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The Rule of Law in the EU Budget

Backing Down Is Too High a Price for the EU to Pay

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Hungary and Poland are threatening to veto the EU's new budgetary arrangements if other governments apply the rule of law mechanism to them. It is becoming clear, however, that the new EU financial framework, and the much-heralded recovery fund, are more vital to Eastern Europe than to Europe's South and that time is not on the side of the former. Awareness of this fact allows for a cool assessment of the pair's bargaining positions – and of the precedent that any hasty resolution to the crisis will set.

- Since the 2021 EU budget can be agreed even without the new multiannual framework, time is, in fact, on the side of a maximalist EU position. It is eastern members like Hungary and Poland, rather than southern members, that most need money.
- Warsaw and Budapest's need for EU cohesion funds is not the only reason why the duo has a weaker hand than meets the eye. They are both facing a backlash at home – from voters and their neighbors in Central Europe.
- The temptation for other members to settle the matter with a quick fix is nevertheless large, not least because the budgetary process is complex and the rule of law mechanism itself has its flaws.
- Of the three basic options available to the other member states, though, the time has surely come to pick the most principled one – meaning forging ahead without Poland and Hungary if they do not back down.

When Poland and Hungary signaled their intention to veto the adoption of the Recovery and Resilience Fund (RRF) and prevent its use as a vehicle for asserting the rule of law in Europe, they seemed to hold all the cards. Huge economic and political pressures would surely divide the other member states and eventually steer them towards compromise. If they only bent to Budapest and Warsaw's demands, the other members would be able to do three key things:

- Ensure the adoption of a clear new 2021 budget before the current Multiannual Financial Framework (MFF) ends;
- Help Germany claim success for its six-month presidency of the Council of the European Union; and, above all,
- Allow for the rapid disbursement of the RRF grants into Europe's – particularly, Southern Europe's – hard-hit economies.

The reality, however, is that none of these three considerations imposes hard deadlines. The member states can adopt an annual budget for 2021 within the current MFF ceilings and under qualified majority voting (with the possible additional benefit of being able to tweak existing spending programs and rebates). This means that a final deal on the new multiannual budgetary package could be concluded in the first part of 2021 under the EU Council presidency of Portugal – a resilient southern member state and one more likely to take a clear line toward Poland and Hungary than their (near) neighbor Germany.

Furthermore, while it is certainly urgent for public spending in Europe to pick up if the EU is to blunt the economic consequences of the COVID-19 crisis, the reality is that the bulk of that recovery effort will remain national. Whether the RRF becomes effective in early 2021 or early 2022 does not alter the fact that domestic budgets will be the primary vehicles of recovery. Indeed, so long as the European Central Bank provides a backstop to national government borrowing, the prime virtue of the RRF is political in character rather than economic: it signals a willingness across the EU to pool borrowing and underwrite transfers.

ECONOMIC PRESSURES MEAN HUNGARY HAS A WEAKER HAND THAN SUPPOSED

This simple reassessment of the economic and political pressures upon (southern) EU members suggests that Poland and, above all, Hungary have overplayed their hand. Budapest's brinksmanship appears to rest on the calculation that time and politics are on its side. This is incorrect. Hungary is, in fact, one of the few EU economies that depends on external financing. Its government's failure to secure EU funds in the face of growing expectations at home could be detrimental to its chances in the next election, which is due in spring 2022 at the latest.

Budapest is, of course, manufacturing precisely the kind of European standoff on which it thrives. For years now, the skilled and single-minded diplomatic apparatus of Prime Minister Viktor Orbán's government has excelled at milking these situations. But because its core motivation is, as ever, domestic politics,[1] it is ironic that Orbán and his diplomats have now misread the situation. They have attributed Hungary's own domestic weaknesses to the other member states and downplayed them at home. Orbán badly needs this international victory – and cash – to boost his chances in the next parliamentary elections.

If Hungary fails to secure external financing and keep its economy stable, the effects will start to bite long before 2022 – and not just in the worst-case scenario in which the other member states find a way to cut Hungary out of the RRF and deprive it of the EUR 17 billion it is due. The COVID-19 pandemic has hit the country harder than most, causing a calamitous 13.6 percent drop in GDP in the second quarter of 2020.[2] EU money, including the RRF, remains the sole remaining and rationally feasible option left open for Hungary. The usual options – running a deficit, devaluing the currency, or driving up inflation – are unpalatable.

