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Money for Nothing? Freezing EU Funds to Generate Compliance with EU Values

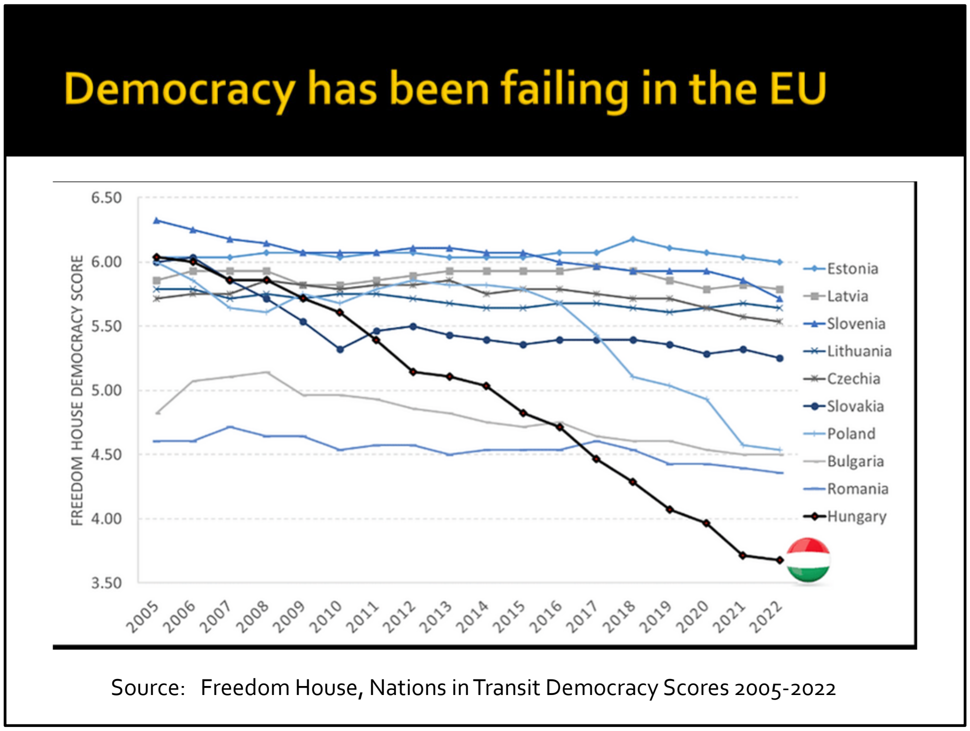
The EU as a Union of liberal democracies

Treaty of the European Union, Article 2

The Union is founded on the values of respect for **human dignity, freedom, democracy, equality, the rule of law and respect for human rights**, including the rights of persons belonging to minorities.

These values are common to the Member States in a society in which pluralism, non-discrimination, tolerance, justice, solidarity and equality between women and men prevail.

Over the last 13 years, the basic values of the European Union have been tested by the growing presence inside the Union of Member States that are no longer committed to democracy, human rights and the rule of law. With anti-democratic parties on the rise across Europe, and not just in the newer democracies of the EU's eastern flank, the values crisis is existential – and with European elections this year, 2024 poses many dangers. What can the EU do to preserve its identity as a Union of liberal democracies, as Article 2 TEU promises?

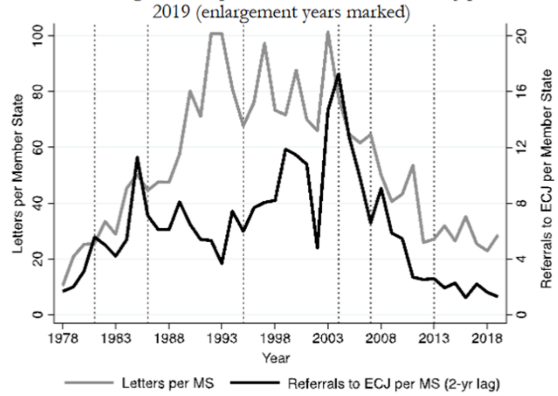


All democracy rating institutions (Freedom House, V-Dem, the Economist Intelligence Unit and even the European Parliament) have agreed that Hungary is no longer a democracy. Hungary's fall from one of the strongest democratic performers to a "hybrid authoritarian regime" in just a decade has been stunning. Poland started its slide after the 2015 election of the PiS party, but with the fall 2023 elections restoring a pro-democratic party to power, we can expect a democratic recovery, though not necessarily an easy one given that PiS holdovers still occupy blocking positions on democratic reform.

