

**EU Funds Watch Project
Hungary**

2013 June

Transparency International Hungary

The study is supported by the European Union Programme Hercule II (2007-2013). This programme is implemented by the European Commission. It was established to promote activities to combat fraud affecting the EU's financial interests, including cigarette smuggling and counterfeiting.

(for more information see

http://ec.europa.eu/anti_fraud/about-us/funding/index_en.htm)"

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Back in 2010 János István Tóth, one of the most important researchers of corruption in Hungary, stated that Hungarian public life is full of corruption risks, involving a variety of stakeholders from the police to judges, and a variety of areas, ranging from public procurement and tendering to legislation. Public administration is falling apart and corruption has built its own institutional system. Within these, the spending of European funds is one of the most infected areas. As he said:

“I think an incredibly retrograde role of the Union has developed in Hungary in many fields in the past few years. The methods of spending these funds create several long term adverse effects. On the one hand, the distribution mechanisms are the hotbed of corruption, on the other hand the way of spending these funds is so illogical, that it is not visible from Brussels, but probably not even from Budapest. The accounting is checked, the invoice is there, the money was spent, something was built, and the goals were met. However, the money is often spent on ‘surreal’ projects such as the 40 cm high observation tower that cost 40 million HUF – no additional economic effect generated whatsoever. On the other hand the “money brought by wind” system creates an image in the mind of economic actors that it is easier to get on, to be financially successful by having a good application writer than to develop innovative production and sales methods.”¹

Executive summary

This research has been conducted within the framework of the “EU Funds Watch” project, financed by OLAF. The “EU Funds Watch” is a complex project aimed at exploring the issues of fraud and corruption related to EU Funds distribution in the Czech Republic, Lithuania, Estonia and Hungary. Our national research contributes to the overall objectives by identifying the most significant corruption risks in the implementation of EU Funds, shedding a light on methods of fraud management and corruption prevention used in different bodies in Hungary and by identifying successful practices as well as caveats in the system.

Monitoring the implementation of EU Funds² is absolutely relevant since it is the money of the European taxpayers that is concerned. *Hungary has access to approximately 25.3 billion EUR for the 2007-13 period*³ from the Cohesion and Structural Funds; this amount roughly equals to half of the yearly national budget.

There are several ways how these public resources of considerable amount can be misused: corruption, fraud and mismanagement of Funds. Different forms of misusing EU Funds necessitate different methods of assessment. Our analysis is based on the relevant legislation and regulations, publicly accessible data, interviews with different stakeholders of the EU Funds implementation system and the review of articles on the topic concerned, written by investigative journalists.

A considerable amount of research⁴ on transparency issues concerning the management of European Funds has been conducted since Hungary joined the EU. The main line of the earlier studies drew attention to the regulatory and institutional system indicating that these

¹ Haász, János, and Péter Magyari. "A pártok együtt számolták a kenőpénzt." 22 March 2012. Web. (Accessed 3 July 2013.) http://index.hu/gazdasag/magyar/2010/03/22/a_partok_egyutt_szamoltak_a_kenopenzt/

² In the recent study we consequently deal with issues related only to the Cohesion and Structural Funds. (We do not deal with issues related to the European Agricultural and Rural Development Fund and the European Fisheries Fund, or the Single Area Payment Scheme.

³ The New Hungary Development Plan, 2007. p. 18. Web. (Accessed 4 July 2013.) http://www.nfu.hu/the_new_hungary_development_plan

⁴ “Transparency in using Structural Funds – the Hungarian case” Research, Transparency International (2005) ; Eszter Kósa: Central Programmes in Hungary 2007-13 (2008), Slovak Governance Institute; Eszter Kósa: Structural Funds Allocation in Hungary 2004-6. (2007), Providus Public Policy Institute, Latvia.

have been properly set-up; and the necessary checks and balances have been enshrined demonstrating an acceptable level of transparency. However, few shortcomings have been identified as well, such as the formal (instead of operative and effectual) civil participation in planning and monitoring, the scarcity of capacity and competence at the implementing institutions, the “grey area” of independent consultants and the conflict of interest their involvement displays. The issue of designated developments implemented in the frame of centrally planned projects where beneficiaries are pre-fixed and open competition is thus excluded has also been subject of the study. However, for the sake of linguistic simplicity, this study refers to this procedure of resource allocation⁵ known by different names in different countries such as central projects, centrally planned projects, preferential projects and priority projects. Two important conclusions were drawn. Firstly, stricter regulations are needed in this kind of procedure. Secondly, as beneficiaries are often state institutions, it is rather questionable if these projects really aim at achieving any development. They instead contribute to the maintenance of public services to be furnished by the public institutions concerned. A 2007 study has furthermore revealed that there is less corruption in the EU Funds implementation system than in other fields of public administration, and these institutions might be able to have a certain “civilizing impact” on the Hungarian public management.

In line with the conclusions of the previous studies we can state that the regulations as well as the institutional system in charge of the implementation of EU Funds are well designed and function in accordance with the European legislation and the expectations (as these are eligibility conditions for the Funds). However, there are some vague or weak points, especially concerning priority projects, selection of proposal and regulating conflict of interests, moreover, rules are sometimes simply not applied or followed. Public procurement, the regular way to spend public money, plays a crucial role in the allocation of EU Funds. Poor legislation in this field, inefficient in preventing corruption and fraud as several analyses⁶ judged, demonstrates a clear threat of corruption. Concerning the possible “civilizing” effect of the system of implementation of EU Funds, i.e. the fact that these institutions might be able to act as role models of transparent operation in the Hungarian public administration, our research disappointingly sustains that during the last couple of years this institutional system worked rather the opposite way. The institutional framework implementing EU Funds has itself become less transparent and to a certain extent opaque public procurement practices widespread in Hungary had an “incivilizing” effect.

Our research aims to identify corruption risks and demonstrate positive examples on enhancing transparency in the different phases of EU Funds implementation; these are planning, distribution, execution and control of resources distribution. We have detected serious corruption risks that are overarching the entire project cycle. All these risks are interrelated, overlapping, synergistic, and positioned in an institutional framework that is becoming more and more centralized.

⁵ In the Hungarian system the official term is “kiemelt projekt”.

⁶ Dr. Tátrai Tünde, dr. Németh Anita, dr. Perczel Zsófia: Korrupciós kockázatok a közbeszerzésben. (Corruption risks in Public Procurement.)

http://www.transparency.hu/uploads/docs/Korrupcios_kockazatok_a_kozbeszerzesben.537.pdf and Észrevételek a magyar közbeszerzési törvény módosításához. (Comments on the Amendment of the Public Procurement Act.) Web. (Accessed 12 July 2013)

http://www.transparency.hu/The_amendment_to_the_Public_Procurement_Act_will_not_reduce_corruption?bind_info=index&bind_id=0

We observed two competing objectives shaping the implementation system and the regulations related to EU Funds: the pressure of absorption (to access and spend the most of the available resources) and the demand for objective, transparent, and accountable procedures (as conditions to access the Funds). The absorption pressure leads to solutions that speed-up and simplify resource allocation (i.e. centralization in decision making, preference of priority projects, etc.), however, at the same time it increases corruption risks by limiting transparency of decision making, and restricting open competition.

Compared to the findings of previous studies on EU Funds and related transparency issues, the most significant and alarming problem is that there are current signs of systemic corruption in the management of EU Funds. It is a complicated and compound new phenomenon related to all corruption risks identified in the different implementation phases: (1) centralization tendencies in decision making, (2) restriction of open competition and the overwhelming presence of priority projects, (3) decreased professional control over proposal selection, (4) favouring formal audit and control instead of a “value for money” approach in the assessments, (5) inefficient regulation of conflicts of interest, especially concerning the “revolving door effect”, (6) the expanding influence of consultancy firms dealing with proposal writing and project management of EU Funds, (7) direct political influence on decisions and corrupt actors in the institutional system. The above mentioned risks mutually strengthen each other and create room for systemic corruption that is formed in a complicated interlacement of consultancy firms and the managing institutions of the Funds. Project executors tend to look not for proposal writers but for proposal winners, as their experiences confirm that this is the shortcut to EU Funds. This gives evidence to the existence of consultancy firms incorporated in the management system (through bribery, political influence or previous work relations) that guarantee the success of applications. Additionally, as the services of the consultants are not eligible costs, financing them from the project budget increases the probability of fraud and false reporting.

Finally, we have drawn up concrete policy recommendations related to the recognized corruption risks and transparency issues of EU Funds implementation focusing on the following: transparent and accountable decision making and grant selection procedures; comprehensive regulation of central projects; content-based monitoring, evaluation, control and audit; detailed conflict of interest regulation with special attention to the “revolving door effect”; strengthened civil participation in planning and monitoring, and enhanced publicity.

Introduction

This research has been conducted within the framework of “EU Funds Watch” project, financed by OLAF. (OLAF/HERCULE 2012/2013. Grant Agreement OLAF/2012/D5/024).

The “EU Funds Watch” is a complex project aimed at exploring the issues of fraud and corruption related to the distribution of EU funds in the Czech Republic, Lithuania, Estonia and Hungary. The objectives of the project are to

- (1) draft a “Compendium of Best Practices“ of fraud and corruption prevention in the participating countries
- (2) improve the expertise of those handling EU funds in order to enhance the prevention and detection of fraud;
- (3) improve knowledge of OLAF and its working methods in the Member States;
- (4) identify shortcomings in the systems aimed at preventing and combating fraud, with a view to rectifying them.

Our national research contributes to the overall objectives by identifying the most significant corruption risks in the implementation of EU Funds, shedding light on methods of fraud management and corruption prevention used in different administrative bodies in Hungary, and by identifying successful practices as well as caveats in the system.

As a result, we hope to contribute to a pool of useful and hands-on knowledge to share on the issue, draw clear conclusions on the state of play concerning EU Funds and corruption risks, and make concrete policy recommendations to enhance transparency.

The screening of EU Funds implementation is relevant since it is the money of the European taxpayers that is concerned. *Hungary has access to approximately 25.3 billion EUR for the 2007-13 period*⁷ from the Cohesion and Structural Funds.

There are several ways to misuse these public resources of considerable amount:

- (1) Corruption – resources are not allocated to the right beneficiaries/investment goals/projects because of political bias, trading in influence, bribery, personal relations. This phenomenon most typically occurs during the phases of planning and selecting proposal as well as during distribution of EU Funds.
- (2) Fraud – the budget of an EU financed project is misused (false reporting, false book keeping, sham contracts, over-pricing, etc.). It mainly takes place during the implementation/execution phase of the projects on the beneficiary’s side, and is supposed to be detected during audit and control.
- (3) Mismanagement of funds – the waste of public resources, even if it does not serve private interest (meaningless projects, wrongly-planned programs, irregularities in the procedures, etc.). This phenomenon appears during the planning, the distribution, and the control phases.

The different forms of the misuse of EU Funds call for different methods of investigation.

In cases of corruption all parties concerned are interested in keeping related information confidential. Certain project executors and employees of the institutions were willing to share their experiences anonymously, which enabled us to conduct in-depth interviews with them. There were a few investigative journalists who had worked intensively on finding information

⁷ Source: The New Hungary Development Plan, 2007. p. 18. Web. (Accessed 4 July 2013.)

http://www.nfu.hu/the_new_hungary_development_plan

This amount is roughly half of Hungary’s yearly national budget

related to EU tender winners, their businesses and political or personal relationships, describing the potential corruption individual cases. We found their investigative publications an excellent source of information, and we met the journalists personally in order to discuss their opinion and experiences related to the issues.

When it comes to fraud, we mainly analyzed the control and audit procedures. We also discussed the issue with project executors and employees of the institutional system responsible for EU Funds management.

The risk of mismanagement of funds can be identified by analyzing the institutional settings, decision-making procedures concerning distribution of resource, planning procedures and the content of control. We used articles on the outcomes of meaningless projects as well as publicly accessible data on EU Funds for the analysis.

The entire system of EU Funds implementation (regulations, procedures, institutions) is rather complicated and difficult to understand from an external point of view. Therefore, firstly, we will share some background information on the topic in order to orientate the reader. Secondly, we will present corruption risks/transparency related issues in the different phases of the implementation of the Funds (such as planning, distributing, execution and control). Thirdly, we will discuss the topics that overarch the phases in a separate chapter (conflict of interest, political influence, corrupt actors in the institutional system, the circle of incorporated consultancy firms, publicity, and civil control). Finally, we will provide a comprehensive conclusion and some policy recommendations designed to curb corruption.

