



OESTERREICHISCHE NATIONALBANK

Stability and Security.

# WORKSHOPS

Proceedings of OeNB Workshops

*The European  
Integration Process:  
A Changing Environment for  
National Central Banks*

October 21, 2005



No. 7

# The Future Voting Modalities of the ECB Governing Council

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## Executive Summary

As a consequence of the future enlargement of the euro area, the functioning of the Governing Council will be adapted. The choice for the new voting system was mainly determined by the limitations deriving from the Nice Treaty, by the will to stick as much as possible to the principles on which the EMU was based and by the need to obtain unanimity on the proposal. As a consequence, some models had to be excluded: changes in the composition of the Governing Council, new division of tasks between the Governing Council and the Executive Board whereby the latter would act as a Monetary Policy Committee, creation of constituencies, double majority or weighted voting systems.

As only the voting modalities could be amended, the option of a rotation of the voting rights of the governors was retained. While no change will occur regarding the members of the Executive Board, a maximum number of 15 voting rights will be allocated to the governors of the National Central Banks (NCB's). These voting rights will rotate among them. The speed of the rotation will vary according to the weight of their Member States of origin, the governors of the large Member States benefiting from longer voting intervals than the remaining ones.

Several uncertainties remain regarding this new regime: when will it be implemented, what will the rules be in an euro area composed of 16 to 18 Member States, how will the voting rights rotate?

Two main concerns prevailed when designing the new system: first, the perceived need to take into account the principle of representativeness, in order to preserve the credibility of the decisions taken by the Governing Council and, second, the balance between the Executive Board and the governors in the Governing Council. The introduction of the element of representativeness creates a fundamental difference in the reform of the Governing Council by comparison with

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<sup>1</sup> The views expressed in this paper represent the position of the author and are not necessarily attributable to the Banque Nationale de Belgique.

the European Commission, where the rotation system will be based on the strict equality of all members.

In our view, the reform should not only be assessed from the efficiency point of view but also from a broader perspective, i.e. the ability to ensure the smooth functioning of the Monetary Union. This means that various aspects should be looked at: the ability to take decisions, the supranational character of the monetary policy and the acceptability of the decisions by the economic agents, by the political bodies and by the citizens. The paper concludes with an assessment of how the new system performs on these aspects by comparison with a more centralised system.

## 1. Introduction

1. On 1 May 2004, a historical event took place, namely that of the accession of ten new Member States to the European Union (EU). Without any fuss, a reform of the European Central Bank (ECB) Governing Council entered into force on that same day.<sup>2</sup> The objective was precisely to adapt its functioning to the future enlargement of the euro area. As no opting out clause had been foreseen for the new Members, they will join the euro in the coming years. The timing is not yet known since this prospect will depend on individual compliance with economic and legal criteria. The reform will therefore only be implemented at a later date, when the euro area will comprise several new Members.

Before describing the new system, we will first briefly recall the origin of the clause introduced in the Nice Treaty enabling the EU Council to adapt the functioning of the ECB Governing Council. It should be remembered that the Council did not get “carte blanche” and several limits were put to its action. We will then explain the new system in the light of the main guiding principles and compare it with the regime that will be put in place for the European Commission. Finally we will assess its possible future impact.

## 2. Origin and Procedure

2. The main objective of the Nice Treaty was to prepare the EU for an enlargement of an unprecedented size. During the Intergovernmental Conference (IGC), new arrangements were discussed covering all EU institutions, including the European Investment Bank. At a late stage, the French Presidency launched the idea of also reforming the ECB. The idea was accepted. It is safe to assume that in addition to the desire not to create an exception for the ECB, the intention was to

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<sup>2</sup> As a consequence, the (non) ratification of the Constitutional Treaty will not affect the new ECB voting system.

ensure an effective decision-making process in the area of monetary policy after euro area enlargement.

No real discussion took place neither on the possible content of such a reform nor even on some guiding principles for it. This can be explained by several factors: the late introduction of this topic within the IGC, the perception that the euro area enlargement was a much more distant perspective than the EU enlargement; the reluctance of some Member States to embark on a substantial discussion on EMU (Economic and Monetary Union) issues.

As a result, an enabling clause was introduced in the Nice Treaty<sup>3</sup>, granting to the EU Council the possibility to adjust the voting modalities within the Governing Council of the ECB<sup>4</sup>.

3. Since no guiding principle was agreed for such a reform, several safeguards were introduced regarding the procedure:

- The decision had to be taken by the Heads of State or Government and by unanimity.
- The recommendation for a decision could be made either by the ECB itself or by the European Commission. If it originated from the ECB, an unanimous decision by the Governing Council was required.
- The European Parliament and either the Commission or the ECB (depending on who would present the recommendation) had also to be consulted.
- Finally, the reform had to be ratified by all Member States.

To a certain extent, this procedure can be compared with a “single issue Intergovernmental Conference”<sup>5</sup>.