But the Commission has generally failed over the last decade to bring democratically failing Member States back into the fold. Worse yet, it has allowed all violations of EU law to slide. So for example, while Romania and Bulgaria always lagged behind and so entered the European Union under the special arrangements of a Cooperation and Verification Mechanism, the Commission in 2023 decided to end the enhanced monitoring under the CVM without substantial improvements in the overall democratic health of either country.

Democracy scores dropped while the Commission abandoned its role as Guardian of the Treaties

Figure 2: Commission Infringements Opened and Referred to the ECJ per Member State, 1978-2019 (enlargement years marked)



Notes: Vertical lines denote enlargement years. Referrals per member state are lagged by 2 years given that it takes approximately 2 years for a letter of formal notice to result in a referral.

Source: R. Daniel Kelemen and Tommaso Pavone, Where Have the Guardians Gone? World Politics, 2023.

Over the last two decades as the rule of law crisis has intensified, the Commission has spectacularly failed to enforce EU law through infringement procedures. This chart shows (on the left axis) the number of infringements opened per Member State since 1978. On the right axis, the number of referrals to the Court of Justice is tracked. Starting with the Barroso Commission, and continuing through the Juncker and von der Leyen Commissions, enforcement actions precipitously dropped.

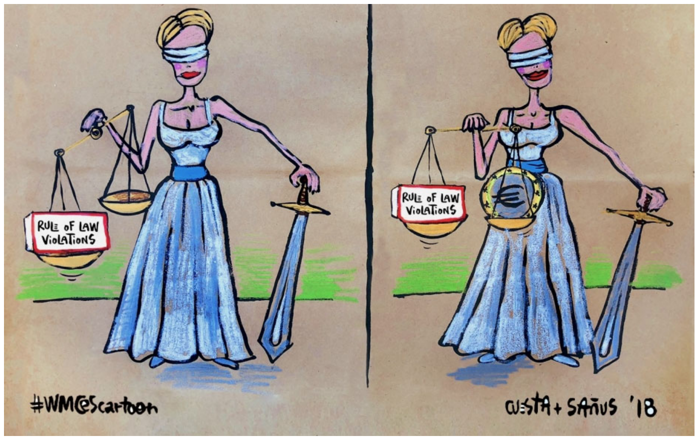
Interviews done by Dan Kelemen and Tom Pavone have indicated that the Commission deliberately de-prioritized EU law enforcement in order to get Member States onside for its political initiatives, leaving the direct enforcement of EU law in free fall. During precisely this period, however, the “rule of law crisis” emerged in Europe, as the government of Hungary that came to power in 2010 and the government of Poland that came to power in 2015 flaunted EU law in the most fundamental ways and yet were rarely challenged by the Commission.

The EU is now at the point where rogue states are emboldened to sabotage the EU from within

How can the EU restore EU values in its Member States?

The EU is now at the point where rogue states are emboldened to sabotage the EU from within. **How can the EU restore EU values in its Member States?**

A new approach to the rule of law crisis: Freezing EU funds to rogue states



In the last days of the Juncker Commission, as the EU began to prepare its multi-annual financial framework for 2021-2027, the Commission floated the idea of a new "Conditionality Regulation" that would make receipt of EU funds conditional on honoring Article 2 TEU values.