We will apply the same construction in all chapters: (1) State of play (2) changes and development (where it is relevant) and (3) problems, conclusions. We will illustrate and confirm our statements by describing concrete cases and by quoting our interviewees. Furthermore, we will draw attention to positive examples and best practices related to the topic of EU Funds and transparency.

Table 1: Different corruption risks in different phases of EU Funds implementation

More centralized institutional system and decision-making process	
Phase	Corruption risks
Planning phase	Priority projects, obligatory partnerships
Distribution phase	Grant evaluation and selection, absorption pressure, meaningless projects
Execution phase	Public procurement, fraud
Control and audit phase	Lack of content based control
Overarching	Conflict of interest, revolving door effect, political influence, corrupt decision makers, incorporated companies and experts, lack of publicity and civil control
Signs of systematic corruption	

1. Methodology

The analysis is based on relevant legislation and regulations, publicly accessible data, interviews with different stakeholders of the EU Funds implementation system and the review of investigative articles. We decided to apply this “mixed” methodology because the different ways of misuse of EU Funds (corruption, fraud, mismanagement) necessitate a multiple approach, as we have already argued in the Introduction section (p.4.).

Document and data analysis: relevant legislation and other regulations, publicly accessible data on Funds

The following acts, decrees and documents were reviewed for this analysis:

- Government Decree 4/2011 on the rules of the allocation of funds from the European Regional Development Fund, the European Social Fund and the Cohesion Fund in the programming period 2007 to 2013
- Act CLII of 2007 on Assets Declarations
- Act CLXXXI of 2007 on Transparency of Subsidies Provided from Public Funds
- Act XXIV of 2003 on the Utilization of Public Funds, the Enhancement of Transparency and Publicity of and on the Extension of Control over the Utilization of Public Property (“Glass-Pocket Act”)- Government Decree 49/2007 on the national institutions involved in the implementation of certain programmes related to European territorial cooperation funded by the European Regional Development Fund, the Instrument for Pre-Accession, and the European Neighbourhood and Partnership Instrument
- Government Decree 140/2012 on the Governmental Committee on National Development
- Order No. 26/2012 of the Ministry of National Development on the Unified Operational Guide.
- Council Regulation (EC) No 1083/2006 of 11 July 2006, Laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999

Interviews

Our aim was to have a diverse pool of interviewees in order to be able to reflect impressions from the different points of view characterizing the different actors. Thus, some of the total of 10 respondents had multiple roles being focused on: e.g. ex-employee of the institutional system who is presently a consultant, a whistleblower who failed to win several public procurements, etc. However, it was problematic to find interviewees working in the institutions implementing EU Funds. We have not received a response from the State Audit Office, from the Government Control Office and from the National Tax and Customs Administration. Most of our respondents required anonymity.

Interviewees represented the following institutions and categories:

- Employees of the National Development Agency
- Employees of Intermediary Bodies (especially employees dealing with proposal evaluation)
- Consultancy Firms, proposal writers
- Winners and non-winners of public procurements

- Former employees of institutions implementing EU Funds
- Law-enforcement and prosecution
- Investigative journalists
- Whistleblowers
- Expert in a priority project

Press analysis

We studied 43 investigative articles (see References p. 44) addressing corruption cases from recent years in the field of use and management of EU resources. These articles revealed important information related to the topics of the current analysis, and will be referred to in the following chapters.

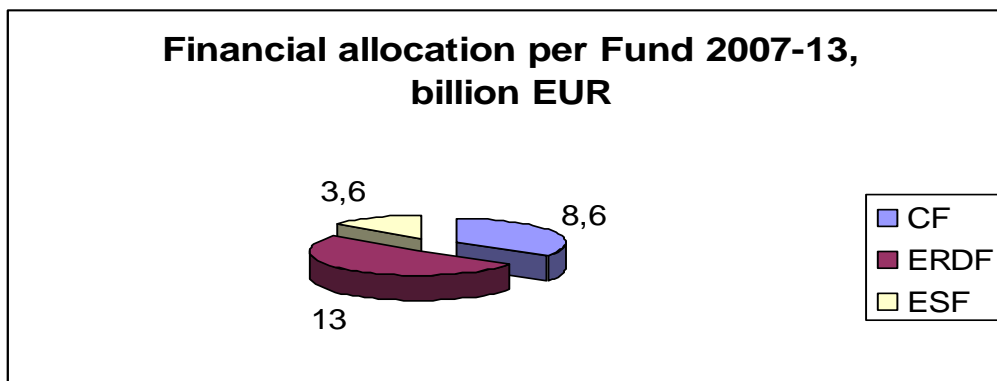
2. Background information

EU Funds

By EU Funds we refer to the tools of the Cohesion Policy, such as (1) the Cohesion Fund, (financing infrastructural mega-projects agreed between the Government and the Commission), (2) the European Social Fund, (financing human resource development projects) and (3) the European Regional Development Fund, (financing infrastructure investments). The last two Funds together are called “Structural Funds”. The activities of the Funds in the Member States take the form of Operational Programs within the National Strategic Reference Framework. Each operational program covers the period between the 1st of January 2007 and the 31st of December 2013⁸.

Hungary is entitled to *EUR 25.3 billion*⁹ from the cohesion policy of the EU between 2007 and 2013, to be co-financed by the national government (approximately 15%) and business sector¹⁰. The proportions of the Funds is: 34% CF, 52% ERDF, 14% ESF¹¹

*Figure 1: Financial allocation/Fund 2007-13 in the Hungarian NSRF, billion EUR*¹²



The Hungarian National Strategic Reference Framework (NSRF)

The objectives and priorities of the NSRF are supposed to be achieved through 15 Operational Programs (OPs), two of which are co-financed by the European Social Fund (ESF) and 13 by the European Regional Development Fund (ERDF) and the Cohesion Fund (CF). The 15 Operational Programs include seven regional and eight sectorial programs. In addition, Hungary participates in four cross-border co-operation programs, two transnational co-operation programs and in the interregional co-operation of Member States¹³.

⁸ Council Regulation (EC) No 1083/2006

⁹ At price level calculated in 2007, see at The New Hungary Development Plan, 2007. p. 18. Web. (Accessed 12 July 2013) http://www.nfu.hu/the_new_hungary_development_plan

¹⁰ The New Hungary Development Plan, 2007. p. 18. Web. (Accessed 12 July 2013) http://www.nfu.hu/the_new_hungary_development_plan

¹¹ “Also, an additional EUR 3.8 billion at current prices (2007) are available from the European Agricultural and Rural Development Fund and EUR 34.3 million from the European Fisheries Fund.” Source: same footnote as 7, p. 18.

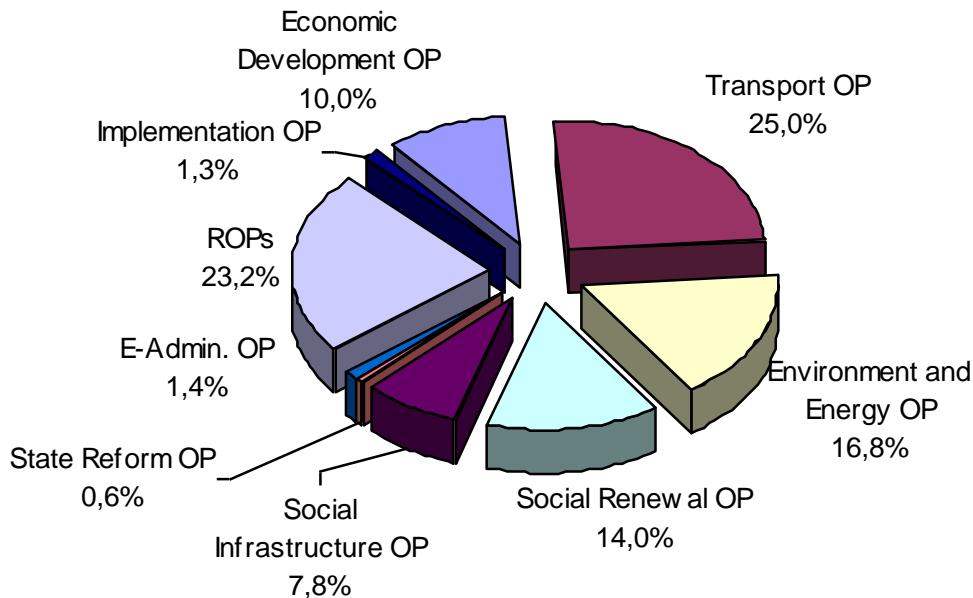
¹² Source: Hungary: Results of the negotiations of Cohesion Policy strategies and programmes 2007–13. (Accessed Web. 10 July 2013)

http://ec.europa.eu/regional_policy/sources/docoffic/official/communic/negotiation/country_hu_en.pdf

¹³ Source: Hungary: Results of the negotiations of Cohesion Policy strategies and programmes 2007–13. (Accessed Web. 10 July 2013)

http://ec.europa.eu/regional_policy/sources/docoffic/official/communic/negotiation/country_hu_en.pdf

Figure 2: The Operational Programs of the Hungarian NSRF 2007-13 (and proportion of funding)¹⁴



Mechanisms of resource allocation

Based on the regulations there are different ways of resource allocation. In fact, there are some procedures that are rarely applied in the Hungarian practice (such as the normative allocation or the so-called system of global grants).

The Cohesion Fund is allocated through centrally planned big infrastructure projects (of a budget of over 50 million EUR) that are individually approved by the Commission. The beneficiaries are appointed in the project plan.

ESF and ERDF are allocated via two procedures; the decision over the mechanism to be applied is made during the planning phase. One is tendering based on call for proposals (open competition); the other one is priority projects, where beneficiaries (often organizations of the state administration) are appointed in the planning documentation based on a governmental decision.

¹⁴ Source: Presentation of dr. Tamás Tétényi: New Hungary Development Plan. National Development Agency. (2007)

Table 2: The procedures of resource allocation

	Cohesion Fund	ESF and ERDF (Structural Funds)	
Planning phase	Big infrastructure projects, centrally planned, Commission's agreement	Tender, Call for Proposals (may be executed in one or two rounds)	Priority projects, Centrally planned, Governmental decision
Distribution phase	appointed beneficiary/executor (no competition)	Grant evaluation / Project selection (open competition)	Appointed beneficiary/executor (no competition)
Execution phase	Public procurement	Public procurement	Public procurement

Institutional setting (before the centralization, described in detail in Chapter 3)

The key elements of the system managing EU Funds are the following:

The central institution in charge of distributing EU Funds is the National Development Agency (NDA). Within the NDA there are several Managing Authorities (MA) responsible for the management of the Operational Programs (which are further detailed in Action Plans and Measures). Intermediary Bodies (IB) handle applications, manage the selection procedure, deal with the payment requests and control the use of funds at the beneficiaries on behalf of the MAs. The Paying Authority (PA) manages payment requests towards the EU and receives the disbursements from the European Union. Monitoring Committees are the main coordinating and decision making bodies of the Operational Programs; they control the implementation of the Programs and the operation of the Managing Authorities. The Committees involve representatives of social partners, Regional Development Agencies, various control bodies, the European Commission and relevant government institutions. Management Committees are further coordinating bodies, where members represent the institutions in charge of implementing the programs.

Table 3: Planning documentations, decision making and implementing bodies

Documentation level	Decision-making body	Implementation
National Strategic Reference Framework	Government, Ministry of Development	National Development Agency (NDA)
Operational Programs, Action Plans	Monitoring Committees	6 Managing Authorities (MA), Paying Authority (PA)
Measures (priority projects or open call for proposals)	NDA	15 Intermediary Bodies (IB)

3. Centralization tendencies in the EU Funds management system

The corruption risks detected in the different phases of EU Funds implementation need to be interpreted in the framework of an increasingly centralized institutional system. As the most recent news indicate this centralization tendency will continue and become stronger in the upcoming months¹⁵.

State of play

As it has already been assessed in previous paragraphs¹⁶, the Hungarian institutional system for the implementation of the EU Funds had been well designed and contains all the necessary checks and balances for appropriate operations.

The National Development Agency was set up in 2006 by merging the National Development Office and the implementing agencies. This restructuring introduced the dominance of expertise of the technical management over the professional influence of the relevant Ministries.

