Eijffinger, Sylvester C. W.

Article
Change at the ECB executive board

Intereconomics


This Version is available at: http://hdl.handle.net/10419/41924

Terms of use:
Documents in EconStor may be saved and copied for your personal and scholarly purposes.
You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.
If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.
The Governing Council of the ECB currently has 18 members – six Executive Board members and 12 national central bank governors, one for each of the 12 euro area countries. Formally, all members have equal weight in the decision-making process. Eighteen members may already be too many from the point of view of effective discussion, deliberation and decision-making. Enlarging an unreformed ECB to include up to perhaps 15 additional national central bank governors would turn the Governing Council into an unwieldy and perhaps unmanageable group of 33 members. The Central Bank’s tradition of consensus-based policy-making – said to play an important role in today’s ECB decision-making process, too – could further amplify the ECB’s “number problem” and increase decision-making costs. Baldwin et al.1 argue that, as a practical matter, the Executive Board initiates many Council decisions, but that its leadership ability will be seriously reduced as the number of euro area member countries increases and its relative power decreases. Furthermore, an increase in euro area member states without reform would widen the wedge between the economic and political weights of EMU member countries within the ECB. Since almost all accession countries are small in economic terms relative to current euro area members, enlargement within the given institutional set-up would significantly increase the degree of over-representation of the area’s smaller member countries in the Council in terms of relative economic size. For instance, in a monetary union with 27 members the current ECB statute implies that the representatives of its smallest 17 member states, representing only about 10 per cent of the area’s aggregated GDP, could determine monetary policy decisions in the euro area.2 Without a reform of the ECB, nearly 80 per cent of the countries will have a larger political than economic weight. If the “one person, one vote” principle were strictly applied, all newcomers except the UK would be allocated a political weight surpassing their economic weight, in most cases by a substantive margin.3

Over-representation could introduce an unwelcome bias into the ECB’s decision-making, if country representatives put at least some weight on national economic developments and these developments deviate significantly from the behaviour of euro-area aggregates. There is reason to believe that such asymmetries could have an impact on ECB policy-making. We shall therefore evaluate various ECB reform options from three perspectives: decision-making costs, the gap between economic and political weights, and political feasibility. First, we discuss various reform options. Second, we zoom in on the reform proposal put forward by the ECB. Third, we shall discuss the following three remaining questions.

• What is the assessment of the current distribution of responsibilities within the ECB Board and its internal political equilibrium?
• Will (or, perhaps, should) there be a major redistribution of portfolios once Mr. Issing is gone?
• What is the general view on the way these hearings are conducted, and the fact that Parliament lacks a real say in the nominations contrary to what happens in the USA?

Finally, we draw some conclusions.

Options for Reform of the ECB

There are various ways in which the ECB can be reformed, such as centralisation (the Executive Board will become responsible for policy decisions), vote-weighting (the vote of a national central bank depends on the size of the economy), representation (one central banker represents various central banks), extending regional central banks across national borders, and rotation (the governors of national central banks have rotating voting rights). Baldwin et al. argue for more centralisation. A pragmatic application of the centralisation scenario would be to put actual policy decisions into the hands of the ECB Executive Board. This would limit the role of the Council to that of an informational forum in which the area's regional central banks would be informed of policy decisions and implementation issues would be discussed. A larger role for the Executive Board in ECB decision-making would go a long way towards limiting decision-making costs and preventing possibly diverging economic developments within a larger euro area having an undue impact on monetary policy in the euro area. Article 112 (2) (b) of the Treaty establishing the European Community specifies that the Board is appointed by "... the governments of the member states at the level of Heads of State or Government, on a recommendation from the Council, after it has consulted the European Parliament and the Governing Council of the ECB". This highly centralised political process at the European level should support a euro-area-wide perspective of the nominees selected for the Board. However, the political feasibility of centralisation seems limited. The principle "one person, one vote" is an important feature of the current ECB framework, also in day-to-day monetary policy-making. Article 10 (2) of the ECB Statute clearly states that, "Each member of the Governing Council shall have one vote", which includes the national central bank governors. Thus, a reform of the ECB that fails to safeguard the established voting rights of current member countries' central banks might not be politically acceptable. After all, an equal right to participate in ECB policy decision-making was an integral part of the Maastricht treaty that established the currency union. Some member governments could experience opposition to letting go the "last" bit of influence on ECB policy-making after having exchanged monetary sovereignty for a seat on the ECB Council in 1999.

