HOW TO ASSESS PROPOSALS FOR ENLARGEMENT REFORM OF THE EUROPEAN CENTRAL BANK

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The forthcoming enlargement of the European Union and consequently, within a few years, of the euro area, requires a reformulation of the decision-making framework of the European System of Central Banks. This article serves as a reminder of the reasons for the necessity of this reform, evaluates the solution adopted by the European Council and surveys other reform possibilities. It proposes a coherent and exhaustive set of criteria to judge the European Central Bank enlargement reform, which allows for a numerical assessment. Finally, it indicates another solution, which closely fits the proposed set of criteria.

JEL classifications: E52, E58, D70

The Maastricht Treaty adopted in February 1992 (and which came into force on November 1st 1993) created a basis for the functioning of the European Central Bank (ECB) and European System of Central Banks (ESCB) as a monetary authority for the Economic and Monetary Union (EMU). The rules adopted were implicitly designed to work properly with 12-15 members of the then European Union (EU).

The approaching moment of the eastern enlargement of the EU necessitates reform of the ESCB. There is a well-established consensus in the literature that the present decision-making structure is completely inadequate in ensuring good policy-making in the EMU of 20 or more members1. The first (highly political-influenced) attempts to reform the ECB’s decision-making process achieved the stage of ratification, in spite of many criticisms.

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1. See e.g. Baldwin et al. (2002), Frioussi and Creel (2002).
On the theoretical ground this problem concerns the optimal decision-making model for a federal-type central bank with an important number of regions/countries. Nevertheless, a political economy approach, taking into consideration divergent preferences of different countries is also necessary.

This paper is mostly focused on the functioning of the Governing Council, whose composition is not fixed and depends (according to the present rules) on the number of countries adopting the euro. Additionally, this is the most powerful decision-making body within the ESCB and consequently its adequate reshaping is highly important. To evaluate the reform proposals we use a three-criteria set: economic efficiency, political acceptability and public perception.

The main objective of this article is to clarify the debate on ECB reform, to sum up the discussions on the enlarged ECB, to propose a more complex point of view- not only concerning the technical matters of the voting system, but also a more general view on the Statute of the ESCB and ECB. It is the author's intention that matters such as independence, accountability, credibility, transparency, strategy and finally the voting system should not be considered as separate but as a kind of package deal.

The article is organised as follows: section 1 provides an overview of the reform scenarios in the literature. Section 2 presents the reform proposed by the ECB and the criticisms that followed. Section 3 contains the criteria set we recommend for the assessment of the ECB enlargement reform. Section 4 describes an alternative reform proposal. Section 5 attempts to objectively evaluate the different reform scenarios. Concluding remarks close the article.

I. Some proposals for reform

The Intergovernmental Conference (IGC) in Nice in December 2000 opened the way for reforming the EU institutions in the perspective of the entry of 12 new members. One of the institutions not reshaped at that time was the European Central Bank. Nevertheless, the Nice Treaty included the so-called “enabling clause” which provided the possibility to reform the voting system in the Governing Council without a new IGC. Such a reform should be adopted by the Council (at the level of the heads of states or governments) by unanimous voting on recommendation of the European Commission (after consultation of the European Parliament and ECB) or on the recommendation of the ECB (unanimity in the Governing Council) after consultation of the Parliament and the Commission (consultation procedure).
Nowadays, the most important monetary policy decisions in the euro area are taken by the Governing Council of the ESCB, composed of six members of the Executive Board of ECB (including its President) and all governors of the national central banks from countries which have adopted the euro. Each member of the Governing Council has one vote. Formally, decisions are taken by a simple majority vote with the President’s vote breaking a tie except in the case of "shareholder matters", where votes are weighted.

The importance of a reform of the decision-making framework in the enlarged ECB was highlighted by Baldwin et al. (2001) who argue that the enlargement of the EMU will pose some serious problems if the current decision-making system remains unchanged. They have underlined that increasing heterogeneity within the enlarged EMU will cause difficulties in adopting the optimal euro-wide monetary policy. They argue that when the relative power of the Executive Board (which they suppose representing the purely euro-wide view) decreases, monetary policy decisions might be taken by a coalition of smaller and poorer countries, with a higher growth rate and higher inflation (at least partially due to the Balassa-Samuelson effect). And even if these countries are not able to change policy in their own way, the enlarged Governing Council would suffer from the increased "status quo bias", which is defined as a situation where the Governing Council hardly changes interest rates in response to economic evolutions or shocks. Baldwin et al. (2001) argue also that voting rules matter even if, according to some statements of the former President of the ECB, they are rarely applied and decisions are taken consensually. This consensus may be reached because dissenting governors are conscious of the potential vote record and thus win nothing by voting against a proposition which would be decided anyway.

Baldwin et al. (2001) have also presented three reform options: rotation, representation (grouping of countries) and "executive decision". All these solutions are based on rules reducing the number of national central bank governors who have voting rights.

Rotation means that governors of national central banks participate in votes with a certain frequency and consequently are not allowed to...
vote during some periods. Thus, the main questions to ask are the following: How numerous should the voting national central bank governors be? How long should be the voting periods? It is worth mentioning that in the case where changes are too frequent (when the vote-casting period is short) this may lead to some credibility problems. On the other hand, when the tenure as vote-casters is too long, some countries would have to stay without a vote for a long time, which might reduce the political acceptability of the solution. Rotation might be applied to a committee in a symmetric way (equal voting periods for every member) but asymmetric solutions are more flexible.

Representation relies on pooling national central banks in a few constituencies and on allocating a certain number of votes to each group. It may take numerous forms depending on the grouping criteria adopted and decision-making schemes within the groups. These two questions are of high political sensitivity and may pose problems at every enlargement stage (realistically supposing that the EMU enlargement will not occur in one wave of 10 countries but will be “spread” over time and that in the further future some other countries may wish to join the euro area).

