EU Policy Brief
FEBRUARY 2021 Issue #6 Centre for European Studies

The EU's new regime for rule-of-law conditionality to protect the budget: Will it make a difference?

Nanette Neuwahl, Université de Montréal

Summary

* *Regulation 2020/2092 establishes a new system of rule-of-law conditionality to protect the EU budget. The Regulation cannot directly remedy democratic backsliding in member states like Hungary and Poland, but it ensures that the EU will not contribute to the problem by making it lucrative. However, there are still many open questions on how the Regulation will be interpreted.*

Background/Challenge

- Regulation (EU, Euratom) 2020/2092 of 16 December 2020 on a general regime of conditionality for the protection of the Union budget is part of the EU's budgetary provisions for 2021-2027. It applies in particular to the COVID crisis financing instrument.
- The Regulation was passed, in part, to address concerns about the rule of law in some member states, especially Hungary and Poland. In the European Council, it was made a precondition for agreement on the Multiannual Financial Framework Regulation and Own Resources Decision.
- Regulation 2020/2092 creates a system for "sanctioning" member states that do not adequately protect the EU's financial interests. This applies when rule of law breaches in a member state "affect or seriously risk affecting the sound financial management of the Union budget or the protection of the financial interests of the Union" [Article 4]. It targets fraud and corruption, but it also mentions generalized deficiencies of a member state's rule of law protection [Article 3].
- The Commission still has to adopt application guidelines in consultation with the member states. The European Council has asked not to finalize such guidelines should an action for annulment against the Regulation be filed, until the Court of Justice of the EU (CJEU) has delivered its judgment.

KEY FINDINGS

◊ Regulation 2020/2092 enables **measures suspending payments** to the member state concerned. These can be adopted through implementing decisions, which the Council can pass using Qualified Majority Voting on a proposal from the Commission. Sanctions can be imposed when a risk to EU financial interests is established and the budget is affected in a sufficiently direct way. The Regulation is based on the powers of the Council and the Commission to establish and implement the budget [Article 322 TFEU].

◊ The Regulation **adds to the existing toolkit of the EU institutions against rule-of-law backsliding**. Article 7 TEU, the procedure on responding to breaches of EU values, has high thresholds, and sanctions require a near unanimous vote. Poland and Hungary tend to prevent that from happening. The new procedure applies when the EU's financial interests risk being affected, without it being necessary to establish the circumstances that would trigger Article 7 TEU sanctions ("serious and persistent" breach of EU values).

◊ Some **ambiguities in the application of the Regulation** still need to be addressed. The Regulation can be applied effectively only in case of a real and direct link between the action or inaction contested and particular EU expenses concerned. Normally the Regulation cannot be used to sanction a government's interference with civil society, media pluralism, or academic freedom. However, failing to involve stakeholders in the distribution of EU funds might be construed as being directly related to the EU's financial interests.

KEY FINDINGS (continued)

◊ One may ask if the Commission needs to wait in applying the Regulation until expenses earmarked for a member state are put at risk, or if it can refrain from considering applications for disbursements by a member state on account of the fact that it has general deficiencies as regards the rule of law. Such **ex-ante conditionality** risks going beyond the issue of sound financial management as a general principle of EU law, which arguably covers only individual cases of fraud, corruption, and inaction on the part of a member state. Establishing an abstract link between rule-of-law deficiencies and the embezzlement of funds might give rise to disproportionate action.

◊ In *Italy v. Commission* (Cases T-99/09 and T-309/09), Italy challenged the Commission's power to provisionally deny funding under a waste directive, although it was under scrutiny by the CJEU for the absence of a general waste management plan. The CJEU ruled that the Commission could halt the payment of installments without having to show that the financing posed a concrete threat to the budget. It just had to show that there was a link between the facts and the risk of affecting the budget. If this case-law applies by analogy, the **Commission has a certain discretion**. This would work even in cases where respect for the national identity of a country is invoked (*Commission v. Poland*, Case C-619/18).

◊ If the Commission is in a creative mindset, it may present a proposal to the Council based on **several complaints against the same member state**, arguing that the combined effect of all mishaps is bigger than the sum of all smaller problems, because it has a direct impact on the willingness of other member states to contribute to the budget in the future.

◊ If the Commission does not act, the **European Parliament can put pressure on the Commission**. It can ask questions, issue resolutions and organize an urgent debate. Some MEPs are even threatening to go to the CJEU in an action for failure to act. Of course, member states have a right to be heard before action is taken against them.

Policy Implications

◊ It is still unclear when Regulation 2020/2092 can begin being applied. Hungary is expected to challenge it before the CJEU in an action for annulment under Article 263 TFEU. If it does, this may delay the application of the Regulation. The CJEU may decide on this action under an expedited procedure. The admissibility of an expedited procedure is the prerogative of the CJEU. Article 133 of the CJEU's Rules of Procedure provides that, on an exceptional basis, the President of the Court can take such a decision of its own motion, after hearing the parties to a dispute, considering that the general elections in Hungary will be in 2022.

◊ Annulment action does not mean that the Commission will not be able take any measures if a country channels EU funding into the hands of fraudsters. It would act in the way it would normally do when EU money is not being spent correctly. It might for instance refuse to pay installments if it appears that a particular project is not being completed as promised. This may be less publicized but it still is a valid policy.

Further Reading

Nanette Neuwahl and Charles Kovacs (2020), "How the EU can better protect the rule of law in its Member States", https://blogs.lse.ac.uk/europpblog/2020/05/08/how-the-eu-can-better-protect-the-rule-of-law-in-its-member-states/

Nanette Neuwahl and Charles Kovacs (2020), "Hungary and the EU's rule of law protection", *Journal of European Integration* 43(1), 17-32.

Author Information

- Dr. Nanette Neuwahl is guest professor at Université de Montréal, Canada.
- Email: nanette.neuwahl@umontreal.ca

Contact

- **Email:** ces@carleton.ca
- **Phone:** (613) 520-2600, Ext. 1087
- **Website:** www.carleton.ca/ces

With the support of the Erasmus+ Programme of the European Union

The Jean Monnet Centre of Excellence at Carleton University is supported by the Erasmus+ Programme of the European Union. The European Commission's support for the production of this publication does not constitute an endorsement of the contents, which reflect the views only of the authors, and the Commission cannot be held responsible for any use which may be made of the information contained therein.