Rotation of voting on the ECB Governing Council: more than symbolic?

By Sandrine Levasseur

Lithuania's adoption of the euro on 1 January brought the number of euro zone members to nineteen, the threshold at which the voting system in the European Central Bank (ECB) Governing Council has to be changed. While this change took place almost unnoticed in France, things were different in Germany and Ireland, where the introduction of the system of rotation in the voting that decides the euro zone's monetary policy has raised concern and even opposition. Is this reaction justified? Here we propose some food for thought and reflection.

1) How will the system of rotation function?

Until now, at the monthly meetings of the ECB Governing Council that decides monetary policy (policy rates, unconventional policies) in the euro zone, the principle "one country, one vote" applied. In other words, each country had, through the Governor of its central bank, a systematic right to vote. To the votes of the 18 Governors were added the votes of the six members of the ECB Executive Board, for a total of 24 votes.

From now on, with the entry of a 19th member into the euro zone, the countries are classified into two groups, in accordance with the Treaty[1]. The first group consists of the 5 "largest" countries, as defined by the size of GDP and the financial sector, with respective weights in the criterion of 5/6 and 1/6. The second group consists of the other countries, currently numbering 14 [2]. Each month the group of five "big" countries has 4 votes and the Group of 14 "small" countries 11 votes (Table 1). The voting within the two groups is organized according to a principle of rotation defined by a precise schedule: the Governor of each "big" country will not vote one time out of every five, while the Governor of each "small" country will not vote 3 times out of 14. However, the 6 members of the ECB Executive Board will continue to benefit from a systematic monthly right to vote. So every month, the conduct of the euro zone's monetary policy will be decided by 21 votes, while under the old principle, that of "one country, one vote", 25 votes were cast.

All the Governors will continue to take part in the Council's two monthly meetings, whether or not they take part in the voting.

Table 1. Rotation group and participation in the ECB's capital

	GPD* (bn euros)	Bank assets (BA)	Criteria for membership in a vote rotation group (GDP 5/6; AB 1/6)	Rotation group	ECB capital****	
Euro zone (19 countries)					Share in %	Million euros
Germany	2 718	7 682	3 545	Group 1 (5 countries/4 votes) The governor of each country votes 80% of the time	18.0	1 948.2
France	2 044	8 229	3 074		14.2	1 534.9
Italy	1 560	4 127	1 988		12.3	1 332.6
Spain	1 023	3 287	1 400		8.8	957.0
Netherlands	602	2 339	892		4.0	433.4
Belgium	380	1 071	496	Group 2 (14 countries/11 votes) The governor of each country votes 78.6% of the time	2.1	228.2
Austria	311	922	413		2.0	212.5
Ireland	164	1 049	312		1.2	125.6
Finland	193	523	248		1.3	136.0
Portugal	164	517	223		1.7	188.7
Greece	182	421	221		2.0	220.1
Luxembourg	45	944	195		0.2	21.9
Slovakia	72	60	70		0.8	83.6
Slovenia	35	49	38		0.3	37.4
Lithuania	34	25	33		0.4	44.7
Cyprus	17	91	29		0.2	16.4
Latvia	23	28	24		0.3	30.5
Estonia	18	19	18		0.2	20.9
Malta	7	55	15		0.1	7.0
	GPD* (bn euros)	Bank assets (BA)	Criteria for membership in a vote rotation group (GDP 5/6; AB 1/6)	Rotation group	ECB capital****	
Other EU members					Share in %	Million euros
Potential members of the euro zone:						
Poland	388	361	384	Timetable abandoned	5.1	20.8
Republic Czech	150	192	157	Timetable abandoned	1.6	6.5
Romania	139	89	131	2019	2.6	10.6
Hungary	99	116	102	Timetable abandoned	1.4	5.6
Croatia	43	59	46	Timetable abandoned	0.6	2.5
Bulgaria	40	49	41	Timetable abandoned	0.9	3.5
Countries with opt-out clause:**					0.0	
United Kingdom	1 916	9 146	3 121	Never	13.7	55.5
Sweden	420	1238	556	Never	2.3	9.2
Danmark	248	1 065	384	Never	1.5	6.0
European Union (28 countries)	**13 036**	**43 753**			100	10 825.0

* At end September 2013.

** Explicit (United Kingdom and Denmark) or implicit (Sweden).

*** As announced by the national authorities.

**** The contribution to ECB capital is based on the country's GDP and population (1/2; 1/2). The key can be different from the amount actually paid into the ECB capital. The net profits and losses of the ECB are not allocated to countries that are not members of the euro zone.

Source: Eurostat and ECB; author's calculations.

Why change the system of voting rights? The objective is clear and justified: it is to maintain the decision-making capacity of the Governing Council as the number of countries joining the euro zone increases.

