

Delivering value for money?

The problematic accountability of the European Stability Mechanism (ESM)¹

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1. Introduction

Concerns about limited democratic legitimacy and accountability have bedevilled the European Union (EU). As the EU's competences have continued to grow in different policy areas, there has been a certain perception of it intruding in the domestic political arenas of the member states. Similar concerns about legitimacy and accountability have been raised when it comes to recent institutional additions to the EU governance landscape, such as the European Supervisory Authorities (ESAs) for the financial sector as well as new bodies created as part of the recently established Banking Union — notably, the Single Supervisory Board (part of but distinct from the European Central Bank (ECB)) and the Single Resolution Board (Howarth and Quaglia, 2014).

This chapter undertakes a critical assessment of the accountability of one recent institutional addition to the Euro area governance system — the European Stability Mechanism (ESM). Regarding Euro area governance in general, Dawson (2015, p. 976) warns that many new structures designed in response to the Euro area crisis 'depart from the mechanisms of legal and political accountability present in previous forms of EU decision-making without substituting new models of accountability in their place'. By examining in greater detail the financial accountability mechanisms applicable to an important new Euro area body, we identify accountability gaps and shortcomings in the complex EU architecture of financial control (see Introduction). As Henning (2017, p. 178) has emphasized, 'the ESM is the first

formal, treaty-based institution uniquely for the monetary union'. Therefore, this case study will yield important insights about the extent to which good governance principles apply to the EMU architecture reconfigured in the aftermath of the Euro area crisis.

The ESM formally came into existence on 27 September 2012 (when the ESM treaty came into force), supplementing the temporary European Financial Stability Facility (EFSF) which is to be wound down when the last of its obligations are repaid. The ESM is a permanent financial mechanism that can lend funds to stabilize Euro area member states and financial institutions in distress with the broader objective of safeguarding financial stability in the Euro area. From a legal and organisational standpoint, the ESM is an intergovernmental body: it is an international organisation headquartered in Luxembourg established by an international treaty that was signed by the Euro area member states on 2 February 2012.² The ESM's intergovernmental status is reflected most clearly by the requirement of unanimity on major decisions and the exclusively national capital contributions (Article 4, ESM Treaty; Article 8, ESM Treaty).

From a global perspective, there is growing demand from academics and politicians in many countries for greater accountability with regard to a range of international financial organisations (Woods, 2003; Woods and Narlikar, 2003; Grant and Keohane, 2005). Until the 1980s, bodies such as the IMF and the World Bank focused on rather narrow technical missions. Over the past three decades, the IMF and the World Bank have come to perform a much wider range of tasks directly affecting the domestic political arenas of their members notably in the imposition and monitoring of conditions linked to lending.

Similarly, the ESM provides a financial backstop for distressed Euro area member states which must comply with the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (the so-called Fiscal Compact)³ signed on 2 March 2012 and the specific reform programme to which they have committed in order to receive ESM funds. Those recipients funded are subject to conditionality policies similar to those developed by the IMF at the international level. Such policies are agreed by the ESM Board of Governors, which consists of Euro area national ministers of finance or their representatives. Operational decisions are taken by the ESM's Board of Directors, consisting of officials 'of high competence in economic and financial matters', with one member appointed by each of the Euro area member states. The Managing Director of the ESM contributes to the drafting of

the financial assistance programme for receiving countries (see Articles 5-7, ESM Treaty).⁴ When an organisation such as the ESM impinges upon state sovereignty so visibly — notably in terms of the imposition of fiscal policy conditionality — it inevitably faces pressure for greater accountability in order to ensure its political legitimacy.

