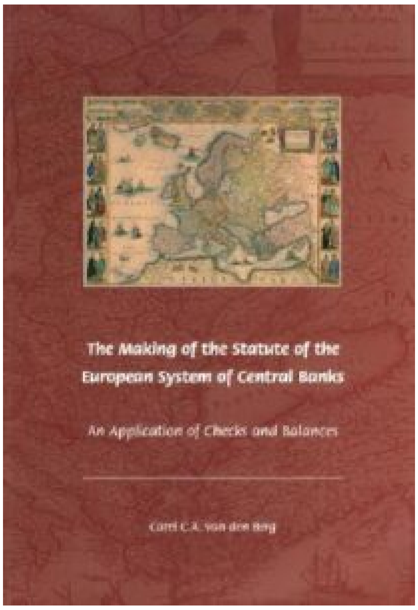
# The Making Of The Statute Of The European System Of Central Banks ~ Chapter 9: Introduction to Cluster III




CLUSTER III
Checks and balances between the Governors and the Executive Board (relations *within* the decision-making bodies)

*Chapter 9: Introduction to Cluster III*
In this cluster we will look for checks and balances within the System's highest decision-making body, the Governing Council. In fact what we have in mind is the relation between the representatives of the NCBs (the governors) and the representatives of the central body, the Executive Board. While both share the same objective, i.e. achieving price stability for the euro area, there are many issues, like organizational issues and issues how to react to political pressure, where the interests of the governors and the board members do not necessarily run parallel. This is reflected in the fact that in the preparation of the Statute there has indeed been an extensive debate on the composition, the voting system and the own (i.e. non-delegated) powers of the Executive Board. Questions were posed like should only the president of the Executive Board be member of the highest decision-making body or all Board members?; should the votes of the NCB presidents (the governors) be weighted and what would that mean for the vote of the Executive Board?; should the Executive Board be a secretariat or an executive arm of the Governing Council, or should it have 'own powers'? Behind these

questions lay the ultimate question on how powerful the Executive Board should be.

For our study we take as a starting point an executive board, and a council in which the federal elements of the System are represented, i.e. the governors. In this council the executive board could be represented, or not. What we will be looking for is whether the drafters envisaged a role for both governors and executive board members, and how they envisaged this role could be protected against intrusion by the other party. In other words, did they design a stable system of checks and balances? [i]

The drafters intended to find a middle ground, i.e. rejecting the extreme of giving all powers to the governors or to the central body. A supranational element was considered important, because it increased the level of accountability (as the board members were to be appointed by European authorities), it helped giving the system a 'face' (important vis-à-vis the political authorities and the financial markets), it would provide leadership and help create unity within the System. There were also arguments against putting *all* decision-making powers in the hand of the new board. These were partly *political*, partly *technical* by nature. For instance, it was considered unacceptable to the German electorate to hand over the monetary powers of the mighty Bundesbank to an unknown body, while not retaining a presence in that new institution.[ii] But also countries that feared a t*oo independent* ECB had reason to propose strong federal elements, which could contain the power of a possibly too independent centre. *Technically* it made sense to use the expertise of the incumbent governors, supported by their staff. Another point usually overlooked is that the Governing Council does not only decide on monetary policy, but also on issues like the external positioning of the System, the degree of decentralization, the annual budget of the ECB, legal opinions, the ordering of new banknotes, payment system regulations. Here the active involvement of the governors is called for. More arguments in favour of a regional presence in the decision-making body of a federal bank are mentioned by Goodfriend (2000): it facilitates surveillance of the economy and helps a central bank to communicate with the public. Furthermore, a federal build-up enhances competition in research and innovative thinking. The above arguments do not indicate whether the governors should have a majority of the votes in the council, or not. One could point to two different, both successful examples: the Bundesbank (with a majority for the LZB-presidents) and the FOMC (with five of the twelve votes reserved for the FRB presidents). In either case, it takes special skills of the ECB president to chair these meetings with central and regional members, because he should both stimulate debate and be able to achieve consensus.

Both the Executive Board and the Governing Council are attached to the ECB and the System is governed by these decision-making bodies of the ECB. The reason for attaching the Governing Council to the ECB was that the System itself would not receive legal personality, which would make the Governing Council, if attached to the System, resemble an agency of the Community.[iii] This explains why in many documents, including the ECB's Annual Report, the words 'the ECB' are used as short for the ECB's highest decision-making body, the Governing Council.

