

The Corruption Risks of EU Funds in Hungary

Transparency International Hungary, as an independent professional organization, contributes to mitigating corruption, promotes transparency and accountability in public decision-making processes as well as in the allocation of public funds, and improves access to information in the public interest.

Transparency International Hungary

2015 October

www.transparency.hu

ISBN:

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Executive Summary

In corruption, a group of players gain an economic advantage without providing any socially beneficial services in return, therefore **corruption is considered to be a form of rent-seeking**. Similar to other forms of rent-seeking, corruption causes **losses on a societal level**, due to the less efficient allocation of resources, as well as the costs of operation and prosecution. Fighting corruption is important not just because of ethical but also economic considerations.

Contributions from the European Union are making possible the use of more funds than ever, and spending the full amount of this money is a priority preference of the government. The abundance of funds and the pressure on absorption increase corruption, by the managers of the funds overplanning the amount of money to be allocated to individual tender invitations, setting generous rules on eligible costs, and specifying low rates of own contribution wherever possible. As a result, the opportunities for rent-seeking are increased, as it is worth it for beneficiaries to carry out the project even after relinquishing part of the funds they have been awarded. **Thus, the abundance of funds generates a sphere of corruption in which rent-seekers may appear on various levels of the system, often even without the knowledge or approval of those on higher decisionmaking levels.**

We have identified the following methods of fraud and corruption in the use of EU funds:

- Selection of unjustified development goals
- Exercising influence in the process of project selection
- Positive tender evaluations in exchange for a high rate of payment for proposal writers
- Positive tender evaluations in exchange for using overpriced services
- Recognizing costs at a price significantly above market prices
- Public procurement tailored to a specific bidder
- “Fine-tuning” a public procurement invitation in order to restrict the market
- Awarding contracts in exchange for providing an own contribution

Based on the results of the study, we reached the following conclusions regarding the fraud and corruption risks of using EU funds:

C1. A rent is built into the system of the use of EU funds, one that is accepted by all the players and is realized in the overwhelming majority of developments that are carried out.

C2. The legal environment and new organizational system for the 2014–2020 period has (also) centralized corruption risks.

C3. Most of the corruption and fraud risks associated with public procurements appear outside of the framework of the institutional system responsible for the use of EU funds.

C4. The main goal of the Hungarian system is to provide the minimum level of regularity that can be accepted by EU institutions, and to reduce the burden on the national budget in the case of irregularity procedures. The prevention and detection of fraud and corruption appears in this context, as an activity that reduces risk for the Hungarian budget.

C5. Measures affecting fraud and corruption in the 2014–2020 period are the following:

- **Organizational changes.** Relocating managing authorities to the relevant ministries has no substantive effect on corruption risks. The level of central control over the process has not changed substantively, and the functions of the National Development Agency (NFÜ) have been taken over by the Prime Minister’s Office. The elimination of intermediate bodies does not increase corruption risks.
- **Cost control during the period of project selection.** This measure plays a role in the case of economic development programmes. It may reduce fraud and corruption risks (Government Decree 1731/2013. (X. 11.)). The planned objective may be attractive for beneficiaries, but it also represents risks. A frequent form of fraud is overpriced expenditure reports. One of the consequences of simplified reports may be that the frequency of this form of fraud increases.
- **Limiting consulting costs.** The government is trying to limit, and in certain areas eliminate, consulting and proposal-writing activities. The opportunity for beneficiaries to price a corruption rent into project budgets will decrease somewhat.
- **Selecting large projects on a government level.** This provides an opportunity for the government to exercise individual preferences and treat project selection as an element of backroom deals.
- **The mandatory use of simplified project selection procedures for public sector bidders** (Government Decree 1731/2013. (X. 11.)). This measure eliminates the need for certain proposal-writing and consulting activities, but project documentation will have to be prepared even in the case of simplified procedures, thus public sector organizations will need assistance from experts.
- **Social control, integrity agreements.** There are no specific experiences yet, but this provides an opportunity for stronger social control. Not only the launching of specific projects is needed, but also that NGOs and the government reconcile their views on important economic policy priorities and how these are interpreted.
- **The public procurement system.** There are no experiences yet on the effects of the new regulations. Another important question is whether there is willingness for controlled public procurements. The complicated, detailed regulations also provide opportunities for abuse.