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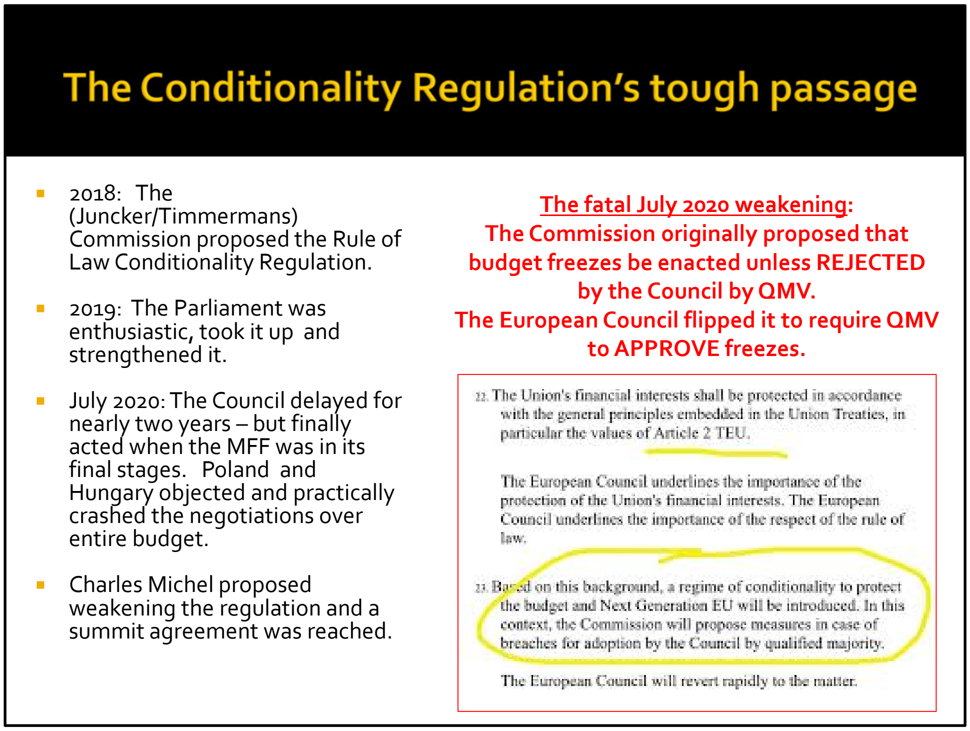
The proposal came as part of the new Multi-Annual Financial Framework and associated legislation

- The **Multi-Annual Financial Framework** (aka "the budget" or the MFF) – the first post-Brexit budget for 2021-2027. **Required EUMS unanimity** + Parliament.
- The **Recovery and Resilience Fund** (aka "NextGen" Fund) – filled Brexit budget hole and provided extra funding above the MFF for special projects originally conceived as coronavirus mitigation. **Required EUMS unanimity** + Parliament.
- The "**Own Resources**" agreement – how the EU paid for the Recovery Fund by issuing debt in the EU's own name. **Required EUMS unanimity** + Parliament.
- The **Common Provisions Regulation** – passed with every budget, the CPR outlines conditions for proper spending of EU funds by EUMS and provides the Commission with tools for clawing back misspent money. **Ordinary legislation to be passed by QVM** + Parliament.
- The **Rule of Law Conditionality Regulation** – provides a mechanism for ensuring that EU funds are spent properly when "rule of law" issues threaten such spending. **Ordinary legislation to be passed by QMV** + Parliament.

The idea to use funding freezes as a way of pressuring EU Member States to come into line with European values was hard-wired into the negotiations over the Multi-Annual Financial Framework (a.k.a. the budget). The new budget process was unusually complicated because a) Brexit left a hold in the basic budget, b) the German Constitutional Court had foreclosed European Central Bank using accounting tricks as a way of making up the shortfall, c) the pandemic left many Member State economies precarious. The revolutionary solution involved creating a Recovery and Resilience Facility funded by issuing EU debt, and this required unanimous passage of two new agreements – one establishing the Recovery and Resilience Fund and the other requiring all EU Member States to sign onto an "own resources" agreement to underwrite this new budgetary authority . Those two agreements were required above and beyond the basic MFF itself. All three of those funding authorizations required unanimous votes in the Council.

