EU COUNTRIES IN THE BALTIC REGION

NEW PRINCIPLES OF RESOURCE DISTRIBUTION IN THE EU AND THEIR IMPACT ON THE COUNTRIES OF THE BALTIC REGION

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The Multiannual Financial Framework for 2021—2027 was adopted during the severe crisis caused by the ongoing coronavirus pandemic. In the face of a rapidly deteriorating economic situation, EU countries took unprecedented steps radically changing the principles of resource allocation in the Union. These included the recovery plan for Europe, making the EU budget conditional on respect for the rule of law and the new EU resources system. This article seeks to identify the essential characteristics of the decisions made within the Multiannual Financial Framework and define their significance for advancing integration. The study attempts to answer two questions: do these decisions mark the transition to a new stage of integration and to what extent do they comply with the law of the Union. Several EU initiatives related to debt redistribution are analysed, along with the impact of these initiatives on Eastern European countries, particularly those of the Baltic Sea region. The research explores the decisions from the standpoint of legal and political science. In particular, it is stressed that, when reaching a compromise on making the budget conditional on respect for the rule of law, the EU and its member states had to use a mechanism for postponing the execution of an act of the Union, which contradicts the basic principles of EU law. From a political

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point of view, the adoption of a package of legislative acts within the Multiannual Financial Framework means growing dependence of the member states and an increase in solidarity and loyalty within the Union.

Keywords:
European Union, debt socialisation, Multiannual Financial Framework, solidarity, conditionality, coronavirus, EU recovery plan

On 16 December 2020, the EU adopted a range of legislative measures within the 2021—2027 Multiannual Financial Framework. Apart from the regulation laying down the multiannual financial framework,[1] the measures included a regulation establishing an instrument to support the recovery in the aftermath of the COVID-19 crisis,[2]a regulation on conditionality for the protection of the Union budget[3] and the Council decision on the Union's own resources.[4]

Compared to previous financial plans, this document introduced more radical changes to the further development of the EU. The Covid-19 outbreak contributed enormously to this. The pandemic, the member states' uncoordinated and often misguided response, the sluggishness and irresolution of the EU institutions at the early outbreak stage put the Union in a precarious position [1, p. 25]. The EU had to resort to radical non-conventional solutions, which, on the one hand, had to demonstrate solidarity within the EU and, on the other, respond to the arising challenges.

The consensus was not overwhelming: discontent of the member states was growing along with intra-Union discord. The pandemic's repercussions aggravated the long-standing problems caused by incongruities in the growth model and institutional architecture of the EU [2, p. 411]. A means to solve those problems was the mechanism for redistributing EU resources.

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[1] Council Regulation (EU, Euratom) 2020/2093 of 17 December 2020 laying down the multiannual financial framework for the years 2021 to 2027, 2020, *OJ L,* 433I, 22.12.2020, p. 11—22.

[2] Council Regulation (EU) 2020/2094 of 14 December 2020 establishing a European Union Recovery Instrument to support the recovery in the aftermath of the COVID-19 crisis, 2020, *OJ L,* 433I , 22.12.2020, p. 23—27.

[3] 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, 2020, *OJ L*, 433I , 22.12.2020, p. 1—10.

[4] Council Decision (EU, Euratom) 2020/2053 of 14 December 2020 on the system of own resources of the European Union and repealing Decision 2014/335/EU, Euratom, 2020, *OJ L,* 424, 15.12.2020, p. 1—10.

Debt mutualisation

The Economic and Monetary Union (EMU) is a notable achievement of the EU, but problems such as asymmetry [3—4] and incompleteness [5—6] came to the fore in the course of its creation.

Article 123 of the Treaty on the Functioning of the EU (TFEU) prohibits overdraft or any other type of credit facility with the European Central Bank or with the central banks of the member states in favour of Union institutions, bodies, fices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of the member states. Yet, according to Article 125 of the treaty, the Union is not liable for undertakings of any member state, nor does it assume these commitments. Thus, the founding treaties lay down the principle of the financial and credit autonomy of the Union and its member states.

