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Markets as an Accountability Mechanism in EU Economic Governance

Armin Steinbach[*]

3.1 INTRODUCTION

By upsetting traditional interdependencies between financial actors, the European sovereign debt crisis has engendered a range of accountability concerns. Prior to the crisis, treaty-based arrangements in the EU subjected both public and private entities to the discipline of market forces. Specifically, governments and financial institutions relied on liquidity furnished by private counterparties, and Member States met their financing needs without central bank intervention or assistance from other EU countries. However, the collapse of financial markets significantly reshaped relations between creditors and debtors. Indeed, a new regime now prevails in which central banks act as pivotal market makers and in which sovereign states backstop other sovereigns. For many years now, the European Central Bank (ECB) has been injecting massive liquidity into markets, which has had strong redistributive effects between EU states while also distorting private-sector competition.[1] As a result, bond rates have been effectively unmoored from practical realities, and the principle of strict national responsibility for public debt has been all but invalidated. In this way, market forces no longer determine the allocation of debt capital; this role is now performed by EU creditor states and the ECB. In exchange for financial assistance, EU creditors have imposed a range of obligations on debtor states in order to encourage their fiscal consolidation.

This shift has been associated with a 'derogation' of democratic governance, according to various legal and political scholars.[2] To be sure, the current structural arrangements did not arrive all at once but rather on a piecemeal basis as

* Professor of Law and Economics at HEC Paris.

[1] Menéndez, 'The Crisis of Law and the European Crises', 44 *Journal of Law and Society* (2017), 56–78, at 59; Steinbach, 'The Lender of Last Resort in the Eurozone', 53 *CML Review* (2016), 361–383, at 368.

[2] White, 'Authority After Emergency Rule', 78 *Modern Law Review* (2015), 585–610, at 587–591; Deters, 'National Constitutional Jurisprudence in a Post-National Europe: The ESM

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part of numerous macroeconomic adjustment programmes, granular memoranda of understanding, and unconventional monetary policy measures, many of which are viewed by commentators as hostile to the democratic principle that parliament should be the progenitor of policy decisions – particularly when it comes to weighty matters of public interest. 'Intergovernmentalism', 'non-majoritarianism' and 'executivism' are just some of the terms that have been deployed in discussing this shift away from standard notions of democratic accountability.[3] However, rather than focus on assessing such developments from the perspective of democratic representation, an examination of how underlying accountability relationships have been transformed would appear to be a more fruitful line of inquiry. Since time immemorial states have been obligated to raise money to fulfil various functions, from waging war to providing infrastructure. Here, a distinction is illuminating, for there have traditionally been two main sources of public financing: specifically, direct taxation of domestic entities over which the state enjoys sovereign authority, and, alternatively, procurement of funding from other states or foreign organisations.[4] The second mode of financing is typically governed by market mechanisms, as states normally enter into a competitive market in which bond rates are free to rise or fall in line with demand and perceived risk. Accordingly, when states raise finance internationally, accountability is typically structured through market arrangements. By contrast, under the non-market model of domestic finance, the entities providing tax revenues exercise a disciplinary effect through political representation.

Notably, the foregoing distinction regarding forms of accountability coincides with the difference typically drawn between the 'tax state' (*Steuerstaat*) and 'debt state' (*Schuldenstaat*). The former term was coined by Schumpeter to draw attention to the crucial role played by taxation in enabling the activities of the state.[5] By contrast, the latter term emphasises the tendency of states to amass large public debts. While states have accrued enormous debt loads

Ruling of the German Federal Constitutional Court', 20 *European Law Journal* (2014), at 204–218.

3 Curtin, 'Challenging Executive Dominance in European Democracy', 77 *Modern Law Review* (2014), 1–32; Crum, 'Parliamentary Accountability in Multilevel Governance: What Role for Parliaments in Post-crisis EU Economic Governance?', 25 *Journal of European Public Policy* (2018), 268–286; Deters (n.2); Rittberger, 'Integration Without Representation? The European Parliament and the Reform of Economic Governance in the EU', 52 *Journal of Common Market Studies* (2014), 1174–1183.

4 Even though in these credit-based relationship, the debtor states must pay a price that may be linked to some market price level, the financial relationship between public entities follows non-market terms.