"Executive decision" means that the monetary power would be delegated to a monetary policy council- a group of independent experts (as currently is the Executive Board). This decision-making framework is applied in the majority of modern central banks. The main parameters at the core of “executive decision” are the number of decision-makers, the length of their tenure and the means of accountability. This solution is the one preferred by Baldwin et al. (2001) and takes the form of the current Executive Board enlarged by five independent experts (“outsiders”).

Centralisation is also found to be the first best solution in the framework of Berger’s (2002) model, based on the standard time-inconsistency approach. He distinguishes three types of decision-makers: board, governors representing the “in” region (with bigger economic weight) and governors representing “out” countries (new adherents with an above-natural output target and some structural inflation). The
features of the “out” region imply an increased inflation bias, which is more accentuated as output considerations increase (the two regions are considered as having identical output-inflation preferences). However, structural inflation is compensated by lower tradables inflation target in the “out” region.

Berger (2002) assumes that the members of the board take the euro-wide perspective (inflation and output targets of “in” and “out” regions are weighted by their respective economic size), and governors coming from both regions consider situations in their countries of origin. Consequently, the governors apply to their loss and reaction functions parameters (inflation and output targets) characterising their respective countries.

Berger (2002) also analyses the weighting of votes (not mentioned by Baldwin et al., 2001) and finds it to be the second best solution, which implies, however, some decision-making costs (due to higher number of decision-makers). The third best solution is then to fit political weights with the economic ones less precisely but try to avoid a large number of decision-makers (for example by an asymmetric rotation scheme). This article is the most formal one among those quoted herein concerning ECB enlargement reform. Nevertheless, it seems to forget any political questions, which would certainly dominate a sensitive area like common European central banking.

Political and juridical questions are present in Artus and Wyplosz (2002). Their three propositions are very similar to those mentioned above, though their “centralisation” scenario is a simple delegation to the Executive Board. They also propose numerous criteria for the design of the enlargement reform of ECB decision-making system, among which:

— number of voters, which should be restrained;
— stability—constant number of voters and no need for adaptations to future enlargements;
— communication smoothness— all committee members should work in headquarters;
— national bias—e.g. incentives to choose monetary policy from the country-specific, and not purely European point of view should be avoided;
— problem of big and small countries— solution should be acceptable for all;

14. Juridical feasibility of potential reform scenarios is analysed in the appendix to this work, by Louis (2002).
15. For some discussion of this phenomenon in the existing ECB as well as weak (but existing) evidence see Heinemann and Huefner (2002) and for support from American experience see Meade and Sheets (2002).
— accountability\textsuperscript{16}, the reformed ECB should be somehow controlled by a democratic institution. Authors acknowledge difficulties in the European context as the most democratic institution— the European Parliament— has only limited powers and they propose instead to increase ECB transparency\textsuperscript{17} e.g. by more frequent communications and policy explanations.

Some criteria, mainly concerning socio-political issues, are also proposed by Heisenberg (2003). Four criteria are mentioned:

— efficient decision making, which is fulfilled when the reformed Governing Council is able to take “consistent” decisions (which should be understood as leading to stable and predictable monetary policy in general);

— problem of human resources, which is solved when all countries are satisfied with ‘diplomatic’ and ‘prestige’ issues;

— building a sense of common European identity, which is met when a solution does not use a Member State as a unit of analysis (it reflects the lack of national bias mentioned above);

— democratic legitimacy (treated together with accountability and transparency).

Using these criteria, Heisenberg chooses grouping as the best reform proposal. According to this author, this solution “rejects the Member State metric and begins grouping geographical areas together to solve the problem of both human resource and that of efficient decision-making”. Nevertheless, this proposal is not free from some important flaws. One of them was mentioned earlier by Fitoussi and Creel (2002): this scenario would complicate the (even now relatively complex) system of territorial units in the EU.

Among the different reform possibilities Fitoussi and Creel (2002) indicated another one: direct nomination. This means that the current Executive Board should be completed by a fixed number (nine) of national central bank governors. This nomination would take place in two steps: two committees would propose members to the Executive Board and candidates (among the national central bank’s governors) to sit in the Governing Council, and the final decision would be taken unanimously by the European Council. Optimism concerning feasibility of such a nomination process is based on


\textsuperscript{17} Transparency is obviously not the same as accountability. Nevertheless, means of transparency and accountability may be sometimes alike, but the addressees are different: in case of accountability these are political bodies, in transparency it is the general public and financial markets. Transparency and accountability are analysed somewhat deeper in section 3, as they are important components of criteria proposed for the assessment of reform proposals.
experience of political negotiations on the nomination of the first ECB President- Wim Duisenberg and his successor- Jean-Claude Trichet. Their second-best solution would have been to adopt a rotation process with two seats permanently reserved for the (four) larger member states.

2. The new decision making framework of the ESCB

The solution, agreed by the Council before national ratifications, was firstly proposed by the ECB Governing Council on February 3rd 2003. The proposal consisted in dividing countries into three groups on the basis of a “composed indicator”. This ranking takes into consideration the GDP shares (with a weight of 5/6 for the ranking) and the importance of the national financial sector (total assets, with a weight of 1/6). The first group would be composed of five countries with the highest ratings, the second group would include half of the national central bank’s governors with the next rating positions and the third would comprise the remainder. There would only be 15 voting national central bank governors in the Governing Council: four coming from the first group, eight from the second and three from the third group. Such a reform would enter into force as soon as the euro area would be extended to 22 members.