*Relative roles of the committees and the IGC*

The *Delors Committee* already laid the ground for a central bank system with strong federal elements, with NCBs continuing to exist and with both the members of the Board of the central institution and the presidents of the NCBs being member of the ESCB Council. In the period May – November 1990 the *Committee of Governors* detailed most of the provisions relating to the internal structure of the system. Most of the governors were rather inclined to minimize the role of the Board, because they liked to the Executive Board as an instrument of the Governing Council, a few NCBs, especially the Bundesbank, wanted an Executive Board endowed with sufficient powers of its own to protect the singleness of monetary policy – see especially Art. 10.2 below. On this very central issue of the relative role of the Executive Board the governors could not agree. In March 1991 the *deputies IGC* leaned towards the position of the Bundesbank, i.e. giving the Executive Board an independent responsibility and powers for ensuring that the Governing Council's monetary policy decisions are executed. On other issues the IGC did not change the balance as drafted by the Committee of Governors, implying the governors are the main designers of this part of the internal organization of the ECB.

*Federal Reserve and other central banks and federal bodies*

Like in clusters I and II we will in our analysis of the genesis of the articles refer to the Federal Reserve, as this will help us understand the different options available for federally organized central banking systems. The *Federal Reserve* has two decision-making bodies: the Board of Governors which takes all decisions except for the decisions on the open market operations, on which the second decision-making body, the Federal Open Market Committee, decides. The Board decides on regulatory, organizational, advisory and *some* monetary policy issues – the latter include reserve requirements and approval of discount rate adjustments by Federal Reserve Banks.[iv] These Banks decided on their own discount rate, subject to approval by the Board of Governors (in practice the FRBs kept their rates closely together). However, the use of the discount window diminished strongly, already in the 1920's (its use actually being discouraged),[v] and thus the importance of the discount rate has declined to irrelevance. Instead open market operations became the most important channel for steering the liquidity of the banking system. Before 1935 FRBs coordinated their open market operations on a voluntary basis with the Board, since then these operations have been under complete control of the FOMC, consisting of the seven government appointed Board members and five out of the twelve FRB presidents (on the basis of a rotating scheme).[vi] Though the Board has staff of its own, it has no monetary balance sheet. Board nor FOMC undertake operational activities, every action is conducted through (one of) the FRBs.

The structure of the only *federally organized* constituent central bank of the eurosystem, the *Bundesbank*, is different: the Landeszentralbanken are branches.[vii] Nonetheless, the Bundesbank law awarded them specific operational tasks. However, all *policy* decisions were taken by the Zentralbankrat (ZBR). In this Rat the presidents of the eleven LZBs[viii] and the members of the Direktorium (up to ten) each have one vote. The Direktorium prepared decision-making by the ZBR, made sure its decisions were executed, but also ran the Head Office of the Bundesbank, which was responsible for the open market operations with the federally important banks and for the foreign exchange management and operations.[ix]

The *non-federally organized* constituent central banks of the eurosystem knew different governance structures, some of them working with a collegiate governance system, like the Dutch, Belgium, Danish, Irish and Portuguese central banks, and others characterized by a presidential-type of governance (France, Italy, Spain and the UK).[x] The Governing Council of the ECB is a collegiate-style body, which is understandable as a presidential-style body would not fit with the intended federal structure. Within collegiate bodies the position of the president may vary; for instance, he may or may not have the casting vote,[xi] he may be appointed for a longer term than the other board members,[xii] or with special approval of the federal president, giving him higher status and protection against dismissal,[xiii] he may have special powers in suspending decisions of other internal bodies.[xiv] When comparing these governing structures, one should also take into account that some central banks were more independent than others. As for the ECB, the members of the Board are relatively equal, they are appointed for the same term and according to the same procedure. On the other hand, the president has the casting vote in the event of a tie and he has a special position in the area of representation, externally (Art. 13.2-ESCB), especially vis-à-vis the European institutions (Art. 109b-EC) and legally (Art. 39-ESCB). Furthermore, he is not only chairman of the Executive Board, but also of the Governing Council and the General Council, making him more than *primus inter pares*.