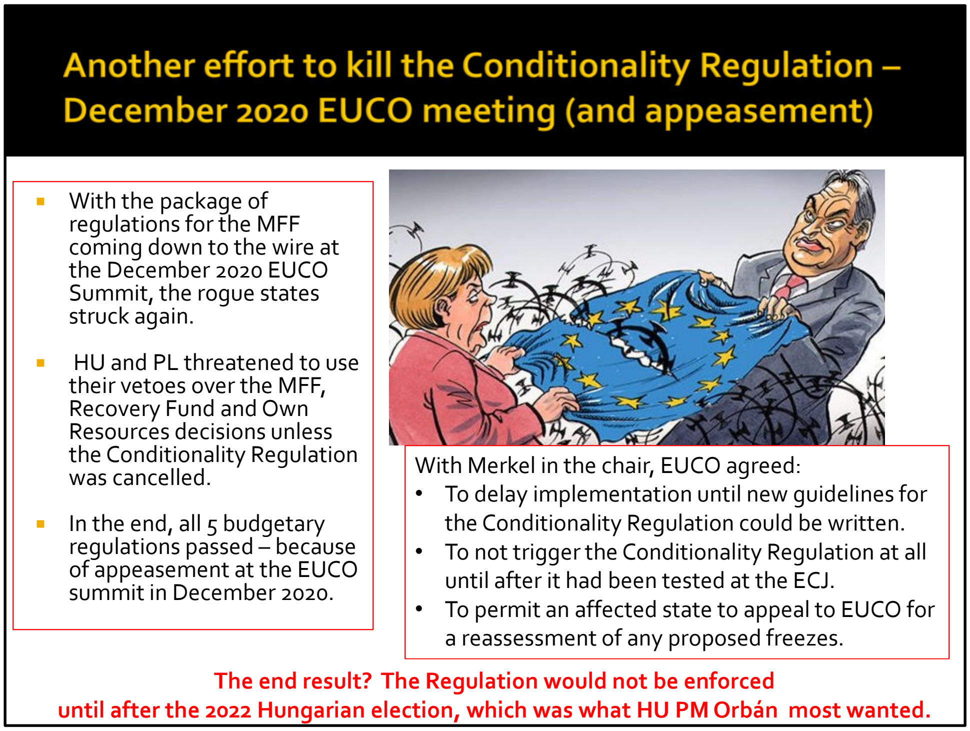
As with previous budgets, the new budget was to be accompanied by a reissuing of the Common Provisions Regulation, which specifies detailed accounting standards for spending EU funds and provides for claw-backs of misspent funds. The CPR is passed with a QMV vote in the Council.

And then there was the Conditionality Regulation. The Commission's new Conditionality Regulation would permit *all* EU funds to be withheld from Member States as long as they had unaddressed rule of law problems that affected the proper spending of EU funds. The Conditionality Regulation was strenuously opposed by the rogue states – Hungary and Poland – but they could not block the regulation because it required only QMV for passage. These five regulations proceeded through the legislative process together and ultimately the rogue states attempted to use their vetoes on the MFF, Recovery Regulation and Own Resources decisions to leverage change on the Conditionality Regulation.



While the Commission had proposed the Conditionality Regulation in 2018 and the Parliament in 2019 had eagerly suggested measures to strengthen it, the Council avoided engaging the proposal until the very last minute before the budget had to be approved in 2020.

In July 2020, the rogue states weakened the regulation at the EUCO summit when the Council agreed to water down the Commission's proposal by requiring an affirmative QMV vote for the Council to approve Commission recommendations of funding freezes for rule of law violations instead of sticking with the proposal that Commission recommendations would go into effect absent a QMV ***veto*** from the Council. The Conditionality Regulation thus proceeded toward passage, but battered.



With the package of regulations for the MFF coming down to the wire at the December 2020 EUCO Summit, the rogue states struck again. Hungary and Poland threatened to use their vetoes over the MFF, Recovery Fund and Own Resources decisions unless the Conditionality Regulation was dropped. In the end, all 5 budgetary regulations passed – because of appeasement at the EUCO summit in December 2020.

With Merkel in the chair, EUCO agreed:

- To delay implementation of the Conditionality Regulation until new guidelines for its use could be written.
- To not trigger the Conditionality Regulation at all until after it had been tested at the ECJ by Hungary and Poland.
- To permit an affected state to appeal to EUCO for a reassessment of any proposed freezes, thus building in another stage of appeal.

The end result? The Regulation would not be enforced until after the 2022 Hungarian election, which was what Hungarian PM Orbán most wanted. And so Hungary and Poland voted no on the Conditionality Regulation but they agreed not to block the unanimity files. The Conditionality Regulation passed by QMV.

What does the Conditionality Regulation 2020/2092 do?

On one hand, **the definition of rule of law values is expansive** including principles of

- Legality
- Legal certainty
- Prohibition of arbitrariness
- Effective judicial protection
- Separation of powers
- Non-discrimination
- And ALL OTHER ARTICLE 2 TEU VALUES

(Article 2,
Conditionality Regulation)

On the other hand, funds can only be frozen if the violation of rule of law values interferes directly with

"the sound financial management of the Union budget or the protection of the financial interests of the Union."