Recent developments demonstrate the potential for the increased importance of the ESM in EU economic governance. The European Commission and German Chancellor Angela Merkel called repeatedly for the ESM to be transformed into a European Monetary Fund (EMF) (*Financial Times*, 29 August 2017, 6 December 2017, 3 June 2018) — and thus a European version of the International Monetary Fund (IMF) — although Chancellor Merkel insisted that the mechanism remain a non-EU, intergovernmental body. While the precise powers and roles of an EMF remain unclear and subject to disagreement, on 4 December 2019, Euro area member state finance ministers agreed to ESM Treaty reform. The revised Treaty — subject to national ratification procedures — is set to reinforce significantly the role of the mechanism and to clarify its relationship with EU institutions (Eurogroup 2019; ESM 2019). The agreed Treaty reform includes transforming the ESM into the official financial backstop to the Single Resolution Fund (SRF), the Euro area-wide bank resolution fund. The reform furthermore assigns to the ESM the following powers: to negotiate with the European Commission and the ECB the economic policy conditionality imposed on member states receiving ESM loans; to assess the macro-economic and financial situation of member states receiving ESM loans; to verify the implementation of conditionality; and to co-sign memoranda of understanding with the European Commission.

In April 2020, in response to the macro-economic impact of the Covid-19 pandemic and the widespread need to reinforce national health care systems, Euro area finance ministers agreed to expand the ESM by establishing a temporary ‘Pandemic Crisis Support’ (Eurogroup 2020). Based on the existing ‘Enhanced Conditions Credit Line’ available to all Euro area countries, funding from the EMS would be available to Euro area member states with standardised terms agreed in advance by the ESM governing bodies, on the basis of up-front assessments by the European Commission and the ECB. Loans would be up to two per cent of the GDP of each member state, for a total of €240 billion. Thus, the powers and roles of the ESM continue to expand and remain the subject of considerable intergovernmental debate. In the meantime, the mechanism’s accountability provisions remain far from clear and certainly inadequate.

The second section of this chapter discusses relevant accountability benchmarks, drawing on the comparative politics, international relations and public administration literatures. Subsequently, the third section presents the ESM's 'dual institutional embeddedness' which gives rise to unique — what we describe as 'tricky' — accountability challenges. The fourth section provides an assessment of how vertical and horizontal accountability and learning perspectives on accountability work in practice in the case of the ESM. The fifth section summarizes the main findings and concludes.

The understanding of the ESM's accountability and the related assessment presented in this chapter are primarily based upon a reading of the ESM's legal texts and official documents that date back to 2012, and secondary material produced by public bodies, academics and journalists on the ESM — in addition to the academic literature on accountability more generally and in relation to specific international, EU and national bodies. In order to corroborate the understanding of ESM financial accountability developed from these readings, we also conducted nine semi-structured interviews with current and former ESM staff, ESM Board of Auditors members (who are not ESM officials but must scrutinise the procedures and activities of the ESM), EU institution officials, and national finance ministry and parliamentary officials with a specific responsibility to follow ESM activities. Because of the small number of officials involved, we ensure their anonymity by not naming their EU institution or member states.

2. The state of the art: understanding and analysing accountability in different academic disciplines

Dawson (2015) points out the absence of adequate accountability models developed specifically for the many new EU governance structures created during the Euro area crisis, such as the ESM. Nevertheless, scholars working in a range of disciplines — and notably in comparative political science, international relations, public administration studies — have studied the concept of accountability extensively. We draw on their work to identify existing and potentially desirable future accountability mechanisms for the ESM. We use Lastra and Shams' (2001) definition of accountability in financial sector governance as an obligation by one person (or institution) to explain and justify his / her / its actions or decisions against a set of criteria to another person (or institution), and to accept the responsibility for shortcomings.

Accountability goes hand in hand with transparency, that is, the provision of information on the decisions, their context, their rationale and their (anticipated) impact, as transparency ensures that the other actors have the necessary information to evaluate the actions of the individual or institution (de Haan and Oosterloo 2006). De Haan and Oosterloo (2006) propose that transparency should only be limited in certain justifiable circumstances — for example, if it were harmful to market stability or to the legitimate (for example, commercial) interests of regulated parties. In the absence of clear benchmarks applicable to new Euro area bodies, such as the ESM, our starting point is to use vertical and horizontal accountability mechanisms, which have been discussed widely in the comparative politics and the international relations literature. These two mechanisms are particularly suitable, considering the ESM's 'tricky' institutional design and its 'dual institutional embeddedness' as an international organization embedded in the EU governance system.