The deficit in the national budget is already running at 8 to 9 percent,[3] and increasing it further is out of

1 Insofar as Budapest has a strategy here, it appears to be to secure cash from the EU (through the MFF and RRF) and notch a victory against the EU's attempts to impose conditions. By escalating the crisis, it presumably hopes the political price of blocking funds will simply become too great for the other member states. But Hungary has given few clues about the path to de-escalation that it foresees. Scrapping the rule of law mechanism is simply not feasible, yet it appears locked on a confrontational course.

2 "Pénzügyminisztérium: ellenállóbbnak bizonyult a magyar gazdaság az Európai Unió átlagánál [Ministry of Finance: Hungarian economy turned out to be more resilient than the EU average]," koronavirus.gov.hu, August 14, 2020: <https://koronavirus.gov.hu/cikkek/penzugyminiszterium-ellenallobbnak-bizonyult-magyar-gazdasag-az-europai-unio-atlaganal> (accessed November 24, 2020).

3 "Varga, Mihály: Akár egész jövő évben is elmaradhatnak az uniós pénzek [Varga, Mihály: EU funds may be halted over the upcoming year]," portfolio.hu, November 25, 2020: <https://www.portfolio.hu/unios-forrasok/20201125/varga-mihaly-akar-egesz-jovo-evben-is-elmaradhatnak-az-eu-penzek-458898> (accessed November 25, 2020).

question. Further devaluing the national currency, is no option either. The exchange rate of the Hungarian forint to the euro is already 1 to 360,[4] up from 315 in mid-2019. And credits on the open market are much more expensive than the EU's bonds would be. As for the option of fueling inflation, the annual inflation rate on certain crucial food products, such as vegetables and meat, is already above 10 percent.[5] Hungary's continued veto of the RRF will only increase the pain.

Hungary's real fear is that its bluff is called by the other member states and that they not only drive through the rule of law mechanism, but also trigger it immediately. Presumably it has a Plan B for this eventuality. Hungary might try to reopen talks on the mechanism and include the (lengthy) right of turning to the European Court of Justice for adjudication. Such an important modification is, however, unlikely to make it through either the European Parliament or the core group of member states that are strongly committed to the rule of law mechanism.

Therefore, if the other member states refuse to back down, it is hard to see how Hungary can stabilize its economy. Such economic considerations will not necessarily lead Hungarians back into the arms of the EU, of course. The 2016 Brexit referendum shows that some voters are ready to be poorer if they believe they are staving off interference from Brussels and reasserting national independence. But in the case of Hungary, the government is no longer master of these popular pressures. And that is even more true of Poland, where the government has seen its reputation among voters nosedive since September.

POLAND'S INTERNAL DIVISION

Over the summer, Polish Prime Minister Mateusz Morawiecki returned from the EU summit and announced the greatest financial windfall in the history of modern Poland – EUR 160 billion from the EU budget and the RRF, all while blocking the introduction of a rule of law mechanism. It was a big boast, and it finally came undone on November 5 when the workings of the rule of law mechanism were publicly agreed upon by the European Parliament and the German presidency. On November 12, Polish media reported that Morawiecki, like Orbán, had officially threatened to veto the EU budget.

Morawiecki's position was and is in line with the tough stance taken by Jarosław Kaczyński, the leader of the ruling Law and Justice party (PiS), and it reflects his desire to keep on Kaczyński's good side. But it is also out of character for the prime minister. Morawiecki has a reputation as a Western, conciliatory politician able to improve Poland's strained relations with the EU. Indeed, his election as Prime Minister in December 2017 was seen as an attempt to normalize relations with Brussels. PiS avoids unequivocally negative rhetoric on the EU, most often calling for dialogue or blaming a single personality (such as EU Commissioner Frans Timmermans) for a conflict with European Institutions.

In Poland and Hungary, the governments are no longer master of popular pressures.

For these reasons, Kaczyński himself views Morawiecki as his chosen successor. The trouble is that the very characteristics that make Morawiecki attractive to Kaczyński do little to bolster his popularity within PiS. Many party members are deeply suspicious of a professional biography that includes heading a large bank and advising the government of former Prime Minister Donald Tusk. This, in turn, makes Morawiecki's main rival, Minister of Justice Zbigniew Ziobro, seem more attractive. Ziobro leads the most radical right-wing faction within the ruling camp, Solidarna Polska. And, although his party enjoys little support in the polls, Ziobro is, thanks to his views and style, a much more natural successor to Kaczyński.

Ziobro sees the standoff with the EU as a way to trap Morawiecki in a lose-lose situation. If Morawiecki succumbs to Brussels, he will lose the trust of

4 Central Bank of Hungary, Official Daily Exchange Rates: <https://www.mnb.hu/en/arfolyamok> (accessed November 25, 2020).