5 See the seminal contribution by Schumpeter, Die Krise des Steuerstaates, 1918.

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in past eras – British national debt, for example, stood at 200 per cent of GDP at the end of the Napoleonic wars – Streeck argues that 1970 was a transitional moment, as the enormous post-war increases in the size of the public sector in all Western states heralded a new stage in the relationship between capitalism and democracy.[6] In Streeck's view, the growing dependence of governments on large-scale debt issuance entailed growing susceptibility to political influence by financiers. Streeck also undertakes a division between the tax and debt state, positing that under the former model, governments are predominantly accountable to their citizenry, or *Staatsvolk*, who enjoy political representation. Under the debt state model, by contrast, citizens have to compete with bondholders, or *Marktvolk*, who demand reliable debt service.[7] The accountability concept introduced previously reflects this point of distinction between the debt and tax state, while also situating them in wider categories. In particular, the tax state is one type of financing regime based on public relationships – that is, between the taxpayer and sovereign, but public relationships are also at stake in financing between states (e.g. bilateral lending between EU states through the European Financial Stability Facility, or EFSF) or between states and other public institutions (e.g. the International Monetary Fund (IMF) or European Stability Mechanism or, indirectly, the ECB when it purchases government debt). This wider notion of the relationship between public entities and political accountability in the domain of state financing transcends Streeck's notion of the tax state. At the same time, the notion of market accountability goes beyond concern with the debt state's dependence on tax revenues (thus creating accountability to *Marktvolk*) by also encompassing the private relationships of market participants who enter into lending and borrowing transactions without the involvement of the state (e.g. on credit markets or interbank markets). The notion of the tax state versus debt state thus differentiates between sources of government revenue (taxpayers versus market actors), while market versus non-market-based accountability attends to the conditions under which such financing is provided.

One key contribution of this chapter is to elaborate an alternative notion of accountability that furnishes a theoretical underpinning for how economic governance has evolved in the post-crisis setting. The theoretical framework that is developed here builds on the observation that states have the option of raising financing through relationships that depend on market accountability or political accountability, respectively, and that one can be substituted with the other. Furthermore, market accountability as a dominant mode of raising

6 Streeck, *Buying Time: The Delayed Crisis of Democratic Capitalism* (New York: Verso, 2014).
7 Ibid. at 81.

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financing has been steadily supplanted in the EU by political accountability in the relationship between debtor states, on the one hand, and creditor states and the ECB, on the other, thus engendering the democratic tensions widely cited in the literature. My central claim is that this shift offers an explanation for the seemingly undemocratic evolution of EU economic governance that has been described by various scholars.[8] Consequently, it follows logically that one way of solving the widely maligned 'democratic deficits' within the Economic and Monetary Union (EMU) would be to restore the market accountability enshrined in the Treaties, as evident in part on the ban on monetary financing, bailouts and state aid. As part of a gradual return to market discipline, it would of course be necessary to enact institutional safeguards that limit the risk of excessive and destabilising market fluctuations. In this regard, with the European Stability Mechanism (ESM) effectively in place, the European Banking Union moving towards completion, and financial market regulations continuously being updated, important safeguards have been established to prevent a return to market accountability from triggering excessive turbulence.

A second contribution of this chapter is to relate the notion of accountability presented here with the accountability concept developed in the introductory chapter of this volume. While the distinction between market and political accountability primarily focuses on *whether* accountability relationships can be organised through market- or non-market-based arrangements, the introductory chapter focuses on *how* accountability standards can be determined and *how* political accountability should be designed. Specifically, Dawson and Maricut-Akbik develop a compelling subdivision between four normative goods of accountability in modern governance – namely: openness, non-arbitrariness, effectiveness and publicness. By reference to their accountability concept, my contribution shows how market accountability – as substitute for political accountability – meets all four of these standards.

3.2 THE EU'S ECONOMIC ACCOUNTABILITY REGIME AND ITS DISSOLUTION DURING THE CRISIS

Accountability can be defined as a 'liability to reveal, to explain and to justify what one does'.[9] *Bovens* offers a general understanding of accountability as a relationship between an actor and a forum – the *actor* has an obligation to

[8] Steinbach, 'EU Economic Governance After the Crisis: Revisiting the Accountability Shift in EU Economic Governance', 26 *Journal of European Public Policy* (2019), 1354–1372.

[9] Normaton, 'Public Accountability and Audit: A Reconnaissance', in Smith and Hague (eds.), *The Dilemma of Accountability in Modern Government: Independence Versus Control* (Macmillan, 1971), pp. 311–346.

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explain and to justify his or her conduct, while the *forum* can pose questions and pass judgement, and the actor may face consequences.[10] Furthermore, this relationship is founded on three elements: *information* captures the actor's duty to provide information to the forum about his or her conduct. *Justification* expresses the forum's authority to demand that the actor justify his or her actions. And *consequences* denotes the forum's power to impose sanctions or offer rewards.[11]

The three elements of accountability – information, justification, consequences – are readily apparent in the normal exercise of public authority. The government in power (the actor) is accountable to the parliament (the forum); the government informs parliament about its actions and policies (*information*), which are subjected to open debate in parliamentary sessions and special committees (*justification*). On this basis, parliament may impose punishments or rewards (*consequences*).[12]

At this conceptual level, accountability is not limited to the exercise of public power. Rather, accountability more generally encompasses the notion of normative dependencies, which can be established in a formal or informal manner, through social norms or laws. In other words, the legal order may stipulate multiple checks and balances or supervisory mechanisms, which can be understood as normative dependencies. Recalling the above differentiation between market- and non-market-based methods of financing a sovereign state, we can infer that accountability as a normative dependency can be established through either market or political relationships.