The proposition includes two intermediate phases: no change before the monetary union exceeds 15 members, and two groups when the number of member countries is comprised between 16 and 21. In this case, the first would be composed of five countries and the latter of the remainder, with 4 votes for the bigger countries and 11 votes for the second group. The five biggest countries would vote with a frequency of 80%, and the “intertemporal voting power” of intermediate countries would depend on the total number of member countries. The voting frequency of the second group of countries in this intermediate stage would gradually diminish to attain 68.75% in the case of 21 members. This intermediate stage might be postponed until the number of EMU members attains 18, if such decision were taken by a two-thirds majority of members of the Governing Council. Such decision would mean a temporary enlargement of the Governing Council up to 24 members.

In the final reform stage, second group countries would vote with a frequency varying from 72.3% in case of 22 members to 57% in case of 28 members (all EU countries + 10 accession countries + Romania,

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18. Published on March 21st and in the Official Journal on April 1st 2003
19. It was made public in a press release on December 22nd 2002, but officially proposed two days after the Nice Treaty entered into force—see ECB (2002) and (2003).
Bulgaria and Turkey). In the latter case a third group country would vote with a frequency of 33.3%. This means that for the first two groups the vote-casting periods are longer than the non-voting ones and that the time the smallest countries will wait for their votes is twice as long as the voting period.

The ECB’s proposal was largely criticised by economists\textsuperscript{20}. Their critics concerned numerous flaws of the proposed reform, which included:

Limited capacity of improving the existing decision-making, because the number of decision-makers is still too large (Gros, 2003, Wyplosz, 2003). A 21-person monetary policy body would be the biggest among the OECD countries and, for example, the Bundesbank was reformed especially to avoid the over-twenty-participant Bundesbankrat. Furthermore, the number of discussion participants is not limited at all, which may lead to long-lasting meetings and consequently weaker responsiveness to economic evolutions and finally problematic efficiency in taking decisions (Bofinger, 2003).

Lack of transparency implied by the level of complication in the rotation mechanism (Gros, 2003), which could “undermine the trust of Europe’s citizens in the ECB and in Europe’s institutions in general” (Bofinger, 2003).

Violation of rules of “one member one vote” and “ad personam participation” (Bofinger, 2003) and the renunciation of the principle of member states’ equality (Gros, 2003, Bofinger 2003) by creation of a three-class membership. These features would reinforce national considerations in monetary decision-making processes and eventually threaten ECB independence. Moreover, the third group would solely consist of new entrants (as a place in the second group was guaranteed for the smallest current member in terms of GDP—Luxembourg by including the total assets of financial system in the “composed indicator”; Gros, 2003; Bofinger, 2003).

Decreased national central bank governors’ accountability for general monetary policy, because their personal responsibility would be diluted by the rotation scheme (Bofinger, 2003).

Lack of sufficient degree of precision, and notably lack of precise definition of the rotation mechanism within groups and possibility to postpone the rotational system unless the euro area reaches 18 members, makes the proposal unclear (Gros, 2003).

Wyplosz (2003) also remarked that, in general, the proposal is internally inconsistent. If the national central bank governors do not

\textsuperscript{20} See Bofinger (2003), Gros (2003) and Wyplosz (2003), briefing papers for the European Parliament as well as Horn (2003), who presented an arbitrary proposition for the allocation of votes.
represent their own countries but act as independent experts (which is systematically argued by the ECB officials and a priori guarantees the credibility of the ECB), then the proposed rotation scheme is problematic and useless. It is difficult to show logically any relationship between the size of the country and personal capacities of its national central bank governor. In other words, the weighting of votes (also by asymmetrical rotation) means that national considerations matter, which has been denied by the ECB since its inception.

The three above-mentioned authors rather advised a more centralised approach. Though their counter-propositions differ in details, all of them recommend an increase in the policy-making powers of the Executive Board (possibly enlarged to 8, 9 or even 10 members).

The European Parliament (2003), in line with these criticisms, published a report and rejected the ECB’s reform proposal. In addition to the afore-mentioned arguments, the report remarks that in a 25-country EMU, it would become theoretically possible that a coalition of small countries, representing only 10% of the Euro area GDP, decides the European monetary policy despite the opposition of the four largest countries and the Executive Board (the latter would count for 10 votes and would be outweighed by the other 11 voting governors). Consequently, under this reform proposal, the Governing Council is far from being representative of the euro area. Moreover, the transparency of the ECB proposal is doubtful, because the adopted rotation system is too complicated to be made clear to the public.

As an alternative for the ECB reform project, the Committee for Economic and Monetary Affairs of the European Parliament proposed a double-majority voting system (simple majority + qualified majority of 60% of euro area population). It mentioned, however, that in a longer perspective, a delegation of monetary power to a supranational enlarged Executive Board would be in line with a genuinely European approach.

The Council’s decision to adopt this reform proposal, despite the will of the most democratic European Institution and in contradiction with the opinions of the Commission’s amendments21, appears to be sub-optimal. Before it enters into force, ratification by all member countries according to their constitutional requirements will be necessary, which allows once again the opportunity to reject it and to adopt a better solution.

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21. Commission’s opinion, dated 19.02.2003 was positive, but recommended limiting the number of voting Governors, including countries’ populations in the composed indicator and asked for more precision in rotation schemes within groups.
3. Defining a new set of reform criteria

Before turning to the assessment of the different reform scenarios, designing the proper organisation of the Governing Council of an enlarged Euroland is necessary.

Conceptually, a central bank is established in a political process to ensure economic stability and consequently the welfare of the citizens. This statement, either too general or too naive, is at the origin of the proposed criteria set. These criteria will touch three previously mentioned spheres: economics, politics and citizens (their rights and need for democracy).