A somewhat different proposal for centralisation that meets some of these objections has been put forward by Gros, who argues in favour of re-defining the division of labour between the Executive Board and the Governing Council. The tasks of the Governing Council should be to set the direction for monetary policy, decide on proposals from the Executive Board, constitute a platform for the exchange of views on the euro area economy and monitor the work of the Executive Board. These tasks can be performed efficiently even by a rather large body and the representation of all member countries in the Governing Council provides the appropriate legitimacy for such a controlling function. According to Gros, the primacy of the Governing Council is not affected in this proposal – all powers would continue to emanate from it. It does, however, reduce the right of the Governing Council to control every single act of the Executive Board. Thus the Executive Board could come to enjoy a certain degree of discretion, which is justified by the fact that it represents not just the aggregation of individual state interests but rather a "general European monetary interest". According to Gros, this division of labour is based on one key difference between NCB presidents and members of the Board that is objective: their respective information bases. Board members concentrate on area-wide aggregates in their daily work and are likely to be in closer contact with global financial markets than the NCB presidents. The latter perform a wide variety of functions at the national level: they supervise the national banking system, they are influential participants in national debates about almost all economic policy issues etc. By contrast the members of the Board can concentrate almost exclusively on issues related to the formulation of the common monetary policy stance. Even though we are quite sympathetic towards this reform proposal, we doubt whether it will sufficiently address the implied risks of the gap between political and economic weight. After all, in the proposal by Gros, all national central bank governors...

---

4 This section is heavily based on Chapter 7 of: J. De Haan, S. C. W. Eijffinger, S. Waller: The European Central Bank: Centralization, Transparency and Credibility, Cambridge Mass. 2005, MIT Press. For further discussion see also the Briefing Papers of February 2003 by the members of the Monetary Experts Panel, for example P. Bofinger and D. Gros, for the Committee on Economic and Monetary Affairs of the European Parliament.

5 Cf. H. Berger, op. cit.


---


8 Ibid.
keep one vote in the Governing Council and the Council still decides on the direction of monetary policy.

In the scheme as proposed by Bofinger, who also favours a set-up in which the Executive Board takes decisions on interest rates, the Governing Council even has some kind of veto power over interest-rate decisions. This would bring us basically back to the current situation. Furthermore, it seems that the political feasibility of a reform in which the Executive Board would have more power is limited.

Berger et al. argue in favour of a reform such that economic size and political power are matched as closely as possible. When countries have as much voting power as GDP share, possible deviations from a purely “European” perspective on the part of Council members would not have an undue influence on monetary policy in the euro area. There are basically four options here: vote-weighting, representation, extending regional central banks across national borders, and rotation. Under vote-weighting, the votes of non-Board members of the ECB Council would be weighted when cast for monetary policy decisions, for instance by using member countries’ share in euro area GDP. By definition, a reform along these lines would better align the political and economic weights of the national Council members. Vote-weighting has a precedence in the qualified voting schemes of the EU Council, which the Treaty of Nice has updated for the case of EU enlargement. Another voting scheme that takes into account differences in economic size is the idea of a required “double majority” of votes and population. Under such a system, there is still an equal voting right for all Board members. Every decision requires a majority of the votes. In addition, however, it is also required that the votes in favour represent a majority of the population of the euro area. An alternative would be to require that these votes represent a majority of the euro area’s GDP. A problem with all the vote-based reform scenarios is, however, that they do not necessarily address the problem of decision-making costs. Decision-making costs in the narrow sense of voting on, say, interest-rate changes, need not be particularly problematic. However, the Council’s decision-making process will involve more than the simple aggregation of votes but also, for example, a more or less extensive discussion of the views of all members. In this case, weighting votes does not necessarily solve the ECB’s “large number problem”.