3.2.1 *Market Accountability in the EU*

The EU is a market economy, which means that investment and spending decisions are guided by price signals. A key principle underlying a market-economic system is individual responsibility, in which companies and individuals reap the consequences of their decisions, whether they produce benefits or culminate in economic failure. If a company wishes to raise investment capital, it must convince investors of its merits. Similarly, when governments borrow money from financial markets, the interest rate they pay is determined by investor assessment of creditworthiness.

The EU Treaties enshrine the notion that both public and private actors should be exposed and accountable to market forces, asserting that economic

[10] Bovens, 'Analysing and Assessing Accountability', 13 *European Law Journal* (2007), 447–468, at 447.

[11] Bovens, 'Two Concepts of Accountability: Accountability as a Virtue and as a Mechanism', 33 *West European Politics* (2010), 946–967, at 952.

[12] Bovens, *supra* note 11, at 952.

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policy should be 'conducted in accordance with the principle of an open market economy with free competition'.[13] This commitment to free market principles applies not only to the private sector but also to the public sector, as governments seeking to raise financing must subject their fiscal conduct to the allocative judgements of the market. Similarly, state aid rules forbid government spending that would distort free competition, while the no-bailout principle and prohibition of monetary financing seek to expose governments to the disciplinary force of the market. A commitment to free competition and market-based accountability – including prohibitions against state aid and bailouts – has been a constitutive element of the European Treaties since Maastricht.[14] Thus, despite financial assistance for crisis-wracked Member States, the EU has not created a so-called Transfer Union in which debt obligations are shifted between Member States or to the EU level.[15] In this way, the EU remains committed at least in principle to the allocative wisdom of freely fluctuating price signals, not only as a means of organising economic activity in the private sector but also as a tool in sovereign debt markets for ensuring that Member States conduct sound fiscal policy.

Referring again to the model of market accountability presented above, the market acts as a 'forum' by which judgements are rendered concerning the behaviour of participating actors. Under the EU's legal framework, markets thus perform a crucial organising function, not only in the private sector, by preventing companies from relying on state aid, but also in the area of fiscal policy, as the prohibition of direct transfers between Member States or the EU is designed to prevent irresponsible fiscal behaviour. Under this framework, markets ultimately have the responsibility for rendering judgement on the fiscal viability of a Member State, based on economic criteria. This stands in sharp contrast to the supervisory function exercised by the citizenry and its democratically elected representatives, as various types of value judgements, rather than a purely economic calculus, typically inform assessments regarding the reasonableness of a given policy. Following Bovens's accountability concept, the state–market relationship corresponds to an agent–forum relationship. Public and private actors provide *information* in the sense that

[13] Articles 119, 120, 127 TFEU.

[14] Lechevalier, 'Why and How Has German Ordoliberalism Become a French Issue? Some Aspects About Ordoliberal Thoughts We Can Learn from the French Reception', in Hien and Joerges (eds.), *Ordoliberalism, Law and the Rule of Economics* (Hart, 2017), 23–48, at 42.

[15] Case C-62/14, *Peter Gauweiler and Others v Deutscher Bundestag*, ECLI:EU:C:2015:7, para. 100; Case C-370/12, *Thomas Pringle v Government of Ireland, Ireland and The Attorney General*, ECLI:EU:C:2012:756, para. 135; Case 2 BvR 2728/13, *Bundesverfassungsgericht*, judgment 14 January 2014.

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both actors communicate signals concerning their performance (whether in the form of macroeconomic statistics or profit statements). The market (as a forum) processes the information provided by the actors (whether public or private) to assess economic viability and solvency. The *debating* element is less explicit, as states are not literally interrogated by markets in the same way that political authorities are. However, state actors do provide justification for their actions to markets at various levels.[16] Specifically, states testify to the soundness of their policies and to their solvency by publishing budgetary statistics and by adhering to certain accounting standards.[17] They comply with the bond issuance requirements requested by investors, and they cooperate with the rating agencies that scrutinise their policies in order to assess their solvency. Finally, *consequences* represent the forum's power to reward or punish actors for their performance;[18] market prices thus act as the disciplinary mechanism. Rising bond rates reflect riskier lending conditions and are an outcome of the assessment performed by market observers. States are thus held liable for their economic performance through interest rates, with sanctions or rewards taking the form of higher or lower risk premiums.[19]

3.2.2 *How the EU Replaced Market Accountability with Political Accountability*

Over the course of the crisis, the market orientation that previously served as a mechanism for ensuring sound fiscal policy was gradually supplanted by a new regime of political accountability, as Member State reliance on market financing was substituted with non-market-based support facilities. As the finances of some debtor states deteriorated, causing them to lose access to capital markets, the EU stepped in to prevent financial collapse, providing bilateral financial aid, which was later replaced by the ESM. The ESM and other forms of assistance were structured with conditions that can be ascribed

[16] Steinbach, 'EU Economic Governance After the Crisis: Revisiting the Accountability Shift in EU Economic Governance', 26 *Journal of European Public Policy* (2019), 1354–1372, at 1361.