In a declaration attached to the Final Act of the IGC, the governments of the Member States expressed their expectation that “a recommendation... will be presented as soon as possible” (meaning: after the Nice Treaty enters into force).

The Commission decided not to use its right to make a recommendation unless the ECB proved not to be able to come with a proposal to reform itself.

4. As a consequence, the reform of the ECB Governing Council was decided by the EU Council (meeting at the level of Heads of State or Government) on 21 March 2003<sup>6</sup>, acting unanimously, on the basis of an ECB recommendation<sup>7</sup>. Thereafter the reform was ratified by all the (at that time 15) Member States.

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<sup>3</sup> Art 10.6 of the Statute on the European System of Central Banks (ESCB) and of the European Central Bank, hereafter called ESCB Statute.

<sup>4</sup> Only Article 10.2 of the ESCB Statute could be amended.

<sup>5</sup> R.E. BALDWIN, E. Recommendation EC B/2003/1, under Article 10.6 of the ESCB Statute, for a Council Decision on an amendment to Article 10.2 of the ESCB Statute (OJ 7.2.2003, C 29, p. 6) BERGLÖF, F. GIAVAZZI, M. WIDGREN, Nice Treaty: Should the Treaty of Nice be Ratified?, Monitoring European Integration 11, CEPR, 2001.

<sup>6</sup> Decision 2003/223/EC, OJ L 83, 1.4.2003, p. 6.

### 3. No Carte Blanche

5. The Council did not receive a “carte blanche” to amend the decision-making process in the ECB. As we have seen, several constraints were built in the procedure.

On the substance, the constraints were even stricter: only the voting modalities within the Governing Council could be changed.<sup>8</sup>

This means that:

- *The composition of the Governing Council could not be modified.* All the governors of euro area central banks and all Executive Board members will continue to have the right to be present during the Governing Council meetings and to participate in the discussions.
- *The division of tasks between the Governing Council and the Executive Board could not be changed.* The Governing Council will remain the supreme decision-making body, in particular in charge of the monetary policy, the Executive Board being mainly responsible for the preparation of the decisions and for the current business of *the ECB*.
- *The voting rules regarding to decisions with a patrimonial effect could not be amended either.* These decisions will continue to be taken according to the national central banks’ shares in the subscribed capital of the ECB.

6. These constraints imply that a substantial reform of the Governing Council was excluded by the Nice Treaty. A reform limiting the number of members of the Governing Council or implying a different distribution of tasks between the two ECB decision-making bodies was out of the scope of the enabling clause. The creation of a “Monetary Policy Committee”, as suggested by the European Parliament for the longer term<sup>9</sup>, was not possible either. This has to be taken into account when assessing the reform that was proposed by the ECB.

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<sup>7</sup> Recommendation ECB/2003/1, under Article 10.6 of the ESCB Statute, for a Council Decision on an amendment to Article 10.2 of the ESCB Statute, submitted on 3 February 2003 (OJ 7.2.2003, C 29, p. 6).

<sup>8</sup> D. Servais, P. Vigneron et R. Ruggeri, *Le traité de Nice et son impact sur l’union économique et monétaire*, European Banking and Financial Law Journal (Euredia), 2000/4, pp. 489–493.

<sup>9</sup> For this reason, the European Parliament called for a proposal to be made by the European Convention to be inserted in the draft Constitution. The alternative proposal of the European Parliament consisted in distinguishing “between operational decisions, to be taken by an enlarged Executive Board of nine Members, adequately representing the euro area economy, and strategic and general monetary policy decisions, to be taken by the Governing Council acting on a double majority, based on the population of the Member States, the total size of the economy and the relative size within it of the financial services sector” (OJ 10.3.2004, C 61 E/374).

7. These constraints set by the Nice Treaty on how the ECB should be reformed in order to cope with the future enlargement of the euro area might seem surprising to an external observer.

In fact, the search for efficiency was counterbalanced by the desire of the Member States not to change the basic rules and balances of Monetary Union and, in particular, to guarantee that all NCB governors would retain a seat in the Governing Council. Our participation in the Maastricht Treaty negotiations, clearly showed that while Member States fully accepted the principle of independence, they were at the same time determined that one of their nationals (namely their central bank governor) should participate in the decision-making body charged with monetary policy decisions. This was the price they asked for the willingness to accept abandoning their monetary sovereignty. When the Nice Treaty was signed, the Monetary Union had only lasted for two years and it was certainly too early to change these basic balances.

## 4. The New Regime

8. Because of the limits defined by the Nice Treaty, the range of possibilities for reforming the functioning of the Governing Council was restricted to changing its voting rules. In order to better understand and later assess the new voting modalities that were introduced, we will first recall the main guiding principles deriving from the Maastricht Treaty (3.1) and explain the main concerns of the ECB when designing its proposal (3.2). We will then present the main elements of the reform (3.3), before detailing the rules that will govern the allocation of the voting rights (3.4). As we will see, the concrete modalities of rotations will be decided later (3.5).