In order to reduce corruption in the use of EU funds, our recommendations are the following:

R1. Making public procurement procedures fully and automatically public.

R2. Avoiding an abundance of funds and high support intensity; the increased use of financial tools.

R3. Strengthening social control in project selection and implementation.

R4. Training and informing those involved, with special focus on presenting anti-fraud methods and the mode of reporting.

1. Introduction

The goal of the study is to describe and evaluate the regulatory and organizational framework of the use of European Union funds, with particular attention to the 2014–2020 programming period, and to identify the main corruption risks.

The analysis extends, among others, to the following risk factors:

- The centralization of decisionmaking processes;
- The restriction of open competition, the exercising of individual preferences;
- The pushing of professional considerations to the background in the project selection process;
- A pro forma treatment of professional controls instead of the “value for money” approach;
- Inadequate rules on conflicts of interest, with particular attention to the “revolving door effect”;
- Exercising direct political influence on decisions, as well as corrupt players in the institutional system.

Our goal is, based on the regulatory framework, to determine the mechanism of the decisionmaking processes and identify the main corruption risks.

2. Research Method

Exploring fraud and corruption risks is a delicate task, because due to the nature of the problem, those involved often do not provide truthful, reliable information. Therefore, we also have to use methods though which we can gain information without it resulting in negative consequences for those questioned. The regulatory and institutional environment is an important source, because it strongly affects the probability and opportunity for fraud and corruption.

It was not the goal of the study to uncover and present specific cases, and we did not have the tools for this at our disposal either. We attempted to uncover and present the possible types of fraud and corruption, and the systemic problems that make them possible, for which we used the following methods:

Theoretical basis. The study uses the set of concepts of new institutional economics. Within this theory, it concentrates specifically on rent-collection, rent-seeking behavior and their associated activities. This provides the interpretive framework of the analysis. The definitions of fraud and corruption were taken from European Union and Transparency International documents, as well as Hungarian legislation.

Analysis of documents and law. We primarily analyzed the documents of the Hungarian and international controlling authorities of EU projects. At the same time, the reports on irregularities also served as a source for describing methods of fraud. With respect to laws, we looked at the ones dealing with procedures, control mechanisms, methods of fraud and measures to combat them.

The laws and documents analyzed concern the use of funds for the 2007–2013 and 2014–2020 programming periods. The information is not final for either period. The laws for the former period will not change, but we are only in the middle phase of negotiations between the Commission and the Hungarian government on the use of funds, and within that, findings related to fraud. For the latter period, the legal framework has already been established, although there may still be some modifications. The documents defining the use of funds, the partnership agreement and most of the operational programmes are also known. However, experiences on the specific use of funds are not yet available, there are no reports, evaluations, or analyses in this regard. The goal of the analysis of documents and law was to present the institutional regulatory framework and the changes recently carried out to it.

Confidential interviews with players of the development programmes. It is a frequent opinion concerning the use of EU funds that there are various methods of fraud and corruption. We did not look for specific cases, but typical methods. We conducted confidential interviews with ten persons who are in some way connected to the use of EU funds. We will present the types of cases described by them, also using these cases to ask the opinions of executives about these methods.

Analysis of press information. The press often deals with the use of EU funds and has reported on several cases where inspections have uncovered problems. We used this information to supplement the knowledge we gained from the confidential interviews.