*“Previously, if the head of the National Development Office advised the Minister of Education on a certain issue, the Minister could easily dismiss the guidance and follow his own professional approach. In the new setting the head of the National Development Agency can practically instruct the line Ministers without them having the chance to contradict”*¹⁷

Moreover, three Intermediary Bodies managing ESF funds for education, employment, social inclusion and health-related development schemes were merged in 2011.

The general framework of the institutional system complies with the relevant EU directives and is regulated by decrees of the government and various ministries. A comprehensive amendment to the legislation, carried out in 2011, unified the various legal instruments in a single decree without introducing major changes in the operational procedures.

Changes and developments

The most significant change was probably the 2012 establishment of the Governmental Committee on National Development (GCND)¹⁸ that took over major decisive roles in the distribution of EU funds, such as approving or modifying Operational Programs and Action Plans, approving priority projects, and other projects with a budget exceeding one billion HUF. This Committee is manned by the Prime Minister, two Ministers and a Secretary of State¹⁹.

Problems, conclusions

Based on the relevant governmental decree (140/2012) the decision mechanism of the Committee is not detailed and is not made transparent for the public. The decree describes (rather briefly) only the licences and decision making competences of the Committee but nothing is mentioned about the preparation of decisions, the consultations with the relevant actors, or publicity. We are convinced that the centralization and exclusivity of decision-

¹⁵ “Orbán magához ragadta az uniós kassza kulcsát.” 15 July 2013. Web. (Accessed 15 July 2013.)

<http://www.origo.hu/gazdasag/20130715-orban-magahoz-ragadta-az-unios-kassza-kulcsat.html>

¹⁶ “Transparency in using Structural Funds – the Hungarian case” Research, Transparency International (2005)

¹⁷ Based on HVG article „Más ez az osztás” HVG magazin 2006/25, quoting an anonymous source, Web.

(Accessed 15 July 2013) <http://hvg.hu/hvgfriss/2006.25/200625HVGFriss137>

¹⁸ 140/2012. (VII. 2.) Government decree

¹⁹ The Chair of GCND is Viktor Orbán (Prime Minister), the members have been at the time of establishment János Lázár (State Secretary of the Prime Minister’s office), Lászlóné Németh (Minister of Development) and György Matolcsy (Minister of Economy)

making in the institutional system weakens transparency, as the role of independent checks and balances declines.

Positive example: the composition of the Monitoring Committees

Monitoring Committees are still important bodies in the implementation of EU Funds (see Table 3.). In practice the civil participation in the Monitoring Committees of the OPs is an important contribution. Different communities of the society and civil bodies are represented wherever their participation is relevant, such as organizations standing for the Roma minority, environmental protection and nature conservation issues as well as disabled people. Civil representation in the decision making process is an important guarantee of transparency.

4. Corruption risks in the planning phase

During the planning phase decisions concerning the most important issues on the allocation of EU Funds are made: what type of investments should be implemented (based on the objectives of the National Strategic Reference Framework) and how should these be executed. Planning the projects (investments) centrally, appointing the beneficiaries in the planning documentations already, and limiting open competition obviously speed up the entire procedure of resource allocation and leave room for concentrated developments. In many cases priority projects are absolutely justifiable (in big infrastructure projects or cases where there is only one available executor) and obligatory partnerships are necessary (participation of key institutions). But based on our analysis the procedure of the priority projects and obligatory partnerships lack strict and transparent regulation and conditions for their application. It leads to an overwhelming presence of priority projects, unfair preference of certain organizations, non-transparent allocation of resources, and misuse of Funds (financing the maintenance of state institutions instead of real developments).

4.1 Priority Projects

State of play

Government Decree 4/2011 defines priority projects as national or regional projects approved by the Governmental Committee on National Development and designated in the Action Plans of the Operational Programs. According to this decree, the NDA submits the list of proposed projects to be designated as priority projects for the Governmental Committee on National Development.

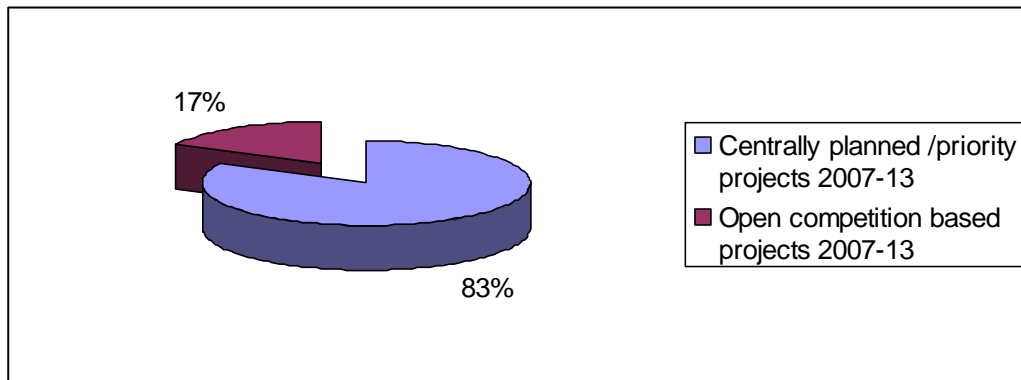
The application procedure of priority projects differs profoundly from that of the grant schemes. Not only does it lack open competition among different applicants, but its single eligible applicant shall in fact take part in the preparation of the call for application. Contrarily to the grant schemes, calls for priority projects are not subject to public consultations (see Chapter 8.4 for details); instead these are solely consulted on by the competent Intermediary Body and the Monitoring Committee. No detail is given as to how the findings of such limited consultations can be utilised.

The evaluation of the submitted priority projects is limited to the check of the eligibility for European funding, the level of its preparation and its accordance with other priority projects. The Operational Guide states that the Governmental Committee on National Development may overturn a decision of the NDA not to support the approval of a priority project. This means that the final say as regards approval and designation of priority projects remain with the Governmental Committee on National Development.

Predominance of priority projects

The database containing priority projects between 2007 and 2013 is available on the website of the National Development Agency.²⁰ Unfortunately, the database does not contain information on the Fund concerned (CF or ERDF or ESF)²¹ or the beneficiary. Since the tables indicate the total project budgets awarded, we assume that these amounts already include the national contributions (15% on average). (See our table aggregated from the information available on NDA's website in Annex 1, including 1225 items.) If we sum up the budgets in the "supported projects" category, the total amount (including both Cohesion Fund-financed big infrastructure projects and Structural Funds-financed priority projects), is 6721.721 billion HUF (ca. 24 billion EUR at a 280 HUF/EUR rate). The total budget of available Cohesion and Structural Funds is 25.3 billion EUR, which is complemented by a 15% national contribution. Calculating at 280 HUF/EUR rates, the total amount for financing investments/projects in the 2007-13 period is 8146 billion HUF. We applied this data for the comparison below; see Figure 2.²²

Figure 3: Funding proportion of priority and open competition based projects



About 80% of the priority projects are implemented in the framework of the Transportation Operative Program. These are big infrastructural development projects (such as the building of the 4th Metro-line in Budapest, or the reconstruction of the Budapest-Esztergom railways), where public procurement (as the second level of resource allocation, see Table 2.) is often exposed to corruption. (See details in Chapter 6.1). Although lagging far behind the Transportation Operative Program, the Social Renewal Operative Program, with a share mounting to 6.5%, is the second largest receiver of funds among the OPs having the second largest portion of priority projects (see Figure 1, where "Regional OPs" means the sum of 7 separate Operational Programs). These programs typically focus on the training of long-term unemployed people and their re-integration into the labour market, or entail complex programs for the social integration of the most disadvantaged groups in society.

²⁰ Source: Kormány által javasolt kiemelt projektek. Web. (Accessed 16 July 2013.)

http://www.nfu.hu/kormany_atal_javasolt_kiemelt_projektek

²¹ http://www.nfu.hu/kormany_atal_javasolt_kiemelt_projektek

²² Our calculations did not include the projects falling into the categories "under adaptation" and "rejected". In the table for some items a negative amount is shown that we could not interpret unequivocally (their share in the total is minimal). We also cannot be sure at what EUR/HUF rate were the amounts in the original tables calculated. Taking all these uncertainties into account we still may state confidently that the proportion of funding centrally planned projects is over 80% in the total budget of Cohesion and Structural Funds completed by national sources in the 2007-13 period.

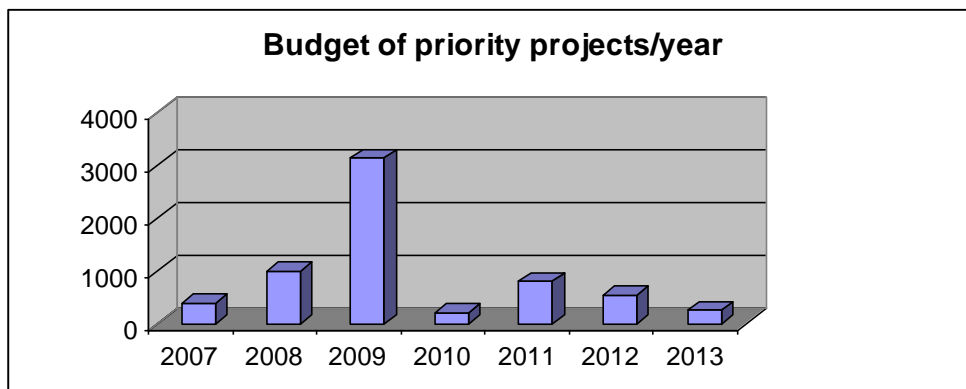
Changes and developments

It seems that governments generally favour the application of priority projects, as they allow concentrated investments (in the case of big infrastructure projects this is justifiable).

“Priority projects have a great advantage: concentrated investments. But the application of this procedure should be better regulated” points out our 2nd interviewee, a former employee of the institutional system.

In fact, concerning the timing of the decisions on priority projects, 2009 was the year when by far the most significant amounts of resources were allocated without open competition. (Decisions were made in 2009 on accepted priority projects having a total budget of over 3000 billion HUF. The bundle of projects includes ten big infrastructure projects with individual budgets of over 100 billion HUF.) We also have to emphasize that the *implementation* of these priority projects (practically: the spending of the money) was obviously extended to the following years.

Figure 4: Total budget of priority projects based on the *timing of the decision*



“Surely, priority projects are applied more often than necessary. But we have to consider two factors: (1) they are a fast way to allocate resources, and we are under an absorption pressure. (2) they are not the invention of the current government, but that of the previous one. A high proportion of ESF resources were allocated under the previous government via this procedure to the National Labor Service. Now the same is happening to the TÜR Training Centre.” 8th interviewee, currently employed at a Managing Authority.

When we raise the issue of priority projects as a risk of corruption in the planning phase we do not refer to infrastructural mega-projects (as they will be focused at when it comes to the execution phase), as these projects obviously need to be centrally planned and have an appointed beneficiary. But the “smaller” investments, especially in the field of human resources development, are often questionable as priority projects (excluding open competition when selecting the beneficiary). It seems that the problem has been present for a while, as a study described in 2008:²³

“The biggest question of the procedure ... is “what makes a preferential project preferential”²⁴? As it has to fulfill – obviously – the goals of the National Development Plan, and within that one of the Operational Programs, how is it proven that the same goals can not be achieved by projects selected in an open competition procedure? If we look at the details of the procedure, we do not get answers for that question. There is no phase in the selection when the final beneficiary would be examined to see if that organization is the most suitable

²³ Eszter Kósa: Central Programmes in Hungary 2007-13 (2008), Slovak Governance Institute. p.7.

²⁴ In our present study: priority project (kiemelt projekt)

for the implementation of the project, and so open competition is not necessary. The following content-based aspects are considered during the preferential projects' selection:

- *It contributes to the social/economical goals of the OP*
- *It is measurable, has achievable goals*
- *Cost effective*
- *Adequately prepared*

The Proposer has to examine the projects based on the following aspects:

- *If it suits the sectorial/regional strategy*
- *If it is reasonable on professional bases*

All these aspects could be valid for the projects selected via open competition as well. The only concrete condition is that "a development cannot be a preferential project if it might be implemented through an existing open call for proposals in the same Action Plan". This is a very wide definition that excludes only some obvious cases when the same types of projects would be implemented parallel, at the same time, from the same resources: by a first beneficiary selected in an open competition, and by a second one appointed in the Action Plan. I am of the opinion that based on two fundamental values of the European Union (freedom of competition and sector neutrality) all the goals set out in the planning documents should be achieved by the most appropriate final beneficiaries – the best way to find them is open competition, except in some cases when competition is impossible (for example in the case when only one institution exists in the country with certain competencies, roles, capacities, etc.)." All these issues are relevant at present as well.

