

# The Evolution of Fiscal Conditionality in EU Law

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## Abstract

*Fiscal conditionality is reflected in EU law in several dimensions and layers. In addition to the most essential conditionality, the conditions for accession to the EU set out in the founding Treaty, there are conditionality requirements related to the Economic and Monetary Union (EMU), the Common Agricultural Policy (CAP), and Regional Policy. Most recently, in December 2020, the European Parliament and the Council adopted Regulation 2020/2092 on the general regime of conditionality for the protection of the EU budget. This paper analyses the evolution, objectives, and instruments of fiscal conditionality legislation of the EU. The author provides a detailed analysis of the relevant elements of the existing legislation, as well as the recent judgments of the CJEU on the subject. The article demonstrates that the Financial Conditionality Regulation is not an instrument for protecting the rule of law in general, but its general purpose is to protect the EU budget by enforcing fundamental requirements stemming from the rule of law.*

**Keywords:** conditionality, EU budget, rule of law, financial interests, CJEU.

## 1. The Evolution of Fiscal Conditionality

The conditionality requirement is reflected in EU law in several dimensions. In addition to the most essential conditionality, the conditions for accession to the EU set out in the Treaty, there are also conditionality requirements in a wide range of other areas of EU law. These include *e.g.* the criteria for accession to the Schengen Treaty or to the Economic and Monetary Union, the good agricultural and environmental conditions (GAEC) and social conditionality requirements for

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Common Agricultural Policy (CAP) payments,<sup>1</sup> or the so-called enabling conditions set out in the general rules for cohesion policy support.<sup>2</sup>

The introduction of certain general conditionality concerning grants financed by the EU budget emerged in the first half of the 1990s, in the framework of the Cohesion Fund regulation. At the time, conditionality was still merely linked to the fulfillment of economic policy requirements by the Member States, to ensure that the convergence criteria for entering the third stage of the Economic and Monetary Union (EMU) were met in all Member States concerned and that all Member States submitted their convergence programs to the Council in due time to avoid excessive budgetary deficits. The Council Regulation establishing the Cohesion Fund,<sup>3</sup> adopted in 1994, excluded projects of a Member State from financing by the Fund in case the European Commission launched the Excessive Deficit Procedure (EDP) against the Member State concerned and the EDP had not been terminated within one year.

Up until the Multiannual Financial Framework 2007-13, only the Cohesion Fund was subject to macroeconomic conditionality.<sup>4</sup> However, the rules of the 2014-2020 horizontal regulation<sup>5</sup> on the Structural Funds sought to strengthen the link between cohesion policy and EU economic governance, and required that the effectiveness of spending be underpinned by sound economic policies and that, in addition to the Cohesion Fund, resources from the European Regional Development Fund, the European Social Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund be redirected to address economic difficulties faced by the Member States (sound economic governance).

- 1 Regulation (EU) 2021/2115 of the European Parliament and of the Council of 2 December 2021 establishing rules on support for strategic plans to be drawn up by Member States under the common agricultural policy (CAP Strategic Plans) and financed by the European Agricultural Guarantee Fund (EAGF) and by the European Agricultural Fund for Rural Development (EAFRD) and repealing Regulations (EU) No 1305/2013 and (EU) No 1307/2013, Articles 13-14.
- 2 Regulation (EU) 2021/1060 of the European Parliament and of the Council of 24 June 2021 laying down common provisions on the European Regional Development Fund, the European Social Fund Plus, the Cohesion Fund, the Just Transition Fund and the European Maritime, Fisheries and Aquaculture Fund and financial rules for those and for the Asylum, Migration and Integration Fund, the Internal Security Fund and the Instrument for Financial Support for Border Management and Visa Policy, Article 15.
- 3 Council Regulation (EC) No 1164/94 of 16 May 1994 establishing a Cohesion Fund, Article 6. These provision were maintained for the 2007-13 multiannual finance framework period by the Council Regulation (EC) No 1084/2006 of 11 July 2006 establishing a Cohesion Fund and repealing Regulation (EC) No 1164/94, Article 4.
- 4 Mario Kölling, 'Policy conditionality – a new instrument in the EU budget post-2020?', *SIEPS European Policy Analysis*, 2017/10.
- 5 Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006, Article 23.