In the comparative politics literature, accountability refers to the presence of robust institutional checks and balances and limitations on the actions of public officials to prevent the abuse of power (Schedler, 1999; Przeworski *et al.*, 1999). Two types of accountability mechanisms are particularly important in the domestic political arena: vertical and horizontal ones. Vertical accountability refers to classical hierarchical governance architectures, where tasks and competences are delegated, for example, by a democratically elected principal to agents. By contrast, horizontal accountability refers to a system of checks and balances among different institutional bodies which are not linked by a hierarchical delegation of tasks but have sufficient competencies and resources to prevent abuse of power. Furthermore, referring to Lastra and Sham's (2001) definition of accountability, governments and public officials should be able to justify and explain their actions to forums representing the public interest, such as parliaments and courts (see also Amtenbrink, 1999). Courts of auditors ensure the accountability of public bodies through financial and performance audits, which can then inform the accountability of these bodies to less specialized bodies, including parliaments.

In political science and public administration studies, accountability refers to a general sense of responsibility in the political system and willingness to act in a transparent, fair and equitable manner (Flinders, 2001; Lord, 2004). Furthermore, scholars of public administration define accountability more concretely as a 'social mechanism', an institutional relation or arrangement in which an actor can be held to account by a forum (Bovens, 2007; Bovens *et*

al., 2008; Bovens, 2010). This conceptualization is particularly helpful when examining the relations between an organization and different potential accountability forums.

Furthermore, Bovens *et al.* (2008, p. 233) put forward the *learning perspective* on accountability, where the intended outcome of accountability is to make public authorities both more effective in fulfilling their mandate and more responsive to the needs and preferences of their key stakeholders. This is useful for our analysis of the ESM, as it adds a dynamic dimension of reflexivity, change and learning over time. By contrast, the vertical and horizontal dimensions of accountability are rather static — they concern relations between institutions in a democratic system that change very slowly over time.

The accountability standards discussed above have been developed for and largely applied to the domestic political arena of liberal democracies. At the same time, Woods (2001, p. 4) shows that both vertical and horizontal accountability mechanisms, as conceptualized in comparative politics, also apply to international organizations such as the IMF, World Bank, and WTO. Therefore, we argue that these standards are applicable to the ESM as an international body, but that they need to be adapted to the specific context. At the international level, vertical accountability rests on country representation in the organization and ability to shape decision-making, while horizontal accountability is more diffuse and depends on linkages with other entities and organizations in the international system. Woods (2001, p. 4) argues that accountability is higher in international organizations with balanced representation and lower where a few powerful member states dominate the decision-making process.

The learning perspective on accountability in the public administration literature is also applicable to international organizations. As Kim *et al.* (2014) demonstrate, international organizations show the same set of bureaucratic traits examined by public administration scholars in the domestic arena. Over time, they have incorporated many management practices such as strategic and performance management tools originally developed for national public sector bodies. These practices facilitate learning from the organization's past experience in order to fulfil its objectives.

Furthermore, public administration and international relations scholars have pointed out that organizations are often subject to conflicting goals, drawing on examples of national public

organizations in OECD countries, international organizations, and non-majoritarian independent regulators (Woods and Mattli, 2010; Koppell, 2010; Busuioc, 2009). Thus, multiple accountability mechanisms may apply, and may even be in conflict with each other. Considering the ESM's similarity to both international organizations such as the IMF and non-majoritarian bodies in the EU — notably the European Investment Bank (EIB) — we would expect to detect similar trends when evaluating how accountability works in practice. In this respect, the learning perspective is very important, because it can facilitate the reconciliation of different accountability benchmarks.