The selection of priority projects should be monitored by the Commission, or, alternatively, the entire decision-making procedure should be done in Brussels (similarly to the big infrastructure projects)." 3rd interviewee – Former manager of a proposal writing and project management firm.

Problems, conclusions

Whenever we raise the topic of transparency and EU Funds, the first issues that come up are usually related to the tendering system: manipulated project selection, corrupt decision makers in the institutional system, etc. We have to draw attention to the fact that over 80% of EU Funds are allocated via the priority project procedure, which lacks open competition. Therefore it is crucial to closely observe the corruption risks of this mechanism, too.

The guidelines pertaining to priority projects represent one of the major loopholes in the regulation and open a wide door to inordinate spending and mismanagement of the funds.

We find it often questionable that the only potential project executor is the one appointed in the planning documentation²⁵, especially in the field of human resources development. One can assume that the tasks of the appointed beneficiaries (training, consultation) could be implemented by other actors, selected via open call for proposals, as well. At least the opportunity of tendering (open competition) should be considered under stricter conditions and the decision to apply the priority project procedure should be justified in detail.

²⁵ During the last governmental period the typical ESF financed central project beneficiary was the National Employment Service (NES) or so called background institutions of Ministries. Since 2010 a new actor has appeared, the Türr István Training and Research Institute (the Türr Institute was established in July 2011) as the beneficiary of several central projects.

“The studies on the implementation of the priority projects should contain serious economic calculations, which should be assessed in detail.” 3rd interviewee – Former manager of a proposal writing and project management firm.

The planning, evaluation and approval of priority projects are completed with minimal requirements for transparency and accountability. Furthermore, evaluation of priority projects particularly lacks content-based approach, and financial scrutiny. The procedures are completed without ensuring an adequate level of transparency or access to public data.

“The so called “priority projects” are problematic, as it is difficult to find relevant information on them, and so the public is excluded from the whole process. We cannot form an objective opinion on whether the selection of the appointed beneficiary happened in accordance with the rules or whether it was truly justifiable and well-founded.” 1st interviewee – Journalist, writer of investigative articles on EU funds and corruption.

Another important issue is that the beneficiaries of the priority projects are state institutions (ministries, background institutions of ministries or other organizations of the state administration). EU Funds clearly aim to finance *development* and not maintenance or the operation of public institutions. As the quality of the control of priority projects is rather poor, we assume that the objective to develop is often set aside or outdone by interests of the institutions (as already described in a previous study on priority projects)²⁶.

“I work as an expert in a priority project in a background institution of the Ministry. I experienced that our project was entirely reshaped in the execution phase in order to serve the instant needs of the Ministry related to a politically prioritized issue. Furthermore about 25% of those administered as working in the priority project with their salary paid from the project budget are simple employees of our Ministry background institution, and their job has nothing to do with the priority project.” 10th interviewee – Expert in a priority project.

4.2 Obligatory partnership

State of play

Concerning the lack of public access to data, it is difficult to systematically map the nature and details of obligatory partnerships; therefore we base our statements on our own experiences and on the interviews. In numerous calls for proposals a concretely identified obligatory consortium member or obligatory cooperation partner is appointed as an eligibility condition.²⁷

One illustrative example of how compulsory partnership functions is the case of the National Roma Self-Government (NRSZ), which is often appointed as obligatory partner in programs where Roma integration is concerned. Nonetheless, NRSZ is not only an obligatory partner in several grant schemes but also the beneficiary of priority projects. Based on the data accessible on the website of the organization they have received over 8 billion HUF so far as beneficiaries of priority projects²⁸.

Although the aim to have Roma representation in the project implementation where the Roma community is concerned is understandable and worth to be supported, the appointment of the partner organization representing the “Roma issue” itself is at least questionable. It is especially so if we consider the fact that the head of the NRSZ is a government MP. This is

²⁶ Eszter Kósa: Central Programmes in Hungary 2007-13 (2008), Slovak Governance Institute

²⁷ For example, based on searching Calls for proposals: TAMOP 5.3.6-11/1, TAMOP 5.3.10-12/1, TAMOP-4.1.2E-13/1

²⁸ TAMOP-2.2.7.A-13/1, TAMOP-5.3.1.B-2-12/1-2, ÁROP-2011/2.2.15. Source: Web. (Accessed 12 July 2013) www.aronk.hu

only one example that caught our attention, but not an ascertainment based on an in-depth analysis. Obligatory consortium members and their roles could be investigated by thorough analyses in all Calls for Proposals.

Problems, conclusions

This problem is similar to the issue of priority projects (it can even be viewed as a sub-case thereof). In certain cases obligatorily co-operating with a designated public institution is undoubtedly crucial for the success of a project. For example, in a project addressing the reintegration to the labour market of the long-term unemployed, the Labour Office has to be involved as the key service provider. This has been an accepted practice in the justifiable cases for years. The question is whether this obligation is not applied unduly to favour concrete organizations? That is, in order to ensure their participation in various projects and to provide them with a certain share from the EU Funds. .)

Similarly to priority projects, appointing often public institutions as obligatory partners obviously (1) limits competition, as project partners cannot be chosen freely, (2) reduces the application opportunities of other organizations that are active in the same field, and (3) puts immense workload on appointed obligatory partner organizations often not prepared to participate in such a high number of projects.

“Obviously, some executors of priority projects and obligatory partners in grant schemes receive more financial resources and assume more tasks than they are capable to deal with. They simply do not have the capacity to keep up with their tasks.” 8th interviewee – Currently employed at a Managing Authority.

5. Corruption risks in the distribution phase

It seems that during the distribution phase (practically the allocation of EU Funds to the beneficiaries) two objectives compete: transparency of the system and successful absorption of available resources. There is a great pressure on political decision-makers to use all funds made available for the country. The importance of transparency, checks and balances in the system, and accountability are often subordinated to the aim of absorption. This pressure increases the risk of corruption. Centralization and declining transparency of decision making hand in hand with feeble professional control over the assessment of the proposals are both rooted in the intention to speed-up resource allocation. However, their consequences are devastating, as they lead to manipulation of proposal selection and waste of public money by the financing of meaningless projects.

5.1 Grant evaluation and selection

State of play

Both Government Decree 4/2011 and the unified operational guide for the use of ESF and ERDF regulate the process of the evaluation and selection of grant applications in detail. These documents describe

- the administrative moves
- the technical evaluation of the applications
- the potential on-site pre-monitoring procedure at the applicant
- the various procedures for assessing the content of the proposals – the simplified procedure where all administratively complete applications are awarded automatically without evaluating the content (up to the financial limit of the scheme); the content-based evaluation of the applications; and the assessment of priority projects

- the procedure of requesting missing or additional documents or information from the applicant
- the relevant decision making bodies – generally the NDA and the Governmental Committee on National Development when it comes to priority projects and projects whose budget exceeds one billion HUF.

Content-based evaluation can be completed by personnel of the Intermediary Body or by contracted external assessors. The evaluation process is regulated in detail by the Managing Authority on a case-by-case basis, at each call.

The evaluation is regulated in detail up to the point where the assessors assign scores to the applicants, give a suggestion on granting, and recommend amendments on the budget or preconditions for funding for each application. After that stage, the final decision remains with the NDA or at the Governmental Committee on National Development.

Changes and developments

The Government Decree 4/2011 was amended as of February 2012²⁹. The amendment aims to simplify the procedures, decrease the level of bureaucracy and speed up the decision-making processes. The list of the exact changes can be found on the website of the NDA³⁰. The amendments set targets such as shorter deadlines for the different phases in resource allocation procedures, precise identification of administrative obligations of the beneficiaries, etc.

“Following the amendment to the regulation (4/2011) in 2012, based on the amended rules the Intermediary Body outsourced the assessment of the proposals (probably in order to speed up the procedure). The outcome of the assessments is observed by the so-called Decision Preparing Committee and the final decision is made by the Director of the Managing Authority. My personal impression is that we (as Managing Authority employees) have had more professional control in the previous system (with two independent assessors from an expert pool) which had been however obviously slow. I believe there had been corruption cases in the previous system, too, but we could at least have a professional control over it. Now we receive very limited information from the firm that is responsible for the assessment, but obviously the procedures are faster.” 8th interviewee – Currently employed at a Managing Authority

An example for the adjustment of regulations to a special situation in proposal selection

A grant scheme of 15 billion HUF (cca 54.5 million EUR³¹) for supporting innovative developments in schools was launched in 2012, based on the above described simplified, automatic evaluation scheme. (“All administratively complete applications are awarded automatically without evaluating the content, they are rated only by the date of submission”, p. 20.) The submission period had originally been 5-18 October 2012, but the submission was closed already on the first day, because the total fund request of the submitted applications exceeded the available funds of the scheme.

The relevant legislation states that in the event that the requested funds exceed the available sum, the submission has to be closed and the applications received prior to the closing date have to be awarded.

²⁹ 25/2012 (II. 29) Governmental Decree

³⁰ http://www.nfu.hu/modosult_a_tamogatasok_felhasznalasanak_rendjerol_szolo_4_2011_i_28_szamu_korman_yrendelet (Accessed 16 July 2013.)

³¹ Calculated at 280 HUF/EUR rate

In the case of this grant scheme the funds requested by the applicants on the very first day of the submission period exceeded the available resources more than six times. Since the applications were not subject to a content-based assessment, the existing operational guidelines did not provide suitable tools for selecting the applications to be awarded. One option would have been to cancel the grant scheme and not award any of the applicants, but the funding system was already under serious pressure to speed up contracting towards the end of the programming period.³²

The Government adopted resolution No. 1483/2012 addressing this particular issue, instructing the NDA to conduct a lottery certified by a notary to establish the order of submission of applications and then select the awarded applications based on this order, up to the limit of the available funds. This government resolution introduced an operational procedure that applied also to projects underway, i.e. with retroactive effect. The procedure had not existed the moment the grant scheme was launched, was not referred to in the documentation of the scheme and despite the instruction included in the resolution – it has not been embedded in the relevant legislation since it entered into force.

This case reveals how regulations in place can be overturned - when peculiarities of individual cases so need by introducing special provisions to legalise procedures ex post facto.

Problems and conclusions

Proposal selection is one of the most sensitive issues related to the allocation of EU Funds. In general there is a strong competition for the available resources in the grant schemes; therefore the rating of proposals has to be objective, transparent and accountable. As we stated above, the regulations concerning these procedures are well designed. The changes in 2012 accelerated the procedures but eventually caused a decline in professional control over the assessments. Assessments are usually executed by external players (independent assessors or contracted firms). It is also true that rejected applicants often claim that the procedures were corrupt or manipulated, however, in most cases they cannot sustain such reproaches.

As we have mentioned before, the practice of regulations based on individual cases makes the selection procedure unpredictable and non-transparent.

It seems to be a question of answers how the procedure can be manipulated while the law provides for numerous checks and balances. One potential explanation we received from one of our interviewees:

“I used to work for one of the Intermediary Bodies. There was a basic change in the group of pre-assessors in 2008. At first sight the process became more transparent and professional, but in reality it was manipulated. Based on the new procedures, those independent experts who intended to get into the pool of assessors had to pass an examination. The exam was tailor-made so as to get certain people in the pool. Based on the professional background of the assessors they were selected through a “lottery” system to assess proposals. But some proposals were directly given by senior officials to those assessors who were expected to give high scores in certain cases. If both assessors give a high score to a proposal, the Evaluation Committee rarely overrides the outcome. It was not conspicuous at all as they received “normal” proposals too, where they all gave different scores, etc.” – Former employee of an Intermediary Body.

³² Based on Index online article „Sorsolással kapnak pénzt az iskolák” Nov 9, 2012, Web. (Accessed 10 July 2013) http://index.hu/belfold/2012/11/09/sorsolással_kapnak_az_iskolak_penzt/ and www.szegedma.hu online article „Innovatív iskolák fejlesztése – sorsolással dönt az NFÜ” Nov 23, 2012, Web. (Accessed 10 July 2013) <http://szegedma.hu/hir/szeged/2012/11/sorsolással-dont-az-nfu.html>

The entire application procedure and the selection of proposals is very complicated and bureaucratic. This is reasoned by a strive to ensure objectivity and accountability. Applicants have to submit an excessive amount of documentation with an extremely detailed project description and numerous certificates and other kind of “official papers”. The assessors have to fill out long and very thorough evaluation forms scoring the various aspects of the proposals. A separate committee prepares the decision. Obviously a lot of effort has been made to have an accountable proposal selection; and still, the outcome is often unfair. (We will discuss the issue of meaningless projects and the phenomenon of incorporated consultancy firms in Chapters 5.3 and 8.3.)

