composition of the Governing Council but restrict the large Governing Council to determining the guidelines for monetary policy and leave their execution to the 6-member Executive Board) is much better than the ECB proposal. The main point is that almost anything (including the status quo) would be better than the official proposal that is now in the process of being ratified at the national level.

Ellen E. Meade*

A (Critical) Appraisal of the ECB's Voting Reform

In March 2003, the European Council approved an amendment to the voting procedures of the Governing Council that was formally proposed by the European Central Bank (ECB) in February. It has long been acknowledged that a revision to the Governing Council's voting procedures would be necessary in order to streamline the central bank's decision-making process in the context of the widening of the euro area to the east. With a prospective size of the euro area of 25 countries,[1] decisions of the ECB Governing Council would depend on a vote of 31 officials (six members of the Executive Board and 25 heads of national central banks) in an unrevised system. The Treaty of Nice provided for an amendment to Article 10.2 of the Maastricht Treaty's Statute of the European System of Central Banks and of the European Central Bank – the provision that specifies the "one man, one vote" procedure currently used. Because the Nice decision focuses on Article 10.2, it does not permit a change to the size of the Executive Board or an alteration of the responsibilities of the Executive Board relative to those of the Governing Council.

The ECB amendment, which has been approved by the Council but awaits ratification by the member states, does not provide an adequate long-term solution for the voting problem. The reasons for this are as follows and are discussed in sequence in this article:

- First, despite the reform, decision-making procedures will become more unwieldy and inefficient with each new addition to the euro area.
- Second, the reform is unnecessarily complex, not fully specified, and unlikely to be transparent even when all the details are enumerated.
- Third, the new voting procedure gives some weight to financial size when sorting countries into groups – a laudable approach, except that the financial variable used is not the appropriate one.

In light of these reasons, it seems likely that the new voting scheme will be operative only for some interim period. A simpler alternative is available and appears to have wide support.

Efficiency

One of the main reasons – if not *the* main reason – for reform of the Governing Council's voting structure owes to concern over the efficiency of monetary policy decision-making in an enlarged euro area. In its recommendation, the ECB (p. 2) pointed to the need to "maintain the Governing Council's capacity for efficient and timely decision-making," suggesting that efficiency can be measured in two ways. Having too large an official body risks that meetings will be unnecessarily long *and* that policy will not respond actively enough to the economic situation at hand.

The reform proposal caps the number of voters at 21, about one-third smaller than an unreformed 31-member Governing Council in a euro area of 25 members. The reform maintains the number of Executive Board voters at six, and limits votes cast by national central bank (NCB) heads to 15. NCB voters are determined by sorting countries into three groups (based on a weighting scheme that is discussed below) and rotating a pre-specified number of votes within each group.

Thus, 31 policy officials (21 with voting rights) will attend meetings of the ECB's Governing Council. The mere thought of the *tour-de-table* is exhausting! Among 18 central banks surveyed by Wyplosz,[2]

* Senior Research Fellow, Centre for Economic Performance, London School of Economics, UK.

[1] The current 12 countries, plus Denmark, Sweden, the United Kingdom, and ten accession countries in eastern Europe (Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovak Republic and Slovenia).

[2] Charles Wyplosz: Briefing Notes to the Committee for Economic and Monetary Affairs of the European Parliament, February 2003.

the Fed's FOMC is the largest decision-making body with 12 voters. Nineteen policy officials participate in the discussion of economic conditions and policy alternatives when the FOMC meets eight times per year.[3] Needless to say, participation by 31 officials at bi-monthly meetings of the Governing Council hardly seems streamlined by comparison.

It is difficult to know how the size of the official body affects the timeliness of policy action, but it seems certain that, at least for very large bodies, an inverse relationship is the case. In a series of monetary policy experiments, however, Blinder and Morgan[4] found that committees of five voters do not require more information when enacting policy than does an individual decision-maker. While this finding is both interesting and surprising, it seems unlikely that their result would hold were the size of the voting committee in the experiments expanded to 21.