The pandemic, however, forced the EU to change its approach and take the unprecedented decision on debt mutualisation, having launched a mechanism whereby the EU assumes the debt obligations of its member states. The EU institutions used a similar practice before the pandemic, albeit on a much smaller scale [7, p. 259].

Wealthier countries did not support the idea of debt mutualisation, considering it harmful and highly undesirable since it could undermine the attractiveness of the EU to investors as a reliable financial and economic system. The opponents of debt mutualisation had to change their position later, making consensus possible [8].

Spain was behind the idea of debt mutualisation. The country sought to create a special EU fund of up to 1.5tn euros to help the most affected countries of the Union by providing them with non-refundable grants to overcome the consequences of the pandemic. These grants were to be financed through the so-called 'perpetual' debt of the European Union.[5]

In response to the Spanish initiative, France and Germany proposed to create a recovery fund within the multiannual financial framework to supplement

[5] Spain proposes a €1.5 trillion coronavirus recovery fund financed through perpetual EU debt, 2020, *El Pais,* available at: https://english.elpais.com/politics/2020-04-20/spain-proposes-a-15-trillion-coronavirus-recovery-fund-financed-through-perpetual-eu-debt.html (accessed 21.04.2021).

the latter.[6] The fund had to be large enough to finance the restoration of the region's economy, used for its intended purpose only and exist as long as was needed to achieve its objectives. The French-German initiative was a symbiosis of earlier divergent demands.

The initiative was at the core of the EU economic recovery plan, drawn up by the European Commission shortly after [9]. The Commission gave the document the pretentious name Next Generation EU.[7]President of the European Commission Ursula von der Leyen presented this plan at the European Parliament on 27 May 2020.[8]

Simultaneously with the economic recovery plan for the region, the European Commission put forward a new version of the multiannual financial framework for 2021—2027 worth 1,074.3 billion euros (because the recovery plan could only be implemented within a budgetary framework). Moreover, budget funds and borrowing from financial markets should pursue common goals and complement each other. This principle has been consistently embedded in the new version of the multiannual financial framework,[9] whose expenditures seek to produce a synergistic effect in terms of the recovery and Next Generation EU plans. Overall, the spending adds up to 1.850 billion euros.

Digitalisation and transition to climate-neutral energy, including the decarbonisation of the economy, have been proclaimed a central element of the European economic recovery plan. But it remains unclear to what extent climate

[6] European Union — French-German initiative for the European recovery from the coronavirus crisis (Paris, 18 May 20), 2020, France Diplomacy, 18.05.2020, available at: https://www.diplomatie.gouv.fr/en/coming-to-france/coronavirus-advice-for-foreign-nationals-in-france/coronavirus-statements/article/european-union-french-german-initiative-for-the-european-recovery-from-the (accessed 21.04.2021).

[7] Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions "Europe's moment: Repair and Prepare for the Next Generation, 2020, COM, 456 final, Brussels, 27.05.2020, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1590732521013&uri=COM:2020:456:FIN (accessed 11.04.2021).

[8] Europe's moment: Repair and prepare for the next generation, 2020, European Commission, Brussels, 27.05.2020, available at: https://ec.europa.eu/commission/presscorner/detail/en/ip_20_940 (accessed 11.03.2021).

[9] Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions. Brussels. The EU budget powering the recovery plan for Europe, 2020, COM, 27.5.2020, no. 442, 21 p. available at: https://ec.europa.eu/info/sites/info/files/about_the_european_commission/eu_budget/1_en_act_part1_v9.pdf (accessed 11.04.2021).

neutrality is requisite or whether these efforts may result in a waste of money. The EU's plan prioritises the construction of a green economy: the Union is to spend up to 30 per cent of its total budget on achieving climate neutrality.

