Beyond the Veto of the EU Recovery Fund

Silvia Merler 2020-11-27T16:46:27

A rule of law (RoL) conditionality has featured prominently in the negotiations of the € 750 billion *Next Generation EU* package. Yet, the Council conclusions in July only included a vague mention of the issue – signalling that it had not been possible to strike a balance at the highest political level and kicking the can down the trialogue road.

On 10 November, the EU Parliament and the German Presidency reached a compromise on the text of a Regulation establishing a RoL conditionality mechanism for the budget. Far from being a blanket tool, this would allow funds to be suspended in case of RoL breaches *"that directly affect the budget or seriously risk doing so".* Proponents seemed to hope the Commission could be creative in finding ways to assess this risk. Opponents feared the ambiguity for the same reason, and the Hungarian and Polish PMs harshly criticised the mechanism and threatened to veto the EU budget which, unlike the Regulation, requires unanimity to be approved.

The Regulation was approved at qualified majority in the Permanent Representatives Committee shortly after, and in the same meeting Poland and Hungary vetoed the Own Resources Decision (ORD). The ORD sets out the maximum level of resources the EU budget can draw from the Member States. Increasing that limit is required for the EU to issue the bonds that will finance the flagship Recovery and Resilience Facility (RRF).

Following the veto, Poland and Hungary issued a joint statement requesting a 'substantial modification' of the mechanism. With so much political capital having been spent on linking the approval of the RoL Regulation to the budget negotiation, the EU should not weaken the language in the Regulation now. Doing so would embolden challengers to the fundamental values while alienating countries who were asking for even stricter conditions, whose vote is equally essential for the ORD. The issue will not disappear with a re-wording, rather it deserves an open confrontation at the highest political level. The key question in that confrontation is whether the veto is credible.

Is the veto credible?

Yes and No. This is a game where sequencing is key: Let's work it backwards.

If Hungary and Poland hold their veto on the ORD, the new MFF will not be approved by the end of 2020. Article 312(4) TFEU states that in such case the 2020 yearly budget (which depends on the 2014 MFF and does not include the RRF) will be rolled over to 2021. Poland and Hungary are typically net recipients from the

MFF, although their net positions could be reduced in the 2021-27 cycle. By blocking the ORD, they would be forfeiting their share of the RRF, but still get more money out of the rolled over budget than most Western EU countries. The amount of money will ultimately depend on whether the programmes within the MFF, whose legal basis expires at the end of the year, will be renewed.

As some have highlighted, the Parliament has long pushed for a decoupling of spending programmes from the MFF, to preserve the flow of funds in case of no deal on the new MFF. Indeed, trialogues on individual programmes are ongoing. Direct payments to farmers would continue anyway, as the legal acts for the first pillar of the Common Agricultural Policy are not limited on their duration.

Hungary and Poland will eventually need a deal on a *new* budget, but they are in a relatively better position to withstand a roll-over budget than countries like Spain or Italy – for which it is the RRF that makes the difference. For the veto to become untenable, it takes the combination of two things: (i) final approval of the RoL Regulation and (ii) a credible threat of a Plan B on the RRF. The first condition alters the sequence of the game: once the Regulation is approved, it will apply to *all* EU spending including any new budget as well as the emergency budget. The 'regular' EU money that Hungary and Poland receive, will be all subject to RoL scrutiny. This alone would not be enough of an incentive to drop the veto. However, if by holding the veto they could claim to be blocking the RRF as a retaliation against the conditionality, it could still make political sense domestically for the Hungarian and Polish governments to do so. To take away this incentive, the rest of the EU needs to show that there is a credible Plan B for the RRF, feasible without Hungary and Poland. At that point, the two would have failed to block the RRF for other countries, would not get any RRF funds themselves, all while still getting the RoL scrutiny on the smaller pot. There would be no way to attach a positive political spin to this, and the incentive to hold the veto would fall.

So, what is Plan B?

There are three options: enhanced cooperation; a variable Euro/non-Euro setting; and an intergovernmental solution. All these have problems and are inferior to the original plan.

Enhanced Cooperation: A qualified majority of countries could trigger enhanced cooperation, which allows a smaller group to move closer in the integration process insofar this does not endanger the rights of the others. This has been used in the past, e.g. to establish a European Public Prosecutor, the European Patent Scheme, and the Financial Transaction Tax. The group could establish the RRF by and on behalf of only those states which participate. The initiative is authorised by the Council at qualified majority, so Hungary and Poland would not muster a blocking minority.

A potential roadblock would be for them to argue that, by establishing an MFF-related instrument through enhanced cooperation, the participating countries would be violating their rights as equal members of the Union to have a veto power on budgetary matters. This seems hardly tenable, however, as any such enhanced cooperation would be the direct result of the exercise of such veto. Once the Council authorizes, the participating countries can establish (by unanimity among them) a special framework for cooperation. Within this framework, the core group would be free to choose to act by qualified majority on the governance. Since the Treaty explicitly states that once the mechanism is established the remaining countries cannot be prevented from joining, introducing qualified majority is essential. If Poland and Hungary were to join, the enhanced cooperation would fully replicate the perimeter of the MFF *but* with qualified majority voting. If the RRF were to be established through enhanced cooperation, the participating countries would need to pay for it by agreeing an ORD limited only to the participants. In a way, this creates a two-tier budget: a broad budget tier, amended by unanimity, including Hungary and Poland but no RRF, and an additional inner tier, amended by majority voting, that would be financed by the enhanced cooperation group to fund the RRF. The Commission could still issue bonds on behalf of only the Member States participating in the enhanced cooperation: the repayment would need to come from the Own Resources Decision relating to what we have called the 'inner budget'.

