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# **What the European Commission says to Budapest should be heard in Rome too**

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## What the European Commission says to Budapest should be heard in Rome too

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Under the pressure of the European Parliament, on September 18 the European Commission finally proposed the application of financial sanctions against Hungary for repeated and extended violations of the rule of law. The European Council is now expected to vote under a qualified majority system in favor of cutting the funds that Hungary was granted after the negotiations for its accession to the European Union. Moreover, transfers connected to the Next Generation-EU program will also be suspended.

On the one hand, the interest for the initiative consists of the more influential role that the EU institutions are assuming in the European polity. The intervention in the political choices and in the assessment of the rule of law in every member state is designing a new, tightly interdependent, institutional form, long advocated by the European Parliament.

On the other hand, the indictment of the Hungarian “system of power” – as it emerges in the documents quoted in this brief – represents a definition of the political requisites for all the EU member states. Politically connected firms, domesticated judicial powers, targeted exemptions for politicians in the discipline of conflict of interests, and tolerance for corruption are not acceptable in the EU. The intervention of the European Commission highlights that only open societies in which the rule of law is fully respected are compatible with the solidarity implicit in the common European budget.

As is well known, Italian politicians were divided in endorsing the European Parliament report and the parties that are likely to form the new government might resist voting in favor of sanctioning Hungary. As this brief intends to clarify, the underlying issue is nothing less than the adherence to the model of an open society.

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On September 18, the European Commission triggered budget protection measures under the conditionality regulation against Hungary. For the first time in the EU's history, the mechanism made the reception of common funds conditional on a country's respect for the rule of law. The mechanism is a new tool meant to protect the EU's financial interests against the breaches of the rule of law taking place within a member state, ensuring the protection of the EU budget and the financial interests of the EU. However, the extent of the change in the relationship between the EU and the member states goes much farther than the financial aspects only. According to the European Commission, the practices revealed in the management of the EU funds by the Hungarian

government constitute systemic breaches of the principles of the rule of law inherent in the Conditionality Regulation (see below), in particular the principles of legal certainty and prohibition of arbitrariness of the executive powers. What the European Commission puts under scrutiny is a system of power that binds a government with politically connected firms. In the Hungarian case, this system of power is protected by the limited independence of the judiciary and by the concentration of powers in other agencies that are also politically connected.

At the current stage of the procedure, the Commission has proposed the following measures:

- A suspension of 65% of the commitments for three operational programs under the cohesion policy
- A prohibition to enter into legal commitments with public interest trusts for programs implemented in direct and indirect management

The Council has now one month to decide whether to adopt such measures, by qualified majority. This period could be extended by a maximum of two months in exceptional circumstances. In order to approve it, the Council must obtain a qualified majority: 55% of the EU countries representing at least 65% of the total EU population. This represents an important difference from [Article 7](#) concerning the risk of severe violations of the fundamental rights and common values, whose activation requires a majority of 4/5 of the EU member states (21 of the 26 states - the state addressed by the decision does not participate).

The Commission's initiative follows the adoption in March 2022 of [its guidelines on the general regime of conditionality](#), which aims to protect the EU budget against breaches of the principles of the rule of law.

European Commission President von der Leyen presented the guidelines saying that *“The rule of law is the glue that binds our Union together, it is the foundation of our unity. We will never tire of defending it. Today's guidelines will provide additional clarity as the Commission continues to address every breach of the principles of the rule of law linked to the EU budget. Because we need to ensure that every euro and every cent is spent according to its proper purpose and in line with rule of law principles.”*

Regulation (EU, Euratom) 2020/2092 of the European Parliament and of the Council of 16 December 2020 on a general regime of conditionality for the protection of the Union budget (‘Conditionality Regulation’) provides in its Article 4(1) that “appropriate measures shall be taken where it is established in accordance with Article 6 that breaches of the principles of the rule of law 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 in a sufficiently direct way.”

Following tense negotiations in late 2020, which saw failed attempts by Hungary and Poland to veto the new normative instrument, the disciplinary system entered into force in January 2021. The regulation defines the rule of law as a set of fundamental values, including legal certainty, effective judicial protection, independent and impartial courts, separation of power and non-discrimination.

The guidelines indicate:

- the conditions to adopt measures, including what the relevant breaches of the principles of the rule of law could be and how it will be assessed whether these breaches affect or risk affecting the EU financial interests in a sufficiently direct way;
- the complementarity between the conditionality regulation and other EU budget protection tools, including the EU financial rules and the sector-specific rules. These include the rules for funds under shared management (e.g. cohesion policy, Common Agricultural Policy) and for the Recovery and Resilience Facility at the heart of NextGenerationEU;
- the need for the proposed measures to be proportionate, suitable and necessary to address the issues at hand;
- the steps to be followed before measures have been proposed, including sources of information the Commission will be consulting, the role of [complaints](#), contacts with the Member States: the procedures to adopt and to lift measures;
- the need to protect the rights of the final recipients or beneficiaries of EU funding, as EU countries should continue to make payments under EU programmes or funds under all circumstances.