The economic recovery plan should be flexible so as to allow the reallocation of funds to tackle urgent problems whenever they may arise. A major proactive reallocation of funds to finance priorities similar to those in the recovery plan was carried out by the Commission in the submitted version of the multi-annual financial framework plan for 2021—2027.[10]

A special meeting of the European Council on 17—21 July 2020,[11] with great difficulty and at the cost of an uneasy compromise [10], reached the political decision to approve a 750bn euro economic recovery plan. The funds are to be borrowed by the European Commission and distributed among the member states most severely affected by the pandemic.

The usual seven-year budget of 1,074.3 bn euros is supplemented with additional 750bn (at 2018 prices), which the European Commission will borrow on behalf of the EU in financial markets. The funds will be distributed among the member states: 360bn euros in loans and 390bn in grants and budget guarantees.

The decision on debt mutualisation changes the very nature of the EU: it takes the Union to an entirely new level of integration, turning it into a fiscal federation [11] with common binding rules for fiscal and macroeconomic regulation [12, p. 38].

The reason for this transformation of the Union is twofold: firstly, the change was prompted by the very nature of the shock caused not by the behaviour of member states but by exceptional objective and universal circumstances; secondly, the crisis had anomalous and dramatic consequences for healthcare, economy and society [13, p. 2]. The solution was purely pragmatic, just as in the previous crises [14], the aim was not so much to save the affected countries as to ensure the preservation of the Economic and Monetary Union.

The financial and economic space of the EU is becoming more integrated by narrowing the gap between the wealthier and poorer countries of the EU. And this is done at the expense of more successful countries, not underperforming ones.

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[10] The EU budget powering the recovery plan for Europe, 2020, European Commission, 27.05.2020, available at: https://ec.europa.eu/info/sites/info/files/factsheet_1_en.pdf (accessed 01.04.2021).

[11] Conclusions. Special meeting of the European Council (17, 18, 19, 20 and 21 July 2020), 2020, European Council, Brussels, 21 July 2020, available at: https://www.consilium.europa.eu/media/45109/210720-euco-final-conclusions-en.pdf (accessed 11.04.2021).

Compared to the initial proposals, the final decision was a compromise: the funds earmarked for grants were reduced from 500 to 390bn euros at the insistence of Austria, the Netherlands, Germany and Sweden, among others [15, p. 20].

The agreement reached by the European Council has been welcomed everywhere. Finally, after a long break, EU member states have a strong joint action programme and the financial capacity to implement it. Next Generation EU is an ambitious vision for renewal that should be reckoned with.[12] Commentaries point to the EU having managed to show wisdom and the spirit of solidarity, look for and find common interests, move forward despite all the obstacles and challenges [16]. In this respect, this decision is a landmark in the development of the Union.

The EU and Germany decided to move towards fiscal integration, which largely affects the effectiveness of the Economic and Monetary Union.

Along with the political decision on the multi-annual fiscal framework and economic recovery plan, the European Council consented to boost its own resources. The European Council's conclusions set out a reform of its resource system. As its first step, the EU has levied a tax on non-degradable and non-recyclable plastic waste since 1 January 2021. A carbon border adjustment mechanism (a tariff on carbon-intensive products) will be introduced along with a digital tax no later than the beginning of 2023. The EU emissions trading scheme will also undergo modification, with possible extension to aviation and maritime transport. In addition, the member states will try to create new sources of revenue for the EU, such as a tax on financial transactions [17].

Rule of law vs rule of money. A mechanism to control respectfor the rule of law

The debt mutualisation project naturally affects the interests of all the member states, and even more so those with economies dependent on EU subsidies.

While discussing Next Generation EU, the European Commission revisited the idea of an EU budget conditional on respect for the rule of law.

