THE NEW GOVERNING RULES OF THE ECB

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Introduction

The ECB reform was not in the agenda of Nice, but EU leaders recognized that it was a precondition for Enlargement. This is the reason why the so-called "enabling clause" of Article 5 of the Treaty of Nice allows the EU to modify the ECB's decision-making procedures of its Governing Council, established in the Maastricht Treaty, without the need to convene a new Intergovernmental Conference (IGC)

These decision-making procedures are enshrined in article 10.2 of the Maastricht Treaty's "Protocol on the Statute of the European System of Central Banks and of the ECB", which deals with the Governing Council. In the said article, it is established that: "Subject to Articles 10.3 and 11.3, each member of the Governing Council shall have one vote. Save as otherwise provided for in this Statute, the Governing Council shall act by simple majority. In the event of a tie the President shall have the casting vote". Article 10.3 establishes that for the decisions of the Governing Council under the articles related to the Capital increases of the ECB and the allocation of its profits, the votes shall be weighted according to the national central banks' shares in the subscribed capital of the ECB.

Article 10.6 of the Protocol it is also very important given that it establishes: "Article 10.2 may be amended by the Council meeting in the composition of the Heads of State or Government, acting unanimously either on a recommendation from the ECB and after consulting the European Parliament and the Commission, or on a recommendation from the Commission and after consulting the European Parliament and the ECB. The Council shall recommend such amendments to Member States for adoption…. and they will enter into force after having been ratified by all the Member States in accordance with their respective constitutional requirements".

The EU leaders in Nice found a subtle and wise stratagem to deal with the, not accidental, absence of the ECB reform in their agenda. As the Treaty of Nice opened the door to a "single issue ICG" and the ECB institutional structure is set in the Treaty on the EU, any change of it would need another ICG. The "enabling clause" of article 5 of the Treaty avoids the need to have another ICG, which would have delayed further the enlargement and would have put the ECB structure into the realm of political trafficking. The Nice solution was ensuring that the ECB reforms must be considered, at least in some extent, in a political uncluttered setting. But, at the same time, the Nice Treaty has restricted the amendment to article 10.2 exclusively, what severely limits the set of its feasible reforms, as it will be explained later.

The main reason why the ECB reform was not in the agenda of Nice is that the same EU monetary authorities, including the President of the ECB, publicly ignored the problem, as they thought that it was an issue that they should discuss quietly at the Governing Council and, then, make a recommendation directly to the European Council, instead to allow the Commission to intervene in their final proposal. This was a wise strategy, given the inefficient way the final deal was handled in Nice.

The need to reform the ECB voting structure

There are two main reasons why the ECB's decision-making procedures needed to be reformed before enlargement.

The first one is that an increasing number of national central banks governors on the Governing Council (GC) reduces the relative power of the Executive Board, which is the one that provides leadership and guidance in the decision making process and that its members do not represent the view of any member state. According to the ECB statutes, every decision on interest rates is taken by simple majority of the GC, where each national central bank governor (NCB) and every Executive Board (EB) member holds a single, non-weighted, vote and the President vote decides in the case of tie. Nevertheless, at present, most of the decisions seem to be taken by consensus. The reason seems quite obvious. If every GC, usually starts with a "tour d'horizon" in which, first the EB, through one of its members, and then all the NCB governors, express their views on the economic situation in the Euro Area and in their own countries, respectively, the President receives clear information on the preferred interest move of each EB member (that he should know in advance) and of each governor, thus, allowing for the mental exercise of "shadow" voting and for figuring out the proposition of a decision that could win a vote. The dissenters realize that have nothing substantial to gain from disagreeing and that do not want to be outvoted in such an small group, so they have an incentive to act collegially and to join the consensus. Naturally, this outcome would be different if the minutes of the meetings were to be published later, in such a case, the dissenters may prefer to vote against.

Such a situation could change with an increasing number of NCB governors. The consensus view will become increasingly more difficult to achieve and the vote will become more the norm than the exception. Today, if a vote takes place, the simple majority rule means 9 votes for the President's proposition to be adopted. If the 6 EB members vote in unison, given that they meet in advance of each GC to try to adopt a common position, the President needs only 3 votes out of the 12 NCB governors, what it is not difficult. When first 12 and later probably 15 new countries will join in the near future, the decision-making will be much more difficult. The present status quo of 18 members of the GC: 6 EB plus 12 NCB, will become 33 GC members: 6 EB plus 12 new NCB entrants through enlargement plus 3 NCB governors from UK, DK and Sweden. With 33 GC members, the power of the EB to guide monetary policy decisions will almost disappear, given that the President will need 11 NCB governors to make a simple majority, instead of the present 3. If getting 12 NCB governors to agree is already difficult, getting 27 will be extremely hard.