3. The ESM's 'dual institutional embeddedness': an international organisation embedded in the EU governance system

The ESM is an international financial institution established by an international treaty signed in 2012 by the then 17 Euro area member states and based in Luxembourg. Its members and shareholders today are the 19 Euro area member states. The ESM was established as a permanent mechanism to mobilize financial resources and make them available to Euro area member states experiencing financial distress. The use of ESM funds to recapitalize banks (public and private) was later confirmed. The ESM's total subscribed capital is €705 billion, made up of €80.5 billion of paid-in capital and €624.3 billion of callable capital raised by debt issue. The ESM's maximum lending capacity is €500 billion. The individual member states' shares in the mechanism are based on their share of capital in the ECB. Hence, the biggest ESM shareholders are, in order, Germany, France, Italy, Spain, and the Netherlands, which collectively hold 81.5 per cent of the mechanism's paid in capital. The ESM is authorized to use a variety of financial instruments such as credit lines and loans to national governments, and purchases of sovereign bonds on the primary and secondary markets. Furthermore, the ESM can carry out the direct or indirect recapitalization of financial institutions within a member state if Euro area financial stability is at risk and the member state is not in a position to carry out a recapitalization measure on its own.

Legally, the ESM is an international financial institution. However, its governance structure and decision-making procedures illustrate its embeddedness in the Euro area governance architecture. To begin with, the ESM's Board of Governors is comprised of the Euro area finance ministers. This body takes major decisions including: granting or withholding

financial assistance; determining the conditions with which aid recipients must comply; and setting the financial instruments to be deployed (Article 5, ESM Treaty). Decision-making takes place on an intergovernmental basis, with each national finance minister possessing either one vote or (on matters concerning ESM capital) a vote weighted according to the capital contribution of his/her member state. Most decisions require unanimity, while decisions on capital require a majority of weighted votes. Emergency decisions are made by a qualified majority of 85 per cent of voting members. In addition to the Board of Governors, the ESM has a Board of Directors in charge of the organization's day-to-day operations (Article 6 ESM Treaty). This operational management body is also composed of one representative from each Euro area member state.

Euro area member state governments in need of financial assistance submit an application to the Chair of the ESM Board of Governors (Article 13, ESM Treaty). Once such a request has been received, it is assessed by the European Commission and the ECB and the IMF is consulted. The three institutions, informally known as the Troika, are also in charge of monitoring compliance with the economic and financial conditions attached to receiving financial assistance. Even though the ESM is not formally part of the EU institutional architecture, it interacts closely with other EU bodies. ESM decision-making relies upon Commission and ECB advice. Furthermore, the informational linkages and interdependence between the ESM and the EU institutions are evident when we consider that the EU Commissioner in charge of Economic and Monetary Affairs and the president of the ECB may participate in the meetings of the ESM Board of Governors as observers. On 14 November 2018, the ESM and the Commission produced a Joint Position on future cooperation between the two institutions as 'joint input' for the December Euro Summit (Commission and ESM, 2018). Officially, the position was agreed in order to clarify the respective roles of the ESM and Commission on a number of financial assistance elements and on building cooperation outside financial assistance.

4. Assessing accountability in practice in the case of the ESM

The ESM's idiosyncratic 'dual institutional embeddedness' as an international organisation embedded in the EU governance system can largely be explained by the crisis-driven design of this body in 2012 and the refusal of certain EU member states to accept Treaty reform in

order to create it (Hodson, 2013). Given the substantial lending capacity of the ESM and the politicisation of the financial stabilisation programmes managed by the European Commission (Dawson, 2015; Moschella, 2017), it is all the more important to ensure that appropriate accountability mechanisms are in place to guarantee the effective scrutiny of the ESM. At the international level, a close comparative case is the IMF, established to help stabilize countries with balance of payments problems (Woods, 2001). At the EU level, a comparative case is the EIB which, like the ESM, is a public financial institution with a mandate to lend, albeit in very different circumstances and with distinct objectives.

Vertical accountability is operationalized in terms of examining the extent to which member states participating in the ESM and, specifically, national parliaments seek to monitor and control closely the operations of the mechanism. Horizontal accountability is operationalized by evaluating the checks and balances between the ESM and other bodies in the EU governance system, even though the ESM is not formally part of the EU governance architecture. Lastly, the learning perspective is operationalised by assessing the ESM's internal code of conduct, recommendations by the organization's Board of Auditors, any commissioned internal and external evaluations, and how these are used by the organization in order to reflect upon and improve its operation over time. Below we present a set of initial conclusions about the nature of ESM accountability, drawn by examining the ESM through the lens of vertical, horizontal and learning accountability. This assessment takes into account the ESM's idiosyncratic 'dual institutional embeddedness'.