The mechanism vests in the Commission the right to suspend payments to member states violating the rule of law. The conditionality principle establishes, in other words, a direct dependence between the payment to a state of funds from

[12] Primakov Readings: New Generation EU, 2020, Interfax, 19.06.2020, available at: https://www.interfax.ru/russia/713768 (accessed 11.04.2021).

the EU budget and the said state's commitment to the core values of the EU, such as the rule of law. The draft regulation was prepared by the Commission as early as 2018.[13] The draft law received a mixed reaction among politicians and experts alike. Blauberger and Hüllen believed that it was a step forward [18, p. 2, 12] as it was, in any case, an improvement on the dysfunctional mechanism [19] under Article 7 of the TEU. Bachmaier stresses the need to protect the rule of law as a dominant value of the EU but doubts that the proposed mechanism will be an effective and appropriate remedy, as it could damage other equally important values of the Union [20, p. 124].

Poland and Hungary, quite predictably, expressed their opposition to the mechanism, threatening to block the adoption of the EU's multiannual financial framework.

The mechanism jeopardised the position of Poland and Hungary since Article 7 procedures had already been launched against both states due to the serious risk of the two countries' authorities violating the rule of law and other fundamental values of the EU [21].

Brussels claims that Poland and Hungary are pursuing nationalistic and authoritarian policies [22, p. 381] running counter to the rule of law [23]. The countries have been condemned for partial destruction of the checks and balances system in their political systems, the concentration of power in the hands of the ruling party and its leaders, undermining the independence of the judicial system, etc. [24—25]. The EU is not satisfied with the ostensible autonomy of the Visegrad Group members, their cohesion, mutual support [26, p. 89] and ability to resist pressure.

The Commission and other EU institutions have been unable to influence these countries since the substantial financial assistance from the EU allows Poland and Hungary to feel economically confident [27].

The EU could have adopted the conditionality regulation without consent from Poland and Hungary since a regular legislative procedure based on a qualified majority in the Council is requisite in this case (Article 322 of the TFEU). But the adoption of a multi-annual financial framework and the decision on the Union's own resources require unanimity of all Council members. At the

[13] Proposal for a Regulation of the European Parliament and of the Council on the protection of the Union's budget in case of generalised deficiencies as regards the rule of law in the Member States, 2018, COM, no. 324 final — 2018/0136 (COD), available at: https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52018PC0324 (accessed 27.03.2021).

EU summit held on 10—11 December 2020,[14] the member states worked out a compromise: in exchange for a range of concessions, Poland and Hungary agreed to withdraw their objections to the multiannual financial framework, including Next Generation EU.

Parameters of the conditionality mechanism were set out in line with the conclusions of the European Council, and guarantees for the states objecting to the mechanism were provided. It was concluded, among other things, that no action could be taken under the regulation until the Commission finalised guidelines for its application. Furthermore, the European Council specifically granted the concerned member states the right to challenge the mechanism under Article 263 of the TFEU. Poland and Hungary exercised this right by challenging the regulation in the Court of Justice of the EU on 11 March 2021 [28]. The guidelines will not be completed until the court has ruled on the legal action against the conditionality mechanism.

The authors of the draft law see the conditionality rule not as punishment for violating the rule of law principle but as protection of the Union budget from fraud, corruption and conflict of interest. After all, it is in countries where the rule of law is not respected that these wrongful phenomena occur. And the access of such countries to EU financial resources should be restricted to avoid the risk of funds misuse. The conditionality mechanism aims to counter corruption rather than support the fundamental principle of the rule of law.

Based on this consensus, the Council and the Parliament adopted Regulation 2020/2092[15] on the conditionality mechanism for the protection of the Union budget. This regulation of 16 December 2020 was based on a project prepared by the Commission in 2018.

The regulation holds that the Council, acting on a proposal from the Commission, may apply measures to protect the financial interests of the Union by restricting member states' access to EU funds when the rule-of-law principle is violated or such violation affects or may affect reasonable financial management of the Union budget.

[14] European Council meeting (10 and 11 December 2020). Conclusions, 2020, European Council, available at: https://www.consilium.europa.eu/media/47296/1011-12-20-euco-conclusions-en.pdf (accessed 27.03.2021).