An alternative reform scenario, representation, combines some of the characteristics of the centralisation and the weighing approach. The principal idea would be to create groups of euro member countries with joint representation and joint voting rights in the ECB Council, integrating the concept of a strong regional anchor with the necessity of restricting the size of the ECB’s main decision-making body after the enlargement. The representation scenario requires a number of specific institutional decisions, in particular on group selection. The selection principle could be based on the idea of common economic regions (taking into account similarities in business cycles or economic structure), economic size, or both. Related issues are the number of groups, the overall Council size, and the delegation of voting power from group members to their representative in the ECB Governing Council. The alternative institutional designs range from a restricted or “imperative” mandate (votes in the Council are pre-determined at the group level) to an unrestricted mandate (group members delegate their full voting rights to their representatives). However, since the latter arrangement could, in principle, deprive individual group members of their right to participate in the decision-making, there is a potential conflict with the idea of national representation and the “one person, one vote” principle. This makes a solution entailing some form of explicit involvement of national central banks at the group level before a Council decision, i.e. a restricted mandate for the group representatives in the Council, a likely part of any representation scenario. Such a restriction is likely to encompass contributions to Council discussions as well as formal voting. In this sense, it will alleviate the decision-making costs problem at the level of the ECB Governing Council. However, these costs will substantially increase at the level of the group. If the mandate of group representatives in the Council is restricted, in the sense that their actions require the explicit consent of group members, the overall time and effort needed for a Council decision will be of a similar magnitude, if not higher, as in the previously discussed scenario.

A variant of the representation idea is the extension of central bank jurisdictions across national borders.

---

10 H. Berger, J. De Haan, R. Inklaar, op. cit.
For instance, the regional central banks in the Federal Reserve System extend the borders of the States of the Union, and some of the (post-1992) Landeszentralbanken in the Bundesbank Council represent more than one German state. An application of this principle to the ECB after enlargement could help to reduce the number of decision-makers in the Council. If the design of central bank areas aimed at establishing regional banks of approximately similar economic weight, it would also contribute significantly to avoiding mismatches between voting power and economic size. However, as with the previous scenarios, there could be issues regarding the political feasibility of a reform that included abolishing the existing voting rights of current euro area member states. Furthermore, it would imply that one of the basic principles of the current ECB set-up, i.e. “representation” of countries, would be surrendered.

An alternative reform scenario that, in principle, might also be able to address both the mismatch between political and economic weights and the decision-making problem associated with the enlargement of euro area membership (while avoiding some of the political constraints discussed above) could be (asymmetric) rotation. The basic idea is that national central bank governors would take turns sitting in the Council, with the frequency of their participation scaled to match the relative economic weight of their respective country. Rotation would thus work to weight the votes of national central bank governors in an implicit fashion. Arguably, therefore, rotation would pose less of a conflict with the “one person, one vote” principle than centralisation, weighted voting, or the representation scenario. While not all governors would participate in every Council meeting, those who participated would cast a full vote. Rotation could also serve to limit the overall size of the ECB Council by allowing only a fraction of central bank governors to participate in meetings. The ability to address the potential problems posed by enlargement while avoiding part of the political feasibility problems associated with some of the other reform ideas make rotation schemes a likely candidate for ECB reform. Berger et al.11 discuss a number of more specific options for such an ECB reform scenario, constructing groups on the basis of three criteria:

- size, i.e. maximise the average share of euro area GDP represented
- inflation, i.e. minimise the average within-group standard deviation of inflation
- correlation of business cycles with other members in the group, i.e. maximise the within-group business cycle correlation.

These authors conclude that only groups based on the size criterion guarantee that more than 50 per cent of the euro area's GDP would constantly be represented in the Council. This implies, however, that the principle of equal voting rights has perhaps to be abandoned. The easiest way to ensure that more than half of the euro area's GDP is always represented is to give the “big five” a permanent seat in the Governing Council. If this turns out to be politically unacceptable, a system may be considered in which the big five also rotate, but substantially less often than the other countries. Berger et al.12 present the example of 4 seats for the big five, who rotate, and 5 seats for all the others, who also rotate.