[17] For example, Member States submit annual Stability and Convergence Programmes as part of the European Semester, which serve the Commission and finance ministers to assess whether Member States are on track towards reaching their Medium-Term Budgetary Objectives (MTOs).

[18] Fearon, 'Electoral Accountability and the Control of Politicians: Selecting Good Types versus Sanctioning Poor Performance', in Przeworski, Stokes and B. Manin (eds.), *Democracy, Accountability, and Representation* (Cambridge University Press, 1999), pp. 55–97, at 55; Strøm, 'Delegation and Accountability in Parliamentary Democracies', 37 *European Journal of Political Research* (2000), 261–290, at 267.

[19] Steinbach, *supra* note 8, at 1358.

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to the categories of *information*, *justification* and *consequences*. Specifically, a Member State must apply for assistance and provide information that fulfils transparency standards (*information*); it must comply with a set of conditions, adopt policy changes, and demonstrate adherence to agreed terms (*justification*); and lastly, it may be subject to consequences – rewards in case of compliance, sanctions in case of non-compliance (*consequences*).[20]

Various policy tools subsequently developed by the EU also adhere to this logic. Prior to the outbreak of the COVID-19 pandemic, a 'reform delivery tool' was envisaged by the EU Commission, under which Member States would enact structural reforms in exchange for financial assistance.[21] In concrete terms, Member States wishing to receive support would submit a proposal for reform commitments to the Commission substantiating how it would address the challenges identified in the European Semester (i.e. *informing*).[22] The Commission would be entitled to request additional information and require the Member State to revise the proposal if needed (i.e. *justifying*).[23] During the implementation process, the Commission would assess compliance with milestones and would be able to suspend disbursement (i.e. *sanctioning*).[24] With the onset of the COVID-19 crisis, this tool was replaced by an even more financially potent instrument: the Next Generation EU (NGEU) and the Recover and Resilience Facility (RRF), which establish a quid pro quo mechanism in which grants are offered in return for compliance with a conditionality regime; financial assistance is made contingent on certain types of public expenditure.[25] The RRF allocation mechanism builds on *information* provided by Member States as they pitch eligible projects;[26] involves an element of *justification* by virtue of an assessment by the Commission, which may entail requests for changes or additional information;[27] and foresees the *sanction* of payment suspension if milestones or targets are not adequately fulfilled.[28]

Thus, rather than being exposed to the collective and (ostensibly) impassioned judgements of the market, ESM or RRF funding, recipients are subject

[20] On the metric of implementation of financial assistance Ioannidis, 'EU Financial Assistance Conditionality after "Two Pack"', 74 *Zeitschrift für ausländisches öffentliches Recht und Völkerrecht* (2014), 61–104, at 76 et seq.

[21] COM/2018/391, Proposal for a Regulation of the European Parliament and of the Council on the establishment of the Reform Support Programme.

[22] Article 11 para. 3 of COM/2018/391.

[23] Article 11 para. 5 of COM/2018/391.

[24] Article 15.5 of COM/2018/391.

[25] Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility, O.J. 2021, L 57/17 (hereinafter: RRF).

[26] Article 17 para. 1, Article 18 para. 4, Article 27 of RRF.

[27] Article 19 of RRF.

[28] Article 24 of RRF.

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to the discretion of the bureaucratic authorities administering these funding programmes.[29] In this way, market accountability has effectively been replaced with a new regime of political accountability. Accordingly, it stands to reason that insofar as a public authority (in this case, the European Commission) is rendering judgement on the policy decisions of a Member State, the principle of democratic representation would demand that Commission's decision be legitimised through an appeal to its proper authority as an elected body. While the relationship between markets and democracy has always been controversial,[30] this new accountability regime would be far less fraught if Member States were to subject their fiscal policy to the judgement of markets, for the abolishment of market accountability has raised major questions surrounding the proper role for EU institutions in the financing of Member States, including associated theoretical issues related to democratic legitimacy.

With fiscal and monetary support for crisis-racked countries undermining the principle of market accountability, strict national responsibility for national debt has been practically invalidated, thereby relaxing the economic accountability rule enshrined in EU Treaty arrangements. Moreover, the shift from market to political accountability has not been limited to state financing. The crisis-induced easing of EU restrictions on state aid illustrates how the decline of market accountability standards has also extended to the private sector. The numerous public–sector interventions that have been witnessed in past years – from bailouts to liquidity lifelines – are far from compatible with the regulatory ideal of free markets that are enshrined in the Treaties.[31]

In sum, with the principle of market exposure weakened by crisis and a greatly expanded role for the public sector in providing financing and ensuring liquidity, debt financing is now granted for political reasons under the logic of discretional conditionality, rather than for reasons of market economics. In this way, markets are no longer the motive force for states to engage in fiscal consolidation – rather, consolidation and restructuring are performed due to conditions attached to ESM, RRF or ECB aid.[32] Numerous observers have argued that the discontinuation of market accountability was predominantly driven by market failure: with bond spreads jumping erratically, fear of financial collapse triggering bank runs, and investors pulling out of crisis-roiled

[29] However, the conditionality type attached to the RRF is more modest than under the ESM, see De Witte, 'The European Union's Covid-19 Recovery Plan: The Legal Engineering of An Economic Policy Shift', 58 *CML Review* (2021), 635–681, at 676.