4.1 Vertical accountability

In terms of vertical accountability, the member states participating in the ESM will seek to monitor and control closely the operations of the mechanism. Drawing on research on the IMF, we would expect the mechanism's biggest shareholders to hold key positions in the mechanism's governing bodies and exert the most influence in ESM decision-making (Woods, 2001; Woodward, 2007; Johnson, 2011). The establishment of weighted voting rights on ESM decisions on capital most clearly reflects the preferences of the mechanism's biggest shareholders. More controversially, it might be argued that the selection of Klaus Regling, a German national, as the first ESM Managing Director and Chairperson of the Board of Directors, reflects German preferences (ESM BoA member, interview, 9 April 2017). Furthermore, one of the first five members of the ESM's Board of Auditors (BoA) was a representative of the German Federal Audit Office which — according to the first European

Court of Auditors nominee to the BoA (also a German national) — was ‘probably’ more than just a coincidence and ‘probably because Germany’s interests in the ESM are indeed very great’ (Carotti, 2012).

The interest of national public institutions in ESM capital raising and lending activities to programme countries is most likely to be considerable in creditor Euro area member states with fewer financial difficulties. Three of these are also among the member states where the national parliament has the legal power to vote on ESM capital raising and lending: Germany, the Netherlands and Finland. It is perhaps not surprising then that the parliaments, courts of audit and other public entities of these three countries have been among the most active in scrutinizing ESM activities. For example, in its opinion on the ESM Treaty, the German Federal Audit Office was seen as particularly well informed on ESM matters having gained relevant experience from the years during which it was responsible for auditing the International Monetary Fund (Noack quoted in Carotti, 2012). Widespread German, Dutch and Finnish opposition to the development of a Euro area ‘transfer union’ heighten political interest in ESM activities.

The finance ministers of the Euro area member states can be held to account by their national parliament for their country’s individual share in the ESM, but not for the functioning of the ESM as a whole or the country programmes that it has funded. There is a complete absence in the intergovernmental treaty of any mention of a role for national parliaments with regard to the operation of the ESM. This absence is surprising given the important role assigned to parliaments in national liberal democracies and in the EU on fiscal policy matters (Armstrong, 2013; Moschella, 2017). However, national constitutional requirements require four Euro area member state governments to seek the approval of the national parliament on all ESM capital raising, lending, bond buying and on each modification to ESM loan packages — these are Germany, the Netherlands, Finland, and Estonia (Hoeing, 2015, p. 50-51). The Austrian parliament has voting power on each ESM capital raising and loan package / bond buying but no voting power on modifications. The Italian and French governments are required by law only to inform the parliament on these matters. The parliaments in the other eleven Euro area member states have no voting power or any legal guarantee of being informed. A German Constitutional Court ruling of 18 March 2014, further clarified that the German government would have to obtain the approval of the German Bundestag on any increase to Germany’s capital contribution to the ESM — beyond the €190 billion already allowed for by the Bundestag. The Constitutional Court ruled that the Bundestag ‘may not relinquish its right to

decide on the budget, not even in a system of intergovernmental governance’ (BVerfG 2014; see also *Financial Times*, 18 March 2014). The ruling notes:

The treaty grants the bodies of the European Union no powers which affect the overall budgetary responsibility of the German Bundestag [nor does it] force the Federal Republic of Germany to make a permanent commitment regarding its economic policy that can no longer be reversed (BVerfG 2014).