### 4.1 The Main Guiding Principles Deriving from the Maastricht Treaty

#### 4.1.1 The Two Guiding Principles

9. Further to the limitations enshrined in the enabling clause (see §5 here above), the design of the new voting modalities had to take several principles into account, which can be considered as pertaining to the fundamentals of the Monetary Union:

- the independence principle

10. A first cornerstone of the Monetary Union as it was designed in the Maastricht Treaty is the independence principle. When participating in the Governing Council and when voting, a member shall not seek or take instructions from anybody (Article 107 of the Treaty and 7 of the ESCB Statute). Coupled with the “one

person-one vote”, the independence principle fully ensures the “ad personam” participation of the members of the Governing Council.

- the “one member-one vote” principle

11. The normal voting rule in the Governing Council is “one member-one vote”<sup>10</sup>. This principle<sup>11</sup>, emphasises the fact that all the members of the Governing Council, including the NCB governors, are appointed in their personal capacity and do not represent their countries or their NCBs. They act in an individual capacity<sup>12</sup>, “in the interest of, and with due regard to the situation in the euro area as a whole”<sup>13</sup>.

This is the way the Governing Council works today, especially regarding monetary policy decisions.

Even if the enabling clause had allowed changing this principle, the ECB nevertheless regarded it as “the core constitutional principle of the monetary policy of the ECB” and stressed this in its Opinion addressed to the Presidency on 5 December 2000<sup>14</sup>.

#### 4.1.2 Impact on Possible Models of Reform

12. On the basis of these two principles, the ECB considered that several possible models for the reform of the Governing Council had to be excluded:

<sup>10</sup> The only case where this principle does not apply are the decisions on certain financial matters where NCBs’ governors act as shareholders in the ECB (Art. 13 of the ESCB Statute).

<sup>11</sup> This principle, as well as the participation of all governors in the Governing Council together with the Executive Board members, was seen by the fathers of the ESCB Statute (the Committee of Governors) as strengthening the federative structure of the Eurosystem and the System’s decision-making process. As it was underlined by the Committee of Governors, the “one member-one vote” principle is “conditioned by the need to direct such decisions to the requirements of the Community as a whole rather than to regional considerations”. (See: Committee of Governors of the Central Banks of the Member States of the European Economic Community, Introduction to the Draft Statute of the European System of Central Banks and of the European Central Bank, published by Agence Europe n°1669/1670, p. 14. See also R. SMITS, The European Central Bank, Institutional Aspects, Kluwer Law International, 1997, p. 101.)

<sup>12</sup> See J-V LOUIS, L’Union économique et monétaire, in Commentaire Megret, Le droit de la CEE, 2<sup>nd</sup> edition, Etudes Européennes, Editions de l’Université de Bruxelles, Brussels, 1995, p. 66.

<sup>13</sup> H. K. SCHELLER, The European Central Bank, History, Role and Functions, ECB, 2004, p. 54.

<sup>14</sup> See the Opinion of the ECB of 5 December 2000, at the request of the Presidency of the Council of the European Union on a proposal to amend Article 10.2 of the Statute of the European System of Central Banks and of the European Central Bank, OJ 16.12.2000, C 362, p. 14, point 5.

- the introduction of a constituency system. In such a system all governors would play at least an indirect part (through mandating the voting member of their constituency) in the decision-making. However, the governor acting as “constituency representative” would have been mandated by his constituency members and would be accountable to them;
- a reform proposal based on weighted voting;
- a double majority system where the current simple majority voting would be supplemented by a control mechanism to assess whether the assembled majority of governors represents a certain threshold of total euro area population, GDP or any other criteria<sup>15</sup>.

These last two proposals were regarded as infringing the “one member-one vote principle” as they would introduce a direct link between the weight of a vote and the country of origin of a governor, jeopardising the supranational character of the monetary policy.

## 4.2 The Main Concerns

13. In fact, two main concerns prevailed when designing the new system: on the one hand, the perceived need to take into account the *principle of representativeness*, in order to preserve the credibility of the decisions taken by the Governing Council; on the other hand, the *balance between the Executive Board and the governors* in the Governing Council.

### 4.2.1 The Representativeness

14. A “problematic characteristic” of the euro area enlargement process is its “highly asymmetric” character “because the majority of the acceding countries are small in size and economic power compared to the current EMU average”.<sup>16</sup>

The question was therefore raised whether it would be acceptable for the political bodies, the markets and the public opinion, that a majority of Governing Council members might come from countries representing only a small share of the economic activity of the total euro area.<sup>17</sup>

<sup>15</sup> The European Parliament rapporteur on this issue proposed such a double majority system as a first step in the reform of the ECB Governing Council, that would be applicable until the euro area has reached the critical mass of 25 Member States (see I. FRIEDRICH, Reform of the Decision-making Rules of the ECB Council in View of EMU Enlargement, *The Way Ahead*, Intereconomics, May/June 2003, pp. 116–119).