The issue of simplified allocation methods is always raised at conferences and workshops discussing the distribution of EU Funds. In Hungary the mechanisms of normative support or global grants are rarely applied, although, these are fast and cheap grant management mechanisms. Usually it is concluded that Hungary has the worst combination of outcomes: the most expensive, slowest and most bureaucratic procedures are applied to distribute funds (we mean open calls), as a result of which resources are often unfairly allocated and the whole process badly lacks transparency.

5.2 Absorption pressure

State of play

Several analyses³³ have argued that the process of tendering, contracting and disbursing of the funds in the present programming period has suffered severe temporal disproportions, exposing the system to immense absorption pressure towards the end of the 2007-2013 period. Reasons are manifold, ranging from inadequate planning to institutional capacity constraints and absorption capacity issues on the side of the beneficiaries. One of the key reasons was the almost complete freezing of the distribution of funds that lasted a year and a half from the inauguration of the government in 2010. This period of standstill brought significant institutional reorganizations and to a certain extent the restructuring of the programmes.

Political pressure to hand out an immense amount of money in a relatively short period, coupled with decision mechanisms that became more centralized and less transparent, again opened strong opportunities for mismanagement and corruption. The establishment of the Governmental Committee on National Development and the restructuring of the Prime Minister’s Office in 2012 were also linked to the absorption pressure, and led again to strong centralization in the decision making process (as referred to in Chapter 3).

Moreover, the restructuring of the institutional system brought about a period during which the decision making mechanisms were unclear and slow. Certain consultancy companies gained new momentum by offering their “cooperation” with the promise of a smooth success of the applications, while the administration of the managing agencies often seemed to be waiting for “higher political decisions”.³⁴ In certain grant schemes it was not unprecedented for the evaluation period to take more than half a year, as opposed to the 30-60 day timeframe set forth by the regulations.

³³ See next three footnotes

³⁴ Based on HVG online article „Beragad a sokmillio euro”, HVG online magazin, Sept 7, 2012, Web. (Accessed 25 June 2013) http://index.hu/belfold/2012/09/07/beragad_a_sokmillio_euro/

A study on absorption compiled in 2012³⁵ showed that by mid-2012 more than 60% of the funds had been allocated. However this means that the remaining portion of funds had to be tendered and contracted within about a year. The worst contracting ratios were found under the Operational Programs with the highest budget. The Transport OP and the Environment and Energy OP had 60-70% of their funds contracted, nonetheless the 15-35% disbursement ratio showed major delays in the implementation of huge infrastructural projects. The Social Renewal OP, disposing of the highest number or relatively small grants, had less than half of the funds contracted, revealing that the tendering in this programme seriously lags behind schedule.³⁶

Changes and developments

Absorption pressure brought changes in the attitude of the government regarding the implementation of EU funds. On the one hand, the greatest proportion of EU Funds is allocated via priority projects which are fast, but also lack free competition. It has to be underlined that the majority of the priority projects were approved by the previous government in 2009. (See in detail in Chapter 4.1)

On the other hand, the stress to spend the total of the available funds loosened the constraint to distribute the money to “friendly firms” as the motivation is stronger to give the funds away, be it to anyone, as it is too much to be wasted on the “comrades”. This resembles the experiences of the 2004-2006 period hallmarked by the “slogan” of the Development Agency: “rather throw away 10 euro bills from helicopters than have the funds unspent”.³⁷

Problems and conclusions

The EU Funds dedicated to member states are not guaranteed subsidies but available resources. The amount available for Hungary during the 2007-13 period is roughly half of the country’s yearly national budget (see in detail in Chapter 2.). Politics is deeply interested in successful absorption for different reasons. As a matter of fact, Hungary has no financial resources of its own to implement development programs, therefore EU Funds are extremely important to execute infrastructure and human resources investments. The absorption of the available resources is not only an issue of economic growth and social development, but also concerns the prestige of the government in power.

This pressure “to spend all the money available” relates to different topics discussed in this report: to the tendency of centralising institutions implementing the projects, to less transparent decision-making in the different phases of resource allocation, to the overwhelming ratio of priority projects, to the documentary-based control and audit and to the financing of meaningless projects. Absorption pressure is the source of numerous non-transparent phenomena in the EU Funds allocation system.

5.3 Meaningless projects

State of play

In the recent years Hungarian press reported plentiful meaningless, overpriced projects that have had no substantial effect on economic growth and social welfare whatsoever. This phenomenon is not unrelated to the absorption pressure; however it cannot be solely attributed to it.

³⁵ By Dávid Szebeni, Corvinus University

³⁶ Based on HVG online article „Háromezzer milliárdot kéne gyorsan elkölteni” HVG online magazin, Sept 18, 2012, Web. (Accessed 5 June 2013.) http://index.hu/belfold/2012/09/18/haromezermilliardot_kene_elkolteni/

³⁷ The whole paragraph, same as footnote 1

The examples below present some projects that were carried out without a meaningful and substantial outcome:

A 8.6 meter high mound was built for sledging

in the middle of the Hungarian plain for 53 million HUF (approx. 190,000 Euro), with 70% financial support from ERDF. The project was supported by the Regional OP, in the framework of a scheme for developing touristic services.³⁸

The municipality of a small town in Western Hungary planned to build a recreation area in the centre of the city. After applying for EU Funds, the municipality won 2.6 million HUF for a development of 3.2 million HUF. Now, the actual product of the large-scale project is a small grassy area with ten wooden trunks.³⁹

A forty cm high viewpoint was built in a village in the North-Eastern region of Hungary for the value of almost 40 million HUF. The substantial resources awarded to the project allowed the building of a bronze compass, a barbecue point, and a few benches.⁴⁰

Topping the list of pointless European projects gathered by Open Europe, in 2010 a Hungarian project for a fitness and rehabilitation centre for dogs was brought to life. A Hungarian IT firm was granted roughly 411,000 EUR by the ERDF for a project aimed at “improving the lifestyle and living standards of dogs”. The company used the funds to build new offices for the centre, however, the offices remained empty and the dog centre itself is yet to be realised.⁴¹

Problems and conclusions

Meaningless projects seem to be a waste of money in the first place. At the same time, they carry the risk of corruption as well. Most of the projects are obviously overpriced; the extra manoeuvring space in the budget leaves ample opportunities to mismanage the funds. It can also be assumed that in certain cases the selection of these projects for funding is not only the result of the absorption pressure. Although the press has created a great deal of publicity for these ridiculous and meaningless projects, no official investigation followed and nobody was found responsible. This strengthens the assumption that political influence can easily bias decisions on the implementation of Funds.

6. Corruption risks in the execution phase

The two main elements in the execution phase that reveal the mismanagement of EU Funds are public procurement and reporting (false reporting, fraud). As the budgets of EU funded projects exceed the obligatory public procurement level in most cases, project executors have to publicly procure partners to the project. As several analyses have proven, the Public Procurement Act (even in its recently amended form) is unfortunately insufficient to ensure transparency. As a result, 85% of big value public procurement procedures are infected by

³⁸ Based on Index online magazine article “A Himaláját mintázza az alföldi szánkódomb”, Index, January 25, 2013, Web. (Accessed 25 June 2013)

http://index.hu/belfold/2013/01/25/37_milliot_nyertek_az_alfoldi_szankodombra/

³⁹ Based on Index online magazin article “26 milliós uniós támogatás tíz fatuskóra” Index, October 29, 2009. Web. (Accessed 25 June 2013.) http://index.hu/belfold/2009/10/29/2_6_millios_unios_tamogatás_tiz_fatuskora

⁴⁰ Based on Index online magazine article “40 centis kilátó épült 40 millióért Bodrogeresztúron” October 4, 2009. Web. (Accessed 15 July 2013)

http://index.hu/belfold/2009/10/04/40_centis_kilato_epult_40_millioert_bodrogereszturon/ October 4, 2009. Web. (Accessed 15 July 2013)

⁴¹ “Another 50 examples of EU waste” by OpenEurope. 10 November 2010. Web. (Accessed 20 June 2013.) <http://www.openeurope.org.uk/Content/documents/Pdfs/top50euwaste2010.pdf>

corruption⁴². Vague definitions in the Act leaves loopholes to escape the rules or the consequences.

The rigid and restrictive regulations on eligible costs and on financial reporting in general, the lack of skills to prepare proposal and manage projects and the documentation-based evaluation, audit and control (instead of content based ones) are opening the door wide to fraud and mismanagement of funds.

6.1 Public procurement

State of play

Most of our interviewees agreed on the fact that one of the greatest corruption risks related to EU Funds occurs at the “second level” of resource allocation, that is, during the public procurement procedures (see Table 2.). Resources are primarily allocated through priority projects or open calls for proposals, but project executors have to select the service providers or suppliers through public procurement. The Public Procurement Act⁴³ does not introduce fair and transparent procedures.⁴⁴ Recently, yet another analysis has drawn attention to the fact that 85 percent of the big value public procurements are infected by corruption.⁴⁵

“The other problematic area is the entire field of public procurement. Most of EU Funds are in the end allocated through this procedure and we know how corrupt this is.” 1st interviewee – journalist, investigative articles on EU funds and corruption

“Public procurement: it is expensive, ineffective and corrupt.” 3rd interviewee - Former manager of a proposal writing and project management firm

“The mayors are easy to corrupt in public procurement tenders. But it is often not for their personal advantage, rather for the community. For example: the supplier offers to do the drainage development of the settlement for price X and – instead of paying facilitation to the mayor – to win the contract, he also undertakes to refurbish the school building for free.” - 3rd interviewee - Former manager of a proposal writing and project management firm

“Since the charge of public procurement complaints has been augmented, the competitors of the “winners” find it hopeless to participate in tenders. They become sub-entrepreneurs instead. This phenomenon has a strongly distorts competition.” 4th interviewee – Investigative journalist

“Public procurement: ultimate way to steal public money.” 5th interviewee – 1st Whistleblower.

Changes and developments

The newest amendment to the Public Procurement Act⁴⁶ (PPA, in force as of 1st July 2013) also fails to offer a solution to the loopholes in the system, leaving several ways to escape

⁴² A nagy közbeszerzések döntő része korrump lehet. 28 May 2013 Web. (Accessed 8 July 2013.) http://index.hu/gazdasag/2013/05/28/a_nagy_kozbeszerzesek_donto_resze_korrump/

⁴³ (CVIII/2011, amended in 2013)

⁴⁴ Dr. Tátrai Tünde, dr. Németh Anita, dr. Perczel Zsófia: Korrupciós kockázatok a közbeszerzésben. (Corruption risks in Public Procurement.)

http://www.transparency.hu/uploads/docs/Korrupcios_kockazatok_a_kozbeszerzesben.537.pdf

⁴⁵ A nagy közbeszerzések döntő része korrump lehet. 28 May 2013 Web. (Accessed 8 July 2013.) http://index.hu/gazdasag/2013/05/28/a_nagy_kozbeszerzesek_donto_resze_korrump/

⁴⁶ Act CVIII of 2013 (the Public Procurement Act)

from the rules or the consequences of procurement procedures.⁴⁷ As TI Hungary summarized its opinion on the amendment:⁴⁸

“What does the bill not touch upon? TI thinks that the bill does not even help to decrease corruption related to public procurement. Conflict of interest rules have not become more objective, fulfillment of contracts is not monitored any more efficiently. Electronic public procurement procedures are not any closer to being introduced – although this would be a highly effective tool to curb corruption – and the relationship between the Public Procurement Authority and the Public Procurement Arbitration Board has not been thought over. Those who want to know what their money is spent on will not have an easier time either. This may be the principal problem.

The first step in fighting corruption is to establish publicity. It would help in cleaning the procurement market if publicity requirements of the PPA were respected and enforced at least by the Public Procurement Authority. It is not only the players of the procurement market, but also every single citizen who has the right to access public data related to procurements. If these could be assessed by all those who are interested through a downloadable database containing reliable data in a user-friendly and digestible format, we could already say that a major step has been made against public procurement fraud.