We propose to name these three criteria as follows: economic efficiency, political acceptability and public perception. They are comprehensive and may be taken as criteria groups, of which more precise components are given later. It is worth underlining that all components have already been indicated (in one or another formulation) in the literature. The novelty of our approach is the crucial link established between the three distinguished spheres. It implies that enlargement reform of the ECB should not be seen as pure reshaping of the decision-making structure but should rather be considered as a package deal, which will establish a new quality in the functioning of the ECB. Thus, it would require an upheaval in the Statutes of ESCB and ECB.

3.1. Economic efficiency

The economic efficiency criterion examines whether the reform proposals improve the satisfaction of the central bank’s objectives. In the case of the ECB, the main objective is to guarantee price stability in the whole Euro area, which was (re)defined in May 2003 as maintaining inflation rates below but “close to 2%” over the medium term.

The efficiency of the monetary policy body is thus connected with its potential to attain its objective(s). In the case of the ECB, we take the position that it will mainly depend on its credibility and independence. Efficiency also depends on the Council’s potential to make accurate decisions just at the right time and, in this perspective, the number of members (to avoid the never ending deliberations and above-mentioned “status quo bias”) and their possible motivations—national or euro-wide point of view—are crucial.

22. For some new theoretical underpinnings of the monetary policy framework in a monetary union, see Dixit and Jensen (2001 and 2003) as well as Walsh’s (1995) seminal paper.
23. Credibility as a mean to attain the price stability objective was introduced by time-inconsistency literature.
Credibility of the monetary policy body is difficult to establish ex ante and normally follows well-managed policy experience. Nevertheless, some institutional arrangements may undermine the ability to achieve it. Notably, when the personal configuration of a policy-making institution changes too often (in the most extreme case, at each meeting a different group of people decides the monetary policy), it may be difficult for the public and financial markets to believe that it will lead a continuous, time-consistent and eventually appropriate monetary policy. Thus, arrangements which may dilute the responsibility (such as rotation) will be considered here as endangering the credibility.\textsuperscript{25}

Independence is another feature of a modern central bank closely related to its efficiency. It reflects the level of autonomy of a central bank (economic, goal setting and legal). According to many economic publications the ECB is the most independent central bank in the world (as its governors practically cannot be revoked, enjoy a long term of office, quantify their objectives themselves, etc.).\textsuperscript{26} Nevertheless, if a reform tends to diminish the level of ECB independence, it obviously may lose this leading position.\textsuperscript{27}

Size problems should be understood as an excessive number of members, which may make difficult good and timely decision-making. It may be problematic to have either too many decision-makers or discussion participants.

Finally, assuring the decision-makers’ euro-wide point of view can be regarded as the best means to attain the interest rate which would be optimal for the euro area as a whole.

3.2. Political acceptability

Political acceptability is related to today’s (indirect) democracy and for the goals of this article will be composed of “adoptability”, accountability and precision of formulation.

In a political system, where citizens delegate a part of their freedom to their states’ institutions and, further, countries delegate a share of their sovereignty to international organisations, control on the use of these delegated powers is necessary. The European Union is an example of international organisation whose supranational powers are very strong, especially in the areas of competition, external trade and monetary policy.

\textsuperscript{25} It may be also argued that working together for the common monetary policy may build up a sense of co-responsibility. However, in this article, we retain the existing argumentation of e.g. Baldwin et al. (2001, p. 23) and Bofinger (2003, p. 5) that rotation solutions decrease credibility.

\textsuperscript{26} For an index of central banks’ independence, see e.g. Cukierman et al. (1992) or, more recently, Gutiérrez (2003)

\textsuperscript{27} This does not mean an automatic policy worse-off. Nevertheless, most economists believe that there is a clear link between a high degree of independence and low inflation. For a survey of the issue see Berger, de Haan and Eijfinger (2001).
Therefore, when establishing rules for these supranational authorities, the Member States tend to be extremely cautious, especially as all amendments of international treaties (which regulate the functioning of supranational institutions) will need unanimity. The mechanism which plays an important role here is the trade-off between the gains of efficiency attained by delegating responsibilities and the costs incurred by a loss of sovereignty. Additionally, unlike in strictly political areas, where (theoretically) all countries are of equal weight, in the economic field, bigger countries wish to exercise more power since even a small relative loss may be huge to them in terms of real effects.

Thus, on the one hand, we have the theoretical rule (i.e. all countries’ votes are equal) and, on the other hand, we may observe discrepancies relied on different economic weights. To find a political-economic solution, some kind of compromise is needed. This compromise, satisfying all countries and increasing the probability for a reform to be accepted, will here be labelled “adoptability”. “Adoptability” is to be understood as a division of votes in the Governing Council that matches the economic strength of the respective countries. These considerations are highly important when governors tend to be considered as their countries’ representatives. A more precise proposition of the measure for adoptability is presented in box.

**Under-representation indicator**

Let us assume that countries wish to exercise at least as much voting power in the Governing Council as is their respective GDP share in the euro area. By voting power we understand the weight (share) of a country’s vote in the whole Governing Council.

In other words the problem of adoptability of a solution is supposed to come from the GDP, which is not fully recomputed into the voting power.

To explain the sense of the proposed “under-representation indicator”, a few simple examples are needed.

Consider a Governing Council which will be dominated by the big countries, let us say representing 80% of total euro area GDP. It means that the GDP not represented in such a Council is 20%. But this solution will not be acceptable (adoptable in the term of this article), because the majority of European countries (small countries) will not be represented.

On the other hand we may have a Council dominated by a coalition of small countries. Such a Council certainly will not be adoptable because the big (underrepresented) countries will object.