In this context, the Regulation allowed for the suspension of commitments and payments if a Member State had not complied with its obligations to address excessive government deficits, and extended these requirements to the macroeconomic imbalances procedure and to non-compliance with economic policy recommendations adopted within the framework of EU macroeconomic loans for payment difficulties.<sup>6</sup> This set of rules was maintained in substance in the horizontal regulation<sup>7</sup> for the period of 2021-27.

## 2. Instruments for Protecting the EU Budget

The EU budget is implemented primarily under the responsibility of the European Commission, but also with the involvement of the Member States' institutions, through a method known as shared management.<sup>8</sup> Under this system, the implementation of the EU budget (calls for proposals, evaluation, award decisions, disbursement, utilization, control, and monitoring) is essentially carried out by the national institutions. It is therefore essential to protect the budget against any irregularities, in particular, to ensure that the funds financed from the budget are used correctly.

Now, the EU's general budget and the proper use of budgetary funds are protected by a highly complex set of rules and institutions. On the institutional side, the role of the European Commission, the European Court of Auditors, the European Anti-Fraud Office (OLAF), and the European Public Prosecutor's Office (EPPO) deserve special mention. However, alongside the EU institutions and bodies, the role of the Member States must also be taken into account, in light of Article 310(6) TFEU, which states that the EU and the Member States shall fight jointly against fraud and any other illegal activities affecting the financial interests of the EU. Article 325 TFEU requires Member States to take the same measures to counter fraud affecting the financial interests of the EU as they take to counter fraud affecting their own financial interests. Besides the institutional system, the substantive rules designed to protect the common budget should be noted, namely: (i) the administrative rules for the protection of the budget; (ii) the rules of criminal law for the protection of the budget; and (iii) the provisions on the recovery of funds unduly used and the related financial corrections defined in the Financial

6 Gabriella Csűrös, 'Az Európai Unió költségvetési joga', in János Kálmán (ed.), *A pénzügyi jog alapintézményei*, ORAC, Budapest, 2022, p. 128.

7 Regulation (EU) 2021/1060 of the European Parliament and of the Council of 24 June 2021 laying down common provisions on the European Regional Development Fund, the European Social Fund Plus, the Cohesion Fund, the Just Transition Fund and the European Maritime, Fisheries and Aquaculture Fund and financial rules for those and for the Asylum, Migration and Integration Fund, the Internal Security Fund and the Instrument for Financial Support for Border Management and Visa Policy, Article 20.

8 Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union, amending Regulations (EU) No 1296/2013, (EU) No 1301/2013, (EU) No 1303/2013, (EU) No 1304/2013, (EU) No 1309/2013, (EU) No 1316/2013, (EU) No 223/2014, (EU) No 283/2014, and Decision No 541/2014/EU and repealing Regulation (EU, Euratom) No 966/2012, Articles 63, and 125-129.

Regulation and the rules on the implementation of agricultural and cohesion policies.

The administrative rules for the protection of the budget were adopted in the mid-1990s and were the first pieces of legislation whose primary purpose was to protect the EU budget. At that time, EU rules on criminal law protection were out of the question, so regulators could only use administrative law tools to protect the budget. In this context, it is the Council Regulation on the protection of the European Communities' financial interests<sup>9</sup> and the Council Regulation concerning on-the-spot checks and inspections carried out by the Commission to protect the European Communities' financial interests against fraud and other irregularities<sup>10</sup> that deserve to be mentioned.

The criminal law toolbox for protecting the budget has developed very slowly, since criminal law, the exercise of criminal powers has always been a crucial part of state sovereignty, and the claim to criminal power has long been seen as the inalienable manifestation of state sovereignty.<sup>11</sup> This approach, however, seems to be declining today, as the EU is claiming for itself more and more competences in all areas of legislation, including criminal law.<sup>12</sup>

The current legal framework, namely Article 83 TFEU, allows for the harmonization of legislation concerning certain criminal offenses (terrorism, trafficking in human beings and sexual exploitation of women and children, illicit drug trafficking, illicit arms trafficking, money laundering, corruption, counterfeiting of currency and other means of payment, cybercrime, and organized crime). These areas of crime obviously cover serious offenses linked to the economy but lack the possibility of harmonized sanctions for fraud affecting the financial interests of the EU.