Transparency

The ECB has indicated that "transparency" is one of the "five fundamental principles" that has guided the design of its voting reform. Upon reading the proposal, it is clear that the rotation of votes within the three country groupings is complex, perhaps even intricate – suffice it to say that "transparent" it is not.

Countries in the euro area will be assigned to one of three groups based upon a measure of size, and votes will rotate across countries within the three groups according to some as-yet-unspecified system. Over time, the groups may be adjusted to take account of changes in relative size among countries. The voting rights will rotate within each group such that officials will vote with equal frequency, but the proposal leaves open the possibility that the rules for rotation may differ across groups.

Any voting system based on a weighting that will be periodically updated (such as the measure of size in the ECB case) is by definition going to be less transparent than one in which the weighting is fixed. In the case of the Fed, for example, four seats on the FOMC have rotated among eleven Federal Reserve districts since 1943. Four groups of Federal Reserve districts share a vote that rotates annually according to a 1942 amendment to the Federal Reserve Act.[5] The rotation system is highly transparent and predictable, and it is so precisely because the rotation does not evolve over time.

It is hard to see how the ECB can reconcile the need to update the weights periodically with the desire for simplicity and transparency. At the core, these objectives are in conflict.

The Weighting Scheme

The Maastricht Treaty established voting rights on the basis of the individual without regard to country importance: Article 10.2 of the Statute states that "each member of the Governing Council shall have one vote" and that the Council "shall act by simple majority." NCB presidents were to participate on the Governing Council "in a personal and independent capacity." Qualified majority voting, the hallmark of European decision-making, was not to be part of the central bank.

The voting reform sorts countries into groups based on their shares in area-wide nominal GDP (with a weight of 5/6) and in the total aggregated balance sheet of monetary financial institutions (with a weight of 1/6). The first group will contain the five largest countries and have four votes. In a euro area of 25 members, the second group would contain the next largest 13 countries and have eight votes. The final group would consist of the remaining seven countries and cast three votes. Thus, countries in the first group will register a vote at 80 percent of the meetings, compared with 62 percent for the second group and 43 percent for the third group.

This system produces an unabashedly nation-based sorting scheme, which will tend to encourage – rather than reduce – any pressure on officials to vote in the interests of their countries. In the four years since the introduction of the euro, have Governing Council meetings been so filled with nationally biased NCB governors that this reform is an attempt to better align their vote with their size? One can only wonder.

Still, the choice of weights leaves many questions unanswered. Some commentators – notably the European Commission – have asked why country rankings are not computed using 50-50 shares in GDP and population, the weights used in the Maastricht Treaty to determine country contributions to subscribed capital of the ECB. The data in Table 1 suggest that this

[3] The Fed uses a rotation system to allocate votes so that only 12 of the 19 officials have voting rights at any given meeting.

[4] Alan S. Blinder, John Morgan: Are Two Heads Better Than One?: An Experimental Analysis of Group vs. Individual Decisionmaking, Working Paper No. 7909, 2000, NBER.

[5] One voting seat is rotated among: Cleveland and Chicago; Atlanta, Dallas, and St. Louis; Boston, Philadelphia, and Richmond; Kansas City, Minneapolis, and San Francisco.

weighting would rank Belgium and Poland the same, in a tie for seventh place. Moreover, a 50-50 weighting of GDP and population would put the Slovak Republic in the second group (with a ranking of 18) and Luxembourg in the third (with a ranking of 22).

If the intention behind the second component in the ECB's weighting scheme is to capture the importance of the financial sector, then the variable used to measure this is the wrong one. Given a central bank's responsibility for financial stability, it is easy to argue that a representative weighting *should* look at the overall financial sector. In fact, an attempt to align Governing Council votes with the economic *and* financial importance of countries in the euro area would be an enlightened approach.