This (extremely sketchy) analysis implies the construction of a simple under-representation indicator. Let us firstly compute the total GDP which is underrepresented in voting powers. It is the sum of positive differences between GDP and voting power (if a country is underrepresented, the difference is added up, if it is not underrepresented, the underrepresented GDP equals 0). Secondly, one should compute the share of number of under-
represented countries (if there are 10 underrepresented countries among 25, this share equals 40%). Finally, the mean of this two values gives the “under-representation indicator”.

Arbitrarily, we set the limit values (for the assessment of reform adoptability) to 25% (if it is lower, the reform is considered as fully adoptable and 50% (if it exceeds 50%, the reform is unacceptable). The first interval (0-25%) means that less than a fourth of power (economico-political) is redistributed, the second (25%-50%), that less than a half of this power is reallocated and the last one (over 50%) means that there is more than 50% unsatisfied (in terms of countries and/or GDP).

The calculations of the under-representation indicator are presented in appendix. Countries are ranked by decreasing value of “composed indicator” used in classification of countries in the ECB reform proposal1.

Voting powers are calculated as follows: frequency (or number or share - depending on the reform adopted) of votes divided by the total number of votes.

The obvious flaw of this approach is in ignoring any possible coalitions, but it would become too tricky to perform.

Among reform possibilities weighting votes and constituencies were ignored. In the case of direct GDP weighting, the value of the indicator should probably be very close to 02. In the case of constituencies the results should not differ significantly from those computed for rotation schemes.

1. See Horn (2003, p.6).
2. A potential problem might stem from slight differences between economic weights and voting powers. In such case, as much as a half of the total number of countries might be underrepresented (while others would be over-represented). This would finally lead to relatively high value of the under-representation index (approximately 25%).

Accountability means that decision-makers should be responsible for their decisions. In the special case of central banks, a trade-off between accountability and independence is necessary. As mentioned above, the ECB is considered as a very independent institution and one could infer from this that some measures of ensuring accountability are needful.

Accountability is determined by the ECB’s reporting obligations to the EU’s and national institutions, as well as some control or supervision powers over the ECB, which these institutions may exercise. In contrast to national central bank, which may be somehow accountable also to their nations, we suppose that the ECB is only accountable to political institutions of the Union and member states. For this reason, as well as because it might be good substitute for ‘adoptability’, the accountability is part of political acceptability criterion and is not taken into consideration in public perception.

A precisely formulated reform proposal leaves no doubt about the composition of the interest rate setting body at any point in time; i.e. one should know not only the frequencies of voting (in case of a rotation-type scheme) but also the schedule. It might be important to know who after whom is going to have the right to vote (in order to analyse potential coalitions) and consequently at least the rules for this order should be fixed. The minimum might be considered as stipulating in the Statute of the ESCB and the ECB (or other act enforcing the reform) who, when, and under which conditions will decide about this schedule. This high degree of precision in the definition of the scheme is needed to avoid any future misunderstandings.

3.3. Public perception

Public perception is our third proposed criterion, which includes transparency simplicity, durability as well as representation. Transparency means that mechanisms and decisions should be made understandable to the public, including financial markets. Obviously the communications to the general public and those addressed to financial agents will be different, but these problems are not of our direct concern. Obligations such as publication of minutes, voting records and motivations are the most relevant to enhance the central bank’s transparency. Increased transparency will probably increase the public support for monetary decisions taken by the reformed ECB.

Simplicity means that the functioning of the Governing Council should also be made understandable in order to generate public support for the reform (and the ECB).

Durability is connected with adaptability to different enlargement scenarios (with potentially numerous stages) without any need for further negotiations. Citizens may be tired of seeing repeated quarrels about the ECB. In the case of a durable solution, public understanding and eventually the support for the ECB will probably be enhanced. Durability as well as simplicity are directly related to the design of decision-making structure and depend solely on rules constituting the Governing Council.

Representation, understood as a certain decision-making power in the hands of every country, is also in the interests of the general public, and for example, a Council dominated by nationals of one country (even if they were the highest class specialists) would not enjoy the

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29. For a measurement of public support in the case of the ECB and its implications see Maier (2002); Maier and Bezoen (2002); Maier and Hendrikx (2002). The latter analyses also the probable support for the ECB after EMU enlargement.

30. For theory as well as an excellent new index of central banks’ transparency see Eijffinger and Geraats (2003). For more information and other concepts see Geraats (2001) and Winkler (2000).
enormous euro-wide public support. On this point, representation is close to ‘adoptability’, but it mimics the point of view of a citizen of a certain country (Is my country’s interest represented in the Governing Council?). As some reforms proposed would need the Statutes of the ESCB and the ECB to be amended, they would thus need to be ratified (at least in some countries) by a referendum. Henceforth, exclusion of any country from the decision-making process might endanger public perception in this country and question de facto feasibility of the reform.

These criteria take into consideration three main aspects of monetary policy: politicians (governments) establish rules for the ECB, which, by the (macro) economic mechanisms should ensure the welfare and stability for the general public. The criteria and their components are summed-up in table 1. For an attempt at numerisation of these criteria, see section 5.

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4. Alternative reform proposal

Following the proposed three-criterion set, the solution we would like to present for the enlarged ECB will consist in three spheres. First, and foremost, the decision-making structure must be reformed to ensure the economic efficiency of the Council. Second, the political dimension should be taken into consideration, and in this matter the proposition consists in some additional accountability measures to be adopted. Finally, the transparency of the ECB should be enhanced, for the comprehension of the general public and better information for financial markets.