<sup>16</sup> M. FRAENKEL and R. FENDEL, The New ECB Voting System: Some Room for Improvement, *Intereconomics*, November/December 2003, p. 334.

<sup>17</sup> In its resolution on the ECB recommendation, the European Parliament also emphasises that “reforms steps must ensure both participation of all ECB Governing Council



15. This was considered as a main concern by the ECB. It therefore considered that “since the introduction of a rotation system could theoretically lead to situations in which the members of the Governing Council having voting rights were from Member States which, taken together, might be perceived as not being sufficiently representative of the euro area as a whole, it should be designed in a manner which excludes such outcomes”<sup>18</sup>.

As we will see, the price to pay to meet this concern will be the introduction, to a certain extent, of a national dimension in the participation of the governors in the Governing Council.

#### 4.2.2 The Balance between the Executive Board and the Governors in the Governing Council.

16. With the enlargement of the euro area, additional governors will become members of the Governing Council. As the number of Executive Board members will remain stable, their relative weight, in numerical terms, would decrease in the absence of any reform. To solve this problem, a cap had to be introduced in the number of voting rights allocated to the governors.

17. Finding the appropriate balance between the number of voting members from the Executive Board on the one hand and from the governors’ side on the other hand was a difficult and sensitive point in the discussions.

On the one hand, the Executive Board wished to come to a ratio close to the model of the Deutsche Bundesbank<sup>19</sup> (eight members of the Direktorium, nine Presidents of Land Central Banks) or to the Federal Open Market Committee (FOMC) in the U.S.A. (seven Board members, five Presidents of Federal Reserve District Banks). On the other hand, the governors feared that by reducing the number of voting governors, the Board would be in a position to systematically impose its views, jeopardising the fundamental nature of a “system” of central banks.<sup>20</sup>

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members in decision-making and adequate representation of the euro area economy” (OJ 10.3.2004, C 61 E/374).

<sup>18</sup> Recommendation ECB/2003/1, explanatory memorandum, op. cit., p. 7.

<sup>19</sup> Before the amendment of the Bundesbank Act of 23 March 2002.

<sup>20</sup> The Treaty assigns the objective of maintaining price stability and the tasks of conducting the monetary policy (among other tasks) to the European System of Central Banks (composed of the national central banks and the ECB) and not to the ECB itself. The System is governed by the decision-making bodies of the ECB. The national central banks are involved in the system as shareholders of the ECB, through the participation of their governors in the highest governing body (the Governing Council) and through the “reliance on national central banks as operational arms of the System”. The main reason for creating such a system” of central banks was “to fully respect the federative structure

### 4.3 The Main Elements of the New Regime

18. Taking into account the above mentioned elements, (in particular the fact that all governors continue to participate in the meetings and that the competences of the Governing Council remain unchanged), the ECB considered that a rotation regime of the voting rights within the Governing Council would best fulfil the Nice mandate, and this was accepted by the EU Council.

It was also deemed important that the new voting system should be able to cope with the uncertainty regarding the timing and the sequencing of the euro area enlargement. Some automaticity had to be introduced in the new system in order to avoid the need to change the rules every time a new Member State (or a group of new Member States) enters the euro area. The new rules had therefore to be stipulated in such a way as to allow the system to automatically adjust to the participation of up to 27 governors in the Governing Council.<sup>21</sup>

#### 4.3.1 Three Key Elements

19. The new voting system is based on *three key elements*:

- a) *All governors will be subject to the rotation system.* All governors will thus lose their voting rights from time to time. Conversely, the six Executive Board members will permanently retain their voting rights. They are thus not covered by the rotation scheme. The argument was made that they have a special status, being “the only members of the Governing Council who are appointed at the European level by a Treaty procedure and who operate in the euro area context and for the ECB, the competence of which spans the whole euro area”.<sup>22</sup>
- b) *The total number of voting rights within the Governing Council is set at 21, which means 15 voting governors.* These numbers correspond to the legal situation in place until May 2005: since no amendment was made to the Maastricht Treaty at the time of the 1995 enlargement, the Governing Council could theoretically be composed of 15 governors and 6 members of the Executive Board. This implies that the current balance between the Executive Board members and the governors will broadly remain unchanged<sup>23</sup>.

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of the Community” and the “subsidiarity principle”. (See: Committee of Governors, Introduction to the draft statute, op. cit. p. 14).

<sup>21</sup> i.e. the current Member States (at that time) and the 12 accession countries listed in the Declaration on the enlargement of the European Union which is annexed to the Treaty of Nice.

<sup>22</sup> Recommendation ECB/2003/1, explanatory memorandum, op. cit., p. 6.

One can however observe that all Governing Council members are supposed to act with an European perspective (see the first guiding principle, supra §10).