Before the procedure against Hungary, the new instrument for the protection of the EU budget had never been used since its entry into force despite continued pleas from the European Parliament, whose members resorted to legal action in a bid to force the Commission's hand. At that juncture, President von der Leyen argued it needed more time to draft practical guidelines and wait for a ruling from the European Court of Justice (ECJ) that was supposed to determine whether the mechanism was legally sound. The ruling was problematic because of a lack of consistency between art. 7 (risks of violation by a member state) and [art. 49](#) (according to which only a state that respects the fundamental values inscribed in art.2 of the Treaty on the European Union, can enter in the EU). Eventually, the ECJ decided that "compliance with those values cannot be reduced to an obligation which a candidate state must meet in order to accede to the European Union and which it may disregard after accession."

After the ECJ ruled in favor of the instrument, the Commission published its guidelines in early March. The letter sent by the Commission reached Budapest two days after Prime Minister Viktor Orbán was once again given a clear majority to govern at the parliamentary elections. Orban commented the result saying: "We won a victory so big that you can see it from the moon, and you can certainly see it from Brussels."

The scope of the European Commission intervention was not to target general breaches of EU law, but only those that affect or pose a serious threat to the EU's financial management, namely the common budget: lack of judicial independence, failure to prevent or correct unlawful decisions taken by public authorities and the presence of obstacles to carry out investigations, prosecute crimes and implement rulings. These violations can have a negative impact on the execution, control and audit of EU funds, the prevention of fraud and corruption, and the cooperation with relevant EU agencies. OLAF, the EU's anti-fraud agency, has put the country at the top of its list of irregularities involving EU funds.

The formal procedure was activated on April 27, 2022, when the Commission sent a written notification to Hungary pursuant to Article 6(1) of the Conditionality Regulation. The notification presented the findings of the Commission regarding a number of issues concerning the public procurement system in Hungary, including:

- systemic irregularities, deficiencies and weaknesses in public procurement procedures;
- a high rate of single bidding procedures and low intensity of competition in procurement procedures;
- issues related to the use of framework agreements;
- issues in the detection, prevention and correction of conflicts of interest;
- concerns related to the use of Union funds by public interest trusts.

According to the Commission, “These issues and their recurrence over time demonstrate a systemic inability, failure or unwillingness, on the part of the Hungarian authorities, to prevent decisions that are in breach of the applicable law, as regards public procurement and conflicts of interest, and thus to adequately tackle risks of corruption. Those breaches constitute breaches of the principle of the rule of law, in particular the principles of legal certainty and prohibition of arbitrariness of the executive powers and raise concerns as regards the separation of powers.”

In addition, the notification presented findings regarding investigation and prosecution, and the anti-corruption framework: “there are additional issues as regard limitations to effective investigation and prosecution of alleged criminal activity, the organization of the prosecution services, and the absence of a functioning and effective anti-corruption framework. These issues also constitute breaches of the principles of the rule of law, in particular regarding legal certainty, the prohibition of arbitrariness of the executive powers and effective judicial protection. Questions were also asked as regards potentially related issues concerning the independence of the judiciary.”

In describing the “systemic irregularities, deficiencies and weakness in public procurement”, the Commission identifies what could be a “system of power” around the political system, subjugating competition, anti-corruption agencies and the independent exercise of judicial power. A quantitative study revealed the importance of political connections in the economy.

The data available to the Commission shows not only an increase of concentration of awards in public procurement, but also an increase in the odds of winning of companies that can be considered as politically connected with actors of the Hungarian ruling party (“politically connected”). The Directorate-General for Budget procured a Study which provided statistical empirical analysis of more than 270,000 Hungarian public procurement contracts between 2005 and 2021. The study demonstrates that the probability of obtaining public contracts (both nationally and EU-funded) of companies that can be considered politically connected were between 1.5 to 2.1 times higher than the probability of success for companies that are not considered politically connected in the period 2005-2010. This difference increased significantly in the period 2011-2021. Considering only the EU-funded contracts for the period after 2011, the probability of successful bidding for companies that can

be considered politically connected exceeded by 3.3 to 4.4 times the probability for companies that are not considered politically connected. In the same period, considering both nationally and EU-funded contracts, the probability of obtaining public contracts for companies that can be considered politically connected was between 2.5 to 3 times higher than those for companies that are not considered politically connected. The study concludes that the direct or indirect political connections of some companies that can be considered politically connected is a decisive factor for increasing their probabilities of success in tender procedures, as compared to companies that are not considered politically connected, and for receiving a higher aggregated value of contracts won. The Commission expressed “concerns about issues related to conflict of interests and transparency for public interest trusts, including the explicit legal exception of members of the boards of these trusts from conflict of interest requirements and conflict of interest rules not being applicable to members of Parliament, state secretaries and other public officials of the government who may serve at the same time as board members of such trusts.”

The system of power is also strengthened by what the Commission defines as “a serious risk of weakening the effective pursuit of investigations and prosecutions in cases involving Union funds, due to the concentration of powers in the hands of the Prosecutor General’s Office, the strictly hierarchical organization of the prosecution service, the lack of a requirement to give reasons when cases are attributed or reassigned, the absence of rules to prevent arbitrary decisions that could hamper an effective investigation and prosecution policy, as well as the lack of judicial review of decisions by the investigating authorities or the prosecution service not to pursue a case.”

The weakness of the judiciary is particularly noticeable in consideration of persisting concerns regarding the prevention and correction of high-level corruption.