The present approach distinguishes among the existing propositions because it argues that there is no possibility to successfully prepare the ECB for the enlargement by reforming only the decision-making structure. Thus, the reform proposed would require a substantial reshaping of the Statute of the ESCB and the ECB. Consequently, the whole decisional process applicable to the treaties (an IGC, the signature of amendments to the Treaty and finally the ratification process) would be necessary. This may be complicated and time-consuming but the ESCB and the ECB need a good framework for their functioning indeed.
4.1. Reforming the decision-making framework

The solution we would like to propose for a new European monetary framework follows the centralisation scenario. This choice is the one preferred by a majority of the above-quoted authors and seems to be optimal from the economic point of view. It may suffer, however, some criticisms from political and democratic points of view. These questions are addressed in the two following subsections.

The proposed solution relies on delegation of the operational decisions, including interest-setting power as well as exchange rate powers (foreign reserves operations), to an enlarged, nine-person Executive Board. These three additional members should ensure a larger political representation. However, they would represent solely the interests of the euro-area as a whole, which should be, in our opinion, enshrined as a principle into the treaties.

Nevertheless, any strategical decision, requiring no urgent action (which interest rate or exchange rate policy may need) would stay in the hands of the Governing Council in its present composition (the Executive Board and national central bank governors from countries which have adopted the euro).

These strategical decisions would, in particular, comprise such actions as adopting legislative acts and broad policy guidelines, defining medium-term targets and fixing the procedures for the ECB. Other important tasks like decisions concerning international co-operation (art. 6 of the present Statute) or advisory powers (art. 4) to any European institutions in fields of competence of the ECB or fixing minimum reserve requirements would be also in the hands of the Governing Council. Thus, the Governing Council would keep some control over the new Executive Board.

The distinction between strategical and operational decisions comes from Bofinger (2003). However, his proposal includes a veto power in the hands of the Governing Council. It might be, nevertheless, difficult to implement it in practice: if the operational decisions are delegated to the Board, it is because the Governing Council is considered as acting too slowly. Consequently, a veto power in the hands of a large body does not make much sense. Instead, accountability should be enhanced (see below).

The new Executive Board members should be chosen in a procedure similar to the present rules: they would be appointed by the Heads

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31. Members of some other bodies of the EU: the Commission, the Court of Auditors (both supranational), as well as the Economic and Social Committee and the Committee of Regions, should act “in general interest of the Community” (art. 213.2, 247.4, 258 and 253 of the TEEC - numeration according to the Amsterdam Treaty). This statement is not present in the Statute of the ESCB and the ECB nor in related articles of the Treaty.

32. Art. 11.2 of the Statute of the ESCB and the ECB.
of States and Governments on a recommendation of the Council after consultation of the European Parliament and the Governing Council. To ensure a wider range of opinions, it may be useful to have a “distinguished personality” from the private sector as a member of the Executive Board. Nevertheless, it is not recommended to set too detailed requirements for the candidates for the Executive Board, as we believe (similarly to Fitoussi and Creel, 2002) that they may block some suitable candidatures. On the other hand, too loose characteristics complicate the appointment system and do not bring much added value. Such a political process would probably ensure that appropriate candidates are chosen and at the same time does not suffer from the democratic deficit.

This (political) reasoning and optimism concerning its outcomes are also based on Fitoussi and Creel (2002) and particularly their comments on the “direct nomination” proposal. Nevertheless it does not concern the co-optation of national central bank’s governors to the Executive Board but the method of appointment of all its members.

It is worth recalling, that, beside Fitoussi and Creel (2002) and Bofinger (2003), centralisation scenario was also the preferred solution of Baldwin et al. (2001), Artus and Wyplosz (2002), Berger (2002), and Wyplosz (2003). Hence, our debt towards their work.

4.2. Additional accountability measures

The accountability of this solution is, to a certain (nevertheless insufficient) extent, ensured by the political process of nomination of the Executive Board members, where the European Parliament (as the most democratic among the EU’s institutions) plays a consultative role. This should be enhanced by involving the members of the European Parliament in the “preselection” process of candidates to the Executive Board, (cf. Fitoussi and Creel, 2002).

However, accountability also necessitates some supervision during realisation of tasks and duties by the decision-making body. This is the reason for more frequent reporting obligations to the European Parliament. Regular explanations of policy decisions and strategies are even more important, due to the extremely high level of the ECB’s independence. The present monetary dialogue, which is held on a quarterly basis, should be more frequent - in our opinion, the best solution is to organise monthly meetings, and in the case of special decisions taken by the ECB, ad hoc hearings.

In this reform proposal, we argue that some additional accountability measures (as described above) are necessary to balance the resistance of politicians to any steps towards centralisation (or federalisation).
4.3. Enhanced transparency

Taking into consideration a certain level of ‘mistrust’ of the public towards such an independent and relatively new institution as the ECB, it is advisable to make it as open and understandable (transparent) as possible.

Any special obligations need not to be enshrined in future treaties to make the ECB more transparent but would perpetuate its good practices in the area. Since its inception, the ECB has increased its transparency without any statutory changes- see Eijfinger and Geraats (2003). Following their transparency index, we would like to recommend improving the ECB’s communications especially in the procedural field, i.e. publication of voting records and minutes of the meetings.

These additional transparency measures might be undesirable in a decentralised Governing Council. The first argument against is the possibility of inciting public debates accusing ‘others’ of adopting a policy not optimal from some country’s perspective. Such mediatic accusations are easier if the vote record is known when voters are clearly identified with their countries (governors of national central banks). Second, more accentuated political pressure on countries’ governors would be possible, as the ‘lobbyists’ would be able to ‘control’ voters’ behaviour. Once again, in case of a centralised decisions, national (or any other) pressures on decision-makers would have less sense and voting records might even enhance the personal independence of the members of the Board.

Summing up, additional transparency requirements should probably generate public support and enhance comprehension and thus credibility in the case of a centralised European monetary policy body, without national connotations.