(Article 3,
Conditionality Regulation)

The Regulation survived various rogue states' attempts to weaken it, but it was changed from encouraging rule of law through financial freezes to protecting the EU budget if threatened by rule of law problems. ***In short, the reason for its existence was inverted during the legislative process.***

On one hand, **the definition of rule of law values is expansive** including a wide-ranging set of principles like effective judicial protection, separation of powers and the prohibition of arbitrariness and it explicitly included not only the rule of law narrowly conceived, but the protection of all EU values in Article 2 TEU. Any of these violations can provide a reason to freeze funds.

BUT, funds could only be frozen if rule of law problems had a strong nexus with the budget. Any proposal to freeze EU funds for rule of law violations had to demonstrate that the funds were likely to be misspent as a direct result of these rule of law issues. So it can't just be that a Member State that destroys judicial independence has its funds frozen. Funds can be frozen only if a lack of judicial independence leads directly to misspending funds. Thus, a regulation that started off with the goal of protecting the rule of law by freezing funds as an incentive to correct the rule of law problems turned into a regulation that only protects EU funds if they would otherwise be misspent for rule-of-law reasons. The rationale of the regulation was therefore inverted as the legislative process continued to be battered by the rogue states demanding concessions.

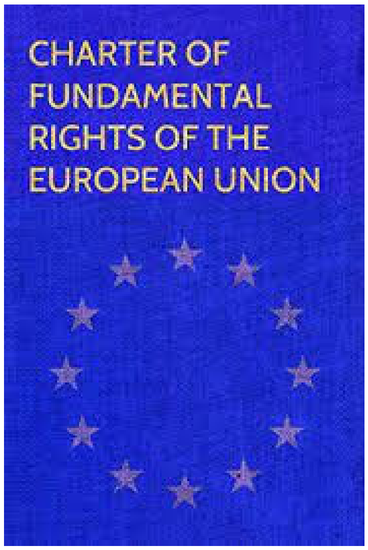
But the Conditionality Regulation has less well-publicized company . . .

The 2020 **Recovery and Resilience Fund Regulation 2021/241**
was enacted with a different conditionality framework!
EU funds can be frozen for violations of "**country-specific recommendations**" growing out of European Semester macroeconomic assessments.

Since 2019, however, the Commission had been putting ***rule of law*** conditionalities related to judicial independence into the country-specific recommendations for Poland and Hungary.
And they had also included anti-corruption recommendations in the country-specific recommendations for Hungary.

While the Commission appeared to concentrate on the Conditionality Regulation as the leading instrument for tying rule of law concerns to the budget, it managed to sneak into other regulations other even stronger conditionalities on funding. The distribution of funds under the Recovery and Resilience Fund (RRF) was made conditional on Member States making progress toward realizing the "country-specific recommendations" that grow out of the European Semester macroeconomic assessments. Since 2019, however, the Commission had been putting ***rule of law*** conditionalities related to judicial independence into the country-specific recommendations for Poland and Hungary. And they had also included anti-corruption recommendations in the country-specific recommendations for Hungary. So unbeknownst to the rogue states that did not object to this feature of the Recovery and Resilience Regulation as it was going through the legislative process, rule of law conditionality snuck in the back door in this new regulation. RRF funds can only be distributed to countries making progress on their country-specific recommendations – which now includes rule of law conditionalities for both Hungary and Poland!

The new Common Provisions Regulation 2021/6010 also now includes conditionality . . .



The 2021 changes to the **Common Provisions Regulation** explicitly allow funds to be withheld . . .

if the Member State violates **the Charter of Fundamental Rights** while spending EU funds [Article 9(1)].

In addition, the Common Provisions Regulation that was written to accompany the 2021-2027 MFF also was amended along the way to include conditionality. Here, too, the rogue states – preoccupied as they were with weakening the Conditionality Regulation – did not seem to notice that all funds covered by the CPR were now subject to explicit conditionality on fundamental rights. CPR conditionality is easier to turn on and off because it involves only the Commission and not the Council. If the Commission assesses that EU funds are in danger of being spent without fundamental rights compliance, the Commission could withhold the funds. The CPR applies to almost all funds except agricultural funds that are otherwise part of the Multi-Annual Financial Framework.