5 Hungarian Central Statistical Office, First Releases, Consumer Prices, November 10, 2020: <https://www.ksh.hu/gyorstajekoztatok/#/hu/document/far2010> (accessed 25 November 2020).

Kaczyński and any remaining support within PiS. If he vetoes the EU budget, however, he will lose the trust of Brussels and, above all, the European funds necessary to govern Poland. In mid-November, in an apparent attempt to increase the pressure on Morawiecki, Ziobro wrote the following in an open letter to the prime minister: “The ‘rule of law’ is only a pretext to introduce the institutional and political enslavement of the Polish state (…) We would like to address to the prime minister a firm request for a veto of the Multiannual Financial Framework and the decision on the EU’s own resources.”[6]

And what of Kaczyński himself? His party has seen a steep collapse in support. From mid-2017 until quite recently, support for PiS never fell below 40 percent; now, the party polls at 27 percent. This leaves PiS neck and neck with the second-ranked Civic Platform (currently polling at 25 percent). Morawiecki’s hardline position on the budget has not helped boost PiS’s approval ratings and was seen by many Poles to threaten Poland’s withdrawal from the European Union. The pro-government newspaper Do Rzeczy recently proclaimed on its cover: “Polexit – We have the right to talk about it.”[7] In all its history, no Polish government has dared to even broach such a possibility due to the record high public support for Polish membership in the EU.[8]

And yet, it is not the crisis in relations with Brussels that is having the greatest impact on the decline in support for PiS – far from it. The party’s popularity was hit worst by the decision of the Constitutional Tribunal to almost completely prohibit the right to abortion.[9] This triggered the largest protests seen in Poland since 1989. And there is no doubt among voters that the decision was ordered by Jarosław Kaczyński himself. This move by Kaczyński is surprising in the context of the ongoing coronavirus pandemic, the second factor behind the collapse of support for PiS. The government has been accused of sleeping through the summer holidays and failing to adequately prepare for a second wave of COVID-19 – failings that have been compounded by the lack of health care reform, which PiS abandoned in favor of direct social transfers.

Here then, is a government in turmoil. Leading politicians are growing ready to use the EU as a political football to deflect from domestic concerns, but they are likely to see it rebound and hit them. Although support for European integration is very high in Poland, this does not directly translate into votes – neither positively for pro-European parties, nor negatively for Euroskeptic parties. This is a field, in other words, in which the EU can gain more by sticking to a principled line than trying to pick winners or enter into transactions.

THE EU HAS MORE OPTIONS THAN MEETS THE EYE

But can the other member states steer the EU into taking a clear, principled line on the multiannual budget? The degree of difficulty of adopting a new MFF every seven years has been compared to that of EU treaty change. Reaching a deal on the current budgetary package will be harder still. It will require agreement on not just one bit of legislation but three:

1. **A deal on the Multiannual Financial Framework itself**
2. **A decision on the EU’s own resources**
3. **A deal on the rule of law mechanism**

Regardless of Poland and Hungary’s domestic difficulties, therefore, the two countries currently appear to have several avenues to block progress before the package even comes before the European Council for a vote. And yet, this impression is too bleak. An assessment of the three main options available to the other EU governments suggests that a principled approach is possible – if they care to take it.[10]

6 See: N.N., “Zbigniew Ziobro sent a letter to Mateusz Morawiecki. ‘Strong request’ to veto the EU budget,” Polish News, November 23, 2020: <https://www.polishnews.co.uk/zbigniew-ziobro-sent-a-letter-to-mateusz-morawiecki-strong-request-to-veto-the-eu-budget-policy/> (accessed November 25, 2020).

7 See: N.N., “‘Gorzej niż zbrodnia, myślozbrodnia’. Burza po zapowiedzi ‘Do Rzeczy’” [Worse than a crime, a thought crime. The storm after the announcement in Do Rzeczy], Do Rzeczy, November 22, 2020: <https://dorzeczy.pl/kraj/162135/gorzej-niz-zbrodnia-myslozbrodnia-burza-po-zapowiedzi-do-rzeczy.html> (accessed November 25, 2020).

8 According to the latest research by Kantar, as many as 87 percent of respondents want Poland to remain in the European Union; only 8 percent are of the opposite opinion. See: Joanna Jakubowska, “87% of Poles believe Poland should remain in the EU,” Euractiv, November 24, 2020: <https://www.euractiv.com/section/politics/short_news/87-of-poles-believe-poland-should-remain-in-the-eu/> (accessed November 25, 2020).

