne studied history." -BBC Radio 4. "A Scottish Pound?" Analysis Programme. 28 January 2013.*
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> *"[ECB President] Draghi countered the view of [German Finance Minister] Schäuble that the Island Republic of Cyprus is not 'systemically relevant,' and that a bankruptcy of the country is not a danger to the future of the Eurozone. Such a comment is what one hears especially from lawyers, argued Draghi. The question whether Cyprus is systemically relevant or not is not a question a lawyer can answer. It is a topic for economists. Schäuble has a degree in law." – Spiegel, first seen in Eurointelligence Daily Briefing, 28 January 2013.*

Should policymakers be experts in their fields? This is an especially relevant issue in the midst of a financial crisis. One potential reason for crises is that the incompetent people made the wrong decisions. If one were to replace these leaders with competent policymakers, then the crisis might end and there might not be crises in the future.

This line of argument can explain the widespread enthusiasm

This line of argument can explain the widespread enthusiasm both among pundits and in a given population for the appointment of technocratic governments, which are thought to have ministers with narrow technical skills, who are expected to produce better policy than their more political, and more generalist, predecessors. The almost simultaneous appointments of Lucas Papademos as prime minister of Greece and Mario Monti as prime minister of Italy in November 2011 are examples of leadership changes that were meant to bring more competent people into government.

Former Greek prime minister Lucas Papademos By Λουκάς Παπαδήμος Πρωθυπουργός της Ελλάδας [CC-BY-SA-2.0], via Wikimedia Commons

It’s an empirical question

The truth of such assertions is – at least on average – an empirical question. After all, it is not a priori clear that technical competence in itself is a desirable trait.

- The staffs of ministries and central banks can number into the thousands and even the tens of thousands.
- A good manager with little economic competence may do as well, or better, than an economics PhD;
- A more politically inclined economic leader may have more success in selling and implementing a given policy than a former economics professor.

Before one can consider whether technical competence affects policy, however, one first has to understand why governments sometimes appoint such people but often do not.

The topic has not been systematically studied. Tim Besley goes as far as to claim that the modern political economy literature “has not only neglected the problem of political selection, it has been positively hostile to the topic”. Yet, historical research and a booming industry in political memoirs and biographies highlight the importance of the personal characteristics of leaders for political choices. For citizens, choosing the right people for political office is arguably no less important than designing institutions that keep them from abusing their powers. Moreover, the empirical study of personal characteristics is more advanced in other areas, such as research on the financial performance of firms.