<sup>23</sup> Even if arithmetically, the Executive Board will need the support of 5 governors in a Governing Council with 15 voting governors, instead of 3 now (in a Governing Council

- c) The voting rights of all governors will rotate but at different speeds. In order to achieve representativeness, differentiation is introduced in the rotation system. Governors will exercise their voting rights with different frequencies depending on the size of their respective Member State, with governors from larger member States enjoying more frequent periods with voting rights than those from smaller Member States.

Groups of governors will be formed and the voting frequency will differ from group to group. Within a group, all governors will enjoy the same voting frequency.

The allocation of a governor to a specific group is determined by a country ranking based on a composite indicator:

- the share of a Member State in the aggregate gross domestic product of the euro area (GDP, at market prices );
- the share of a Member State in the total aggregated balance sheet of the monetary financial institutions of the euro area<sup>24</sup> (TABS-MFI).

The first criterion was chosen because the impact of central bank decisions is greater in Member States with larger economies than in those with smaller ones. The second because the size of a Member State's financial sector also has a particular relevance for central bank decisions since the counterparties of central bank operations belong to this sector.<sup>25</sup>

This composite indicator was heavily criticised: many, including the European Commission, would have preferred opting for the population criterion, besides GDP; others consider the attempt to align Governing Council votes with the economic *and* financial importance in the euro area as “an enlightened approach”<sup>26</sup> but stressed that the TABS-MFI does not reflect the whole financial sector and is biased in favour of the particular segment of banks within the financial sector<sup>27</sup>.

with 12 voting governors), this should not lead in practice to the weakening of the position of the Executive Board in the Governing Council, mainly for two reasons: i) the Executive Board members will permanently be entitled to vote; ii) the cohesion of the Board as a group should get stronger, in contrast to the governors who will be more numerous but will lose their voting rights from time to time. This means that governors will lose power on an individual basis (see M. FRENKEL, R. FENDEL, *op. cit.*, p. 336).

<sup>24</sup> A 5/6 weight was given to the GDP criterion and a 1/6 weight to the TABS-MFI one. No rationale was given to explain this ratio, but, according to the ECB recommendation, it ensures “that the financial component is sufficiently and meaningfully represented” (see explanatory memorandum, *op. cit.*, p. 7, comment on Article 1).

<sup>25</sup> ECB Monthly Bulletin, May 2003, p. 77.

<sup>26</sup> E. E. MEADE, A (Critical) Appraisal of the ECB's Voting Reform, *Intereconomics*, May/June 2003, p. 131.

<sup>27</sup> According to the TABS-MFI criterion, Luxembourg has a higher share than UK and the same share as Spain and the Netherlands. It is however likely that the TABS-MFI component will be “exposed to substantial momentum in the coming years especially in

### 4.3.2 Implications

20. In a certain way, these key elements might be regarded as a reinterpretation of some basic principles of the Monetary Union:

- Some members of the Governing Council will enjoy permanent voting rights, while others will take part in the decisions on a rotating basis only.
- The “one member-one vote” will continue to apply to the Executive Board members; as regards to governors, it will only apply insofar as governors enjoy a voting right. This principle should therefore now be read as “one voting member-one vote”.
- A new element is introduced, namely the need to guarantee the representativeness of the decisions. Representativeness was not deemed to be a cause of concern in a EU composed of 12 or 15 Member States given the relative homogeneity of the Union. As the last enlargement changed this, specific measures had to be taken to ensure the representativeness of the decisions. An adequate balance had however to be found between this concern and the need to preserve the “ad personam” participation of the members of the Governing Council. This led to the introduction of a differentiation between the governors, regarding their voting frequency.

The ECB justified it by the fact that “this is exclusively motivated by the need to accommodate the impact of enlargement on the Governing Council’s decision-making’ and exclusively limited “to the prior determination of the frequency with which each governor has the voting right. For all governors having voting rights at any point in time, the “one member-one vote” principle would continue to apply. Consequently, this differentiation should not impact on actual substantive decision-making”.<sup>28</sup>

## 4.4 The Rotation System when the Euro Area Comprises 16 up to 21 Member States

21. In principle, the system for the rotation of voting rights will start operating as soon as the euro area comprises at least 16 Member States.

Governors will then be allocated to two groups:

- the first group, composed of the 5 governors from the Member States which occupy the highest positions in the country ranking, should be assigned 4 voting rights;
- the second one, composed of the remaining governors, should share 11 voting rights.

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the accession countries (new Member States)”. (M.FRENKEL , R. FENDEL, op. cit., p. 337).

<sup>28</sup> Recommendation ECB/2003/1, Explanatory memorandum, op. cit., p. 7.

