2.2. WHAT ARE THE CHANCES OF NEW CONDITIONALITY IN THE NEXT EU BUDGET?

by Sándor Richter

The negotiations on the next seven-year EU budget will reach a decisive stage this year and next. The main issues will be how to mitigate the impact of Brexit (whatever happens); a new conditionality related to respect for the rule of law and the fundamental values of democracy in beneficiary Member States; and, finally, the search for innovative solutions to reduce the risk of corruption related to EU transfers.

Never at the preparatory stage of a Multiannual Financial Framework (MFF, generally referred to as 'the EU budget') has there been more uncertainty as now, as preparations are being made for the 2021-2027 MFF. The potential for a so-called 'hard' Brexit, 'soft' Brexit or no Brexit creates three diverging scenarios for the next MFF. A 'hard' Brexit could even affect the current 2014-2020 MFF, with transfers to be paid for two additional years after the nominal closure in 2020. Spending cuts will be necessary as a consequence of Brexit (the UK is one of the main net contributors), but the remaining Member States are by no means in agreement on how these cuts will be allocated across the main policy areas, and finding a good (or at least acceptable) compromise is likely to be fairly difficult.

2.2.1. The rule of law

Beyond the question of the available resources for the next EU budget, one of the top issues in the coming months will be how to link cohesion policy to the rule of law and respect for basic European values. In January of this year, the European Parliament endorsed a draft law to reduce pre-financing or suspend EU budget payments to Member States that interfere with the courts or that do not tackle fraud and corruption: 397 MEPs voted in favour, 158 were against and there were 69 abstentions.[12]

Based on the work of a panel of independent experts, the EU Commission would be invited to establish 'generalised deficiencies as regards the rule of law' and to decide on sanctions, which could include suspending EU budget payments or reducing pre-financing. The European Parliament and Council would have to approve the decision. The Member States involved would not lose the resources for good: if and when the Member State remedies the deficits identified by the EU Commission, the European Parliament and EU ministers can unlock the funds.[13]

The European Commission may establish that the rule of law is under threat if one or more of the following are undermined:[14]

› proper functioning of the authorities of the Member State implementing the EU budget;

› proper functioning of the authorities carrying out financial control;

› proper investigation of fraud (including tax fraud), corruption or other breaches affecting implementation of the EU budget;

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[12] https://multimedia.europarl.europa.eu/en/protection-of-the-unions-budget-vote-debate_I166383-V_v

[13] http://www.europarl.europa.eu/news/en/press-room/20190109IPR23011/member-states-jeopardising-the-rule-of-law-will-risk-losing-eu-funds

[14] ibid.

› effective judicial review by independent courts;

› recovery of funds unduly paid;

› preventing and penalising tax evasion and tax competition;

› cooperation with the European Anti-Fraud Office and, if applicable, the European Public Prosecutor's Office.

It is planned that the above-mentioned panel of independent experts should include one expert appointed by the national parliament of each Member State, while five would be delegated by the European Parliament. Sanctions could include reducing pre-financing and suspending payments, depending on the scope of the problems identified. For governments under threat of sanctions, a particularly unpleasant feature of the draft is that they would have to implement – from their own resources – the necessary programmes, and also provide payments to final beneficiaries (firms, NGOs, local and other government bodies).[15]

It is no coincidence that the topic 'rule of law and the fight against corruption' has become one of the central issues in discussion of the 2021-2027 MFF. Conflicts between the EU institutions and certain Member States have never before been so sharp as now, in the course of the current MFF, with the main protagonists being Hungary and Poland. Traditional 'soft power' attempts to compel those countries to change their behaviour (which is, in many respects, at odds with the fundamental democratic values on which the European Union is based) have proved rather toothless. However, a requirement for the stability of institutions that safeguard democracy, the rule of law and human rights is nothing new: it has always been an integral part of the 'Copenhagen Criteria' membership requirements for any candidate country wishing to join the EU. Unfortunately, the original expectation – that if a candidate country fulfils the criteria, then no further proof will be necessary – has proved flawed.