[30] Streeck, 'How Will Capitalism End?', 87 *New Left Review* (2014), at 35–64, 40 et seq.

[31] Menéndez, *supra* note 1, at 59.

[32] Viterbo, 'Legal and Accountability Issues Arising from the ECB's Conditionality', 1 European Papers (2016), at 501 et seq.

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countries, policy officials enacted far-reaching interventions to clamp down on market turmoil and limit the economic fallout of the crisis. Legally, the ESM has a mandate to intervene if 'indispensable to safeguard the financial stability of the euro areas as a whole and of its Member States';[33] similarly, it has been argued that unconventional monetary policy measures were necessary to sustain the transmission of monetary impulses to the real economy.[34] In the wake of the crisis, should we therefore conclude that market accountability has failed as an organising principle for sovereign financing, and should thus be abandoned, as some have argued?[35] Insofar as one supports this view, one must contend with the limitations to state sovereignty that emerge from dependence on creditor countries and institutions, and associated challenges to democratic legitimacy. Accordingly, it would appear more promising to advocate the preservation of market accountability, yet in a modified form that limits risk market failure through sound regulatory and monetary policy in combination with limited backstopping and bailout measures.

3.3 THE NORMATIVE, PROCEDURAL AND SUBSTANTIVE DIMENSIONS OF MARKET ACCOUNTABILITY

In the introductory chapter, Dawson and Maricut-Akbik develop a standard of accountability with two-fold applicability: on the one hand, it can serve as analytical benchmark for assessing the degree and scope of accountability; and, on the other, it can serve as a normative standard for ensuring a high level of democratic accountability. This section engages in greater detail with the accountability concept presented in the introductory chapter. Specifically, I argue that market accountability can serve as a conceptual vehicle for 'four normative goods' doctrine developed by Dawson and Maricut-Akbik, not least because it also accommodates the procedural and substantive dimensions of this typology. Accordingly, market accountability is useful not only as an analytical category but also as a conceptual tool for framing an accountability regime grounded in normative ethics, one that supports subjecting public policy to the allocative wisdom of the market. I argue that, when properly regulated, market accountability promotes openness, incentivises impartiality among policy officials, augments the effectiveness of policy measures, and support decisions oriented to the common good. Yet this does not mean to elevate market accountability to

[33] Article 3 ESM Treaty.

[34] Case C-62/14, Peter Gauweiler and Others v Deutscher Bundestag, ECLI:EU:C:2015:7, para. 50.

[35] Stiglitz, 'The Fundamental Flaws in the Euro Zone Framework', in da Costa Cabral, Gonçalves, and Rodrigues (eds.), *The Euro and the Crisis: Financial and Monetary Policy Studies* (Springer, 2017), 11–16.

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the status of universal applicability at the expense of democratic accountability norms – market considerations should not trump democratic legitimacy where core matters of public interest are concerned.[36] However, market exposure would appear decidedly preferable to political accountability when multiple levels of governance confound clear lines of democratic control, as in the case of European sovereign debt financing.

3.3.1 *Market Accountability and the Four Normative Goods*

Dawson and Maricut-Akbik developed their accountability concept against the backdrop of the structurally flawed EMU accountability regime, subject as it is to a complex array of intergovernmental and supranational actors, who interact at multiple decision-making levels. The authors propose a new deductive framework for studying accountability that is more suitable to the EMU setting. Drawing on the public administration literature and liberal and republican strands in political theory, they develop a model of accountability that posits four normative 'goods' of accountability: openness, non-arbitrariness, effectiveness and publicness. They explore this normativity along the two normative dimensions of accountability typically recognised in public law – namely, procedural accountability, which focuses on the processes used by actors to take decisions, and substantive accountability, which focuses on the merits of the decisions themselves.

In a previous section, we discussed how Bovens's general characteristics of accountability – that is, information, justification and consequences – are evident not only in market accountability relationships but also in the political accountability relationships that structure EMU financial assistance and RRF support. Notably, there are clear parallels between Dawson's and Bovens's accountability standards: first, *openness* refers to the expectation that the workings of the state should be transparent. It is a defining feature of the democratic ideal that citizens should be in a position to observe the actions of public authority as a necessary prerequisite for rendering judgement on it. This relates directly to Bovens's notion of 'justification', according to which the actor must give an account of her actions in a public forum. Crucially, openness (and Bovens's 'information' and 'justification') can be found in both market and non-market accountability settings. For example, in federal systems, regional authorities who obtain financial transfers from the federal government are held politically accountable, as they are typically obliged to demonstrate their

[36] Grauwe, *The Limits of the Market: The Pendulum Between Government and Market* (Oxford University Press, 2017).