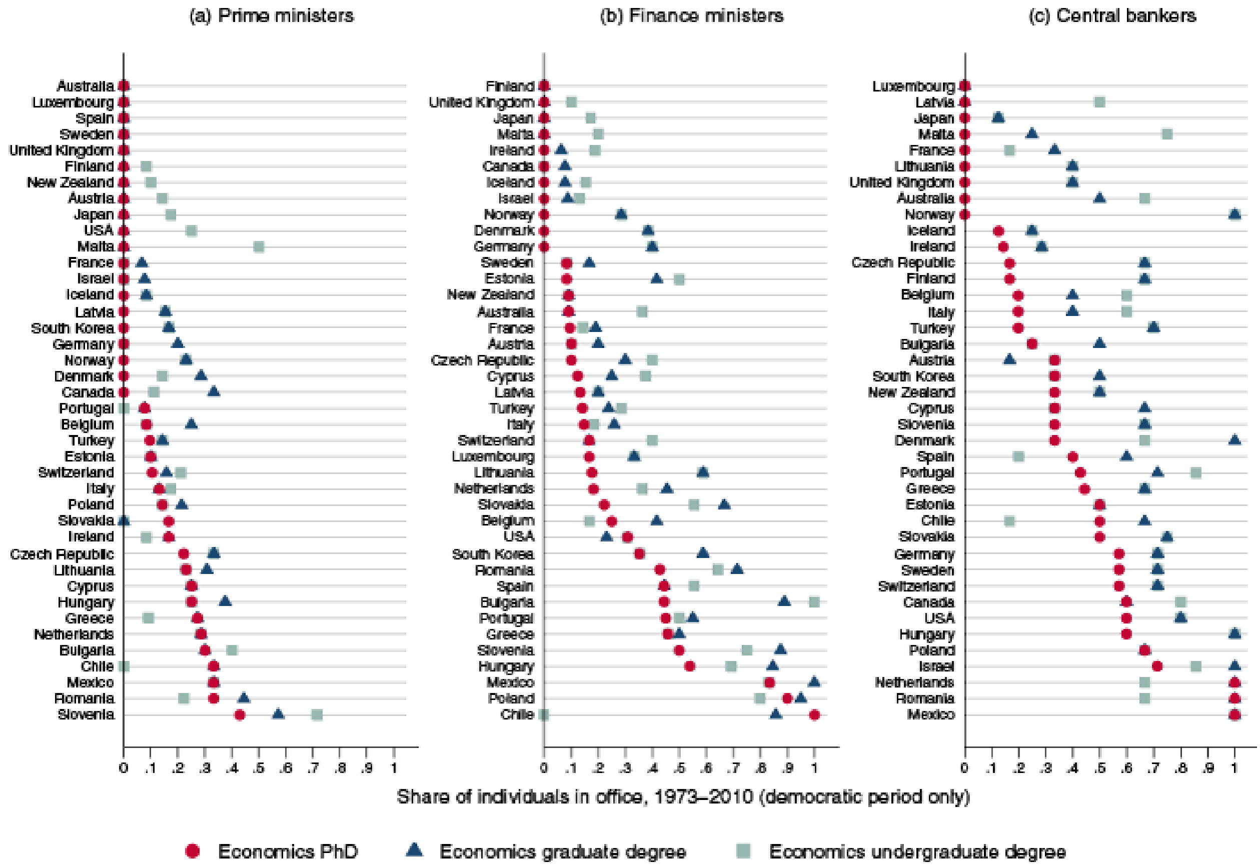
Political versus economic competencies

We focused on the type of economic policymaker, and considered political competence versus technical competence. Political competence, in turn, can have two interpretations. One is political skill; a finance minister with no economics training may be effective because she can impose spending cuts on her ministerial colleagues because she has the political ability to do so. A second interpretation is that an appointment satisfies a given constituency and has political value regardless of the (political) skills of the appointee. By economic policymaker we mean the head of government (either prime minister or president), the finance minister, or the governor or president of the central bank.

New data on education and occupation backgrounds

We have employed a new dataset that codes the educational and occupational backgrounds of prime ministers, finance ministers, and central bankers from 1973 through 2010. The resulting dataset contains information on almost 1,200 economic policymakers, 427 prime ministers or presidents (we use the former as the generic term), 540 finance ministers, and 216 central bank chiefs. Figure 1 summarises our data on education.

Figure 1 – Comparison of the economic training of economic policymakers



An analytic framework for structuring the empirics

In our recent research we examine the determinants of economics training. Our model has two parts to it. The first is the demand side – when do governments, and by extension the voters who elect them, want to have more technically competent economic leaders instead of generalists? The second part is the supply side – when is there a constraint on the availability of technical policymakers?

On the demand side, we find that governments appoint more technically competent economic policymakers during financial crises. Those in power during an economic crisis need to gain the confidence of two groups: investors in markets and voters.

First, if markets baulk at the government's rescue plan, then it is not possible for a government to borrow money at a time when it needs funds quickly. Second, someone bears both the economic and the financial costs of the crisis. Negotiating a politically viable set of policies to address the crisis is difficult. This is especially important during banking crises – no private actor can buy out the financial sector to solve the crisis, and it falls to the government to propose solutions and to execute decisions. The appointment of a technically competent economic policymaker may help the government gain credibility with both groups.

A second demand-side reason for a competent economic leader relates to partisanship. Governments on the left that represent largely labour power have to gain credibility with capital markets to finance the state, and they may be more likely to appoint trained economists as either finance ministers or central bank governors. While we do not find that the left always has more technically competent economic decision-makers, we do find that governments on the left appoint more technically competent finance ministers in years with a stock-market crash.

Third, new democracies select more technically competent leaders. Such governments have greater incentives to signal technical competence than their counterparts in established democracies. In terms of economic management, the appointment of competent economic policymakers following a transition to democracy can help reassure investors who might be unsettled by political uncertainty.

A fourth finding on the demand side counter to our expectations – Eurozone countries are less likely to have prime ministers with an economics education. We had presumed that membership in an economic union, in particular the Eurozone, would increase the demand for more competent economic policymakers. The responsibilities of the EU more generally are strongly weighted towards economic policy.

A demand-side perspective on competence, however, is incomplete – another relevant factor is the supply side. Why does the availability of potentially competent leaders vary across countries and across time?

The first such finding concerns a difference in how parliamentary and presidential systems appoint their cabinets, which in practice means that presidential systems have more technically competent finance ministers. In parliamentary systems, prime ministers may be constrained to select finance ministers from members of parliament. Jim Flaherty, the Canadian finance minister in August 2012 was also a Conservative member of parliament from Ontario. In contrast, the US secretary of the treasury, Timothy Geithner, had no such background. Presidents are therefore less constrained than prime ministers to appoint legislators to their cabinets who can help to coordinate the passage of legislation. For these reasons, we expect a higher level of technical competence among presidential appointments. As Robert Skidelsky quips in his biography of John Maynard Keynes: "In a Presidential … system he would probably have been Minister of Finance."

A supply-side perspective also suggests that the number of economically competent individuals who could be appointed to the cabinet typically declines with a government's time in office. This is especially true in those parliamentary systems where the main cabinet positions are drawn from parliament and where the available pool of ministerial talent is constrained to legislators – each ministerial change during an electoral term depletes the stock of potential ministers. Indeed, the longer a government is in office, the less technically competent are the finance ministers appointed, but the more competent are central bankers.

Implications

Taken together, our results have several interesting implications, and we conclude with just two. Our findings add a new twist to Besley and Reynal-Querol (2011), who find that democracies are more likely than dictatorships to select government leaders who have a graduate education. While we do not consider economic leaders during periods of dictatorship in our set of countries, we do have variation within all democracies.

- We find that levels of economics education among finance ministers are substantially higher in new democracies than in old ones.
- Our work suggests a possible additional piece to the causal story on why democracy matters; It is not just the fact of democracy but the age of that democracy that plays a role.

There are also interesting extensions to the central-banking literature, which notes a big increase in central-bank independence by the 1990s. Those who consider why some countries have more independent banks focus either on the number of veto players – more veto players generally leads to more independent banks and more credible monetary policy – or on ideational change, where there is a move to more neoliberal thinking about the difficulties of using inflation to increase economic growth.

It may require a crisis to change thinking on what sorts of policies are effective. Indeed, our results suggest that banking crises can lead to big jumps in the technical competence of central bank heads in terms of their education – the appointment of an economics PhD as a central bank president is 22 percentage points more likely during a banking crisis.

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