The bill links deadlines to the obligatory publication of the data by the contracting authority, however, if somebody does not respect these deadlines, there is no consequence: no sanctions have been introduced by the bill. Similarly as if it was forbidden to travel on the bus without a ticket, but those who do so would not have to suffer any consequences.”

Problems and conclusions

Most investments in Hungary are funded by the European Union, therefore the competition to participate in EU financed projects is extremely high. This makes service providers accept the prevalence of an “anything goes” approach. No price is too high to be awarded a contract, which significantly increases incidents of corruption.

Since the recently amended Public Procurement Act does not contain the necessary guarantees of transparency, the corruption risks related to EU Funds will definitely remain high.

We also understand that executors of priority projects assuming huge amounts of funds (the budgets are often above 1 billion HUF, and in cases of big infrastructure projects they may reach several hundreds of billions of HUF) often lack the professional skills to manage public procurement procedures appropriately.

Positive example

Withdrawal of a manipulated tender

A consulting firm advertising itself on its webpage as “having high level connections to the government and municipalities” was active in health service-related infrastructure developments funded by EU. It won a tender for equipment procurement for a hospital, submitting a bid that was 50 million HUF more expensive than the bid of the single other competitor. The other tenderer was excluded from the procurement because of a missing document that the winning tenderer in fact also failed to submit. Later the Arbitration

⁴⁷ Észrevételek a magyar közbeszerzési törvény módosításához. Comments on the Amendment of the Public Procurement Act. Web. (Accessed 12 July 2013.)

http://www.transparency.hu/The_amendment_to_the_Public_Procurement_Act_will_not_reduce_corruption?bind_info=index&bind_id=0

⁴⁸ Same previous footnote

Committee of Public Procurements cancelled the tender and a criminal investigation was initiated against the company, based on whistleblower information – probably from a market competitor.⁴⁹

6.2 Frauds, mismanagement of Funds at the beneficiary

State of play

Frauds and irregularities committed by beneficiaries of EU Funds are hard to establish. However, two statistics can illustrate the magnitude of the problem:

The increasing EU Funding of *state institutions* comparing the years 2011 and 2012 have concluded in the parallel growth in the number of irregularity procedures (from 4,5% to 15,3%). 6% of the cases concluded in a condemnation by either national or EU institutions⁵⁰. A presentation⁵¹ highlighted that 64% of all irregularity procedures concerning Social Renewal OP touched upon public procurement issues.

Our respondents views on fraud and mismanagement:

“I am convinced that the entire financial reporting and accounting system of the EU Funds is too rigid, fraud is coded in the system (which is not necessarily corruption).” 2nd interviewee –Former employee of the institutional system.

“The expenses of the proposal writers are often not eligible costs, although the services are necessary as most beneficiaries do not have the competences to write a proposal. This situation directly leads to fraud. The group of eligible costs should be reconsidered.” 3rd interviewee – Former manager of a proposal writing and project management firm.

“There is a great lack of project management expertise, proposal writer companies overprice their services and their performance is not measurable, the expectations are immense. There are no real project contents, the project owners do not have real responsibilities, the outcomes and impacts are not assessed. Most harmful is when “bad projects are well managed” and all the money is spent for nothing.” 1st Whistleblower.

Problems and conclusions

Based on our experience and on the interviews there are two crucial issues related to fraud and the mismanagement of funds at the beneficiary. (1) The rigidity of financial rules and accounting. Some costs are not eligible or only to a very limited extent. This is the case for the costs of presenting the proposal, and of project management, however these are necessary for the beneficiaries, since they are often short of proposal writing and project management capabilities. Therefore the beneficiaries are “forced” to report falsely (hide these costs in other categories) as they need to pay the consultants. (2) Since the reporting is formal and no evidence-based assessment follows, a lot of costs can be reported using “creative” accounting. In sum, the lack of content based control and audit (see in detail in Chapter 6) results in over-pricing, false reporting, simulated performance, etc.

⁴⁹ Based on Index online magazine article “Nem nyerhetett a drágább, ejtették a beszerzést”, 06 Feb 2012. Web (Accessed 25 June 2013.) http://index.hu/belfold/2012/02/06/nem_nyerhetett_a_dragabb_ejtettek_a_beszerzest/ and on personal interviews

⁵⁰ A 2012. évi integritás felmérés eredményeinek összefoglalója. A magyarországi költségvetési szervek működésében rejlő korrupciós kockázatokról. Állami Számvevőszék, 2012. December. (Summary of the 2012 Integrity Survey, State Audit Office, December 2012.) Web. (Accessed 13 July 2013.) http://integritas.asz.hu/uploads/files/2012-es%20eredm%C3%A9nyek_%C3%B6sszefoglal%C3%B3.pdf

⁵¹ Presentation of Balázs Nagy. Web. (Accessed 15 July 2013.) <http://www.szpi.hu/download/Tavaszi-konferenciasorozat/Eloadasok-letoltheto-anyagai/Szolnok/ESZA-Nagy-Balazs.pdf>

The role of EU funds in adult education: a smaller part was spent on useful training projects, a more significant share was wasted to improve the skills of market players already powerful before: an act of hackery.

Most probably the newest form of corruption is linked to adult education. Due to the nature of the training services the field is at risk of fraud: it is difficult to set precise standards to assess whether the aims of a given training programme have been achieved and to evaluate the quality of the training itself... When EU funds came into sight on the adult education market, administrative “document factory” grew in size and importance. A game of these dimensions can only be maintained if all actors get an adequate share of the pie: the trainers, the procurers and the participants of the trainings as well. Due to the strict administrative rules of the projects funded by the EU, the final beneficiaries have to comply with the administration, e.g. sign attendance sheets in order to be legally eligible for financial support. However, nobody ever assesses if unemployed people did really participate in the trainings or the sheets of attendance concerned were forged. Only a smaller fraction of the EU funds reach the target groups, while a more significant part lands at the training service providers and in the pockets of the procurers, often NGOs with a mission to support disadvantaged, unemployed people. Thus, even though the funds are not targeting the training organizations themselves (the real target group is unemployed people), a meticulous administration ensures low risk and high profit for numerous organizations.⁵²

7. Corruption risks in the control and audit phase

Hungarian system managing EU Funds disposes of a complex auditing and controlling mechanism as well as detailed definition and policy to tackle irregularities. Still, both the definitions and the procedures of audit and control focus only on the financial irregularities and the related risks, without taking into account professional implementation and qualitative outcomes. If the value-for-money principle is not assessed during control procedures and projects can be realized without the pressure to ensure high quality and meaningful outputs, a significant fraction of the grant can be used for non-project-related costs (hidden item costs) with the help of some “creative” administration and accounting, a practice to which legal provisions on fraud apply in many instances.

State of play

Control and audit institutions

A number of institutions are assigned with control and audit of EU Fund implementation. These functions are conferred on various levels of the institutional system.⁵³

Intermediary Bodies perform process-embedded control including on-site-audits at the beneficiaries during every instance of the financing process. The NDA has the main responsibility to supervise public procurements, while the Hungarian State Treasury carries out audits on behalf of the Managing Authorities⁵⁴.

⁵² Based on HVG online article „Miszter Tíz Százalék bármilyen képzést megrendel”, June 21, 2012. Web Accessed 20 June 2013.) http://hvg.hu/gazdasag/20120621_felnottkepzes_korruptcios_sorozat

⁵³ Based on VINCZE IBOLYA: Managing, controlling and auditing systems in Hungary providing subsidies from European Funds. Web. (Accessed 10 July 2013.) <http://www.asz.hu/publikaciok/2011/az-eu-s-tamogatasok-iranyitasi-es-ellenorzesi-rendszereinek-mukodese-magyarorszagon-managing-controlling-and-auditing-systems-in-hungary-providing-subsidies-from-european-funds/get-2011-152-163-oldal-vincze-ibolya.pdf>

⁵⁴ Based on the 4/2011 Governmental Decree: regularity control, control of site audits, targeted investigation and project audit.

The National Authorizing Officer's Office (a department of the Ministry of Economy) has key functions in managing irregularities. It acts as an intermediary between the implementing agencies and the Coordinating Office of OLAF, and it incorporates two main bodies. The Paying Authority is responsible for all the control and audit functions guaranteeing that the paying requests presented to the EU are accurate. The Certifying Body – previously the Government Control Office, since 2010 the Directorate General for Audit of European Funds – warrants for that the entire managing system complies with the regulations.

Internal audit systems are in place at the National Development Agency and at the Intermediary Bodies. The internal audit department of the NDA audits not only the activity of the NDA, but the operation of the Intermediary Bodies as well.

External audit is performed by the State Audit Office, which supervises the overall control and audit activity of the system of EU Funds implementation. It has the right to inspect all the above listed agencies as well as the final beneficiary organizations.

Definition and tackling of irregularities

Decree 4/2011 defines irregularity as an infringement of requirements set forth by Council regulation 1083/2006, the national regulations or the grant contract, that results in *potential damage of the financial interest of the country*. On-site audits and investigations related to irregularities aim at checking the documents supporting the cost claims: invoices and other documents backing the payment requests.

Problems and conclusions

As it is highlighted in the description, there is a complex auditing and controlling system in place that ensures that all administrative and financial aspects of the implementation procedure are in accordance with the regulations both at the level of fund management institutions and that of the beneficiaries.

However, these control procedures put relatively small emphasis on the qualitative aspects of the project implementation, usually not engaging in more than the mere control of compliance with quantitative indicators set in the proposals. The lack of monitoring of qualitative achievements allows for properly administered, but ineffective and unimaginative projects to pass scrutiny while opening up vast opportunities for the mismanagement of the funds as well.

The formal control and audit processes do not examine if the value-for-money principle was employed, neither in the project selection phase, nor during the control of the projects. As a result, both project owners and application writers got used to the fact that once the project has been selected for financing, the only aspects they have to take care of are the quantitative indicators and the administrative/financial regulations. However, only control processes that take into account qualitative aspects could screen out projects that do not lead to substantial effects either due to malicious fraud and mismanagement of the funds or caused by a waste of money resulting from unprofessional implementation.

Transparency of irregularity investigations is limited to the issuance of enquiries where irregularities were actually suspected. However it cannot be assessed if an irregularity procedure was actually initiated if the said inquiry uncovered a grounded suspicion of irregularity, let alone accessibility of the findings of such procedures.⁵⁵

⁵⁵ Based on online article of www.atlatszo.hu "Fordulat egy furcsa EU-pályázat történetében – pert nyertünk az NFÜ ellen" Apr 12, 2013. Web. (Accessed 10 July 2013.) <http://atlatszo.hu/2013/04/12/fordulat-furcsa-eu-palyazatban/>

8. Corruption risks overarching the different phases

Certain phases of allocation and implementation of EU Funds evoke risks of corruption that overarches the whole project. Although the regulations on conflict of interest are relatively detailed, occasionally the institutional system seems to be reluctant to recognise violations thereof. A special conflict of interest case is the so called “revolving door” effect: people move from one sector to the other – from the management system of EU Funds to private firms implementing projects funded by the EU for example. This special case is not addressed by the rules at all, while it represents a significant threat of corruption. The previously mentioned centralization of decision making has created more space for direct political influence, which, combined with the presence of corrupt decision-makers in the system, results in graft and unfair exclusion of further players from the competition. The most alarming phenomenon detected in this research is the group of consultancy firms and experts incorporated in at least some segments of the institutions implementing EU Funds. Publicity and civil control should have a crucial role in ensuring transparency, however, a devastating experience shows that the general public became inconsiderate and fell into apathy because of too much public talk on corruption going unpunished.

8.1 Conflict of interest

State of play

Conflict of interest regulation

The Government Decree no. 4/2011 gives a very detailed list of circumstances that raise conflict of interest and therefore exclude persons or institutions from the preparation of calls for proposals, grant evaluation and selection procedures, as well as control and audit processes at the beneficiaries.

Persons and institutions applying for a given call or implementing a funded project are excluded from the decision making process on granting. Prominent politicians, mayors, MPs or members of local governments delegates are altogether not allowed to take part in the decision making. They may not be involved in the control, audit and payment procedures either.

Priority projects of the NDA and the Ministries create peculiar exceptions, cases to which none of the rules on exclusion apply. The only prerequisite to get exempted from the above criteria is to have separate and accountable units in charge of the preparation, submission and implementation of the project and the decision on grants.