The second one is that the present natural coalition of the GC will be dramatically altered. Let us correctly assume that the 6 EB members do not have any national bias, that is, they only care about the Euro Area inflation, which, statistically speaking, is a GDP weighted average of national inflation rates. Given that a small group of "core" members dominate the Euro Area GDP, their national inflation rates will dominate the average Euro Area inflation rate, as well. This means that the EB will find natural allies among the NCB governors of these "core" economies, not only if these governors take a purely national perspective at the time of voting, but even more if, as they are suppose to behave, they do not have a national bias and behave as purely independent members, exactly the same as those of the EB. Therefore, if the “core” NCB governors tend to side with the proposition of the EB, and the “non-core” or “less-synchronized” members have a different view from the decision proposed by the President, the GC decision-making will be very smooth because the Euro Area weighted average inflation is dominated by 7 member nations whose macro-economies are reasonably synchronized (Germany, France, Italy, Benelux and Austria) and that make 85% of the Euro Area GDP.

After enlargement, the applicant nations are now, and will remain for some time, very different and “less-synchronized” than the “core” members when it comes to inflation and growth. This means that the decision-making will become much more difficult, since various coalitions of non-core members can achieve a blocking majority and there will be a high probability that the EB efforts to pursue a target based on the weighted average inflation could be frustrated. For instance, let us assume that there are 12 new entrants in the Euro Area, while the UK, DK and Sweden stay out. In that case, the GC voting shares change dramatically. The EB voting share falls from 33% to 20% of the total and the EB plus the 7 “core” NCB members share falls from 72% to 43%, while the less-synchronized members increase their voting share from the present 28% to 57%. Therefore, a coalition of less-synchronized members could have a simple majority despite accounting for only 20% of the Euro Area GDP. Even in the more probable case that the UK, DK and S will also join the Euro Area, together with the new entrants from Central Europe, as their economies are not as synchronized as the ones of the 7 “core” members, it will be difficult to get them to agree with the position of the EB members and to achieve a smooth decision-making at the GC.

This new situation will make it very difficult for the GC of the ECB to react promptly, and even to react at all, to any random shock that could affect the Euro Area. These are the reasons why a change in the voting structure of the GC was so necessary.

The options available for reform in the ECB voting structure

There were three basic options available to the ECB to try to overcome its decision-making difficulties due to enlargement of the Euro Area.

The first one was representation. This option is the one chosen by the IMF, the World Bank and other International Financial Institutions as well as in the Bundesbank Council, after reunification. Representation reduces the number of voting NCB governors by grouping them together and allocating only one vote per group. There are many forms of doing these groupings but, usually, the best solution is to form even groups in terms of GDP. One way to achieve it would be to maintain the 12 NCB members by giving the main members, Germany, France, Italy, Spain and the UK, if it joins, a vote each and divide the rest of the 22 members into 7 even groups with one vote each. Another one could be to reduce the number of NCB voting members to the largest 5 countries and to form even groups, in terms of GDP as well as on geographical terms, around these 5 voting members. A third one could be to have 7 voting members, the 5 largest plus one group composed of the small incumbent 7 members and DK and Sweden and another one composed by all the new Central European entrants. Finally, it could be achieved a mixed form of representation and rotation, for instance, having 9 groups of

3 members each that will rotate, let us say, every 2 years, in the vote-casting tenure, therefore every member will be able to vote for 2 years every 4.

The second option was delegation. This is the option that was chosen by the Bank of England, as well as the Central Banks of Sweden, Canada, Australia and New Zealand. In this solution, the decisions of monetary policy are delegated by the GC to a group of independent experts chosen by their competence, experience and reliability, appointed for fixed terms Those experts form a board or a committee, whose composition is unrelated to the national composition of the Euro Area. This option could be form by enlarging the present EB 6 members of the ECB with another, say, 9 experts to achieve a total of 15 members in the EB. The meetings of the GC would still be attended by the 27 NCB governors, who will discuss all the issues together wit the enlarged EB members, but the final decision will be left to the EB 15 members. The problem with this option, which is by far the optimal, in terms of an efficient and credible monetary policy for the ECB, is that, by having decided by the "enabling clause" of the article 5 of the Treaty of Nice that the proposition to reform should only affect Article 10.2 of the Statutes of the ECB, that is, the voting system of the GC, and neither Article 11, that deals with the EB, nor Article 12 which says that "in addition, the EB may have certain powers delegated to it where the GC so decides" it seems to make very difficult to achieve now a delegation to the EB to conduct the monetary policy decisions.