The ECB Reform Proposal

In its meeting of 19 December 2002, the Governing Council of the ECB adopted a proposal for reform of the ECB after enlargement of the monetary union. As in the analysis by Berger et al.,13 the ECB proposal puts a limit on the number of central bank governors exercising a voting right. However, the ECB puts this maximum at 15, instead of 9. Consequently, the Governing Council will consist of 21 members, which is much too large from a decision-making cost perspective. No modern central bank has a decision-making body this size. Moreover, all members of the Governing Council (with and without voting rights) will continue to sit at the table and have the right to participate in the discussion. As Bofinger14 puts it, “in spite of its complexity the Recommendation clearly fails to meet the main target of the ECB's institutional reform. The danger that the Council would be paralysed by too many participants is still there.” The ECB proposes that, if the euro area increases to more than 15 countries, there will be two groups with rotating voting rights. The first group will consist of the governors of the member states that occupy the highest positions in the country rankings on the basis of a composite indicator of “representativeness”. They share four voting rights. The second group will consist of all other governors, who will share 11 voting rights. The principal compo-
nent of the “representativeness” indicator will be the member state’s GDP. The second component will be the total assets of the aggregated balance sheet of monetary financial institutions (TABS-MFI) within the territory of the member state concerned. The relative weights of the two components are 5/6 for GDP and 1/6 for TABS-MFI. Once there are 22 euro area member states, there will be three groups with rotation. The allocation of central banks to the groups will be based on a ranking according to the composite indicator. The rotation scheme as proposed by the ECB is as follows. The first group, which will have four votes, will be composed of the five central bank governors from the euro area member states which occupy the highest positions (the “big five”). The second group, with eight voting rights, will consist of half of all national central bank governors selected from the subsequent positions in the ranking. The third group will be composed of the remaining governors. They will share three voting rights. Thus, if there are 27 members, the intertemporal voting power of a national governor would be 80 per cent in the first group, 57 per cent in the second and 38 per cent in the third.15

The ECB proposal has met considerable criticism from academic observers. Gros16 argues, for instance, that “the solution proposed by the ECB is worse than the status quo. It is inefficient, opaque, internally inconsistent and arbitrary.” Apart from critique on the size of the Governing Council that we share, Gros has the following objections to the ECB proposal.

• First, it “gives up the principle of equality of member states, thus potentially undermining the idea that all members of Governing Council should forget the particular interests of their home country and act only in the interest of the entire euro area.” As we have argued before, the best way to ensure that national interests will not unduly influence ECB policy-making is to bring political power and economic weight of national central bank governors as closely into line as possible. Even if national central bank governors take economic developments in their home country into account, this will not lead to decisions that will be out of line with the ECB’s mandate for price stability in the euro area as a whole. Some preliminary calculations under the assumption of an EMU with 27 members by Berger et al.17 suggest that the average share of GDP represented is quite high under the reform as proposed by the ECB: 73 per cent. So, reform along these lines is certainly helpful to overcome the most important institutional design failure of the ECB.

• Second, the proposal lacks clarity. For example, it is not clear how the first group of 5 countries will share four votes. Will they rotate every meeting, every month, every year? In what order? What happens to new members of the euro area? It is clear that the ECB proposal has to be further specified, but it seems that these practical matters are not a principle objection towards the proposal as such.

• Third, Gros argues that the proposal is internally inconsistent, because “the aim is to ensure better representation of the larger countries. But this will not be achieved if the rotation principle is applied immediately once euro area membership reaches 15.” In our view, this critique does not make much sense. In the longer term, the proposal implies that bigger countries will have a larger say in monetary policy-making.

• Fourth, Gros argues that the ECB proposal is not transparent because it is too complicated. Furthermore, it has arbitrary elements: the weight given to the indicator of the size of financial markets (one sixth) is not motivated in any way and seems designed to ensure a better position for one country (Luxembourg). According to Gros, Luxembourg will have a larger weight than Finland (a country with about 10 times the population and 6 times the GDP of Luxembourg). The third group with the lowest voting power would consist exclusively of the new members.

We agree that the criteria for determining the voting groups is rather arbitrary. As pointed out before, we prefer grouping on the basis of economic size (GDP) only. Furthermore, there should be a clear rule on how often the grouping can be reconsidered to take into account that the relative size of countries may change over time. If the new member countries grow faster than the current euro area countries, they must get a higher voting share. There is evidence suggesting that voting in the Bundesbank decision-making body was actually influenced by regional economic considerations.18 The best way to mitigate any political influence that could be at odds with the aim of price stability in the euro area as a whole is to align political and economic weight more closely, as we are arguing for in this paper.