Suddenly, there were THREE conditionality frameworks in place to freeze EU funds!

Conditionality Regulation	Recovery and Resilience Regulation	Common Provisions Regulation
Rule of law conditionality with broad definition of the rule of law	Country-specific recommendation conditionality (macroeconomic conditions)	Fundamental rights conditionality
Recommended by the Commission, must be approved (and later reversed) by Council in QMV decision.	Recommended by the Commission, must be approved (and later reversed) by Council in QMV decision.	May be assessed and implemented solely by the Commission; also may be ended solely by the Commission.
Applies to all EU funds	Applies to RRF funds only	Applies to nearly all funding streams except agriculture and RRF, including cohesion funds.

And with this flurry of legislation, suddenly, there were THREE conditionality frameworks in place to freeze EU funds! The three different conditionality frameworks are not identical. The Conditionality Regulation with its explicit rule of law conditions applies in principle to all EU funds, upon recommendation of the Commission confirmed by QMV at the Council. The RRF conditionality with its macroeconomic conditions (including some rule of law conditionalities) only applies to RRF funds. Freezes are recommended by the Commission, approved by QMV at the Council. The Common Provisions Regulation applies to nearly all funds *except* agricultural funds and RRF funds, and the Commission does not need Council approval to withhold funds under this regulation. And, for that matter, under the CPR, the Commission does not need Council agreement to allow the funds to flow again.

The conditionalities in action!

Conditionality Regulation	Recovery and Resilience Regulation	Common Provisions Regulation
HUNGARY: In December 2022, the Commission recommended, and the Council approved withholding €6.3 billion from 3 cohesion programs, pending successful installation of a new anti-corruption program.	**HUNGARY**: In December 2022, RRF proposal was approved contingent on meeting milestones including strengthening judicial independence and fighting corruption. All €5.8 billion are presently blocked.	**HUNGARY**: The Commission froze all €22 billion available under the CPR, pending changes strengthening judicial independence, academic freedom, LGBTIQ+ rights and asylum protections.
POLAND: Not invoked.	**POLAND**: In June 2022, RRF proposal was approved contingent on meeting judicial independence milestones. All €35.4 billion are presently blocked.	**POLAND**: The Commission informally froze all €75 billion in Cohesion Funds. Plus the Commission deducted €1.5 million/day in fines for noncompliance with ECJ decisions.

After all of the fuss over the Conditionality Regulation, it was invoked in December 2022 to withhold only €6.3 billion and only from Hungary for reasons of corruption. The Commission triggered the Conditionality Regulation against Hungary right after the April 2022 Hungarian election, went through all of the stages in the law that gave Hungary a chance to comply before a funding freeze – but Hungary did not do enough to meet the Commission's concerns. So the Council voted in December 2022 on the first ever funding freeze for rule of law related problems. Once the Council acted, the dam broke on all of the other conditionalities.

In December 2022, the Commission recommended to the Council to freeze all of Hungary's RRF funds pending creation of an anti-corruption program and pending the strengthening of judicial independence. And at the same time, the Commission on its own initiative also froze all €22 billion in funds covered by the Common Provisions Regulation, citing lack of judicial independence, incursions on academic freedom, violations of LGBTIQ rights and noncompliance with ECJ decisions on asylum. All told, in December 2022, the Commission – backed by the Council on the Conditionality Regulation and RFF funding – froze about €30 billion in EU funds to Hungary, pending substantial reforms.

With Poland, the situation is murkier because not all of the Council implementing decisions have been published. The Conditionality Regulation was never invoked for Poland. But in June 2022, the Commission approved Poland's RRF funds with conditionalities related to judicial independence that did not fully enforce all ECJ decisions against Poland. As a result, there was a political backlash from the Parliament and rule of law defenders and five commissioners publicly dissented from the decision. The Commission has since acted as if all ECJ decisions must be honored before funds will be restored in excess of the formally agreed "milestones." So in practice, all RFF funds to Poland have been frozen, with the approval of the Council, ever since.

In the meantime, in December 2022, the Commission froze all funds for Poland covered by the CPR for violations (we assume) of judicial independence under Art 47 CFR even though no official documents explain the rationales. Our information is based on interviews with the Commission and news reports.