The Convention on the Protection of the European Communities' financial interests, signed in 1995, and its subsequent protocols, are one of the first cornerstones of a single European criminal law regime. However, this Convention is formally not a source of EU law, but an international treaty, which happens to have been concluded by (all) Member States to ensure the protection of the Union's financial interests. The proclaimed objective of the conclusion of the Convention in its preamble was that the criminal law and not simply the administrative law of the Member States should contribute effectively to the protection of the EC's (succeeded by the EU) financial interests. This is due to the fact that the protection of EU financial interests requires the criminal prosecution of fraud against them, and also requires a uniform definition of the relevant offenses.

9 Council Regulation (EC, Euratom) No 2988/95 of 18 December 1995 on the protection of the European Communities financial interests.

10 Council Regulation (Euratom, EC) No 2185/96 of 11 November 1996 concerning on-the-spot checks and inspections carried out by the Commission in order to protect the European Communities' financial interests against fraud and other irregularities.

11 László Valki, 'Az Európai Unióhoz csatlakozó Magyarország szuverenitása', *Magyar Tudomány*, 1999/8, pp. 1000-1007.

12 Sándor Madai, 'Új büntetőjog? Közpénzvédelem az Európai Unióban', in Tamás Horváth M. *et al.* (eds.), *Honnan hová? – A közpénzek védelméről*, Debreceni Egyetem, Debrecen, 2017, p. 259.

To protect the financial interests of the EU budget, the Commission presented a proposal for a Directive on the fight against fraud affecting the financial interests of the EU by means of criminal law in 2001, and a second proposal later in 2012. Based on this proposal, which had Article 83 TFEU as its legal basis, the Council and the European Parliament endorsed Directive 2017/1371 on the fight against fraud affecting the financial interests of the EU by means of criminal law in the summer of 2017.<sup>13</sup>

The Directive defines the concept of the EU's financial interests,<sup>14</sup> fraud, and other offenses affecting the Union's financial interests, which must be considered as criminal offenses in the Member States, as well as sanctions. Accordingly, the Directive requires Member States to criminalize (i) fraud, (ii) fraud in public procurement, (iii) VAT fraud, (iv) active and passive forms of bribery, (v) misappropriation of funds, and (vi) money laundering. It also introduces the criminal liability of legal persons in addition to natural persons and defines the minimum length of imprisonment to be applied.

Alongside the criminal law provisions on the recovery of unduly used funds and the related financial corrections, the rules on the implementation of different EU Funds primarily oblige the Member States to take the necessary corrective measures, in particular the recovery of funds used irregularly. Should a Member State fail to comply with this obligation, the Commission may impose a financial correction on the Member State to exclude it from EU financing expenditure affected in breach of the applicable provisions.<sup>15</sup>

### 3. The Rule of Law Conditionality

While the budgetary, administrative, and criminal law instruments for the protection of the common budget are now fully developed and a part of EU law, the EU approach to the proper use of budgetary resources is not merely based on compliance with and enforcement of the directly applicable legislation, but also the proper functioning of the entire national legal system. This includes in particular but is not limited to, a properly functioning system of public procurement rules

13 Directive (EU) 2017/1371 of the European Parliament and of the Council of 5 July 2017 on the fight against fraud to the Union's financial interests by means of criminal law.

14 According to the definition of the Directive (EU) 1371/2017, 'Union's financial interests' means all revenues, expenditure and assets covered by, acquired through, or due to: (i) the Union budget; (ii) the budgets of the Union institutions, bodies, offices and agencies established pursuant to the Treaties or budgets directly or indirectly managed and monitored by them.