Interviews with executives. We conducted interviews with people working in executive positions within the institutional system, during which we asked them about the lessons learned from cases of corruption that have been uncovered so far, changes that have already been carried out and are planned, and the opportunities for reducing corruption. Interview subjects included, in addition to officials at the Prime Minister’s Office, people who work at the managing authorities and within the controlling system; a total of five executives and their co-workers. During the structured interviews, the composition of the questions also depended on the position of the given subject.

3. The Definition of Corruption

In this study, we used the definition that **corruption is the abuse of entrusted power for private gain**.¹ The various definitions of corruption always contain the element that it concerns the abuse of entrusted power, usually mentioning that corruption is often accompanied by bribery.

It is important to differentiate between corruption and fraud. Funds can end up at rent-seekers not only through corruption but through fraud as well. The difference between the two concepts is that in the case of fraud there is no participant who has influence on the allocation process, with the fraudsters acquiring rent by misleading this person. To demonstrate the difference through examples of corruption and fraud methods that will be presented in detail later on: if a beneficiary charges unjustifiably high expenditures and tries to do this by misleading their principal or the provider of the funds, than that is “simple” fraud. If the provider of the funds also participates in the reporting of

¹ *The definition of corruption is based on the English-language definition found on the website of Transparency International.*

high expenditures in exchange for some kind of – direct or indirect – compensation, then that embodies corruption. It is also worth considering that that system of the use of EU funds is built on the assumption that the managing authorities and the legal systems of the member states keep the rate of fraud low. However, if controls are lax and therefore fraud is frequent, we can also talk about systemic passive corruption². In the use of EU funds, authorities may benefit indirectly from tolerating fraud to a certain extent. The only aspect of the use of EU funds that is being treated with priority is whether Hungary is able to spend all of the allocated funds, a goal that overpricing helps in achieving. Thus, it is not in the interest of authorities to check the reporting of expenditures in a strict manner until the controlling bodies of the EU do not raise any objections.

The payment of EU funds also improves measured economic performance. The value of investments and GDP are higher, and wages also increase in several areas. At the time of payment, there is also an immediate accounting effect; paradoxically, the bigger the overpricing of the costs, the bigger this effect is. In periods of intensive payments, the surplus from the payment of EU funds may reach 3–4% of total GDP. Thus, it is in the interest of the entire government administration that the use of funds be accounted, even at unrealistically high costs, and that the loss of funds be avoided.

Corruption does not occur exclusively in the public sector. Another possible area, for example, is corporate corruption, as especially in large corporate organizations, there are many executives and workers with entrusted power who may have the opportunity to perpetrate abuse. Although we cannot rule out the possibility that in the course of the use of EU funds, benefiting businesses make corrupt decisions even without the knowledge or participation of the supporting authorities, the present study deals with the question of corruption in the public sector.

So, corruption transactions typically have at least two players. The first (type of) player is the person who has the entrusted power – and thus some form of influence –, while the other is the briber, who gains a relative advantage in exchange for the bribe. In the practice of corruption, there are often much more complicated formulas as well, which are generally created in order to cover up the corruption as much as possible, thus making detection more difficult. Whatever form corruption takes, it definitely presupposes the cooperation of more than one player.

We can differentiate between active and passive corruption. In the former, the person with entrusted power actively participates in some form in the execution of the corrupt transaction, in exchange for direct financial gain. Passive corruption is when persons with entrusted power, even though they would have the means, do not try to prevent fraud even if they do not have any direct financial gain from the given transaction.

3.1. The Definition of Fraud and Corruption in Laws

Numerous laws regulate the definition, detection and management of irregularities, fraud and corruption committed during the course of the use of EU funds.

² We use the term “passive” corruption not just in the criminal law sense, but for every case where those in charge do not take adequate action to uncover fraud.

3.1.1. EU regulations

The Treaty on the Functioning of the European Union (TFEU) does not contain separate provisions on corruption; it only stipulates rules relating to the definition of fraud. Of these, the following are important to our topic:

TFEU, Article 325 “(1) The Union and the Member States shall counter fraud and any other illegal activities affecting the financial interests of the Union through measures to be taken in accordance with this Article, which shall act as a deterrent and be such as to afford effective protection in the Member States, and in all the Union's institutions, bodies, offices and agencies.