While there is no formal obligation for the ESM to be accountable to Euro area member state parliaments, in practice, ESM officials have been responsive to the demand for more engagement with national parliaments (interview, former ESM official 15 June 2018; Regling, 2017). Moreover, Harald Noack, the first European Court of Auditors member of the ESM Board of Auditors claimed that he would make himself ‘available to interested members of the national authorities of states ... as long as this [was] compatible with [his] duties as a member of the Board’ (Carotti, 2012). Klaus Regling and a number of ESM officials regularly visit national finance ministries and national parliaments (interview former ESM official, 15 June 2018) and while the ESM does not yet publish a report cataloguing its engagement with national authorities, videos of a number of national parliamentary visits are posted online and national parliamentary archives provide minutes of public hearings. This voluntary effort directed at national parliaments resonates with Bovens and Curtin’s (2016) analysis of the drive toward greater political accountability in Euro area governance; they find that ECB President Draghi’s accountability to national parliaments has become stronger and more visible over time, even though there are no explicit legal obligations that compel him to engage with member states’ national parliaments (Bovens and Curtin, 2016, p. 19).

Nevertheless, there are significant differences in the frequency and level of informed debate about the ESM in different national parliaments. A review of parliamentary archives showed that more active parliaments, such as those of the Netherlands, Germany, Finland and Austria frequently organise committee sessions where the ESM is discussed. These parliaments also request more information from their respective governments about their position on the ESM ahead of important EU summits, such as the European Council meeting in December 2017 when the future of the ESM and its possible transformation into a European Monetary Fund was discussed (Netherlands Parliament, 2017; European Council, 2017; Meiers, 2015, pp. 38-39; Ketterer, 2016). Furthermore, the German Bundestag also created a special closed-door

committee on the ESM, created in 2014, the membership of which is voted by the Bundestag plenary (interview, Deutscher Bundestag finance committee staff member, 7 June 2018; see also Deutscher Bundestag 2014). The creation of this committee reflected Bundestag efforts to ensure greater scrutiny of ESM activities by tackling the — often repeated — argument that ESM transparency was necessarily limited because of its market-sensitive policies and the fear that transparency on some matters would undermine Euro area stability. Meeting *in camera* allows this committee to discuss the full range of sensitive ESM matters and engage in more open discussions with ESM officials than would be the case in public fora.

4.2 Horizontal accountability

Horizontal accountability encompasses the interactions between the ESM and the European Commission and the ECB, which provide important input to the ESM's decision-making. These bodies, and specifically, their advisory role in deciding upon ESM decisions on capital raising, lending and conditionality are subject to European Parliament and European Court of Auditors scrutiny — the former in terms of parliamentary questions, interviews and reports; the latter in terms of performance audits. In the EU context, ESM officials hold up the accountability arrangements of the EIB as a potential model for the ESM — in the event that the ESM is eventually brought into the EU (interviews ESM officials, 7 February 2017 and 23 March 2017; interview former ESM official 15 June 2018). EIB capital raising and lending activities, in addition to the specifics of lending programmes, are subject to European Parliament scrutiny and to annual financial and performance audits undertaken by the Court of Auditors.

Overall, EU level democratic control and public scrutiny apply to the ESM only to a very limited extent. The ESM Treaty assigns the European Parliament no role regarding the ESM and the European Court of Auditors no audit right of its own. Only indirect oversight mechanisms are assigned to the European Parliament under Regulation 472/2013 (European Parliament and Council 2013). During the enhanced surveillance of a member state or an ongoing macroeconomic adjustment programme linked to EU financial assistance, the competent committee of the European Parliament may invite representatives of the Commission, the ECB and IMF to participate in economic dialogue. Furthermore, the Commission regularly informs the Chair and Vice-Chairs of the relevant European Parliament committee — orally and confidentially — of the conclusions drawn from the preparation and monitoring of member states' macroeconomic adjustment programmes. The Court of Auditors

(ECA) principally performs an indirect role regarding the work of the EMS by auditing the structural adjustment reforms undertaken by countries receiving ESM loans, and the role of the Commission and the ECB in implementing these reforms. The potential role of the Court of Justice of the EU (CJEU) in ensuring the accountability of the ESM is also very limited. The ESM Board of Governors is responsible for the interpretation of the intergovernmental treaty and its application. Thus, the Board of Governors has the power to decide on any conflict between or among ESM member states and between ESM member states and the ESM itself. However, an ESM member state can appeal a decision of the Board of Governors to the CJEU (Article 37(3), ESM Treaty).