Lowering the fiscal boom on HU and PL

- Since December 2022, the EU has been withholding about €30 billion from Hungary because of corruption, lack of judicial independence and violation of academic freedom, asylum and LGBTIQ rights.
- Since December 2022, the EU has been withholding €110 from Poland because of lack of judicial independence and violation of gender equality and LGBTIQ rights.

Since December 2022, the EU has been withholding about €30 billion from Hungary because of corruption, lack of judicial independence and violation of academic freedom as well as asylum and LGBTIQ rights.

Since December 2022, the EU has been withholding €110 from Poland because of lack of judicial independence and violation of gender equality and LGBTIQ rights.

Do funding freezes work to change facts on the ground? POLAND

- Once the Recovery Funds were frozen in June 2023, the government acted to get the money back.
- It reformed the Disciplinary Chamber of the Supreme Court which had been punishing judges for turning to the ECJ with preliminary references and otherwise criticizing the judicial reforms. The ECJ had found Poland in violation of EU law for this.
- The Commission quickly saw through the Potemkin reforms and did not approve them.
- The funding freezes remained.

After this, the government stopped attempting reforms and thumbed its nose at the Commission, refusing to do anything that the Commission asked.

In Poland, once the RFF was frozen in June 2023, the government changed the status of the much-contested Disciplinary Chamber of the Supreme Court, which had been punishing judges for turning to the ECJ with preliminary references and otherwise criticizing the judicial reforms. So the Polish government appeared to comply. But the Commission quickly saw that the changes were merely cosmetic and did not approve them.

The funding freezes remained. After this, the government stopped attempting reforms and thumbed its nose at the Commission, refusing to cooperate at all.

Poland, election 2023: A return to Europe!

- The Polish elections in October 2023 turned largely on whether the opposition's promise of a "return to Europe" won over the voters, in the face of these funding freezes.
- Donald Tusk, former EU Council President, was elected Prime Minister. He immediately met with EU officials to discuss unfreezing funds for reforms.
- Was the election proof of success of the funding freezes? It could well have been!
- The tricky part now is *when* the EU releases the money to Poland as the new government will have trouble reforming the system over the twin vetoes of the legacy PiS president and the packed Constitutional Tribunal.

The Polish elections in October 2023 turned largely on whether the opposition's "return to Europe" platform attracted voters to reject the incumbent government that had run Poland into trouble with the EU.

In the end, Donald Tusk, former EU Council President, was returned as Prime Minister, and as a first effort, he met with EU officials to discuss unfreezing funds for reforms.

Was this a success of the funding freezes?   It could well have been!

The tricky part now is *when* the EU releases the money to Poland as the new government will have trouble reforming the system over the twin vetoes of the legacy PiS president and the packed Constitutional Tribunal.   If the EU releases the money to Poland based on an unfulfilled promise, Hungary will scream that there are double standards.

Starting in mid-2022, as funding freezes under the Conditionality Regulation were first threatened, HU government frantically passed a set of laws appearing to comply. These laws established a new anti-corruption agency and a set of new anti-corruption measures, but the EU quickly saw through it as empty.

In 2023, the Hungarian government also reformed the judiciary with a plan negotiated behind closed doors with the Commission leaving out the domestic opposition. This enabled the Hungarian government to set the terms of the reforms without knowledgeable people at the table who could have explained what changes would really have made a difference. Hungary enacted promised the judicial reform in May 2023, but it does not restore the independence of the judiciary. The Commission gave HU too much credit for having done what the Commission asked.

Blackmail – again?
The EUCO scandal December 2023

Buying Orbán's vote for EU accession for Ukraine and for new funds for Ukraine.

Orbán agreed on the first by leaving the room and allowing a vote in his absence, but insisted on getting the rest of the money before agreeing to a revision of the budget.

- Faced with two unanimity files that the Commission was desperate to push through the Council in December 2023, the Commission declared success of the judicial reforms two days before the EUCO summit and gave Orbán €10 billion from the CPR-withheld funds.
- **It turned out to be money for nothing.**

But the Hungarians are now demanding "their money! And they are not above using blackmail to achieve their goal.