- this system will continue to apply until the euro area comprises more than 21 Member States.
22. However, even if the system was conceived for an euro area composed of 16 to 21 Member States, an exceptional adjustment will need to be made in the case where the euro area would temporarily be composed of 16, 17 or 18 Member States:
- If only 4 voting rights were to be allocated to the 5 governors forming the first group, their voting frequency would be lower than the voting frequency of those in the second group.
  - A solution could therefore be to shift one voting right from the second to the first group, which means that the governors coming from the big Member States would permanently retain their voting rights during that period.
  - Another solution could be to postpone the start of the rotation system until the euro area comprises at least 19 Member States. This can be decided by the Governing Council acting by a two-thirds majority of all its members<sup>29</sup>. Such a solution would be more in line with the principle that all governors are subject to the rotation scheme, all being equal and having the same voting power<sup>30</sup>.

*Table 1: Euro Area Composed of 16–21 Member States – Voting Frequencies of Governors in Each Group*

		Number of governors in the Governing Council								
		16		17		18		19	20	21
1st Group	No. of voting rights/	5/5		5/5		5/5		4/5	4/5	4/5
	No. of governors									
	<i>Voting frequency</i>	100%		100%		100%		80%	80%	80%
2nd Group	No. of voting rights/	10/11	11/11	10/12	12/12	10/13	13/13	11/14	11/15	11/16
	No. of governors									
	<i>Voting frequency</i>	91%	100%	83%	100%	77%	100%	79%	73%	69%
Total voting rights		15	16	15	17	15	18	15	15	15

*Source: ECB Monthly Bulletin (May 2003) and author's calculations.*

<sup>29</sup> With and without voting rights.

<sup>30</sup> Except in financial matters.

## 4.5 The Rotation System when the Euro Area Comprises 22 Member States or More

23. As soon as the euro area comprises 22 Member States or more, the governors will be allocated to three groups, instead of two:

- The first group will be composed of the five governors from the euro area countries which occupy the highest positions in the country ranking. This group shares four voting rights.
- The second group will be composed of half of all governors<sup>31</sup> selected from the subsequent positions in the country ranking. This group shares eight voting rights;
- The third group will be composed of the remaining governors. It shares three voting rights.
- This means that the voting frequency within the first group will always remain 80%; in the second group, it will vary from 73% (when the euro area is composed of 22 countries) to 57% (when the euro area is composed of 27 countries); in the third group, the voting frequency will vary from 50% to 38% in the same hypothesis.

*Table 2: Euro Area Composed of 22 of More Member States – Voting Frequencies of Governors in Each Group*

		Number of governors in the Governing Council					
		22	23	24	25	26	27
1st Group	No. of voting rights/	4/5	4/5	4/5	4/5	4/5	4/5
	No. of governors	4/5	4/5	4/5	4/5	4/5	4/5
	<i>Voting frequency</i>	80%	80%	80%	80%	80%	80%
2nd Group	No. of voting rights/	8/11	8/12	8/12	8/13	8/13	8/14
	No. of governors	8/11	8/12	8/12	8/13	8/13	8/14
	<i>Voting frequency</i>	73%	67%	67%	62%	62%	57%
3rd Group	No. of voting rights/	3/6	3/6	3/7	3/7	3/8	3/8
	No. of governors	3/6	3/6	3/7	3/7	3/8	3/8
	<i>Voting frequency</i>	50%	50%	43%	43%	38%	38%
Total voting rights		15	15	15	15	15	15

*Source: ECB Monthly Bulletin (May 2003).*

<sup>31</sup> Rounded up when necessary.

## 4.6 Concrete Modalities of Rotation

24. The operational details of the rotation system of the voting rights are not yet set.

This includes in particular the length of the periods during which the governors of a group will exercise their voting rights. This will for instance depend on:

- The time interval between the rotation of the voting rights (voting rights can rotate e.g. at the beginning of each month, each trimester, each semester, each year).
- The number of voting rights to be rotated in each of the groups each time rotation occurs (e.g. all the voting rights available in each group, only one or a few).

25. A decision on these issues will be politically sensitive from the point of view of each individual governor. All governors will be particularly eager not to prolong the periods during which they will be deprived of their voting rights. Also from the more global perspective of ensuring the continuity of the decision-making process, a decision will not be easy: continuity can be regarded as implying a stable composition of the group exercising the voting right but also as avoiding large reshuffles of the group exercising the voting right at the beginning of each rotation interval<sup>32</sup>. So there is a clear trade-off for the two above-mentioned parameters.

Given the complexity and the technicality of the matter as well as the uncertainty related to the sequencing of future euro area enlargements, these operational details were left out for a future decision of the Governing Council. They will be decided on by the Governing Council acting by a two-thirds majority of all its members, with and without voting rights.

## 5. Comparison with Commission

### 5.1 Main Features of the Future Commission Rotation Model

26. Contrary to what was done for the ECB, the Nice Treaty already set the guiding principles governing the future composition of the Commission in order to take into account the foreseen enlargements of the Union.

The principles are the following ones:<sup>33</sup>

- a) When the first Commission takes up its duties after 1 January 2005, it will comprise one national of each of the Member States.<sup>34</sup>

<sup>32</sup> This could be achieved if fewer voting rights were to rotate more frequently.