This solution, which restrains the size of monetary policy body, does not suffer from any national bias, and the Executive Board’s credibility will not be endangered ex ante. These features together with guaranteed independence should allow price stability objectives to be met. The increased accountability should make this reform proposal politically acceptable for member states in spite of the lack of national representation. Its simplicity, durability and transparency will also probably generate public support. Obviously, political acceptability as well as public perception are very difficult to assess objectively, but to estimate the latter we could, for example, arrange opinion polls.

As mentioned above, this complex solution would require considerable amendments to Treaties (even if some proposed changes- e.g. transparency measures - need not to be written into them).
5. An assessment of major reform proposals

In the quest for objectivity of the criteria proposed in section three, we establish an assessment scheme, which allows for numerical (and thus potentially more objective) judgment (criteria coding is presented in table 2). A first numerical attempt to assess the reform proposals in view of the proposed three-criterion set is presented in table 3.

5.1. Criteria coding

All the adopted criteria assume a value on a range between 0 and 5. Criteria assessments depend on some simple features (also presented and defined in section 3), which were weighted in order to attain the value of 5 for each criterion. These weights are arbitrary, but reflect the importance of components, as argued below. Components whose weight equals 1 are assumed to be discretionary variables.

<table>
<thead>
<tr>
<th>2. Criteria measurement</th>
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<tbody>
<tr>
<td>Economic efficiency</td>
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<td>Public perception</td>
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<tr>
<td>Independence</td>
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<td>Adoptability</td>
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<tr>
<td>Credibility</td>
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<tr>
<td>Accountability</td>
</tr>
<tr>
<td>Simplicity</td>
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<tr>
<td>Size problems</td>
</tr>
<tr>
<td>Precision of formulation</td>
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<tr>
<td>Durability</td>
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<tr>
<td>Euro-wide view</td>
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<tr>
<td>Representation</td>
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</tbody>
</table>

Among components of the economic efficiency criterion, the higher rank (2) is accorded to size problems. This choice is justified by the fact that the size problem is the most directly related to enlargement of the ESCB. This component assumes value of 2, if the number of decision-makers does not exceed 15\(^\text{33}\), equals 1, if the number of decision-makers is comprised between 15 and 21, and 0 if it exceeds 21\(^\text{34}\). Independence is given 1, if the index of legal central bank independence (Cukierman et al., 1992) does not fall below 0.7\(^\text{35}\), 0 instead. As remarked above, we only consider the credibility of the adopted decision-making structure of the monetary policy body and not credibility of its actions. The monetary policy body is assumed to be credible if at least 50% of its members are permanent ones\(^\text{36}\). In this case the component takes value 1, in the opposite- 0.

\(^{33}\) Number equal to the number of Bundesbankrat members (after reform).

\(^{34}\) Number to which the Governing Council will be limited after the adoption of the reform.

\(^{35}\) Value accorded to the Bundesbank by Cukierman et al (1992) was equal to 0.69.

\(^{36}\) As is the case in the Federal Open Market Committee, where only four members (out of 12) rotate.
Within the criterion of political acceptability, the higher weight (of 2) is accorded to adoptability and accountability. These two features seem to be more important than the precision of formulation, which is only a formal (and relatively easy to meet) requirement. Adoptability equals 2 if the under-representation indicator (as defined in box) does not exceed 25%, amounts to 1 if the under-representation indicator is between 25% and 50% and 0, if it exceeds this value. As a proxy for accountability we have chosen the reporting obligations to the European Parliament. Consequently, the component equals 2 if reporting obligations (or practices) to the European Parliament are at least on monthly basis; 1 if they are at least on annual basis, and 0 if they are less frequent or they do not exist. Precision of formulation is given 1 if reform proposal leaves no doubt about the precise mechanism of the decision-making nor its schedule and 0 instead.

Among public perception components, transparency is considered as the most important. It is proposed to accord 1 point, either for the publication of the minutes of meetings or voting records if they are published within a year from the meeting; 1 point for detailed explanations of every decision taken; 2 if both are fulfilled and 0 if none\(^{37}\). Simplicity is given 1 if there is no need to use any indicators (including GDP or arbitrary weights) in reform definition, 0 instead. Durability assumes 1 if there is no need for adaptation for further enlargement stages and 0 in the opposite case. Finally representation is given the value of 1 if every country representative has some voting power and 0 instead.

5.2. Assessment of reform proposals

The status quo, as argued in section one, is unacceptable. Nevertheless, it is interesting to assess it, according to our criteria, and use it as a benchmark. Its main disadvantage is the growing size problem—up to 31 decision-makers. Also problematic is the euro-wide view, because, in spite of official statements, NCB governors may be considered as their country representatives\(^{38}\). The under-representation indicator equals 42.4%\(^{39}\). Status quo is surely not a durable solution: even if there is no formal need for adaptation, it has to be changed precisely because of forthcoming enlargement. Of course, status quo enjoys a high degree of precision, simplicity and independence; existing transparency and accountability measures are

\(^{37}\) Other important transparency requirements (with exception of policy inclination) are already present in the ECB practice—see Eijfinger and Geraats (2003).

\(^{38}\) It may be argued that in case of some personalities this is certainly not true (see e.g. the behaviour of Jean-Claude Trichet). However, we decided to follow the (weak) evidence of Heinemann and Huefner (2002) and conclusions for the ECB from the American experience presented by Meade and Sheets (2002).

\(^{39}\) Supposing a euro area of 25: all present EU members + 10 accession countries. See box 1 and appendix.
kept; credibility is not directly endangered and finally every nation is represented. Overall assessment amounts to 8 and this high result shows that to improve significantly the existing framework, the simple reshaping of decision-making structure will probably not be sufficient.