2.2.2. Corruption

Another key issue that will play a role in discussions about the next MFF is corruption. Recently published research confirms the existence of a strong relationship between corruption and the use of EU cohesion policy funds in the EU Member States.[16] Identifying and proving individual cases of corruption is a difficult and lengthy process that often ends inconclusively. In their ground-breaking publication, the researchers used mathematical methods to analyse over 100,000 individual cases of public procurement contracts issued by public and semi-public organisations in two EU Member States (Hungary and the Czech Republic) in the period 2009-2012.[17] Of the 100,000-plus public procurement contracts, about a third were co-financed from EU funding. The combined value of the EU co-financed contracts investigated amounted to over 17 billion euros.

15 ibid.

16 Beblavý and Sičáková-Beblavá (2014); Bouda et al. (2013); Corruption Research Centre Budapest (2016); Fazekas and Tóth (2015); Fazekas and King (2018).

17 Fazekas and King (2018).

The core of the analysis involved the identification of so-called ‘red flags’, i.e. circumstances which suggested a high probability of corruption. Then the EU co-financed contracts were compared to similar contracts financed from national funds.[18]

Red flags:

- Instances of single-bidder contracts: lack of competition allows above-market-price contracts and makes the extraction of corrupt rents possible.
- A particular company winning a large share of all the contracts awarded by the issuer in a given period.
- Short time between the advertisement of the tender and the submission deadline: it is harder for competitors to prepare a bid.
- Changing the bidding conditions (technical conditions, eligibility criteria) after the official publication.
- Tailoring the conditions to a single company through over-specification.
- Eligibility criteria that are subjective and hard to quantify.

Take the case of the red flag of ‘single bidding’. Single-bidder contracts are 6-15% more expensive than multiple-bidder contracts. The authors of the study estimate that increased corruption risks in EU co-financed projects may have pushed up procurement prices by between 218 million and 219 million euros in the two countries in the four years analysed. In an earlier published study, the EU28-wide loss due to corruption in EU-funded contract awards (contracted price versus estimated price) was put at 9.9 billion euros annually.[19] It should be added that the misuse of EU transfers is not confined to the CEE Member States: it is a problem elsewhere, too (e.g. Greece and Italy).

Fazekas and King come to the final conclusion that ‘resources associated with EU Structural and Cohesion Funds increase institutionalised grand corruption in two characteristic countries of the CEE, the Czech Republic and Hungary’.[20] Their recommendation is not to introduce greater administrative control, but rather to decrease the ratio of EU funds to beneficiaries’ own funds in the financing of individual projects. This is important in order to maintain or restore the link between local taxes, local policy performance and local civil society oversight.

2.2.3. Grants versus financial instruments

The recommendation just outlined can be interpreted as a desperate call for more ‘ownership’ of EU co-financed projects. Greater ownership also provides motivation for stronger competition in the bidding process, which in turn situates EU co-financed projects in the real world, subordinated to the rules of careful management of limited resources. Here we have to confront the fact that a large part of EU financing comes in the form of grants. If a local kindergarten is financed predominantly from grants (from EU funds), then the local ‘ownership’ (and with that, resistance to corruption) will be much weaker than if the project were implemented from a preferential credit (supported by the EU), to be paid back by the

18 Ibid.

19 Fazekas and Tóth (2015).

20 Fazekas and King (2018).

local government from its revenues. In that case, a higher price through corruption would hurt the local community in a much more perceivable way.

Compared to market-compatible assistance, grants increase the temptation of corruption. An escalation of the fight against corruption can be facilitated by phasing out grants from the cohesion policy funds and replacing them with financial instruments (FIs). The idea and practice of employing FIs in cohesion policy is not new: they were used (albeit to a modest extent) as early as in the 1994-1999 MFF. Their importance increased in subsequent MFFs, and is expected to rise even higher in the current one. However, the result is fairly modest: in 2014-2020, FIs amount to about 6% of funding for cohesion policy. It would be expedient (for reasons that go far beyond curbing corruption) to attach much more significance to this tool in the 2021-2027 MFF. FIs could fully replace grants in cohesion policy expenditure in the business sector, while in the non-profit sector and parts of public investment, grants could continue to be given, but in line with carefully selected criteria.

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