(2) Member States shall take the same measures to counter fraud affecting the financial interests of the Union as they take to counter fraud affecting their own financial interests.

(3) Without prejudice to other provisions of the Treaties, the Member States shall coordinate their action aimed at protecting the financial interests of the Union against fraud. To this end they shall organise, together with the Commission, close and regular cooperation between the competent authorities.

(4) The European Parliament and the Council, acting in accordance with the ordinary legislative procedure, after consulting the Court of Auditors, shall adopt the necessary measures in the fields of the prevention of and fight against fraud affecting the financial interests of the Union with a view to affording effective and equivalent protection in the Member States and in all the Union's institutions, bodies, offices and agencies.

(5) The Commission, in cooperation with Member States, shall each year submit to the European Parliament and to the Council a report on the measures taken for the implementation of this Article.” (Highlights made by the author.)

It is worth pointing out that the Treaty on the European Union lays an obligation on Member States to combat fraud and other forms of abuse. Member States are obligated take **the same** measures to protect the financial interests of the EU as they take to protect their own financial interests.

The legal environment of the 2014–2020 programming period has changed significantly in several areas compared to the previous period. Péter Salamon describes in detail the EU and Hungarian laws for both periods, from the viewpoint of controls on the use of EU funds (Salamon, 2014).

The general rules are contained in Regulation (EU) No. 1303/2013 and its executive decrees, of which the provisions relevant to our topic are the following:

“irregularity”: any breach of Union law, or of national law relating to its application, resulting from an act or omission by an economic operator involved in the implementation of the European Structural and Investment (ESI) Funds, which has, or would have, the effect of prejudicing the budget of the Union by charging an unjustified item of expenditure to the budget of the Union;

“systemic irregularity”: any irregularity, which may be of a recurring nature, with a high probability of occurrence in similar types of operations, which results from a serious deficiency in the effective functioning of a management and control system, including a failure to establish appropriate procedures in accordance with this Regulation and the Fund-specific rules;

“serious deficiency in the effective functioning of a management and control system”: means, for the purposes of implementation of the Funds and the European Maritime and Fisheries Fund (EMFF) under Part Four, a deficiency for which substantial improvements in the system are required, which exposes the Funds and the EMFF to a significant risk of irregularities, and the existence of which is incompatible with an unqualified audit opinion on the functioning of the management and control system.

The European Commission’s Directorate-General for Regional Policy prepared an information note³ on how fraud as defined by law can be detected in practice during the course of the use of EU funds.

According to this guide, “Corrupt influence in the contract and procurement area is often reflected as:

- improper (such as unjustified non-competitive) selection,
- single source acquisition (there might be multiple awards under the threshold for public procurement),
- unjustified high prices, excessive quantity of purchases,
- acceptance of low quality and delayed or no delivery.”

The information note says that “the most common indicator of bribes and kickbacks is unexplained favorable treatment of a contractor by a contracting employee over a period of time.”⁴

The following additional warning signs (“red flags”) should be considered in the detection of fraud (European Commission Directorate-General Regional Policy, 2009):

- close socialisation between a contracting employee and service or product provider;
- unexplained or sudden increase in wealth by the contracting employee;
- contracting employee has an undisclosed outside business;
- contractor has a reputation in the industry for paying kickbacks;
- undocumented or frequent changes to contracts increasing the value of the contract;
- contracting employee declines promotion to a non-procurement position;
- contracting employee fails to file or complete conflict of interest declaration.