Free transit between sectors – the “revolving door effect”

“The movement of individuals between the public sector and the private sector is an natural phenomenon in all open societies. While such mobility has its advantages on an individual, organisational and societal level, it creates risks as well. The public is often confronted with conflicts of interest or even corruption in connection with the turn of the revolving door. Those who crossed over from one sector to another or have close ties to others who went through the revolving door may sketch the issue out in more detail and may point out advantages and profits of a benign and beneficial character that are produced by this movement.”⁵⁶ Although it is a widespread phenomenon in the field of EU Funds implementation – officials of the institutions managing EU Funds leave the sector and start

⁵⁶ The “Revolvoing Door” Phenomenon in Hungary. by Petra Burai, Ádám Földes and Péter Tausz, Contribution by Judit Dietz-Blaskó and Ildikó Bozsó. TI Hungary, 2012, p. 1.

their own consultancy business on proposal writing and management of projects funded by the EU, like our 2nd interviewee did –, there is no regulation in place to prevent this.

Problems and conclusions

The conflict of interest regulation described above is detailed and complete; however, when rules of the law are not put into practice, the institutional system becomes reluctant to recognise the fault. Let us introduce concrete examples to sustain this.

A grant scheme was launched to train employees. The civic member of the Evaluation Committee at the ESF Intermediary Body was the managing director and co-owner of one of the major training companies – representing the training profession in the evaluation process. Later on, the training company won the public procurement as one of the beneficiaries of the grant scheme.

The Tax and Customs Administration conducted two investigations. In the first case the relationship between the beneficiary and the training company was explored with regard to the grant evaluation process, but no evidence of fraud was found. In the second procedure the public procurement of the beneficiary was examined and judged to have been “tailor-made” for the parameters of the winning training company. This investigation established also that the winning company should have been excluded from among the tenderer as it was in possession of insider information as the director had been part of the evaluation process earlier.

The procedure reveals a flaw in the regulations in relation to the management of EU funds, shown by the fact that the investigations into the above case were fragmented instead of looking at the big screen and recognising that the application and the following public procurement procedures were part of an equally biased process.⁵⁷

A tender was launched by the NDA for developing broadband internet networks up to the value of 20 billion HUF. Half of the amount was awarded to five companies founded a few weeks before submission of the tender, all registered on the same day and at the same seats, with similar ownership backgrounds and equal subscribed capitals. Two of the winning firms are co-owned by one company, where a former member of the supervisory board and the legal advisor is currently a government MP and also a member of the parliamentary committee for economic and IT issues. The MP claimed that he had withdrawn from the board the year before and has no connection to the tenders. No investigation was launched to prove that the MP had no influence on the tender.⁵⁸

The National Development Agency awarded a consortium in which the law firm of a former state secretary took part in a framework contract for advisory tasks for the value of 225 million HUF. The tender was published in March 2013 and involved no competition as it was

⁵⁷ Based on a HVG article “Öngólpasz” HVG magazin 2013/13. Web (Accessed 8 July 2013.)

http://hvg.hu/hvgfriss/2013.13/201313_gyanus_unios_palyazatok_ongolpassz

⁵⁸ Based on HVG article “Alaphálózat: gyanús internettender”, HVG magazin 2013/09. Web. (Accessed 18 June 2013.) http://hvg.hu/hvgfriss/2013.09/201309_gyanus_internettender_alaphalozat,

and Index online article “Dörzsölt ügyvéd a csendes KDNP-s” Feb. 15, 2013, Web. (Accessed 28 June 2013.) http://index.hu/belfold/2013/02/15/ingyen_dolgozott_sesztak_az_enternetnel/

a non-public, invitation and negotiation-based procedure. Coincidentally, the state secretary was in office until May 2013.⁵⁹

“In some cases staff members of ministries and state agencies leave the public sector to join proposal writing companies. Hiring them gives the companies a decisive advantage, as former state employees have immense networking potentials that can be used in favor of project owners who contract them. They are the ones who know the “shortcut” to win a project.” 6th interviewee – 2nd Whistleblower.

“It is simply impossible to win financial support from the EU Funds in some areas (such as tourism and infrastructure development) without bribing decision makers – and without knowing whom to contact. While corruption has previously been the exception, now it has become the norm in certain segments of the market attracting EU funds.” 2nd interviewee – Former employee of the implementation system of EU Funds, now working in the consultancy sector

The National Integrity Study published in 2012 indicated that the missing or non-functioning regulation on the revolving door phenomenon presents a significant weakness of the Hungarian anti-corruption system.⁶⁰ A recent study of Transparency International⁶¹ introduces different categories of corruption risks inherent in the revolving door phenomenon. Based on our understanding the management of EU Funds is mostly affected by the “undue influence”. In this case “a former state official who works for a business association may try to influence his or her former colleagues in order to receive a decision which is favourable to his or her current employer.”⁶² The recent regulations are not sufficient to manage this special type of conflict of interest, although it definitely leads to corruption cases.

8.2 Political influence and corrupt decision-makers

State of play

Undoubtedly, the centralization of decision making (described in Chapter 4.1) leaves more space for direct political influence and non-transparent interventions. By political influence we mean pressure exercised in decisions concerning the allocation of EU Funds and/or the applicants/beneficiaries themselves.

Corruption and bribery

Based on our interviews we are convinced that corruption and bribing of decision makers is an existing phenomenon.

“I managed 11 proposals, all of them were refused for minimal formal reasons. We were informed that if we complained officially afterwards we should pay 1.5 M HUF to a certain person working in a high position in the background institution of the concerned Ministry. Our contact was a proposal writing firm; they had connections and asked the background institution how much the tariff of the bribe should be.” 6th interviewee – 1st Whistleblower

⁵⁹ Based on Index online article “Volt államtitkár cége kapta az NFÜ pénzt”, June 18, 2013, Web. (Accessed 15 July 2013.) http://index.hu/gazdasag/2013/06/18/volt_allamtitkar_cege_kapta_az_nfu-penz/

⁶⁰ Petra Burai – Péter Hack (eds.), Corruption Risks in Hungary 2011 - National Integrity Study 2011, Transparency International. (Accessed 10 July 2013.) http://www.transparency.hu/uploads/docs/Corruption_Risks_in_Hungary_NIS_2011.pdf

⁶¹ The “Revolvoing Door” Phenomenon in Hungary. by Petra Burai, Ádám Földes and Péter Tausz, Contribution by Judit Dietz-Blaskó and Ildikó Bozsó. TI Hungary, 2012,

⁶² See previous footnote p.3.

“In the case of another grant scheme I had a meeting with an employee of the ministry, the direct colleague of the Minister. He told me that the only possible way to get the grant was to pay a facilitation. “Name the proposals, each costs 1 M HUF, and they get supported.” I never accepted these offers.” 6th interviewee – 1st Whistleblower

Politically preferred beneficiaries

Political influence can prevail not only in the form of undue personal intervention in the decision-making processes, but also by excluding organizations that had been successful in the former governmental period from the competition.

The case entailed a call for proposals published for content development in digital education. Before the deadline, the conditions were suddenly altered: according to the new guidelines, proposals could be submitted only with references dated in the office term of the current government. This restriction provided an advantage for those companies that had not been successful during the term of office of the previous administration.⁶³

Assumption of political influence on decisions

In certain cases the assumptions of political influence and intervention in the decision-making are easy to justify, since beneficiaries have recognizable linkages to prominent politicians.

Billions of HUF were allocated for health tourism projects managed by a newly founded micro-enterprise without any reputation in the field. The publicly available information on the NDA’s website about the projects and the implementers was very limited. Still, it was enough to establish that the proposals contained identical chapters, supposedly copy-pasted from one another. An investigative journalist of HVG Hungarian weekly highlighted the inextricable relationship between the owners of the winning companies, the decision makers and the prime minister’s dentist, already famous in Hungary for the generous public funding he had received for dental tourism projects.⁶⁴

Problems and conclusions

Since we cannot prove these very serious statements on particular corruption cases, we are only able to ascertain that according to several interviewees’ accounts, personal connections and the bribing of senior officials in Ministries and related institutions are without any doubt a great help for applications to succeed. The same applies to political interventions in decision-making: we can quote numerous cases and examples in order to confirm the assumptions. Referring to previous chapters, transparent and accountable decision-making at all levels; strict, detailed and consistently applied conflict of interest regulations; quality-based proposal selection, audit and control; as well as publicity and civil control should lead to the decline of these phenomena.

8.3 The circle of “incorporated” companies and experts

State of play

Several interviewees mentioned that there was a group of proposal writers (consulting firms that assist potential beneficiaries in designing and compiling applications), incorporated in the EU Funds management system, that had connections to the institutions guaranteeing the success of their proposals. As mentioned before, potential beneficiaries look for proposal

⁶³ Based on the article: “Pályázni csak az Orbán kormány idején szerzett referenciákkal” 12. December 2012. Web. (Accessed on 25 June 2013)

http://index.hu/belfold/2012/12/12/palyazni_csak_az_orban-kormany_idejen_szerzett_referenciakkal/

⁶⁴ Based on HVG article Zárt osztály. Gáti Júlia. HVG 2013. június 1.

winner and not for proposal writers. In other words: they look for consultants who guarantee success instead of firms that perform high quality work.

Corrupt relationship between this particular group of consulting firms and the managing institutions of the Funds expose honest competitors to bankruptcy, as they cannot compete with players that have a serious influence on the decision-making process.⁶⁵

“- What was your main focus as a consultant dealing with proposal writing and project management?

- *ERDF financed infrastructure development projects.*

- Why did you leave the consultancy sector?

- *After 2010 we could not be successful on the market any longer. Newly founded competitors have appeared and they took over almost all the projects. We also experienced that our clients (potential beneficiaries) had started to look for “proposal winners” and not for “proposal writers”. We did not have (and did not even intended to) relationships in the institutional system in order to ensure that our projects win. We performed the same high quality work as before but it was not enough anymore.*

- How do you think these newly founded proposal winner companies work in practice? How do they manage to have their projects win so frequently the tenders?

- *I am not sure. The concrete technique might be an obscure combination of political relations and lobbying power. Alternatively, the direct bribing of certain decision-makers. And of course the success could be achieved by producing high quality work, however, this does not give an exhaustive explanation for the rapid and radical restructuring of the proposal writing market.”* 3rd interviewee – Former manager of a proposal writing and project management firm. Now works in an entirely different field.

Changes and developments

When EU Funds became available for Hungary (as a result of the accession in 2004) there was a research conducted on the corruption risks of the newly founded institutional system and its regulation.⁶⁶ Among the conclusions the researchers mentioned the unclear position of consultants.

“There is a certain “grey area” in the field of the usage of Structural Funds: the group of independent consultants. These experts are outside of the official bureaucracy, however, they are often hired by the Management Authorities or the Intermediary Bodies. Their role is crucial, as many tasks could probably not be carried out without them⁶⁷. However, their position on conflict of interests and their competence is not screened carefully enough at the moment.”⁶⁸

It looks like since 2005 this “grey area” has grown into a wide range of consultancy firms that have corrupt relations to the institutions implementing EU Funds.

Problems and conclusions

Incorporated consulting firms or consultants in the implementation of EU Funds act as intermediaries between the beneficiaries and the management system. The price of the

⁶⁵ See the description of the same in: “Így lopják el a pályázati pénzeket” 3 June 2013. (Accessed 3 July 2013) http://index.hu/gazdasag/2013/06/03/igy_lopjak_el_a_palyazati_penzeket/

⁶⁶ “Transparency in using Structural Funds – the Hungarian case” Research, Transparency International (2005)

⁶⁷ Meaning the lack of competences and capacities of the personnel in the newly set institutions, as analyzed in another part of the paper.

⁶⁸ Same as footnote 57, p. 26.

“consultancy” for the beneficiary includes the cost of the actual work (proposals have to be prepared in any event), possibly the facilitation to be paid to the management system, and the profit of the intermediaries. These costs are incurred in the project budgets (e.g. as overpriced services or outsourced management) and are extracted by creative accounting. This means that beside corrupt decision-making, fraud is also involved in the form of “creative budgeting”(see Chapter 6.2).

“For some proposal writer companies you have to pay back 60% of the entire budget of the project. But they win for sure.” 6th interviewee – 2nd Whistleblower.

One of our interviewees (an official at an Intermediary Body) described an even more complicated interlacement of consulting firms and the implementation system of EU Funds.