The new system of voting rights clearly benefits the members of the ECB Executive Board, which now have 28.6% of the voting rights (6/21), while the old system would have given them "only" 24% (6/25). The group of "big" countries has 19% (against 20% in the old system). The group of "small" countries gets 52% (11/21) of the voting rights, whereas it would have had 56% (14/25) if the old voting system had been maintained. The group of "small" countries loses relatively more voting rights than the group of "large" countries, to the advantage of the ECB Executive Board.

2) The arguments of German and Irish opponents of the system of rotation

The arguments of German opponents of the new system, beyond just a loss of prestige, are that the largest economy in the euro zone and also the largest contributor to the ECB's capital (Table 1) must necessarily take part in the votes deciding the zone's monetary policy. To ensure that Germany's interests are not neglected, when Germany doesn't vote its Governor should have a veto. This veto would also be justified by the principle that you should be responsible only for your own decisions.

In Ireland, according to the opponents of the new system, the myth of equality between the countries of the euro zone is finished: the introduction of a rotation system that favours the big countries is formalizing the lack of equality between the zone's countries. Ireland has thus been explicitly relegated to being a second tier country. Furthermore, Ireland's influence in the decision-making process will be reduced even further as the euro zone continues to expand.

The introduction of the rotation system doesn't seem to have aroused as much resentment from politicians or civil society in other countries in the euro zone.

3) Do the German and Irish arguments make sense?

As is well known, Germany has a culture of stability all its own, in particular due to its history a strong aversion to inflation. In contrast, the countries of southern European are reputed to have a much less marked aversion to the “inflation tax”. It is this difference in the degree of “acceptable” inflation that has led to modelling the statutes of the ECB more or less on those of the Bundesbank, which was considered the only way of securing Germany’s participation in the euro zone. Today, however, the issue of inflation is no longer posed since the euro zone is entering into deflation, a situation that some think could last for years[3].

Today, it is much more the *methods* the ECB is using to conduct monetary policy that are being questioned in Germany by some of the country’s politicians, economists and citizens. The arguments being made by opponents of the rotation system, based on contributions to the ECB‘s capital and more generally being Europe’s leading economic power, echo the policies that have been pursued in recent years by the ECB (e.g. easing eligibility criteria for securities deposited as collateral at the ECB, purchase of securitized assets) but also the future policy of purchasing sovereign bonds. These policies have raised fears in Germany that the ECB balance sheet will contain too much “toxic” debt that sooner or later could be dropped, with the cost of this being borne by the Bank’s principal funder.

Is it really believable that Germany’s interests wouldn’t be taken into account?

There are three arguments for answering “no”. First, even when the German Governor doesn’t vote, Germany will still have a “representative” on the Executive Board (currently Sabine Lautenschläger)[4]. In theory, of course, the members must consider the interests of the euro zone when they vote and not just the interests of their own country, but the reality is more complex[5]. Furthermore, the Governors, even when they do not vote, still have a right to speak, and therefore some power of persuasion. Finally, more generally, the desire for a consensus will make it necessary to take into consideration the opinion of the Governors who are not voting.

How justifiable are the arguments of the Irish opponents of the rotation system? It is clear that the counter-arguments developed above (concerning the right to speak and the need for a consensus) that apply to the Germans also apply to the Irish.

However, it is true that Ireland, like all the countries in Group 2, will see its voting rights further diluted as the euro zone expands. When the euro zone is comprised of 20 members, the 15 Group 2 countries will have to share 11 votes (Table 2, source: p. 91). When the euro zone expands again to 21 members, 16 Group 2 countries will still have to share 11 votes … At 22 members, the creation of a third group will result in further dilution of the voting rights of groups 2 and 3, but not of group 1, the group of "large" countries, which will still continue to vote 80% of the time.

The question that is posed for Ireland but also for all the countries currently in Group 2 concerns the future expansion of the euro zone. To date, all the countries of Central and Eastern Europe (CEE) that have not yet adopted the euro have abandoned a timetable for joining the euro zone (Table 1). The only exception is Romania, which has proposed 2019 for joining[6]. Though the prospects of the other countries have not been abandoned, they nevertheless appear very distant[7]. The likelihood that the euro zone will soon include 21 members is rather low, and the probability of exceeding 22 members even lower. Anyway, whatever the configuration, Ireland will never be part of group 3. It is thus the countries that are lagging in today's group 2 (Malta, Estonia, Latvia, etc.) that have the most to lose in terms of the frequency of voting.

Table 2. Rotation system (first and second steps)

Total no. of governors	Group 1			Group 2			Group 3		
	Governors	Votes	Frequency of vote	Governors	Votes	Frequency of vote	Governors	Votes	Frequency of vote
First step: euro zone from 19 to 21 countries									
19	5	4	80%	14	11	79%			
20	5	4	80%	15	11	73%			
21	5	4	80%	16	11	69%			
Second step: euro zone from 22 to 27 countries									
22	5	4	80%	11	8	73%	6	3	50%
23	5	4	80%	12	8	67%	6	3	50%
24	5	4	80%	12	8	67%	7	3	43%
25	5	4	80%	13	8	62%	7	3	43%
26	5	4	80%	13	8	62%	8	3	38%
27	5	4	80%	14	8	57%	8	3	38%

Source: ECB (2009).