3.1.2. Domestic regulations

In Hungarian law, the punishable offenses of bribery and trafficking in influence as defined in Chapter XXVII of the Criminal Code correspond to corruption in the stricter, criminal sense. However, corruption often takes the form of other criminal actions. One typical such case is the abuse of office, but in many cases fraud, embezzlement and misappropriation also presume corrupt behavior. Corruption appearing as a crime against property is typical especially with regard to the abuse of public funds. Behavior manifesting in the questionable use of EU funds is classified in criminal law as budget fraud. In Hungarian criminal law, budget fraud functions as a general public finance offense, and serves to punish fraud against all domestic budgets as well as the budgets of foreign

³ European Commission Directorate-General Regional Policy (2009): *Information Note on Fraud Indicators for ERDF, ESF and CF*.

⁴ These are often referred to collectively as “**SPQQD**” factors: improper **S**election, high **P**rice, excessive **Q**uantity, low **Q**uality, delayed or no **D**elivery.

organizations, such as the European Union, the Norwegian NGO Fund, the European Economic Area, etc. The regulations on budget fraud that entered into effect in 2012 combined several previous public finance-related criminal offenses, such as for example crimes against the financial interest of the European Union (“subsidy fraud”) and tax fraud.

The law on the use of EU funds, when defining corruption, refers to the crime as included in Chapter XXVII of the Criminal Code⁵.

4. Corruption as Rent-Seeking

We can define corruption that takes place during the course of the use of EU funds as a form of the behavior known as rent-seeking.

Rent-seeking is regarded as the behavior by which an organization or person uses their resources to gain economic advantage without providing anything in exchange. Rent-seeking takes place in conjunction with “regular” economic activities and results in the gaining of extra income or other economic advantages. Rent-seeking is not necessarily illegal or hidden activity. The professional literature considers as rent-seeking, among others, the securing of favorable tax breaks, budget financing or regulation for a given player, through the influencing of decisionmakers. Most rent-seeking is public and regulated by law in many countries, which however does not mean that it cannot cause economic damages.

In the interpretation of *Murphy et al. (1993:409)*, rent-seeking also threatens the security of property rights and has a negative effect on economic growth by causing a less efficient allocation of resources. The opportunity for rent-seeking is fundamentally determined by the institutional environment of the economy. Under institution, we mean the collection of written and unwritten rules, and the organizations responsible for the application and observation of these rules. The efficiency of an economy is determined among others by the extent to which it is able to limit and reduce attempts at rent-seeking and prevent that income or wealth be gained without any actual performance behind it.

Murphy (1993) points out that the strength of rent-seekers is in their numbers, meaning that if there are only a few them in an economy then it is easier to take measures to combat them, while if there are many of them then there is less chance of punishment and rent-seeking behavior is more profitable.

As we can see in the presentation of the domestic situation, the general level of corruption in Hungary can be considered average (albeit high in a European comparison), while the relative proportion of abuses in the use of EU funds is considered high in a European comparison. Meanwhile, official bodies in Hungary do not seem to be active in combating corruption, as we are among the few countries where official bodies did not file a single report on fraud at the European Anti-Fraud Office (OLAF) in 2014. So the current situation is that authorities are taking action against

⁵ Government Decree 272/2014 (XI.5.) on the Rules of the Use of Funds from Certain European Union Funds in the 2014–2020 Programming Period

the relatively high level of rent-seeking with only low intensity, therefore stepping up the fight against corruption would be especially important.

Rent-seeking does not simply mean that certain players gain economic advantage without providing anything in exchange, but also that they expend resources on gaining these advantages, which resources are thus not used to produce useful goods. This also includes the costs of combating rent-seeking, as these are necessary in order to reduce the gaining of undeserved economic advantages.

Corruption is considered to be a form of rent-seeking because it is clearly a situation where a group of players gains economic advantage without providing anything useful in return to society. The general statements made above about rent-seeking clearly apply to corruption as well. It causes losses on a societal level, both through the less efficient allocation of resources as well as the costs of operation and prosecution. Reducing it is important not only from an ethical, but an economic standpoint as well.