15 Ibid.
16 D. Gros, op. cit.
17 H. Berger, J. De Haan, R. Inklaar, op. cit.
economic weights as closely as possible. If national politicians put pressure on their central bank, based on the economic situation of the country concerned, and central bankers act upon it, this would not lead to distorted decision-making.

Change at the ECB Executive Board

In its meeting of 2 March 2006, the Governing Council of the ECB adopted an opinion on a recommendation from the Council of the European Union on the appointment of a new member of the Executive Board of the ECB. This ECB opinion means that the Governing Council has no objections to the proposed candidate, Dr. Jürgen Stark, who is a person of recognised standing and professional experience in monetary or banking matters, as required by Article 112 (2) (b) of the Treaty establishing the European Community. Following this ECB opinion and a similar opinion expressed by the European Parliament, the new member of the Executive Board will be appointed by common accord of the governments of the member states, which have adopted the single currency at the level of Heads of State or Government. The ministers of finance of the European Union have already expressed their support for Dr. Stark. In view of the upcoming hearing in April at the European Parliament with the nominee replacing Prof. Otmar Issing as a member of the ECB's Executive Board, the Committee on Economic and Monetary Affairs has asked, amongst others, the following three questions.

• What is your assessment of the current distribution of responsibilities within the ECB Board and its internal political equilibrium?
• Do you think there will be a major redistribution of portfolios once Mr. Issing is gone?
• What is your general view on the way these hearings are conducted, and the fact that Parliament lacks a real say in the nominations contrary to what happens in the United States?

In order to address these interrelated questions, I will first discuss the current distribution of responsibilities within the Executive Board and its internal political equilibrium. Table 1 gives an overview of the various business areas and the present reporting lines to the members of the Executive Board. The Executive Board of the ECB is a collegial body and has a collective responsibility for all business areas. This means that all decisions are taken jointly by the Executive Board and not by individual members of the Board. The distribution of particular responsibilities for various business areas is determined by the Executive Board itself; this can change and, indeed, has changed in the past. It is for reasons of functionality that business areas report to the Executive Board through one of its members. As shown in Table 1, President Trichet is responsible for communications and internal audit, while the responsibility of Vice-president Papademos is financial stability and supervision, as well as human resources, budget and organisation. Chief Economist Issing is responsible for both the DGs economics and research; these departments are directly involved in the preparation and formulation of all decisions on monetary policy. Mr. González-Páramo is responsible for information systems, statistics and banknotes, while Mrs. Tumpel-Gugerell oversees market operations, payments systems and market infrastructure. Finally, the

Table 1
Business Areas and Reporting Lines to the Members of the Executive Board

<table>
<thead>
<tr>
<th>Jean-Claude Trichet, President</th>
</tr>
</thead>
<tbody>
<tr>
<td>Directorate Communications</td>
</tr>
<tr>
<td>Directorate Internal Audit</td>
</tr>
<tr>
<td>Lucas Papademos, Vice-President</td>
</tr>
<tr>
<td>Directorate Financial Stability and Supervision</td>
</tr>
<tr>
<td>Directorate General Secretariat and Language Services</td>
</tr>
<tr>
<td>Directorate General Human Resources, Budget and Organisation</td>
</tr>
<tr>
<td>Otmar Issing</td>
</tr>
<tr>
<td>Directorate General Economics</td>
</tr>
<tr>
<td>Directorate General Research</td>
</tr>
<tr>
<td>José Manuel González-Páramo</td>
</tr>
<tr>
<td>Directorate General Information Systems</td>
</tr>
<tr>
<td>Directorate General Statistics</td>
</tr>
<tr>
<td>Directorate Banknotes</td>
</tr>
<tr>
<td>Gertrude Tumpel-Gugerell</td>
</tr>
<tr>
<td>Directorate General Market Operations</td>
</tr>
<tr>
<td>Directorate General Payment Systems and Market Infrastructure</td>
</tr>
<tr>
<td>Lorenzo Bini Smaghi</td>
</tr>
<tr>
<td>Directorate General International and European Relations</td>
</tr>
<tr>
<td>Directorate General Administration</td>
</tr>
<tr>
<td>Directorate General Legal Services</td>
</tr>
<tr>
<td>ECB Permanent Representation in Washington DC</td>
</tr>
</tbody>
</table>

Source: European Central Bank, Directorate Communications.

most recently appointed Executive Board member, Dr. Bini Smaghi is responsible for international and European relations, including the ECB’s permanent representation in Washington DC. The key issue is whether the current distribution of responsibilities constitutes a stable, internal political equilibrium and, in view of this, whether there will be (or, perhaps, should be) a major redistribution of portfolios once Mr. Issing is gone.