4.3 Learning perspective

The learning perspective on accountability refers to designing robust codes of conduct, internal and external evaluations, and how these are used by an organization to learn and improve its operation over time. In this respect, the ESM has developed both a code of conduct and an auditing architecture to examine its operations. The statutory audit of the ESM is performed by the external auditors and the Board of Auditors (BoA) may conduct performance audits of the regularity, compliance, performance and risk management of the ESM in accordance with international auditing standards (Article 30 (3) Treaty, 24 (4) By-Laws). The BoA has five members — formally appointed by the ESM Board of Governors — two of whom are nominated by the public audit bodies of the 19 Euro area member states, two by the ESM Chairperson, and the remaining member by the European Court of Auditors, who serves in an *ad personam* capacity. The BoA's mandate, composition and procedures are laid down in part in the ESM treaty. BoA members (interview 9 April 2017; Carotti, 2012) argue in favour of the credibility and efficacy of their audits. The set of ESM by-laws include further agreements about the range of activities in which the BoA can engage and its reporting requirements.

The Board of Auditors is just one of three bodies in the oversight structure of the ESM; the two others being the internal ESM audit department and the organization selected to conduct the ESM's external financial audit — normally one of the Big Four audit firms, each with a significant presence in Luxembourg. Nevertheless, the BoA is the only body that can give an independent assessment of the actual outcomes of the support programmes funded by the ESM. It has full access to all ESM documents and reports (Accountant.nl, 2015; Court of Audit of the Netherlands, 2012). As the ESM's Managing Director, Klaus Regling, has

pointed out, ‘the Board of Auditors is an important counterpart to the ESM management. It plays an important role in our corporate governance and guarantees the trust of our shareholders and the general public’ (interviewed in Accountant.nl, 2015).

The ESM has also been responsive to the demands of Euro area member states for greater transparency of its decision-making. For example, in 2012 the Dutch Court of Audit (2012), amongst others, pressed for two points to be included in the ESM by-laws. First, it demanded a broad audit mandate of all support programmes funded by the ESM in accordance with international audit standards. Second, it asked for a more extensive reporting on the ESM’s activities than stipulated in the ESM Treaty. For the first five years of the ESM’s operation, the only ESM BoA information provided publicly was found in a statement by the BoA on the last page of the ESM Annual Reports, confirming the legality and regularity of the ESM’s operations during the year (see ESM Annual Reports, 2012-2016). The Dutch Court of Auditors called for the ESM BoA’s annual report to be made available to national parliaments (Court of Audit of the Netherlands, 2012). In 2016, the ESM made the necessary amendments to its by-laws to meet these two requests. The ESM BoA’s *Report in Respect of the Financial Statements and Annual Report*, which summarises the Board’s audit work and recommendations for the respective year and is prepared for the ESM’s Board of Governors, were made publicly available.

Regarding the need for a broad audit for ESM-funded support programmes, in June 2016, the ESM Board of Governors (thus Euro area finance ministers) decided to commission the first ever independent evaluation of the role of the ESM (and EFSF) in financial assistance programmes. The Board of Governors agreed the appointment of the Austrian former ECB Executive Board member, Gertrude Tumpel-Gugerell, to undertake the evaluation. In agreeing the evaluation, the Board of Governors explicitly noted its inspiration from other international financial institutions, including the IMF and World Bank (ESM 2017). The evaluation assessed the relevance, effectiveness, and efficiency of ESM (and EFSF) financial assistance in safeguarding the financial stability of the Euro area and of its member states. The evaluation was complementary to previous evaluations of these programmes undertaken by the IMF’s Independent Evaluation Office, the European Court of Auditors, and the European Commission — with greater focus on ESM involvement. The evaluation — presented in mid-June 2017 — praised the ESM and EFSF for their contribution to

safeguarding Euro area financial stability but called for further improvements (Strupczewski, 2017).