Conclusion

There can be no talk of a unified Europe while explaining that there are several categories of countries. How can there be congratulations for the euro zone gaining new members while at the same time explaining that only certain members can or should participate in its decision-making. In a unified Europe it is not acceptable for there to be a vote in the Council that is systematic only for certain Governors (but not all) or a right of veto that only a few Governors can exercise. Each country loses its monetary sovereignty by joining the euro zone: why should some countries lose more than others? But is it really desirable to go back to the old system of “one country, one vote”? No. The new voting system in the Governing Council is a good compromise between the need to maintain the Council’s decision-making capacity (and therefore have a reduced number of voters) and the need to allow each Governor to vote on a regular basis. From this point of view, the rotation system used in the euro zone is more balanced than that used in the United States, where some members may not vote for one, two or even three years[8]. In the euro zone, the length of time that a Governor does not vote on monetary policy will not exceed one month for Group 1 countries, and for countries currently in Group 2, it shall not exceed three months (so long as the euro zone consists of just 19 countries).

At least in theory. Because, in practice, while the Governing Council will continue to meet twice a month, the vote on the conduct of monetary policy will now take place only every six weeks … (previously every four). The voting abstention time will thus be (slightly) longer than what is stated in the official documents of the ECB and the euro zone's national central banks…

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[1] More specifically, on 21 March 2003 the European Council amended Article 10.2 of the statutes of the Eurosystem in order to allow the establishment of a system of rotation in the ECB Governing Council. The amended article provided that the rotation system could be introduced from the entry of the 16th member into the euro zone and at the latest upon the entry of the 19th member.

[2] The Treaty provides for the creation of a third group upon the entry of a 22nd country.

[3] For the first time since 2009, consumer prices fell, with prices falling -0.2% year on year.

[4] The other members of the Governing Council are from Italy (Mario Draghi, President of the ECB). Portugal (Vítor Constâncio, Vice-President of the ECB), France (Benoît Cœuré), Luxembourg (Yves Mersch) and Belgium (Peter Praet).

[5] The experience of the US Federal Open Market Committee shows that there is a regional bias in the way the Governors vote (Meade and Sheets, 2005: "Regional Influences on FOMC Voting Patterns", *Journal of Money Credit and Banking*, 33, pp.

661-678).

[6] It will in any case have to respect the Maastricht criteria (criteria on the public deficit, interest rates, inflation, etc.).

[7] This shift is due in part to the fact that many of the Central and East European countries have benefited from the depreciation of their currencies against the euro. They have thus understood that joining the euro zone would not just bring them benefits. In addition, it is assumed here that the United Kingdom, Denmark and Sweden will never join the euro zone because of their opt-out clause.

Does housing wealth contribute to wealth inequality?

par Guillaume Allègre and Xavier Timbeau

In a response to *Capital in the twenty-first century*, Odran Bonnet, Pierre-Henri Bono, Guillaume Chapelle and Etienne Wasmer (2014) attempt to show that the conclusion of the book in terms of the explosion of wealth inequality is not plausible. They point out what they see as an inconsistency in the thesis: according to the authors, the capital accumulation model used by Piketty is a model of accumulation of productive capital, which is inconsistent with the choice to use housing market prices to measure housing capital. To correctly measure housing capital, one should use rent and not housing prices.

By doing this, the authors conclude that capital/income ratios have remained stable in France, Britain, the United States and Canada, which contradicts the thesis of Piketty.

In *OFCE briefing note n°9* (“Does housing wealth contribute to wealth inequality? A tale of two New Yorks”), we show that the authors minimize the contribution of housing to inequality. In particular, we do not believe that trends in housing prices have “second order redistributive effects”. As is often the case, the disagreement is in part due to a lack of consensus on what really matters when discussing inequality: wealth inequality or income inequality or consumption inequality? If we follow the authors, only the consumption from wealth income should matter.   We emphasize a theoretical inconsistency in the authors’ main argument. In fact, they value housing capital as the sum of the present values of rents, under the assumption that what matters is the housing service, then they use a dynastic model in which what matters is the transmission of wealth and not the discounted value of the housing service.

In short, our conclusion is that with regard to inequality, wealth matters, housing wealth is in fact wealth, and should be measured in a manner consistent with the measure of other types of wealth. By doing so, one finds that housing wealth does contribute to the growth of wealth and consequently, Piketty’s thesis is not refuted.

For more on this, see: Allègre, G. and X. Timbeau, 2015: “Does housing wealth contribute to wealth inequality? A tale of two New Yorks”, *OFCE briefing note, n°9*, January.