For a stable, internal political equilibrium within the ECB’s Executive Board it is desirable that the responsibilities for the DG Economics and the DG Research are not concentrated within the portfolio of a single Executive Board member. Since these two departments are directly involved in preparing and formulating all decisions on monetary policy (the central task of the ECB), it would be desirable for the functioning of a proper system of checks and balances within the Board that the responsibilities for the two departments are distributed over two different Executive Board members. As President Trichet chairs both the Executive Board and the Governing Council of the ECB, it would also be desirable to have these two departments not under his direct supervision in order to preserve his role as independent chairman. The DG Economics could, for example, report to Vice-President Papademos, because of his extensive experience in this field, and the DG Research could e.g. report to Mr. Bini Smaghi. The advantage of separating the reporting lines of the DG Economics and the DG Research could be that key aspects of the debate on monetary policy decision-making would move to the level of the Executive Board as a collegial body instead of taking place and being resolved within the portfolio of a single member of the Board. The responsibility for international and European relations could then be handed over from Mr. Bini Smaghi to Mr. Stark, who has both as State Secretary in Bundesfinanzministerium (Germany’s Federal Financial Ministry) and as Vice-president of the Deutsche Bundesbank ample and wide experience in international and European relations.

Finally, I shall give my view on the way these hearings for the appointment of an Executive Board member are conducted, and the fact that the European Parliament lacks a real say in the nominations contrary to what happens in the United States. Unfortunately, the European Parliament does not have the same position as the US Congress with respect to the nominations for the Board of Governors of the Federal Reserve System. This difference in positions can be explained by the fact that the Federal Reserve System is a creature of the US Congress. For the European Parliament to have a real say in the nominations for the ECB’s Executive Board would require a change in the Statute of the ECB, which seems quite unlikely. This does not mean, however, that the ECB could not consult the Committee on Economic and Monetary Affairs ex ante on future Executive Board nominations on its own initiative.

Some Conclusions

It is clear that the ECB has to be reformed in view of the future enlargement of the euro area. Under the current set-up, the Governing Council will become an excessively large body. From the decision-making cost perspective, a larger role for the Executive Board would be an attractive option for reform. If the Board were also to become responsible for monetary policy-making, the risks of a distorted monetary policy would also be minimal, provided that the Board had a truly euro-area-wide focus. If, however, the Governing Council remains the decision-making body, a reform that brought the political power and economic weight of national central bank governors as closely in line as possible would be preferable. From this perspective, the reform proposal of the ECB points in the right direction. The reform foresees a rotation system in which the likelihood that a national central bank governor will have a voting right depends on the size of the economy of his home country. However, a serious problem in this proposal is the size of the Council (15 national central bank governors with voting rights and 6 Executive Board members) and the fact that national central bank governors without voting rights can also participate in the discussion. A smaller Governing Council – with, for instance, 15 members – in which only national central bank governors with a voting right can participate would probably lead to more efficient decision-making than the proposal of the ECB. For the European Parliament to have a real say in the nominations for the ECB’s Executive Board would require a change in the Statute of the ECB, which seems quite unlikely. This does not mean that the ECB could not consult the Committee on Economic and Monetary Affairs ex ante on future Executive Board nominations on its own initiative.

---

20 Cf. Board of Governors of the Federal Reserve System: Federal Reserve Act And Other Statutory Provisions Affecting the Federal Reserve System, Washington DC, August 1990, Section 10.1 (T-077) of the Federal Reserve Act reads as follows: “The Board of Governors of the Federal Reserve System (hereinafter referred to as the “Board”) shall be composed of seven members, to be appointed by the President, by and with the advice and consent of the Senate, ..., for terms of fourteen years except as hereinafter provided, ...”