15 Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union, Article 101 and the sectoral regulations: (i) Regulation (EU) 2021/2116 of the European Parliament and of the Council of 2 December 2021 on the financing, management and monitoring of the common agricultural policy and repealing Regulation (EU) No 1306/2013. (ii) Regulation (EU) 2021/1060 of the European Parliament and of the Council of 24 June 2021 laying down common provisions on the European Regional Development Fund, the European Social Fund Plus, the Cohesion Fund, the Just Transition Fund and the European Maritime, Fisheries and Aquaculture Fund and financial rules for those and for the Asylum, Migration and Integration Fund, the Internal Security Fund and the Instrument for Financial Support for Border Management and Visa Policy.

and institutions, sufficiently functioning legal remedies, and all elements of a legal system whose effective functioning ensures the proper use of EU budgetary resources in accordance with the principle of sound financial management and the protection of the Union's financial interests. This set of requirements is known collectively as the rule of law conditionality.

The notion of the rule of law itself was introduced by the Maastricht Treaty, Article 6(1) of which provided that

“[t]he Union is founded on the principles of liberty, democracy, respect for human rights and fundamental freedoms, and the rule of law, principles which are common to the Member States.”

Well before the Maastricht Treaty, the CJEU had already pointed to the rule of law as the basis for the functioning of the European Communities in *Les Verts* when it conceived the essence of the rule of law as a fundamental ideal where neither the EU institutions nor the Member States are above the law:<sup>16</sup>

“the European Economic Community is a Community based on the rule of law since neither its Member States nor its institutions can avoid review of the question whether the measures adopted by them conform with the basic constitutional charter, the Treaty.”<sup>17</sup>

Respect for the Rule of Law was already identified in the Sapir Report<sup>18</sup> in 2003 as a key point for the effective implementation of EU investments.

In December 2020, the European Parliament and the Council adopted Regulation 2020/2092 on the general regime of conditionality for the protection of the EU budget as part of the legislative package for the multiannual financial framework 2021-27. This was to enforce the operation of a legal system that adequately protects the budgetary interests in the Member States, complementing the economic policy conditionality that has been put in place for more than a quarter of a century.<sup>19</sup> The Regulation lays down the necessary rules to protect the EU budget in the event of breaches of the rule of law in the Member States.

16 Koen Lenaerts, ‘On Checks and Balances: The Rule of Law within the EU’, *Columbia Journal of European Law*, Vol. 29, Issue 2, 2023, p. 28.

17 Judgment of 23 April 1986, *Case C-294/83, Les Verts v European Parliament*, ECLI:EU:C:1986:166, para. 23.

18 André Sapir *et al.*, *An Agenda for a Growing Europe – Making the EU Economic System Deliver*, Report of an Independent High-Level Study Group established on the initiative of the President of the European Commission, 2003, p. 104.

19 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.

The proposal for the Regulation was presented by the Commission in 2018<sup>20</sup> and, as pointed out by the European Court of Auditors in its opinion,<sup>21</sup> was criticized on certain points. (i) Contrary to Article 7 TEU, which requires a four-fifth majority of the Council to establish a clear risk of a serious breach by a Member State of the values referred to in Article 2 and unanimity in the European Council to establish a serious and persistent breach of those values, the reverse qualified majority voting originally proposed was intended to give the Commission clear discretionary power. (ii) The draft Regulation did not set any deadlines for the Commission in the procedure while imposing strict deadlines on the Member State concerned. (iii) The draft Regulation did not contain a clear obligation for the Commission to examine on its own initiative the possibility of terminating the measures. (iv) The draft regulation did not impose any obligation on the Commission to assess the potential impact on final beneficiaries and the national budget (the imposition of appropriate measures is without prejudice, in principle, to the obligations of governments or Member States concerning the implementation of the program or fund concerned by the measure, and in particular their obligations *vis-à-vis* final beneficiaries).

Although the adopted text of the Regulation has been amended on several points (decision-making, deadlines, review) compared to the original proposal, following its publication, the Hungarian and Polish governments filed actions before the CJEU for the annulment of the Regulation.<sup>22</sup> Although the CJEU dismissed the actions, it gave important interpretative guidance on the correct application of the Regulation in the reasoning of its judgments.