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financial need ('informing'), while accounting for how they have spent this funding in the past or will do so in future ('justifying').[37] Public entities are required to maintain open books and to report their expenditures to parliament and to the citizenry. Similarly, market accountability relies on openness – governments seeking to receive obtain financing through bond sales are expected to disclose their financial position so that market actors can assess associated lending risks, with more precarious macroeconomic and fiscal conditions leading to higher risk premiums and less favourable financing conditions, which can culminate in extreme cases in loss of access to financial markets.

The second good in the model posited by Dawson and Maricut-Akbik is *non-arbitrariness*. Drawing on principal–agent theory, non-arbitrariness limits the agent's scope of authority and links it to the principal's interest. Non-arbitrariness also encompasses the legal protection of the principal against non-compliant actions of the agent. Holding officials responsible for their conduct allows the arbitrary application of power to not only be discouraged but also remedied, should it occur.[38] The concept of non-arbitrariness is inherent to public fiscal relationships, as parliament approves and monitors budgets proposed by government, and citizens also exert an oversight function through elections. Similarly, under a market accountability regime, financing conditions are (in theory) determined by underlying economic fundamentals, thus compelling the state to pursue viable fiscal policies. Furthermore, if a state were to act arbitrarily or in opposition to the interests of the principal (i.e. investors) by defaulting on bond payments, the state in question would not only face legal attempts to force repayment but would witness a withdrawal of market confidence, and, by extension, rapidly deteriorating economic conditions.[39] However, the principle of non-arbitrariness in the domain of market accountability does have certain limitations, as markets can behave irrationally, such as when investors are seized by herd behaviour.[40] This is an important point of divergence from political accountability that is based on constitutional rights. When the relationship between economic fundamentals (as an outcome of policy) and bond rates (as a judgement rendered on that policy) becomes fundamentally disturbed or arbitrary, market accountability

[37] Steinbach, *supra* note 8, at 1360.
[38] Dawson and Maricut-Akbik, Introduction in this volume.
[39] On the reputational function of markets, see Eaton and Gersovitz, 'Debt with Potential Repudiation: Theoretical and Empirical Analysis', *The Review of Economic Studies* 48 (1981), 289–309, at 290; Tomz, *Reputation and International Cooperation: Sovereign Debt across Three Centuries* (Princeton University Press, 2007).
[40] De Grauwe, Ji and Steinbach, Armin. 'The Euro Debt Crisis: Testing and Revisiting Conventional Legal Doctrine', *International Review of Law and Economics* 51 (2017), 29–37.

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as an operative principle breaks down. This underscores the importance of embedding market accountability in an adequate regulatory and institutional architecture that can limit and address such instances of market failure.

The third good that accountability seeks to ensure is *effectiveness*. Unlike the first two goods, effectiveness refers to a standard of performance: public officials are expected to enact policies of a satisfactory quality. Indeed, explicit efficiency benchmarks are not foreign to the accountability standards that are applied to government authorities. To be sure, the notion that public goods should be supplied in line with market mechanisms is a rich strand in the public administration literature, one that has stimulated numerous managerial reforms in the public sector.[41] Effectiveness may well be the aspect of accountability most closely related to market accountability, as functioning markets impose clear financial constraints on public-sector budgets. In this regard, effectiveness also mirrors Bovens's criterion of 'consequences' – as the agent (here, the state) suffers immediate disadvantages if its conduct does not conform with market expectations. Specifically, bond rates can be expected to fluctuate in line with a state's financial position and solvency. In this way, sovereign debt markets send price signals that act as a disciplinary mechanism, incentivising policymakers to adopt judicious policies.

The fourth and final normative good is 'publicness', which refers to the notion that policy should serve the *common good*. This aspect enshrines the notion that government authorities should not pursue selfish purposes but rather take into account collective interests. This does not mean, however, that each forum must pursue the same collective interests: for example, courts review public authority on the basis of certain legal standards; citizens vote in elections based on their political convictions; and parliaments monitor the executive with a view to the fulfilment of legislative goals. This criterion subsumes the notions of both 'justification' and 'consequences' contained in Bovens's model, as it implies officials are to be scrutinised and must also give an account of their actions. Regarding the mechanisms of market accountability, markets price the risk of default based on a country's ability to service a bond – and this risk depends on numerous factors, including the performance of the economy as a whole, which depends in part on inclusive growth. In this way, financial investors will punish countries that flout the interests of the society at large. However, the market may also be indifferent to ethical considerations when a country is otherwise fiscally sound. For example, authoritarian states may enjoy the full confidence of the market, particularly if they are rich in commodities, and high levels of inequality do not necessarily impair fiscal stability. However, as open

[41] Harlow, *Accountability in the European Union* (Oxford University Press, 2002), p. 24.

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and stable societies with a strong tradition of individual rights are generally more prosperous, we often find a correlation between these characteristics and the market's valuation of a country's creditworthiness.