<sup>33</sup> Protocol on the enlargement of the European Union annexed to the Maastricht Treaty and to the Treaties establishing the European Communities by the Nice Treaty, Article 4.

<sup>34</sup> However, the number of Members of the Commission may be altered by the Council.

- b) When the first Commission takes up its duties after the European Union consists of 27 Member States, “the number of Members of the Commission shall be less than the number of Member States. The Members of the Commission shall be chosen according to a rotation system based on the principle of equality...”. The implementing arrangements shall be adopted by the Council, acting unanimously, and shall contain all the criteria and rules necessary for determining the composition of successive colleges automatically on the basis of the following principles:
- Member States shall be treated on a strictly equal footing as regards determination of the sequence of, and the time spent by, their nationals as Members of the Commission; consequently, the difference between the total number of terms of office held by nationals of any given pair of Member States may never be more than one’;
  - Subject to the latter, “each successive college shall be so composed as to reflect satisfactorily the demographic and geographical range of all the Member States of the Union”.

## 5.2 Comparison between the Commission and the ECB Model

27. If we compare the rotation systems foreseen for the Commission and for the ECB Governing Council, we note that while the functioning of both institutions is based on the same idea that their members are independent and act on a personal basis, the basic features of the two rotation systems differ:

- The number of Members of the Commission will be reduced (the precise number is not yet decided) while within the Governing Council, the governors of all euro area NCBs will continue to participate (the rotation regards only the voting rights).
- The rotation system within the Commission will be based on the principle of strict equality of all Member States, in all respects, while this principle will only apply to the weight of the vote of the governors within the ECB, allowing different voting rights frequency among governors according to their country of origin.

The rotation system within the Commission only tries to take into account the demographic and geographical range of the Union if it does not prejudice this equality principle of all Member States. On the contrary, as regards the ECB, the representativeness principle was considered important enough to deviate from this principle and to allow for different voting frequencies among governors.

28. How can we explain these differences? Besides more political factors, we see two possible reasons:

- The difference of roles between the two institutions, as it was perceived by the ECB, may have played a role. Not only does their field of competence differ (and monetary policy decisions were probably regarded by the ECB as more



sensitive for the markets) but also their respective roles in the decision-making process.

- The Commission is a much older institution than the ECB (see our remarks in § 7), and in addition, during the Nice Intergovernmental Conference, huge and difficult discussions took place before the Member States finally accepted not having one of their national permanently present in the Commission.

## 6. Assessment

29. Enhancing the efficiency of the decision-making process was presented in the Nice Treaty as the main objective of the reform of the Governing Council. However, in our view, to assess the reform we should take a broader perspective, i.e. the ability to ensure the smooth functioning of the Monetary Union.

This means that various aspects should be looked at: the ability to take decisions, the supranational character of the monetary policy and the acceptability of the decisions by the economic agents, by the political bodies and by the citizens.

### 6.1 Many Uncertainties Remain

30. It is difficult to make a firm assessment of the reform today since many uncertainties remain:

- The concrete modalities have yet to be set especially regarding the length and the frequency of the periods during which a governor will be deprived of his voting right (see above §§ 24–25).
- We do not know how the decisions will be taken in this new environment.

Today, Governing Council decisions are mainly taken by consensus. However, in practice, “consensus” is applied in a rather dynamic way: it does not mean that decisions are postponed until all members of the Governing Council agree. On the contrary, when the positions of most Governing Council members are known and diverging, the President often makes a proposal taking into account the majority view and the other members are invited to join the majority, knowing that in the end, the decision can be taken by a simple majority anyway. Such a “dynamic consensus” reinforces the collegiate character of the decisions taken by the Governing Council and the team spirit among its members.

Will the Governing Council continue to pursue such a “dynamic consensus”?

Will the enlargement, on the contrary, be used as an argument to introduce more formal voting?

In both cases, it will be interesting to see whether and how the non voting governors will be taken on board in particular when critical decisions are taken with serious implications for them. This is an important question if we want to ensure in the long term the continuity of the decisions, the unity of the system and the acceptability of its decisions.

For most of these aspects, the President will play a key role. He will indeed be the person who will decide on these issues and, in the end, who will allow for a smooth functioning of the Governing Council.

## 6.2 The New Voting Modalities

31. If properly implemented, the reform can ensure that after the enlargement of the euro area,

- The Governing Council will still be able to take decisions in time.<sup>35</sup>
- The supranational character of the monetary policy should be preserved. When sitting at the table of the Governing Council, all members will continue to have the same weight.<sup>36</sup>
- The acceptability by the economic agents will be guaranteed by the fact that the system ensures that decisions are taken by members coming from countries representing a large share of the economic activity of the total euro area;
- The acceptability by political bodies was confirmed by the decision of the EU Council and its ratification by the Member States;
- The acceptability by the citizens will clearly benefit from the participation of all governors to the discussions.