The legal basis for the Regulation is Article 322(1)(a) of TFEU, which is in fact a general legislative power conferred on the European Parliament and the Council in the field of budgetary rules. Contrary to the views of certain researchers<sup>23</sup> on the scope of the Regulation, it makes it clear that it does not protect the rule of law in general, but it sets out the rules necessary to protect the EU budget in the event of breaches of the rule of law in the Member States. The CJEU also pointed out in its judgment that the EU can defend the value of the rule of law not only through the procedure laid down in Article 7 of TEU, but also through other instruments.<sup>24</sup> The CJEU reaffirmed in its judgment, that the purpose of the Regulation is to protect the EU budget in a sufficiently direct way, and not to penalize breaches as such. It's

- 20 Proposal for a Regulation of the European Parliament and of the Council on the protection of the Union's budget in case of generalized deficiencies as regards the rule of law in the Member States, COM(2018) 324 final.
- 21 European Court of Auditors: Opinion No 1/2018 [pursuant to Article 322(1)(a) TFEU] concerning the proposal of 2 May 2018 for a regulation of the European Parliament and of the Council on the protection of the Union's budget in case of generalized deficiencies as regards the rule of law in the Member States.
- 22 Judgment of 16 February 2022, *Case C-156/21, Hungary v European Parliament and Council of the European Union*, ECLI:EU:C:2022:97; Judgment of 16 February 2022, *Case C-157/21, Republic of Poland v European Parliament and Council of the European Union*, ECLI:EU:C:2022:98.
- 23 Justyna Łacny, 'The Rule of Law Conditionality Under Regulation No 2092/2020 – Is it all About the Money?', *Hague Journal on the Rule of Law*, Vol. 13, Issue 1, 2021, p. 84
- 24 *Case C-156/21, Hungary v European Parliament and Council*, paras. 163, 168, and 173.

apparent, that the nature of the Regulation has changed during the legislative process, since the

“Commission’s original proposal focused less on the financial conditionality and more on protecting the rule of law whereas the final text of Regulation 2020/2092 became an instrument of financial conditionality under which safeguarding the rule of law operates as a horizontal condition that must be respected by Member States in implementing the budget.”<sup>25</sup>

The rule of law and the sound financial management of the EU budget are interlinked in the sense that respect for the rule of law and the requirements towards state operation stemming from it are a prerequisite for the confidence in that the utilization of the EU funds in the Member States is adequately protected.<sup>26</sup> The Regulation is not applicable to all kinds of breaches of the rule of law but may be considered as a basis for the adoption of measures against a Member State if it is established that a breach of any of the principles of the rule of law in that Member State directly affects or seriously jeopardizes sound financial management or the protection of the Union’s financial interests.<sup>27</sup>

In its judgment, the CJEU stressed that the EU budget is one of the most important instruments for putting into practice the principle of solidarity enshrined in Article 2 TEU, which is itself a fundamental principle of EU law, underlying the policies and activities of the EU. The CJEU further emphasized the fact that the implementation of the principle of solidarity through the EU budget is based on mutual trust between Member States concerning the responsible use of the common funds paid into the EU budget. This mutual trust is itself based on the commitment of each Member State to comply with its obligations under EU law and to uphold the values enshrined in Article 2 TEU, including the rule of law.<sup>28</sup>

Consequently, according to the CJEU, a conditionality mechanism may fall within the concept of ‘budgetary rules’ within the meaning of Article 322(1)(a) TFEU even if it introduces a horizontal conditionality on the use of funds from the EU budget which is linked to the respect by the Member State of the values of the rule of law enshrined in Article 2 TEU and to the implementation of the EU budget.

As regards the definition of the rule of law, the Regulation (in Article 2) sets anF own definition by referring to the fundamental values of the Union as set out in Article 2 TEU, which include the rule of law, and defines the principles included by the rule of law: (i) the principle of legality implying a transparent, accountable, democratic, and pluralistic law-making process; (ii) the principle of legal certainty; (iii) the principle of prohibition of arbitrariness of the executive powers; (iv) the principle of effective judicial protection, including access to justice, by independent and impartial courts, also as regards fundamental rights; (v) the principle of

25 *Case C-156/21, Hungary v European Parliament and Council*, Opinion of Advocate General Campos Sánchez-Bordona, para. 135, Isabel Staudinger, ‘The Rise and Fall of Rule of Law Conditionality’, *European Papers*, Vol. 7, Issue 2, 2022, p. 729.