9 This ban would eliminate the right to abortion in cases in which a prenatal examination indicated a high probability of severe and irreversible impairment of the fetus or an incurable, life-threatening disease. It was inconsistent with Poland’s constitution, which allows abortion in the event of a threat to the mother’s life or rape.

10 There have been multiple analyses of the situation and options by leading experts. See, for instance: Lucas Guttenberg and Piotr Buras, “Wie die EU den Spieß umdrehen kann” [How the EU can turn the tables], Zeit Online, November 23, 2020: <https://www.zeit.de/politik/ausland/2020-11/veto-eu-haushalt-polen-ungarn-erpressung-corona-hilfen-rechtsstaatlichkeit?utm_referrer=https%3A%2F%2Fwww.google.com%2F>; R. Daniel Kelemen, “Von der Leyen is weak on rule of law,” Politico, September 21, 2020: <https://www.politico.eu/article/ursula-von-der-leyen-weak-rule-of-law/>; Daniel Hegedus, “Three EU exits from Poland and Hungary ‘hostage crisis,’” EUobserver, November 18, 2020: <https://euobserver.com/opinion/150098> (all accessed on November 25, 2020).

Option 1: Carry On with the EU Budget Negotiations and Find a Compromise

The path of least resistance seems to be for the German presidency to muddle through, searching for a means to allow Hungary and Poland to withdraw their vetoes and all sides to claim victory. There is speculation that a political declaration could provide the necessary fig leaf. Legally non-binding, but politically marketable, such a declaration would proclaim that the rule of law mechanism would not limit the sovereignty of any member state. This deal could be eased in with a transactional approach, aimed at driving a wedge between the two outliers – in particular, isolating Hungary.[11] This might involve the stick of threatening to tweak the allocation key on structural funds or the carrot of allocating the seat of the EU's new cyber center to Poland. A fudge of this kind would, however, risk the ire of the European Parliament. It could also carry severe long-term political costs now that this crisis has been defined as a test of the EU's commitment to its principles. Choosing this option would also shift the onus back to the EU's other rule of law mechanisms – Articles 7 and 19 of the Treaty on European Union, the European Public Prosecutor's Office, and the rule of law peer review – all of which have so far proved limited in their effectiveness.[12]

Option 2: Accept the Impasse and Move Toward Enhanced Cooperation

A second option would be to abandon the idea of pushing through all three pieces of the budget package together, and instead find a more piecemeal way forward. The first step would be to force a vote on the rule of law mechanism. Unlike the other two pieces of legislation which require consensus, this measure requires only a qualified majority vote in Council. Agreement there would pull the rug out from under Poland and Hungary at once. If the duo persisted in blocking progress on the other two proposals, the member states could proceed with enhanced cooperation. Enhanced cooperation allows for a sub-group of member states to cooperate on an initiative within the structures of the EU. While it is not applicable to the MFF itself, it could be used for a novel instrument like the RRF. By this means, a large coalition of member states could embed the RRF in the EU's legal framework but disburse funds only to a coalition of the willing. And yet, this would raise a number of protracted technical and legal challenges – and could certainly be met with a veto on the EU budget and the own resources, leaving the EU without a new budget in 2021.

Option 3: Agree on the RRF Under an Exclusive Intergovernmental Arrangement

The third option is to return to the idea, first proposed by France, of an intergovernmental agreement among a coalition of states for the RRF, thereby removing the veto power on its implementation. This was avoided at the time mainly because of the desire to display unity, but also because of the specter of "differentiated integration," which many capitals – in particular, Berlin – dislike. An intergovernmental agreement could well be achieved rapidly, but it would sit outside of the EU's legal framework and weaken the control of the European Parliament. It might also see governments reopen the RRF spending key and raise complicated questions about the EU borrowing on behalf of an intergovernmental vehicle. Moreover, it would not solve the question of the multiannual budget, which is a substantial part of the recovery plan. Member states did, however, successfully take this path with the Fiscal Compact in 2011 and the European Stability Mechanism in 2012. Taking it again would be an important political signal to countries tempted to ransom the EU. Poland, in particular, remains viscerally afraid of the prospect of its marginalization by the "EU core."[13]

> *The option of a large coalition forging ahead without Hungary or Poland is sub-optimal.*

11 Hungary is a small member state and relies on the much larger Poland to uphold its veto. If it had been left alone in this affair, Budapest would likely have been rather more timid.