[15] 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, 2020, OJ L, 433I , 22.12.2020, p. 1—10.

The regulation describes elements of the breach of the rule of law by the member states, as well as the conditions for applying the conditionality mechanism and its procedure.

Article 10 of Regulation No. 2020/2092 states that it shall be applicable from 1 January 2021 when the multi-year financial framework comes into effect. The members of the European Council, however, have agreed that the mechanism will not be applied until the guidelines have been drawn up, i. e. until the Court of Justice has ruled on the legal action against the regulation.

There is a significant contradiction here as the regulation is a direct and binding legal act. But the European Council's conclusions are different purely political documents, essentially acts of soft law. This circumstance creates a situation where a regulatory act is suspended based on an act of soft law. And this is inconsistent with the tenets of EU law, the principle of the rule of law amongst others. In other words, the non-binding conclusions of the European Council make the regulation virtually unenforceable [29, p. 176].

The compromise reached by the European Council and the subsequent adoption of Regulation 2020/2092 establishing a conditionality mechanism is somewhat controversial. This mechanism, albeit difficult to implement, is preventive. There has been a lack of solidarity within the EU in recent years, and the EU institutions have few means of coercing 'opposition countries' into complying with common interests [30]. But now, the Commission has been formally equipped with an instrument comparable to a non-combatant firearm. And this is the downside of the compromise. Firstly, as noted above, the very mechanism of the rule of law conditionality undermines the rule of law itself. Secondly, virtually frozen and linked to bylaw guidelines, the new instrument is becoming less effective, becoming a political rather than legal instrument.

Thus, the adoption of the conditionality mechanism cannot be regarded as a triumph of the rule of law; it is just a temporary deal that does not resolve existing contradictions between the states but merely masks the discord.

Rail Baltica: the terminus station?

The implementation of the legal acts adopted within the multiannual financial framework was once again put in jeopardy. But this time, the threat came from the 'obedient' Baltic States.

Under Article 311 of the TFEU, the decision on the own resources of the Union should be adopted unanimously by the Council; this decision comes into

force only when approved by the member states in line with national constitutional rules. Thus, the corresponding decision of the Council, No. 2020/2053,[16] of 14 December 2020, must be approved at the national level. Otherwise, the multiannual financial framework and the recovery and Next Generation EU plans lose any sense.

In January 2021, the Lithuanian, Latvian, and Estonian leaders sent a letter to the Prime Minister of Portugal, the country holding the presidency of the EU Council, in which they threatened to block approval of the Council's decision on its own resources unless funding for the railway is guaranteed [31].

The ambitious Rail Baltica project is a high-speed railway line of the 1435 mm standard European gauge, connecting Tallinn, Riga, Kaunas, Warsaw and Berlin. There are also plans to build a railway tunnel between Tallinn and Helsinki or launch a ferry linking the cities.

The project has long been a priority for the Baltic States, as it would connect the three countries to Western Europe and provide a rail link between the Baltic, which was interrupted when the Soviet Union collapsed.

The economic situation of the Baltic States is not such that they can run this large-scale project on their own, so they are counting on financial support from the EU.

Paragraph 32 of the Conclusions of the European Union of 17—21 July 2020[17] states that the heads of state and government agree to allocate 1.384 bn euros under the Connecting Europe Facility to connect the countries by rail. Although paragraph 31 of the Conclusions names Rail Baltica a principal cross-border project, there is no indication in the document that the funds were earmarked for this project specifically.

Nevertheless, the Baltic leaders construed these provisions as a political decision to allocate money for Rail Baltica. But members of the European Parliament thought differently since financing under the Connecting Europe fund should be done on a competitive basis rather than following a political decision.

It was announced in mid-March that representatives of the Council and the Parliament had reached a compromise on the approval of the Connecting Eu-

[16] Council Decision (EU, Euratom) 2020/2053 of 14 December 2020 on the system of own re-sources of the European Union and repealing Decision 2014/335/EU, Euratom, 2002, OJ L, 424, 15.12.2020, p. 1—10.