## 6.3 Comparison with a More Centralised System

32. The reform of the Governing Council was criticised by several observers as being too cautious. They argue that efficiency could be best ensured by limiting the size of the Governing Council or by transferring some of its powers to an enlarged Executive Board or to a Monetary Committee composed in such a way as to maintain an euro area-wide view. As we have seen, both measures could not be retained on the basis of the Nice Treaty.

Would such a system be more efficient?

A more centralised system should be able to take decisions faster, since the number of persons involved would be more limited.

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<sup>35</sup> If the current practice of looking for a consensus even if dynamic is to be pursued, the limitation of the number of voting rights will help to avoid undue delays in the decision-making process. On the contrary, this limit (which can be justified on other grounds, such as for representativeness reasons) does not add a lot in terms of ensuring fast decisions if more formal voting is introduced (when voting, the ability to decide quickly does not primarily depend on the number of members participating to a vote).

<sup>36</sup> The risk mentioned by some authors that the differentiation introduced in the voting frequency of the governors might “cultivate thinking in national categories” (see I. FRIEDRICH, *op. cit.* p. 120) should be weighted by the fact that the experience has shown that when taking monetary policy decisions Governing Council members usually sit on the same side and adopt a euro area perspective.

33. However, even if such a more centralised system is sometimes also presented as the best way to safeguard the supranational character of the Monetary Union, things are more nuanced.

For instance, an IMF working paper<sup>37</sup> highlights the advantages of maintaining the current balance between the Board and the governors in the Governing Council. Two arguments are invoked: first, the role that governors play in providing the ECB with first-hand and on-the-spot analyses of national developments, “especially in the case of a currency union that encompasses a large number of heterogeneous countries and regions”; second, the optimisation of monetary policy, since the presence of a governor from each Member State “might be a means to moderate the impact of political preference shocks on monetary policy”.<sup>38</sup>

To a certain extent, the presence of national governors in the Governing Council could be regarded as a safeguard for the independence of the decision-making body in charge of monetary policy decisions. In their absence, it is likely that Member States will fear that nobody will listen to their domestic problems. So they might be tempted to exert more direct pressure on the ECB.

In the same sense, looking at the U.S. example, a Fed study reveals that when deciding on monetary policy, central bankers at the hub (the Federal Reserve Board members, in Washington) do take regional developments more into account than central bankers in the spokes (the Reserve Bank Presidents).<sup>39</sup>

34. The acceptability by the economic agents of the decisions taken by a more centralised body should not be a problem.

By contrast, on the political side, as stated by Frenkel and Fendel, Member States do not seem “ready to accept such a loss of power... Realistically, it must be admitted that the EMU is not yet ready for such a high degree of centralisation... A

<sup>37</sup> H. BERGER, *The ECB and Euro-Area Enlargement*, IMF Working Paper, October 2002, pp. 28–29.

<sup>38</sup> “In a fully centralised scenario, a relatively small number of Board members would be chosen through a selection process on the European level that could favor the politically most influential countries in the eurozone. In a completely decentralised process, however, each government would select a central bank governor for a relatively large ECB Council. The latter might be preferable simply because, if political shocks differ across member countries, a fully decentralised nomination process will allow country-specific preference shocks to offset each other to a greater extent than a less balanced, more centralised appointment process. Thus the current ECB policymaking process, which balances the decision power in the ECB Council between the Board and central bank governors and puts the nomination of the latter entirely in the hands of national governments (...) might help moderate monetary policy in a polarised world with random shocks to government preferences, and thus increase the ECB’s political independence in this sense”.

<sup>39</sup> E. E. MEADE, D. N. SHEETS, *Regional influences on U.S. monetary policy: some implications for Europe*, Board of Governors of the Federal Reserve System, International Finance Discussion Papers, Number 721, February 2002.

higher degree of centralisation can only be reached through an evolutionary learning process".<sup>40</sup>

Often neglected, the acceptability by the citizens should also be taken into account. This is perhaps the aspect where a more centralised system appears to be the weakest.

Centralised communication is not very efficient. The experience has shown that because of the different cultures, languages and traditions, governors play a crucial role in this regard.

Currently, the participation of all governors facilitates the communication between the ECB and the citizens of the whole euro area. Their proximity also reassures the citizens that their concerns are taken into account. Tough decisions are more likely to be accepted as necessary and legitimate if all countries are represented in the decision-making body.<sup>41</sup>

35. One of the lessons of the referenda in France and in the Netherlands is, in our view, that besides the need for efficiency, we should also stress that need for European institutions to be as close as possible to the citizens. To a certain extent, the ECB reform as it was approved, anticipated this by preserving the role of NCB governors in the main decision-making body of the Eurosystem.

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<sup>40</sup> M. FRENKEL, R. FENDEL, *op. cit.*, p. 336.

<sup>41</sup> D. GROSS, *An opportunity missed*, *Intereconomics*, May/June 2003, p. 128.