12 On Article 19, see: Gerald Knauss, "An Article 19 Mechanism to save the rule of law in the EU," European Security Initiative Newsletter, August 5, 2020: <https://www.esiweb.org/sites/default/files/newsletter/pdf/ESI%20-%20An%20Article%2019%20Mechanism%20to%20save%20rule%20of%20law%20in%20the%20EU%20-%205%20August%202020.pdf> (accessed Novmeber 25, 2020).

13 This fear has grown following the United Kingdom's exit from the EU. When the UK left, Poland lost a strong partner that was not a member of the eurozone (or Schengen Area) and that had historically fought against the emergence of an exclusive hardcore of EU members.

THE ROLE OF THE GERMAN PRESIDENCY

Germany currently holds the EU presidency, and it has refused to behave like other countries in this role. It refused, for instance, to trumpet the MFF pre-deal in July and has instead operated with the quiet attempts at mutual accommodation that have typified its diplomacy since the financial crisis. That low-key approach considerably diminishes Poland and Hungary's hold over Berlin: it means the German presidency is not bound to tying up the MFF as a prestige project before its semester ends. This should allow it to resist the temptation for a quick fix and coolly assess the weakness of Poland and Hungary – not least their relative isolation within Central and Eastern Europe.

And yet, Berlin will likely continue with its quiet attempts at accommodation and use this critical distance to defuse diplomatic tensions and fashion a suitable compromise. After all, it hardly seems worth taking a principled stand here. The rule of law mechanism is weak and narrow – little more than a tool for preventing the misuse of the budget. A tool like the Article 7 mechanism, by contrast, which allows for a suspension of a member's voting rights, seems more germane. But such a course would be a mistake: the EU-25 cannot abandon the rule of law mechanism just because they have already watered it down – especially when dealing with a governing political class like Hungary's, which seems to care more about the flow of cash from the EU than voting rights.

This is a critical juncture for the EU, and, while other member states prevaricate, Viktor Orbán's Fidesz party has continued resolutely along its path away from liberal democracy and the rule of law. Exploiting the noise and fury of the budgetary crisis, the governing majority in Budapest has quietly pushed through a domestic electoral amendment designed to curtail the ability of opposition parties to run in the upcoming 2022 elections. And as divisions emerge between the EU-25, Polish Prime Minister Morawiecki has made a point to visit Orbán in Budapest and forge a common line – evidently in expectation of accommodation when the pair return to Brussels.[14]

But the divisions between the member states are not as great as expected. In previous years, facing disciplinary cases launched under Article 7, Warsaw and Budapest could rely on tacit support from some of their neighbors. This time, there is only criticism from them. The foreign ministers of the other two Visegrad states, the Czech Republic and Slovakia, welcomed the compromise deal negotiated by the German EU presidency and spoke out against the veto. Thus, an unintended side effect of this crisis could be a growing divide between Orbán and two – if not, three – Central European societies. And not just them. Romania's Prime Minister Ludovic Orban chastised his Hungarian and Polish counterparts, reminding them that his country, like other eastern members, sorely needs financial assistance.[15]

The other member states are well placed to call the EU-2's bluff and broach the possibility of moving ahead without them. The option of a large coalition of EU member states forging ahead without Hungary or Poland is, of course, sub-optimal. It is legally complex and may sow divisions which take years to overcome. Indeed, observers – particularly, in Poland – would say that these exclusive EU clubs are at the heart of the EU's current problems. They prevented Warsaw from properly influencing eurozone and Schengen policies, thereby pushing it into a spoiler role. And it is true that, as a vehicle of inclusive integration, the option of a coalition of the willing clubbing together may have failed. It may be better suited to be a tool of discipline.

The era of quiet accommodation and transactional deals in the European Council must surely be coming to an end. When German Chancellor Angela Merkel leaves office, it is Orbán who will take her place as the longest-serving political operator there. A face-saving fudge on the MFF – or even the assertive exploitation by the EU-25 of Poland and Hungary's asymmetrical need for EU cash – would set a poor precedent for the new era of European integration. These cannot be the only tools for resolving this crisis. A more principled stand on this vital issue of European integration is required to ensure the European Union remains a club worth belonging to.

14 N.N., "Sobolewski on Morawiecki's visit to Hungary: The goal is to establish a position on the EU budget," Polishnews, November 25, 2020: <https://www.polishnews.co.uk/sobolewski-on-morawieckis-visit-to-hungary-the-goal-is-to-establish-a-position-on-the-eu-budget-policy/> (accessed November 25, 2020).

15 It should also be noted that Slovenian Prime Minister Janez Janša, the only prime minister to express his approval for Hungary and Poland, relies on media outlets at home that are owned by Hungarian oligarchs who are reputedly close to Orbán.

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