The two main executive branches of the European Community (*Commission* and *Council of Ministers*) are also of a federal nature (all countries participating in them), however neither of them was applying the rule 'one country, one vote'. In the Commission large countries used to have a second Commissioner, each Commissioner having one vote, while in the Council of Ministers most decisions were (and are) taken by weighted votes.[xv] The drafters of the ESCB Statute opted for the principle of 'one member, one vote'.[xvi] The ECB is also different in the sense that the Governing Council encompasses both regional members and Executive Board members, as if the members of a small-sized Commission were member of the Council of Ministers. There are no rules for the distribution of the nationality of Executive Board members. In view of the political appointment procedure,[xvii] the Board can however be expected to be dominated by national from large countries, but board members should – and can reasonably safely be – expected to act in complete independence, still upholding the principle of national equality. The larger economies of the countries receive a larger weight indirectly, because the ECB defines the euro area's inflation rate as the *weighted* average of the national harmonized consumer price indices.[xviii]

In the next chapter we will describe the genesis of the relevant articles. This genesis will show us which considerations the drafters had in mind as to the division and sharing of power of the Executive Board and the Governing Council and their respective roles. In chapter 11 we will assess how stable the balance is, whether we see room for improvement, and we will mention a few recent developments. The articles we selected for this part relate to the composition of the Governing Council, the voting system and the respective decision-making powers of the Governing Council and the Executive Board.

*Notes*

[i] We should also mention the existence of a third decision-making body, the *General Council*, which includes the governors of the NCBs of EU Member States that have not yet entered the euro area and the members of the Governing Council; however, in order to ensure that this Council could not start to act as an enlarged Governing Council, it was decided by the drafters of the Statute that not all Executive Board members should be member of the General Council – in fact only the president and vice-president. The body acts as a forum for exchange of information. In the General Council responses may be coordinated in areas where the ESCB has an interest in a common position by the EU Member States, but no competence of its own, like issues relating to the role of the IMF in preventing financial crises. The General Council has a role in administering credit and debit positions resulting from foreign exchange interventions conducted in the context of ERM-II. The functions of the General Council are formally listed in Art. 44 and 47-ESCB.

[ii] Stoltenberg memorandum of February 1988 and contribution by Pöhl in the Delors Report (1989).

[iii] See Art. 1-ESCB, section II.2.

[iv] The Board of Governors does not have a direct mandate in the area of facilitating payments, the FRBs have. The Board exercises though general supervision over the FRBs, including whether they fulfil their tasks properly. Furthermore, the Board usually has the right to fix, for example, prices for FRB services and determine rules for activities like check clearing.

[v] See Art. 12.1c-ESCB, section I.2.

[vi] See also appendix 1 at the end of cluster II.

[vii] For a history, see appendix 3 at the end of this cluster.

[viii] Initially ten, because West-Berlin received the status of Bundesland only later.

[ix] See also chapter 8.2.4.

[x] Source: European Commission (1990a).

[xi] Central bank of Portugal; Bundesbank (casting vote in Direktorium).

[xii] Central banks of Portugal and Ireland.

[xiii] Central banks of Denmark and Ireland.

[xiv] Central bank of Belgium.

[xv] The Treaty of Nice (2000) determines that as of 2005 large countries lose their second Commissioner, in exchange for the rule that decisions by the Council of Ministers requiring a qualified majority need the support of Members States representing at least a certain minimum share of the population of the EU (double weighted voting). However, such decisions also require the support of at least half of the Member States (which protects the position of the smaller states). In the IGC of 2003 ideas were floated to reduce the number of votes for the Commissioners or, alternatively, to form a small cabinet of Commissioners with special responsibilities on behalf of the whole Commission.

[xvi] Weighted voting is restricted to cases of decisions affecting the relative financial positions of the ECB's shareholders (i.e. the NCBs).

[xvii] Art. 11.2-ESCB.

[xviii] The Treaty of Nice has opened the way for the political authorities to change the ECB's voting system (see Art. 10.2, section I.1), either based on a recommendation by the Governing Council or by the Commission. The Governing Council's recommendation to limit the number of votes for the governors as of a certain size of the Governing Council to fifteen was adopted by the political authorities in 2003. These votes will rotate over the governors within three different sized groups of NCBs, giving a preferential treatment to governors from larger countries. The alternative of equal rotation was not pursued, because it would probably have been blocked by the larger Member States, in which case the Commission might have recommended reducing the number of votes for the governors to five. Rumour has it that this was (and still is) the preference of some parts of the Commission. The Executive Board would then outvote the governors, which, however, might make this board a likely target for political pressure. This might strengthen the Commission's position. A dominant Executive Board voting en bloc would lead to negative dynamics within the Governing Council, and it would allow the Executive Board to introduce changes leading to a centralization in the operational area and would put the continuity of the federal character at risk. Therefore, such a proposal would strike at the heart of the system.