However, the variable used to measure the financial sector (TABS-MFI) is akin to banking assets, and bears only a limited relationship to the breadth, depth, and scope of overall capital markets. This variable will give too much weight to a country with a large banking sector relative to one with highly diversified financial markets. One could imagine, for instance, that an appropriately structured measure would rank the United Kingdom first in light of the breadth, size, and importance of its financial markets. However, as shown in my table, the United Kingdom is the fifth largest country among the 25 when evaluated in terms of bank assets as a share of GDP. Has this component been included, as some have suggested, only for the purpose of boosting Luxembourg into the second group? The ECB proposal offers us no answer whatsoever to this question.

Table 1
Alternative Rankings of Euro-25
(largest = 1 to smallest = 25)

	Nominal GDP	Population	½GDP + ½Pop	Bank Assets (% of GDP)
Germany	1	1	1	1
UK	2	2	2	5
France	3	3	3	8
Italy	4	4	4	13
Spain	5	5	5	7
Netherlands	6	7	6	4
Belgium	7	9	7	2
Sweden	8	13	9	16
Austria	9	14	11	3
Poland	10	6	7	22
Denmark	11	16	14	20
Finland	12	17	16	15
Greece	13	8	9	17
Portugal	14	12	12	10
Ireland	15	18	17	19
Czech Republic	16	10	12	11
Hungary	17	11	15	21
Slovenia	18	21	19	18
Slovak Republic	19	15	18	14
Luxembourg	20	24	22	12
Lithuania	21	19	20	25
Cyprus	22	23	23	9
Latvia	23	20	21	24
Estonia	24	22	24	23
Malta	25	25	25	6

Sources: Nominal GDP in euros and population statistics for 2000 taken from the IMF and Eurostat. Deposit money bank assets as share of nominal GDP for 1997 from the World Bank Financial Structure and Economic Development database.

Merely an Interim Solution?

The ECB's reform creates more problems than it solves. It might best be regarded as an interim solution, one that reveals the complexities involved in setting monetary policy for a large and diverse euro area. A number of commentators – including importantly the European Commission and the European Parliament in their official opinions of the reform proposal – have called for a re-structuring of the decision-making bodies of the ECB. The Executive Board would be turned into a monetary policy committee and its membership would be increased (from six to perhaps nine or a few more); it would be a "small, efficient decision-making body" similar in size to policy committees of other central banks.[6] Importantly, this enlarged Executive Board would set short-term interest rates for the euro area. The Governing Council would have authority over broader issues, such as the monetary policy strategy and instruments, and so would continue to play a key role in overall policy. Such a reform is broader than what the Nice Treaty permits and, as such, would require an intergovernmental conference to negotiate the requisite changes.[7]

In the European context, an enlarged Executive Board with sole authority over the day-to-day setting of interest rates would likely reduce (perhaps greatly) any pressures for national bias. Interestingly, in the United States, such a reform might yield concerns of exactly the opposite! This is because the officials at the Fed's center are political appointments of the US President and, rightly or wrongly, have at times been thought to share a political party perspective on monetary policy. For the ECB, however, appointments to the Executive Board are seen as technical experts with the backing and perspective of the European Community as a whole.

[6] Committee on Economic and Monetary Affairs: Report on the proposal for a Council decision on an amendment to Article 10.2 of the Statute of the European System of Central Banks and the European Central Bank, European Parliament, March 2003, p. 10.

[7] For a proposal of this sort see Peter Bofinger: Consequences of the modification of the Governing Council rules, Briefing paper for the European Parliament, February 2003; Committee on Economic and Monetary Affairs, op. cit.; European Commission: Commission Opinion, February 19, 2003; Daniel Gros: Reforming the composition of the ECB Governing Council in view of enlargement: How not to do it!, Briefing paper for the European Parliament, February 2003; Charles Wyplosz, op. cit.