26 This has been explained in detail by the CJEU in *Case C-156/21*, paras. 130, and 131.

27 *Case C-156/21, Hungary v European Parliament and Council*, para. 144.

28 *Id.* para. 129.

separation of powers; and (vi) the principles of non-discrimination and equality before the law.

The definition implies that the following may be indicative of breaches of the principles included in the rule of law: (i) not only the infringement of the independence of the judiciary but also the endangerment thereof; (ii) failure to prevent, correct, or sanction arbitrary or unlawful decisions by public authorities, including by law-enforcement authorities, withholding financial and human resources affecting their proper functioning or failure to ensure the absence of conflicts of interest; and (iii) limiting the availability and effectiveness of legal remedies, including through restrictive procedural rules and lack of implementation of judgments, or limiting the effective investigation, prosecution, or sanctioning of breaches of the law.

As regards the notion of the rule of law, it must be made clear that the model of the rule of law itself, the *Rechtsstaat*, as opposed to the concept of the *Polizeistaat*, was developed in Germany in the 19th century.<sup>29</sup> Although the TEU refers to the principles of the rule of law, and some of the EU's secondary legal sources also try to define it, the rule of law is not a homogeneous notion, but it has national characteristics and national interpretations. The components of the rule of law are interpreted and developed by the constitutional courts of the Member States. Based on the Regulation, measures may be adopted in case breaches of the principles of the rule of law in a Member State affect in a sufficiently direct way: the sound financial management of the Union budget, or the protection of the financial interests of the Union, or otherwise seriously risk affecting them.

In this context, typical cases are also defined in the Regulation, when one of the following is not ensured: (i) the proper functioning of the authorities implementing the Union budget, including loans and other instruments guaranteed by the Union budget, in particular in the context of public procurement or grant procedures; (ii) the proper functioning of the authorities carrying out financial control, monitoring, and audit, and the proper functioning of effective and transparent financial management and accountability systems; (iii) the proper functioning of investigation and public prosecution services in relation to the investigation and prosecution of fraud, including tax fraud, corruption, or other breaches of Union law relating to the implementation of the Union budget or the protection of the financial interests of the Union; (iv) the effective judicial review by independent courts of actions or omissions by the authorities referred to in the points above mentioned; (v) the prevention and sanctioning of fraud, including tax fraud, corruption, or other breaches of Union law relating to the implementation of the Union budget or the protection of the financial interests of the Union, and the imposition of effective and dissuasive penalties on recipients by national courts or by administrative authorities; (vi) the recovery of funds unduly paid; (vii) effective and timely cooperation with OLAF and, subject to the participation of the Member State concerned, with EPPO in their investigations or prosecutions pursuant to the applicable Union acts in accordance with the principle of sincere

29 Otto Mayer, *Deutsches Verwaltungsrecht*, Duncker & Humblot, Band 1, Leipzig, 1895; Band 2, Leipzig, 1896.

cooperation; (viii) other situations or conduct of authorities that are relevant to the sound financial management of the Union budget or the protection of the financial interests of the Union.

The range of measures can be quite broad, in particular, the suspension of payments and/or of the implementation of legal commitments, the prohibition on entering into new legal commitments or suspension of them, the suspension of the disbursement, the suspension of program approval, the reduction of commitments – including the application of financial corrections, and the interruption of payment deadlines.

The measures may be proposed by the Commission and adopted by the Council. When initiating the procedure, the Commission shall inform the Member State concerned in writing, indicating the factual reasons and specific grounds on which its findings are based. The Member State concerned shall provide the Commission with the relevant information on the case and may comment on its findings within a period of one to three months to be determined by the Commission. In considering whether to submit a proposal for an implementing decision on appropriate measures, the Commission shall take into account the information received and the comments made by the Member State concerned, as well as the adequacy of any proposed appropriate measures. In its assessment of the situation, the Commission also takes into account relevant information from available sources, including decisions, conclusions, and recommendations of the EU institutions, other relevant international organizations, and other recognized international institutions. Where the Commission intends to submit a proposal for any action to be taken to the Council, it shall first give the Member State the opportunity to submit its observations, in particular on the proportionality of the envisaged measures, within one month.