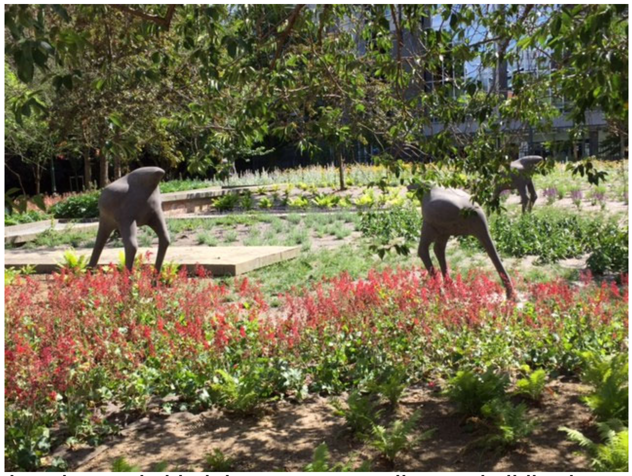
Faced with two unanimity files that the Commission was desperate to push through the Council in December 2023, the Commission declared success of the judicial reforms two days before the EUCO summit and gave Orbán €10 billion for having met the required milestones under the CPR withholdings.

Orbán agreed to permit Ukrainian accession to the EU – but not by actually voting for it. Instead, he left the room and allowed a vote to proceed in his absence, but he then vetoed a revision of the EU budget that would have given the Commission more money for collective projects, including urgent funding to help the Ukrainian war effort.

At the December EUCO summit, Orbán's chief political aide made clear that Hungary would not agree to a revision of the EU budget until it receives ALL of the funds that are presently frozen. As we speak, the EU is developing a workaround facility that will allow it to fund Ukraine without Hungary's vote. But reform of the EU budget in midstream cannot proceed around Orbán's veto.

So the EU gave Orbán €10 billion for nothing. And the Commission's cave-in on the CPR funds signaled that blackmail works.

The main problem isn't lack of tools, but lack of political will to use them



Ostrich sculptures behind the European Parliament building in Brussels. Will the EU institutions have the courage to hold the line and insist on no money to Hungary as long as it fails to honor EU values?

As long as the Commission and Council do not old fast on the rule of law, it will get more of what it has just experienced. The EU institutions are vulnerable to blackmail by a rogue states whose funds are withheld unless the institutions prioritize rule of law matters over all others – and are willing to develop workarounds to vetoes on unanimity files to escape the blackmail.

At the end of a Commission presidency, however, with President von der Leyen desperate for accomplishments to mark the end of her term and with the Commission eager to close as many files as possible, the chances that the EU will hold the line in maintaining these funding freezes against Hungary through the EU elections in June are not very high.

And there is more danger ahead:

France	January-June	2022
Czech Republic	July-December	2022
Sweden	January-June	2023
Spain	July-December	2023
Belgium	January-June	2024
Hungary	July-December	2024
Poland	January-June	2025
Denmark	July-December	2025
Cyprus	January-June	2026

From July through December 2024, the rotating presidency of the Council will be in the hands of Hungary,

which can use its agenda-setting leverage to blackmail the EU into restoring its funds in exchange for no meaningful reform.

Hungary will also have an important seat at the table after the EU elections as the top jobs are being distributed. So – EU beware!

And there is more danger ahead! From July through December 2024, the rotating presidency of the Council will be in the hands of Hungary, which can use its agenda-setting leverage to blackmail the EU into restoring its funds even if it has not substantially restored the rule of law. Hungary will also have an important seat at the table after the EU elections as the top jobs are being distributed. So – EU beware!

{There's another story to be told about how the EU could have – but didn't – ensure that Hungary would not have autonomy in its Council presidency but the other two member states in its Troika – Spain and Belgium – were not interested in exercising control over their troika partner. So Hungary will have free rein to control the Council agenda and use its blackmailing power in an unlimited way in the second half of 2024.]

So – do funding freezes succeed in restoring the rule of law?

Funding freezes appeared to generate a flurry of compliance activity by rogue states, but The reforms were superficial and not major enough for substantial change. Plus the EU has so far not held the line until it gets results. Political will is still weak.

Viktor Chernomyrdin, former prime minister of Russia under Boris Yeltsin, once said: We tried to do better but it turned out as usual. And, with regard to funding freezes in the EU, so far we might say the same. Funding freezes can be a powerful tool, but they require political will. And given the structure of the EU, with so many unanimity files and the ever-present opportunity for blackmail by rogue states, holding out for real rule of law reform will not be easy.

Not the end. Not yet.