While little is known about the internal decision-making dynamics of the ESM, its 2015 *Annual Report*, stresses that ‘as a publicly funded international institution, the ESM has also moved unilaterally to enhance the transparency of its decision making’ (ESM, 2015, p. 83; interview former ESM official, 15 June 2018). ESM officials interviewed accept the desirability of the improved reporting on and transparency of the ESM’s activities both to other bodies and to the wider public (interviews 7 February 2017; 23 March 2017). However, they also stressed the importance of limiting public transparency on information that could be deemed to be market sensitive. The ESM releases on its website key documents adopted by its two governing bodies on the programme countries. In spring 2016, the ESM made a commitment to publish more details about the country loan programmes discussed in the ESM Board of Governors, the ESM Board of Directors and the Eurogroup. This ESM transparency initiative was introduced in parallel with a similar move in the Eurogroup.

5. Conclusion

This chapter has argued that two forms of accountability — vertical and horizontal — and the learning perspective on accountability are particularly relevant for understanding the ESM’s financial accountability. They also demonstrate the complex inter-institutional relationships in EU financial accountability (see the Introduction to this volume). The bulk of the perceived inadequacy of the ESM’s current accountability arrangements is attributed to its unique institutional design, a point confirmed in most of the interviews undertaken for this study. The ESM’s vertical accountability remains limited, although the supply of information to national finance ministers and ministries and through them to national parliaments ensures some accountability. Vertical accountability is further reinforced in the five Euro area member states that grant the national parliament voting powers on ESM capital raising and lending. While there is no legal obligation for the ESM to be accountable to and engage with Euro area member state parliaments, in practice, the mechanism has been responsive to the demand for more engagement with national parliaments. Concerns about the provision of market-sensitive information have been partially overcome in the German case through the creation of a special parliamentary committee on the ESM that meets *in camera*.

Horizontal accountability has only been marginally improved since the creation of the ESM. The kind of scrutiny and audit to which the EIB is subject — by the European Parliament and the European Court of Auditors — is currently absent, given the legal status of the ESM outside the EU institutional framework. The leadership of the EU institutions argues that this is problematic: the Five Presidents’ Report (2015, p. 18) emphasizes that the ESM’s ‘governance should ... be fully integrated within the EU Treaties’ to ensure an effective Euro area crisis management framework’. The transformation of the ESM into an EU body also features on the Commission’s (2018) list of ten policy priorities for the period 2015-2019. In its Joint Position with the European Commission of November 2018, the ESM states clearly its preference to become part of the EU legal framework (European Commission and ESM, 2018). However, this transformation of the ESM — or a future EMF — is unlikely in the near future given German (and other) government opposition (*Financial Times*, 3 June 2018). While reinforcing the powers of the ESM and the potential for relationship-building with the European Commission and the ECB, the ESM Treaty reform agreed in December 2019 does not transform the status of the mechanism as a non-EU intergovernmental body (ESM 2019). Unilateral ESM action to improve its engagement with the European Parliament remains nonetheless legally possible — a point made publicly by Klaus Regling (2017).

Under the learning perspective, the ESM’s Board of Auditors ensures a level of scrutiny of ESM activities that is then — in part — made available to other institutions and the wider public. The move by the ESM Board of Governors in June 2016 to commission an external evaluation of the ESM’s participation was directly inspired by IMF and World Bank practice. The critical evaluation of June 2017 (ESM 2017) — and the range of recommendations to improve the ESM’s involvement in programmes and disbursement of funds — suggests the objectivity of this report and its potential effectiveness in ensuring greater accountability.

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Endnotes

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² The ESM Treaty is available at: https://www.esm.europa.eu/sites/default/files/20150203_-_esm_treaty_-_en.pdf; last accessed on 25 July 2019.

³ The Fiscal Compact is available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=LEGISSUM%3A1403_3; last accessed on 25 July 2019.

⁴ Regulation 472/13 Articles 6 and 7 note that the Member States make a request to the ESM to draw up a financial assistance programme for a country (ESM Member). However, the Commission, in liaison with the ECB, assesses the sustainability of the ESM Member's public debt and develops a draft macro-economic adjustment programme. This programme in turn must be approved by the Council. The ESM's role in the design of the programme is focused

principally upon drawing up the lending instruments for the disbursement of funds to the ESM Member. See also Article 13(3) of the ESM Treaty.