In its judgment, the CJEU emphasized in particular that the Commission can only initiate the adoption of ‘appropriate measures’ for the protection of the EU budget if it finds that there are reasonable grounds for considering not only that there have been breaches of the principles of the rule of law in a Member State, but, in particular, that those breaches 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.<sup>30</sup>

The Commission must apply an evidence-based approach when assessing whether the adoption of appropriate measures is justified and respect the principles of objectivity, non-discrimination, and equality before the Treaties.<sup>31</sup> When the Commission considers that a breach of the rule of law in a given Member State has a significant direct and immediate impact on the sound financial management of the Union budget or the protection of the Union’s financial interests, or a serious risk thereof, and the corrective measures proposed by the Member State, if any, do not adequately address the findings of the Commission’s notification, it submits a proposal to the Council for an implementing decision on appropriate measures.

30 *Case C-156/21, Hungary v European Parliament and Council*, para. 141.

31 *Id.* para. 148.

The proposal shall set out the specific reasons and pieces of evidence on which the Commission's findings are based.

The Council adopts the decision by a simple majority within 1-3 months of the date of its submission, however, if the Council wishes to adopt its decision with a amended content compared to the Commission's proposal, it can only do so by a qualified majority.<sup>32</sup>

Termination of measures requires the Member State to take appropriate corrective action, which demonstrate to the Commission that the conditions for the application of the measures no longer persist. The budgetary resources affected by the measures may be re-budgeted for a maximum of two years following the year concerned, after which they may no longer be made available to the Member State concerned.

The revision of the measures may occur either at the request of the Member State concerned or on the Commission's own initiative, at the latest one year after the adoption of the decision by the Council. In this context, the Commission shall re-evaluate the situation in the Member State concerned, taking into account any evidence provided by the Member State concerned and the appropriateness of any new corrective measures.

Based on the conclusions of the evaluation, the Commission may (i) either submit a proposal to the Council for an implementing decision terminating the measures adopted, or (ii) if the situation which led to the adoption of the measures has been partially remedied, submit a proposal to the Council for the adaptation of the measures taken, or (iii) if the Commission considers that the situation which led to the adoption of the measures has not been remedied, address a reasoned decision to the Member State concerned and inform the Council accordingly. As it is well-known, the rule of law conditionality measures for the protection of the EU budget was first applied against Hungary in December 2022.<sup>33</sup>

#### 4. Summary

In conclusion, it is apparent that conditionality has become an increasingly widespread instrument in the EU legal system in recent decades, and the public finance and budgetary rules themselves are no exception.

The toolbox for the protection of the common budget has evolved rather slowly, over more than half a century, but has now become a highly complex, multi-layered system of defense. The most recent element of this system is conditionality, which is currently being put into practice in respect of Hungary.

32 It should be noted that the original Commission proposal for the Regulation proposed an automatic and reverse qualified majority voting system, whereby the decision would have been deemed to be adopted by the Council unless the Council, acting by qualified majority, decided to reject the Commission proposal within one month of its adoption by the Commission. In the view of the author, this decision-making system might not have stood the test of the rule of law.

33 Council Implementing Decision (EU) 2022/2506 of 15 December 2022 on measures for the protection of the Union budget against breaches of the principles of the rule of law in Hungary.

This system of conditionality is clearly designed to protect the common budget and not, independently of it, to meet the requirements of the rule of law in general.

We will only know later whether this set of rules is a suitable instrument for properly protecting the general budget of the EU, or it is just a new battleground for political debates.

Conditionality is likely to play an increasingly important role in the EU legal system in the foreseeable future. Since it will exist alongside the ordinary control and sanction mechanisms of the EU, they must be governed by different rules and pursue clearly different aims. Conditionality requirements cannot simply bypass other (ordinary) sanctioning mechanisms provided by the Treaties or the secondary legislation.