Against this backdrop, we infer that market accountability can be assessed within the normative framework proposed by Dawson and Maricut-Akbik and that the normative premises grounded in public law are not alien to market accountability. This does not mean to imply that political accountability can be substituted in all instances with market accountability, as the exercise of public power in line with democratic principles requires political legitimacy to traceable to the will of the citizenry.[42] However, in domains in which market actors and political actors supply an identical good – that is, financing – it is important to recognise that market accountability can fulfil all of the standards associated with political accountability – namely, openness, non-arbitrariness, effectiveness and publicness.

3.3.2 *Procedural and Substantive Dimensions of Market Accountability*

The concordance between market accountability and procedural and substantive notions of accountability also deserves our attention. The respective scope of procedural and substantive accountability emerges most clearly from the judicial review of parliamentary decisions, where courts exercise judicial restraint with regard to substance. Typically, the substantive and procedural dimensions of a legality review interact as communicating vessels: the more the court requires in procedural terms, the more it alleviates the judicial review on substantive grounds towards a 'manifestly inappropriate' standard.[43] Judicial procedural review implies a thorough assessment of the process by which a parliamentary act was adopted.[44] Not the substantive content of the decision is at stake but rather the procedural steps that led to the formation of a policy decision. Conversely, a substantive account would value the substantive worth of the policy decision itself.

Regarding the first normative good – openness – market accountability operates on the basis of procedural grounds: states periodically disclose statistics and

[42] Böckenförde, 'Demokratische Willensbildung und Repräsentation', in Isensee and Kirchhof (eds.), *Handbuch des Staatsrechts der Bundesrepublik Deutschland*, volume 3, 3rd ed. (C.F. Müller, 2005), pp. 31–54.

[43] Brenncke, Case Note (2010), 47 *CML Review* 1793, at 1809–1810; Mendes, 'Discretion, Care and Public Interests in the EU Administration: Probing the Limits of Law', 53 *CML Review* (2016), 419–452.

[44] Lenaerts, 'The European Court of Justice and Process-oriented Review', *Research Papers in Law* 1 (2012), at 15.

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indicators that reveal their fiscal position and economic outlook. Also, public-sector emitters of bonds must comply with certain transparency requirements in order to protect investors.[45] The regulatory framework, which includes the requirement to publish transparent statistics and adhere to good accounting practices, generates trustworthiness through behavioural compliance. The second criterion – non-arbitrariness – also has a procedural and behavioural dimension. Rating agencies play an important role in this regard. While they do not perform a public policy function, rating agencies serve the interests of the principal (i.e. the market) by requiring the state to reveal the information necessary for markets to monitor the state's conduct. Rating agencies help to discipline states, dissuading them from putting their solvency at risk. There is a procedural dimension in the fact that rating agencies work through a web of more or less formalised interactions between actors and market institutions, by which they subject states to justification and transparency. Internally, rating agencies apply substantive standards, on the basis of which they form their solvency assessment and assign a bond credit rating. Rating grades are a substantive and quantifiable metric of fiscal viability – however, as a substantive standard, such ratings are not legally contestable, nor are they transparent or uniformly applicable.

Effectiveness as an accountability standard is of a substantive nature, as it mirrors the degree to which markets can hold states to be fiscally viable or not. The precise nature and scope of solvency in terms of market judgement may be hardly computable, but the market price for debt is the numerical tool through which markets impose fiscal discipline on states. Functioning markets translate the fundamental performance data of a state into a price that ultimately has an impact on the state's conduct. While price signals are a market-based tool for promoting effectiveness, reporting and disclosure practices are undertaken to fulfil demands imposed by market actors and public transparency expectations. As mentioned, public-sector emitters of bonds must comply with certain transparency rules. At the same time, states justify their fiscal expenditures in the public sphere, and they also publicise statistics through multiple channels, as required by EU reporting duties. These legally defined reporting duties (e.g. as imposed by the European Semester) seek to capture various dimensions of economic viability.[46]

Finally, publicness also contains both procedural and substantive dimensions. This criterion encapsulates the expectation that the state demonstrate

[45] Most recently, COM (2021) 391 final, Proposal for a Regulation of the European Parliament and of the Council on European green bonds.

[46] For example, the Semester requires Member States to submit Stability and Convergence Programmes on basis of which the Commission assesses whether Member States are on track towards reaching their Medium-Term Budgetary Objectives (MTOs).

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its commitment to working towards the common good. Clearly, markets are not formally committed to promoting the general welfare, so it cannot be expected the market forces will necessarily encourage states to pursue the common good. While there are often political movements that aim to constrain markets and make them subject to the public will, markets do in fact promote virtuous policy to some extent, for they discourage kleptocratic fiscal management that is harmful to economic fundamentals or growth prospects. An economy will fare better over the long term if its resources are managed to encourage growth and prosperity, rather than to enrich a narrow segment of society. In this way, while market exposure can neither assure socioeconomic fairness nor prevent corrupt rulers from holding power, a market's assessment of a country's solvency may indirectly promote innovation and inclusive growth. As with the other normative goods, disclosure and transparency have an important signalling effect that a country is engaged in practices that are generally supportive of a healthy society.