“In one of the grant schemes I worked on, several companies having close relations to each other (working with the same experts, having shared employees) played a crucial role in the whole process. They were prepping the calls, they shaped the professional content of the grant scheme and later on they took part in the assessment/evaluation of the proposals as well. On the side of the beneficiaries they were presented as consultants, compiling proposals and managing the funded projects. In fact, they were present at all stages of the project, and had a strong influence on it. (Of course smartly alternating their identity, they appeared under a different “logo” in different situations.) They basically carried the grant scheme from the cradle to the grave.” 7th interviewee – Currently employed at an Intermediary Body.

The new phenomenon of systemic corruption has mostly appeared in the segments of the implementing institutions of the EU Funds which are entangled with for-profit firms.

8.4 Publicity and civil control

State of play

Public debate of Calls for Proposals

The preparation of calls and their public debate are regulated by the Decree 4/2011 and by the Operational Guide. These documents set out that the competent Minister shall submit his/her proposal to the NDA outlining the content of the planned project at least 40 days prior to the date of the envisaged launch of the call. The NDA has the possibility to comment on this document, but is obliged to launch the call within a period of 30 days starting when the Minister finally approves the professional content of the call. Public consultation is performed during this period of 30 day, although the time of the consultation is deductible from this timeframe.

The NDA operates a subpage on its website aimed at fostering public debate on all planned grant schemes. The site allows anyone to follow the planned calls, comment on them and see all other submitted opinions as well. Comments are collected in a given time-frame and replies from the experts involved in the planning of the call are published before the scheme is launched. Experience shows that the calls remain basically unchanged even if they are challenged considerably in the public debate.

Changes and developments

The planning for the 2014-2020 budgetary period is already underway. Unfortunately, there is only very limited public debate over the process. Initially, steps to step up public consultations were taken – for instance, in January 2005 a civil association was established under the name “Civil Organization for the Publicity of the National Development Plan”⁶⁹

⁶⁹ “Civilek a Nemzeti Fejlesztési Terv Nyilvánosságáért” Web. (Accessed 16 July 2013)
<http://cnyy.honlaphat.hu/>

with the mission to enhance transparency of the planning procedure and to foster the participation of civil society therein. However, it seems that this attempt aborted as the planning procedure remained at least as opaque as it used to be during the previous planning period. The criticism coming from the civil society has in fact become less harsh in this respect, as the COPNDP is not active in the current planning period.⁷⁰

Problems and conclusions

The framework for public debate and the gathering of feedback from the civil society is given, but it seems that none of the parties uses this opportunity. Civil partners have become more passive – possibly based on their experiences that civil arguments do not really matter, and the entire procedure of public debate is merely formal, and set up in order to meet the obligations of the managing institutions.

We must see that while the corruption issue is frequently and widely discussed, the general public seems to have been fallen into disinterest, in the meantime. Most of the people take it for granted that all EU money is “stolen” and everybody playing any kind of role in the allocation and usage of the grants (be it a decision maker or a beneficiary) is corrupt. Of course public views in this regard exaggerate, however, the importance of civil consciousness should be the basis of common demand for transparency in EU funding.

Positive example: whistleblowers and case collection on the internet

Based on the experiences of TI Hungary, whistleblowers are often disappointed competitors who were excluded from the market. In other cases they are former employees of the institutional system who are not in a dependent situation any longer. Their activity is extremely important as they represent a civil control role, explore corruption cases and call attention to hidden phenomena. Two whistleblowers shared their experiences with us as interviewees, contributing with great resources to the exploration of the issues at stake.

As an opposite example to public apathy, a new blog on EU funding cases was recently launched by some professionals. The bloggers introduce themselves as stakeholders in this field: company managers, proposal writers, or staff members of the planning and implementing institutions. They collect concrete cases, positive and negative examples related to EU source allocation.⁷¹ This is also a promising initiative concerning EU Funds and transparency, publicity and civil control.

⁷⁰ While this study has been written on the 10th of July 2013 the strategic document concerning the 2014-20 period has been uploaded on the website of the National Economy Planning Office, for public debate, the deadline is 13th August, 2013. Unfortunately the conclusions of this debate cannot be presented in our recent paper. (Accessed 15 July 2013)

http://www.nth.gov.hu/magyarorszag_partnersegi_megallapodasanak_tervezete/index.html

⁷¹ Blog on EU Funds (Accessed 15 July 2013) <http://papakapitalizmus.wordpress.com/>

9. Conclusions

After the 2004 enlargement of the European Union, new member states – the majority of Eastern European countries – gained access to the Cohesion and Structural Funds. Based on the logic of Cohesion Policies, the less developed regions receive more funds in a Europe-wide redistribution system in order to decrease regional inequalities. The new member states are obviously the beneficiaries of this mechanism that allows countries to have access to considerable amounts of funding. Hungary has access to approximately 25.3 billion EUR from Cohesion and Structural Funds in the 2007-2013 period, which is approximately half of the national yearly budget of the country.

In the process of analyzing the different phases (planning, distribution, execution and control) of the implementation of EU Funds we have identified a wide range of corruption risks. We have also detected serious corruption risks that are overarching the entire project cycle. All these risks are interrelated, overlapping and mutually strengthen each other, and are positioned in an institutional framework which is itself becoming more and more centralized.

The regulations and the institutional system implementing EU Funds are well designed and are in line with the European legislation and expectations (as these are conditions of eligibility for the Funds), but there are some vague or weak points especially concerning priority projects, selection of proposal and regulating conflict of interests; moreover, rules are sometimes simply not applied or followed. Public procurement, the regular way to spend public money, plays a crucial role in the allocation of EU Funds. Poor legislation in this field, inefficient in preventing corruption and fraud as several analyses⁷² claimed, demonstrates a clear threat of corruption.

Since there is a strong political pressure to ensure the highest success rate in the absorption of the available resources for Hungary, several other aspects (transparency, checks and balances and civil participation) are subordinated to the objective of speeding-up the implementation of EU Funds. The centralized and less transparent decision-making practice concerning EU Funds was introduced by the establishment of the Governmental Committee on National Development (GCND), which allows fast decision-making but excludes other actors from the procedure.

Although the most frequently mentioned concept in relation to the topic of EU funds and corruption is “tendering”, more than 80% of the resources are allocated through priority projects. The application of this mechanism obviously speeds up resource allocation and leaves space for concentrated developments. In this process the projects (investments) are planned centrally, and beneficiaries are not selected through open competition but they are appointed. This mechanism is justifiable in certain cases (such as big infrastructure projects or if there is only one available executor). Similarly to this, obligatory partnerships necessitate the participation of a key institution. But these procedures not only limit competition, but badly lack strict regulations to establish transparency. All this leads to an overwhelming presence of priority projects, unfair preference of certain organizations, non-transparent resource allocation, and the misuse of Funds (in some cases financing the maintenance of state institutions instead of real developments).

⁷² Dr. Tátrai Tünde, dr. Németh Anita, dr. Perczel Zsófia: Korruptió kockázatok a közbeszerzésben. (Corruption risks in Public Procurement.)

http://www.transparency.hu/uploads/docs/Korruptios_kockazatok_a_kozbeszerzesben.537.pdf and Észrevételek a magyar közbeszerzési törvény módosításához. (Comments on the Amendment of the Public Procurement Act.) Web. (Accessed 12 July 2013)
http://www.transparency.hu/The_amendment_to_the_Public_Procurement_Act_will_not_reduce_corruption?bind_info=index&bind_id=0

For the sake of more efficient and faster resource allocation the procedure of selecting proposals was also altered. The downside of the changes is the decline of professional control over the selection process, which leads to unfair decisions on awarded and rejected applications and to the support of meaningless projects.

The opportunity of financing meaningless projects from EU Funds (like the 40 cm high observation tower, which then attracted a relatively strong public attention) is also related to the documentation based (instead of content based) proposal selection, control and audit. The control and evaluation processes concentrate on quantitative indicators and formal implementation instead of high quality professional content of the projects and their social and economic impact.

This “paper-based” approach leads not only to the waste of public resources (in fact, European tax-payers’ money) but also to fraud at the beneficiaries’ end. Especially in some sectors (such as adult training and education) the phenomenon of non-existing, but smartly administered and creatively accounted projects is a crucial issue. Concerning the beneficiaries, the lack of prepping proposal and poor management of projects create a wide market for consulting firms, which again leads to further corruption risks.

As mentioned before, the conflict of interest regulations are not strict and detailed enough, and they completely ignore the so called “revolving door effect”, where people move from one sector to the other but take advantage of their previous work relations. Our attention was called by several interviewees to the phenomenon of consulting firms – specialized in proposal writing and project management – hiring former workers of the management system of the Funds, or firms that are even managed or owned by these people.

Along with the above mentioned corruption risks, there are documented cases and statements of interviewees (whistle-blowers) pointing at direct political influence on decisions concerning the distribution of EU Funds and corrupt actors in the institutional system who can easily be bribed for the support of proposals.

The most significant and alarming change according to previous studies on EU Funds and transparency issues are the signs of systemic corruption in the management EU Funds. It is a complicated and compound new phenomenon related to all corruption risks mentioned above, that is: centralization tendencies in decision making, restriction of open competition and the overwhelming presence of priority projects, shrinking professional control over proposal selection, documentation based audit and control instead of a “value for money” based assessment, lack of efficient conflict of interest regulation especially concerning the “revolving door effect”, the expansion of consulting firms dealing with proposal writing and project management, direct political influence on decisions and corrupt actors in the institutional system. All these above mentioned risks mutually strengthen each other and create room for systemic corruption that is formed in a complicated interlacement of consulting firms and the Funds’ managing institutions. Project executors tend to look not for proposal writers but for proposal winners, as their experiences confirm: this is the shortcut to EU Funds.. In addition to all, the services of the consultants are not eligible costs, therefore financing them from the project budgets provokes further fraud and financial misstatements. We do not have exact data as to what extent the institutional system is affected by systemic corruption, but it is an existing problem that has to be dealt with. As our interviewees stated, in some fields it is almost impossible to gain EU Funding without corruption. According to their experiences there have been some tremendous changes over the past year: the usage of the various tools of corruption has never been as widespread and as diversified as it is at the moment.

Based on an interview with an officer in the prosecution we can conclude that legal consequences of fraud or corruption, related to the national and the EU budgetary resources, have been adequately harmonized by now. However, we agree with our interviewee that these crimes cannot be prevented effectively solely by legal instruments, but rather through publicity. The importance of civil participation and publicity is inestimable. The disappointing experience is that there is a public ignorance; most people have become overwhelmed and fell into apathy because of too much public talk on corruption going unpunished. Public debates over the planning documentations are also ineffective, since the procedures are rather formal. On the contrary, we met whistleblowers who found it important to call attention to cases of fraud and corruption. A recently established blog even collects corruption cases related to EU Funds. The investigative articles on the topic also enhance publicity and the transparency of the implementation of EU Funds.

10. Policy recommendations

This analysis shows that the usage of EU funded resources entails substantial corruption risks that endanger the efficient allocation and usage of funds. As the new budgetary period is to start in 2014 there is still time for the Hungarian government to implement changes based on the policy recommendations below:

(1) We recommend the establishment of clear and transparent decision-making competencies and responsibilities in the entire institutional system as a prerequisite to a fair allocation and implementation of EU Funds. To this end, it would be crucial to have publicly available information on the decisions of the National Development Governmental Committee. Transparent and accountable grant selection procedures also have an outstanding importance.

(2) We recommend the introduction of a more comprehensive regulation of priority projects, however, not on the national but on the EU-level. As freedom of competition and sector neutrality are basic values in the EU, it is crucial to have a clear set of requirements pertaining to the cases where decision makers may deviate from open competition. The same applies for the assessment/evaluation criteria of the priority projects.

(3) Instead of formal control and audit procedures we recommend the introduction of thorough, content based control and evaluation of the projects. It would be crucial to examine the real impact of the projects, and the “value for money” criteria already at the selection phase. We also suggest ex-ante evaluation and monitoring instead of the exclusively applied penalties, in order to reduce the number of meaningless projects and over-pricing, fraud and false reporting of EU financed developments.

(4) We recommend the introduction of a more detailed conflict of interest regulation that concerns a wider range of actors, as well as the introduction of special regulations on the “revolving door effect”.

(5) We recommend the enhancement of the civil participation in the planning and monitoring procedures.

(6) We recommend ensuring free access to more detailed public information related to projects financed by the EU, since we have found it rather difficult to find detailed data on concrete projects, implementers, partners, activities, budget, etc.

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