The third one was the rotation of the NCB governors. This has been the option chosen, many years ago, by the Board of Governors of the Federal Reserve Board, and now by the ECB. This option had many different sub-options. At one extreme, there could be a few NCB governors, let us assume 3, with long term appointments of say 5 years. The GC would have a very stable composition but this would mean that a typical NCB governor will have to wait many years to have a vote. At the other extreme, there could be many voting NCB governors, let us assume 13, with short tenures, say 6 months, this would leave almost half of the NCB 27 governors out of voting, but for a short period. The membership of the GC, however, would be very volatile, reducing the predictability and the credibility of the ECB's monetary policy. The ECB has finally chosen an intermediate form.

According to the new ECB rotation proposition, the EB will have permanent voting rights. The total number of voting rights in the GC will be capped at 21, adding 3 new NCB members to the present 18 members. No NCB governor will have a permanent voting right but, at the same time, no NCB governor will be out of the vote forever. Having restricted the number of voting members, it is important to ensure that the GC does not become unrepresentative of the Euro area as a whole, measured, for example by GDP or population.

The NCB governors will be divided into three groups. The first one, to include Germany, France, Italy, Spain and the UK (if it finally joins) would have 4 votes. The second one comprising one half of the total number of NCB governors will have 8 votes and the third group comprising the remainder governors will have 3 votes. Therefore, the number of votes at the GC will be capped at 21. Nevertheless, the large NCB governors will have a longer tenure and will rotate slower than the NCB governors of the second group and the latter will have a longer voting tenure and a slower rotation than those in the third group.

With such a proposition, the ECB tries to achieve a series of objectives. The first one is to give more prominence to the EB in respect to the NCB governors in order to streamline the decision-making process and avoid the predominance of national interests. The second one is to avoid frequent and disruptive changes in the voting membership, so that the course of monetary policy remains steady and predictable. The third one is to ensure that conditions prevailing in the largest economies be given due weight in the decision-making process. The fourth one is to reduce the number of voting GC members to make the working of the decision process more efficient and give sharper signals to the markets. Finally, to maintain democratic accountability with the populations of the Euro Area member States.

Some shortcomings of the ECB's reform proposition

Although the ECB proposition to reform the voting procedures of the GC apparently solve most of the issues concerning the dramatic changes that produces the enlargement in the decision-making process, avoiding an almost impossible reaction by the ECB to the threat of random shocks and making monetary policy more efficient and prompt to tackle them, such a proposition shows certain shortcomings.

The first one is that it seems to violate one of the main principles of the ECB statutes, which establishes that the NCB governors sit on the GC in a personal and independent capacity, not as national representatives. In this new proposition the NCB governors are given different voting weights according to the economic importance of the Member States that they represent and have different voting tenures and periods of rotation according to the same criteria. It seems as if the ECB has decided, after three years of experience, to abandon such a principle and consider that the NCB governors are representatives of the national interests of their respective countries, leaving only the EB members as truly independents.

The second one is that the voting cap is still too large to gather a smooth process of consensus in the ECB decision-making. To achieve a consensus among 21 voting members is not going to be easy, given that many new entrants will be very little synchronized wit the "core" members, and it might happen that sometimes rates will be kept unchanged, as it happens already now, because it proves very difficult to gather consensus in favour of a rate change. The US FED rotation system has proved to be very efficient, but there are only 11 members who vote in its Federal Open Market Committee, which is the one taking the final decisions on interest rate changes, of which, 7 are regional governors and 4 are permanent voting members, and the Chairman plays a major role. Therefore, the ECB should have tried to reduce further the number of NCB members to less than 18. For instance, the 6 permanent voting members of the EB, plus another 9 members representing the 27 potential NCB governors, would mean that each governor could have one year voting tenure every other two, or two years voting every other four.

The third one is that it proves that the negotiation with the present NCB governors of the GC has been very difficult and that it has limited the extent of the reform. A clear sign of this difficulty is that, paradoxically, a tiny country as Luxembourg, allocated to the second group, is going to have a more weighted vote and longer tenure than Poland, the sixth largest country, in terms of population, of the future Euro Area, and a larger GDP than the Grand Duchy, allocated in the third group. There should be a system of rotation based purely on a mixture of GDP and population weights and not on individual power of negotiation.

Let us hope that the present Convention and the future revision of the EU Treaty, that the Convention will entail, might reduce or abolished these shortcomings and, even more, could find a way to achieve a system of delegation similar to the one that two members of the EU have already put in practice with excellent results.