Special Framework for Euro countries. The special provisions for Eurozone countries may also offer an alternative for the set-up of the RRF. The legal basis would be akin to the one previously identified for the now-defunct Budgetary Instrument for Convergence and Competitiveness, i.e. the joint effect of Art. 175 (3) and Art. 136 – the former allowing for actions beyond the structural funds and the latter allowing for enhanced coordination of the economic policy of the Euro members.

The main advantage of framing the instrument in terms of Euro Area stability is that Hungary and Poland become natural outsiders, and the treaty itself provides the ground for exclusion from the governance mechanisms. As the recent position taken by Slovenia illustrates, however, limiting the perimeter to the Eurozone would not in and of itself shield the RRF from a veto – unless the Eurogroup were to explicitly embrace qualified majority decision-making. Conversely, other non-Euro Area countries who may be ardent supporters of the initiative would be naturally excluded under this framework. One way to remedy would be by complementing the tool with provisions grounded in Art. 143, whereby assistance may be provided with a temporary derogation from Eurozone membership. This however would not allow for the exclusion of Poland and Hungary, although defusing their veto power. The legal basis for autonomous Eurozone action, especially when it comes to appropriations, is clearly more blurred than in the case of enhanced cooperation. While a possibility, this would be overall inferior to enhanced cooperation, entailing higher legal risks and a much more complex set-up.

***Ad hoc* Intergovernmental Treaty:** An extreme option would be for the group of willing to take the RRF out of the EU budget, replicating it into an intergovernmental agreement. This would entail two types of complications. On the governance side, previous experiences with the intergovernmental setting have been skewed towards unanimous decision-making and complexity, including by involvement of the German Bundestag on decisions of a financial nature. To mitigate this concern, the intergovernmental agreement could carbon copy the governance structure from the July Council agreement, which already fleshed out the role of the Commission in the assessment of recovery plans and the role of the Council in assessment and disbursement. The use of an intergovernmental treaty does not automatically prevent the attribution of functions to existing Union bodies: for instance, Art. 5 of the ESM treaty provides for linkages between Union bodies and the ESM; Art. 5 and Art. 8 of the TSCG provide for a limited set of new responsibilities bestowed upon the Commission, the Council, and the Court of Justice. Hence, there is no reason why an intergovernmental treaty should not be able to bestow on a specific configuration of the Council certain competences.

Assuming that the July agreement was concluded by all signatories in good faith, there is in principle no reason why an intergovernmental transposition would require changing the governance structure to require unanimity, particularly because the July agreement already includes a safeguards in the form of an 'emergency brake'. In the intergovernmental setting, participating countries would need to set up some form of special purpose vehicle (SPV) to issue the bonds that would fund the RRF – as that task could no longer fall on the EU once the RRF is taken out of the Community framework. In the past, when dealing with the EFSF, Eurostat had stated that debt issued by an SPV should be re-routed back onto the member states' books. In the RRF case, a similar decision would nullify the key benefit from disbursing half the funds in the form of grants. A key argument in the Eurostat decision was that the EFSF only reported on its activities to the Eurogroup and was "not under the control of existing European institutions": this problem could again be mitigated by adopting the governance structure agreed in July, in which the Commission and the Council have a clear role and say on the RRF.

None of this would solve the fact that taking the RRF outside of the Community framework would also deprive the European Parliament of scrutiny rights, but providing a role for EP scrutiny is a *formal* change to the agreement that leaves the *substance* unchanged – for EP scrutiny is there automatically when the RRF is part of the MFF. Hence, there is no fundamental issue in attributing to scrutiny powers to the EP in the intergovernmental setting.

Finally, some argue that constitutional barriers exist (especially in Germany) to the construction of budgetary instruments outside the MFF. These arguments strongly rely on a literal reading of the 2013 ESM decision delivered by the *Bundesverfassungsgericht*. However, the issues raised pertain to the fundamental relationship between democratic oversight, the rights of German citizens, and public spending – and hence appear to be substantive rather than formalistic issues. One could argue that replicating intergovernmentally the *substance* of the July RRF agreement as discussed above (inclusive of the rights of oversight bestowed upon the European Parliament, the Commission and the Council) should help mitigate the risk of rebuttal from BVerfGE. If the RRF were to be judged as consistent with Basic Law when part of the MFF, an identical degree of democratic oversight under a different legal basis should not alter the assessment. After all, the Union was based on a plurality of Treaties not so long ago. It appears likely, than an instrument like the RRF is consistent *as such* with Basic Law, since it does not produce potentially unlimited liabilities for the German citizens (the RRF agreed in July is capped in size, repayment in an intergovernmental setting would appear to be even clearer than in the original MFF version, as the uncertainty related to the own resources discussion would no longer exist) and it remains under control of the Council and of the Parliament throughout the process, including with an emergency brake on disbursements.

Under these conditions, switching from a Community governance grounded in the TFEU to an identical community governance based on a new legal basis should not alter the *substantive* appraisal regarding the RRF constitutionality.

It is time to call the bluff

The EU is facing a historic cliff moment: the biggest step towards closer economic integration to date (the Next Generation EU package and most notably the RRF within it) risks being nullified by severe tensions on the equally vital issue of rule of law. In light of Hungary's and Poland's most recent joint declaration, it is time to start hedging the bets. The EU should not compromise on the Rule of Law Regulation: holding the ground on that is one of two necessary elements to call Hungary's and Poland's bluff. The second necessary element is the threat of a credible outside option for the RRF. Three such options, all of which are sub-optimal to the original plan of having the RRF as part of the EU budget, but that would allow the EU to show that the commitment to advance economic integration and preserve fundamental values is serious enough for leaders to withstand blackmailing, even if this requires going down a more complex route.