[17] Conclusions. Special meeting of the European Council (17, 18, 19, 20 and 21 July 2020), 2020, European Council, Brussels, 21 July 2020, available at: https://www.consilium.europa.eu/media/45109/210720-euco-final-conclusions-en.pdf (accessed 29.03.2021).

rope fund budget. Priority will be given to railway projects, and the Baltic states can also expect funding for the Rail Baltica project. Still, the distribution of funds will follow the standard procedure, with no targeted funding [32].

Although this compromise, which is yet to be legislated upon, is generally acceptable to the Baltic States, it is not what they hoped for. Nonetheless, the Baltic leadership is no longer threatening to sabotage the Council's decision on own resources.

Despite its political and economic significance for the Baltic States, the Rail Baltica project has raised serious doubts about its economic and technical feasibility. Given the declining population of the Baltic states, a decrease in freight traffic and the lack of major production facilities, it is not clear what and who will be carried on this railway.

The construction of the railway alone will not solve the problems of the Baltic States. The EU political elites are convinced that all the problems of the Union's periphery are due to the member states shirking or delaying the necessary socio-economic reforms.

Moreover, the budget funds provided by the EU to complete the cross-border railway project accounts for only one-fifth of the total cost of Rail Baltica, and the Baltic States have few arguments to convince the European Commission that their project deserves EU funding.

This situation, once again, points to growing contradictions between the Western and Eastern European countries. The Visegrad Group used to be the troublemakers earlier, but now they have been joined by the Baltics, which were always loyal to the EU's common policy. Nevertheless, the resistance of the newly joined countries has not been effective so far.

Obviously, this situation is beginning to irritate Brussels, and this could eventually lead to a revision of the decision-making system to adapt it to such challenges.

Conclusion

The EU countries have come a long way within a few months. The action plan for recovery and a qualitative transformation has opened up new avenues for the EU. Huge funds have been allocated to press ahead with this plan, paving the way for even greater investments. If implemented pragmatically and effectively, these measures will speed up the integration of the EU. They will

further unlock the Union's industrial and technological potential. The EU will gain greater autonomy, become more competitive and have more reasons to claim global leadership.

Brussels succeeded in introducing the rule of law conditionality mechanism. Yet, the victory was at the cost of concessions to the mechanism's opponents, and this circumstance reduces the effectiveness of the instrument. Moreover, there is still a certain ambiguity about the rule of law, leaving considerable room for interpretation.

On the one hand, adopting the legislative package as part of the multiannual financial framework will open up new economic recovery opportunities for the periphery. On the other hand, the EU demands loyalty, solidarity and obedience, whose deficit has recently been conspicuous — all in exchange for financial aid. Deeper economic integration presupposes a closer political union, causing resentment among some of the member states, which have increasingly few tools for resistance.

The EU is becoming a growingly centralised organisation, with the countries of Eastern Europe losing their economic and political autonomy. At the same time, the new principles of resource allocation are affecting the Baltic Sea region very differently. Poland and the other Visegrad Group states have been able to defend their interests, whilst the Baltic States have had to be almost completely obedient to Brussels.

Consensus on an anti-crisis package does not mean that all the differences have been reconciled. There is still a long way to go in approving national spending programmes and financing decisions to be taken by EU institutions. The implementation of the economic recovery plan will be lengthy, complex and unpredictable. Drawing an analogy with the 1790 events when, following Alexander Hamilton's proposal, the debts of American states were transferred to the federal government, experts refer to debt mutualisation in the EU as 'Europe's Hamiltonian moment' [33], emphasising the possibility of far-reaching federalisation. Although it is difficult to foresee the consequences, these decisions give the Union a chance to build a next-generation EU.

Moreover, the EU's experience in debt mutualisation will be of interest to the EEU, which may also face the same challenge in a longer-term perspective. How the EU goes about this phase will largely determine whether other integration organisations can benefit from borrowing this mechanism.

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