The ECB proposal somehow solves size problems, but not very efficiently - up to 21 decision makers are involved. Asymmetric rotation ensures a small improvement in matching economic weights and voting powers (under-representation indicator equals 41.1%). As over 50% of decision makers rotate, and consequently the composition of the body is not stable, its credibility might be considered as endangered. Similarly to the status quo, the euro-wide point of view is not assured and this argument is implicitly enhanced by an asymmetric rotation scheme. The proposition is not stipulated precisely enough (e.g. unknown schedule). The basis for the rotational system is far from being simple. However, this solution is durable and every nation is represented. The total of 7 consequently signifies a slight worse-off compared to the status quo.

Centralisation - the analysis concerns the simplest delegation of the interest-setting power to the Executive Board, but the assessment does not change much in other possible centralisation scenarios. Economically, the solution seems perfect: size problems are eliminated and the euro-wide view even if not embedded in the treaties, is implied by the nomination process. Credibility and independence are not endangered at any point. This scenario is equally simple, precise and durable. On the other hand the ‘adoptability’ of such a solution is null, because, supposing supranational character of technocrats, all countries (and consequently all euro-area GDP) are underrepresented. Thus, the proposed under-representation indicator would be equal 100%. Representation of citizens of all the countries would also be non-existent.

Simple rotation may take some diverse forms and consequently its assessment lacks precision. Unfortunately, there is a trade-off between credibility and adoptability: relatively stable composition of the Council would enhance credibility but adoptability would then be null (see appendix).

Grouping is the most vague solution and its assessment depends on many detailed arrangements adopted. Its durability would be doubtful, as probably the groups would change at every enlargement stage. Grouping countries would, in our opinion (and contrary to Heisenberg’s, 2003), even raise suspicion about regional motivations of the governors.

Weighted votes’ major inconvenience lies in the size of the Council and in the implicit confirmation of national preferences instead of euro-wide view. Its major advantage consists in matching economic and political weights.
The alternative proposal (section 4) in general follows the centralisation scenario and, consequently, its economic efficiency is (in the light of adopted criteria) perfect; moreover, the euro-wide view would be guaranteed by an appropriate statement in the Statute. Likewise in the case of centralisation, its adoptability would be null, but this would be offset by additional accountability measures and a more politically involved nomination process. This reform would be also precise, simple and durable. The lack of national representation would be compensated by additional transparency measures. Summing up, its score is 12.

The alternative proposal has an outstanding result in comparison with the other analysed reform scenarios. One may argue that under this criteria set, this is natural, as our criteria have considered some questions (accountability, transparency) which were not of direct concern in the purely technical improvements of the ECB’s decision-making framework. Nevertheless, it seems relevant to turn attention to the integrality of the different aspects of the ECB’s preparations on the enlargement.

As a conclusion, evaluations reported in table 3 indicate that the ECB proposal is a slight worse-off compared to the status-quo. This should incite the main decision-making bodies in the EU to reconsider if the adopted reform will improve the functioning of the ECB.

<table>
<thead>
<tr>
<th>3. Numerical assessment of analyzed reform scenarios</th>
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<tbody>
<tr>
<td><strong>Criterion/component</strong></td>
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<td>-------------------------</td>
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<tr>
<td>Economic efficiency</td>
</tr>
<tr>
<td>Independence</td>
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<tr>
<td>Credibility</td>
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<tr>
<td>Lack of size problems</td>
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<td>Euro-wide view</td>
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<td>Political acceptability</td>
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<td>Adoptability</td>
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</tr>
<tr>
<td>Representation</td>
</tr>
<tr>
<td><strong>Total</strong></td>
</tr>
</tbody>
</table>

1. Depends on precise arrangements adopted.
2. Close trade-off, impossible to make both equal 1.
Source: author’s assessment.
6. Conclusions

The present article surveys economic literature concerning the necessity of reforming the European Central Bank in view of the forthcoming enlargement of the EU and, sooner or later, of the EMU.

In this article, we have tried to place the debate surrounding the necessity and possibilities of the reform of the ECB decision-making system in a larger context of a contemporary central bank. In order to do so, we have devoted some space to highly discussed problems of transparency and accountability.

This analysis indicates the need for a more complex context while reshaping the existing Statute of the ESCB and the ECB in view of the forthcoming enlargement. Such a need is linked to the necessity of a modern central bank law for the enlarged European (Monetary) Union.

The survey of the literature devoted to the enlargement of the euro area indicates the criticability of the reform adopted by the European Council for the enlarged ESCB. At the same time, this literature demonstrates some ways to formulate criteria for assessment of this reform. We propose a criteria set, addressing three main spheres of political economy (economics, politics and general public) and precisely define its components. We put forward an alternative scenario of the reform, which turns some attention to the importance of linkages between the decision-making framework, its political acceptability as well as public perception and other important matters in central banking such as accountability and transparency. Finally, the main reform scenarios are assessed numerically and thus more objectively.

The main conclusion of this assessment is that the adopted ECB reform slightly worsens the existing framework. It also indicates, that the basic reform proposals are not able to improve significantly the ECB’s structure. Among them the centralisation scenario is probably the best. Considering the reform as a more complex one (going beyond the pure reform of the decisional structure), should be more acceptable for the politicians as well as for the public.

Finally, we would like to point out some possible paper extensions. First of all, the attempt at numerisation of reform performances in the light of criteria proposed seems to be too simplified and may be surely improved. Second, not all possible reform scenario (especially mixed ones) were sufficiently discussed and analysed.
References


APPENDIX
### Computations of under-representation indicator for some reform options

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>GDP Share</th>
<th>ECB PROPOSAL</th>
<th>STATUS QUO</th>
<th>ROTATION 6</th>
<th>ROTATION 15</th>
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<td>% Countries under.</td>
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Sources: Author, GDP and classification see Horn, 2003.