3.4 CONCLUSION

With the outbreak of sovereign debt crisis, there was a gradual shift in European state financing from market-based accountability relationships to a political accountability regime. From the perspective of democratic accountability, there is a significant difference between, on the one hand, raising financing from financial markets, with bond rates determined by a dispassionate assessment of default risk, and, on the other hand, from accepting financing on conditions set by sovereign foreign or supranational entities, which, by virtue of their creditor position, can directly impinge upon the state's sovereignty. As part of the massive market interventions undertaken since the outbreak of the crisis, the ECB and EU lending facilities such as the ESM have extended financing to debtor nations at favourable rates unmoored from economic fundamentals while simultaneously imposing various forms of political conditionality, thus engendering numerous tensions related to democratic representation and legitimacy.[47] Specifically, the public authorities empowered to intervene in the affairs of debtor nations are not subject to the accountability controls normally ascribed to democratic systems. This situation is directly attributable to the regime shift from market accountability to (anaemic) political accountability, a shift that occurred in the absence of robust public discussion or debate.[48]

[47] Heldt and Mueller, 'The (Self-)Empowerment of the European Central Bank During the Sovereign Debt Crisis', 43 *Journal of European Integration* (2021), 83–98.

[48] Joerges and Kreuder-Sonnen, 'European Studies and the European Crisis: Legal and Political Science Between Critique and Complacency', *European Law Journal* 23 (2017), 118–139.

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As shown in this chapter, market-based accountability exhibits strong congruence with other accountability regimes. Market accountability features both an actor and a forum, and relationships are structured based on information, justification and consequences. Our analysis suggests that market accountability may also undergird the supply of normative goods by promoting openness, non-arbitrariness, effectiveness and publicness. Markets exercise behavioural pressure on debtor states, encouraging transparency, fiscal stability and inclusive growth. Of course, there are strong limitations on the ability of international financial markets to encourage states to respect individual rights and the general welfare.[49] However, given the role ascribed to the market-based allocation of financial resources in the EU Treaties in tandem with ongoing concerns about the democratic deficits exhibited by alternative arrangements, reinvigorating market forces may in fact represent a solution for encouraging a more impartial and broadly accepted governance architecture in the EU.

While this discussion by no means aims to assert that market accountability should generally prevail over political accountability regimes, the major contribution of this chapter is to highlight that market accountability has theoretical underpinnings that are congruent with traditional accountability systems rooted in public law or political theory. At the same time, market-based modes of accountability are less intrusive and less susceptible to control by narrow interests than the EU economic governance regime that has emerged in the wake of the crisis.[50] Hence, in order to avoid economic and social policy in debtor states from being subjugated by the fiat decisions of creditor nations or supranational governance bodies, there is a need for an eventual retreat from political accountability as an organising principle in the domain of European sovereign debt financing. A return should be sought to the EU Treaties' choice of free market rules that subject the financing needs of private actors and states to the judgement of markets, rather than political actors.

As it stands, current trends indicate there could be a further weakening of market accountability in favour of an even greater role for EU institutions in the area of public-sector financing. Since the outbreak of the COVID-19 pandemic, the ECB has been purchasing sovereign debt on an expanded scale, and there has been an attendant growth in political conditionalities. More generally, Member State reliance on EU-based financing is slated to expand dramatically in the coming years as part of the general proliferation

[49] Merkel, 'Is Capitalism Compatible with Democracy?', *Comparative Governance and Politics* 8 (2014), 109–128.

[50] Steinbach, *supra* note 8, at 1368.

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of lending facilities. This will increase the EU's exposure to market accountability while also increasing the political accountability of Member States to EU institutions.

Finally, drawing on the difference between market and political accountability, our analysis relates back to Streeck's critical view on the gradual shift from the tax state to the debt state. For Streeck, the shift from the publicly dominated tax state to the privately dominated dependence on markets is undemocratic, since the emergence of private creditors as a second constituency alongside national citizens requires public officials to balance between maintaining the loyalty of their citizens while at the same time preserving the confidence of private investors.[51] This contrasts with the finding of this study: starting from the vast body of literature that has spotlighted the democratic issues emerging from abandoning market exposure in sovereign debt financing,[52] this study argued that market accountability poses fewer issues from a democratic perspective, for it avoids the inevitable intrusions into national sovereignty that result from borrowing at preferred terms from EU bodies or other Member States. Clearly, market accountability comes with its own specific risks, which is why it is necessary to adopt an institutional framework that contains and combats the risks of market irrationality or Black Swan events. Ultimately, when properly managed, markets thus appear to be more compatible with responsible accountability and policy founded on a chain of legitimacy and stems from the citizenry.

[51] Streeck, Buying Time, 2014, p. 79.
[52] *Supra* notes 2 and 3.

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