Murphy differentiates between individual and community rent-seeking; it considers corruption, as it necessarily takes place with the cooperation of several players, as a form of the latter (Murphy, 1993, p. 412).

Corruption also comes with opportunity cost⁶. A development objective that is much less useful to society than other developments that have not been carried out – in other words, one compared to which there are much more useful goals – reduces social welfare. Funds that are used for developments that in themselves serve a good cause but are unjustifiably expensive cannot be used to finance other developments, which thus reduces the program's effects on development.

Social loss is also created by the fact that acquiring the corruption rent ties down resources at the project's contractors, the organizations and persons they cooperate with that have an influence on decisions, as well as at the bodies fighting corruption. The stronger the corruption pressure is and the wider the practice of corruption, the higher the administrative burden on the use of the funds is.

Another factor that is important from the viewpoint of interpreting corruption is the theory of agency. Recognizing that in modern economies economic operators exercise some of their functions in the process of exchange indirectly, through an agent, the theory examines how the relationship between the agent and the principal affects economic efficiency. The theory of agency points out that the agent-principal relationship is characterized by asymmetric information, and also that the players often provide false (opportunistic) information to serve their own self-interest. In this situation, the regulation and content of contracts and procedures is especially important, as well as measures to enforce these rules.

There are complicated, multistage and multiplayer principal-agent relationships present in the organizational and institutional system of the use of EU funds. We can consider as principals the managers of the funds: the European Union and the Hungarian government. Both players empower several organizations with controlling the management of funds. For example, the EU charges the relevant directorates-general of the European Commission, the Anti-Fraud Office and the European Court of Auditors with these tasks; and the Hungarian government charges these tasks to the

⁶ *Under the opportunity cost of a resource-allocation decision, we mean the lost gains of unrealized alternatives.*

managing authorities, which in the previous system delegated a part of these tasks to intermediate bodies – which are thus the “agents.” Additional authorities and controlling bodies can also be considered agents, such as the certifying authorities, the accounting authority, or the State Audit Office. The organizations in the role of agents have different preferences and concepts of their role, which also leads to conflicts between them. We attempt to present the relationships between them in the specific analysis itself.

Theoretical literature also defines the concept of a captured agency. The original definition refers to government bodies dealing with regulation, which are under the influence of some kind of group, typically large corporations or business lobby groups, and take less into account the interests of other players, such as the consumers. The agencies implementing development programs can also be captured by interest groups, when the rules on the use of funds and the decisions on project selection are not made based on goals for the society but in accordance with the interests of influential groups that exercise rent-seeking behavior.

5. The Abundance of Funds and Corruption

Hungary (like several other countries in Central Eastern Europe that joined the EU at the same time) has in the first more than 15 years of its membership gained access to external development funds in a volume that is unprecedented in its economic history. Under the Marshall Plan, which was previously regarded as the model of large-scale development plans, the western part of Germany received funds at the time corresponding to 2% of its annual GDP, spread over a three-year period, while in the case of countries on the winning side of the war the proportion was 3–4% of GDP, which came to an average of 0.7–1.2% of GDP per year in the beneficiary countries. In the period between 2007 and 2020, Hungary is set to receive total funds equivalent to 60% of its annual GDP from the European Union budget for development purposes, which comes to more than 3.5% of GDP per year. Since this amount can be used only for financing developments, in certain areas the amount of funds that is available and has to be spent is significantly more than ever before. This situation considerably increases the opportunities for, and risk of, corruption.

A comparative study on the corruption risk of EU funds (Fazekas, 2013, p.29) concluded that EU funding considerably increase corruption risks in the countries subject of a comparative research (Czech Republic, Hungary, Slovakia) primarily by making a large amount of additional public resources available for rent extraction.

Since Hungary has started receiving large amounts of money from the EU budget, the professional community as well as the wider public has paid a lot of attention to the subject. Public discourse is dominated by the question of whether we will be able to spend all of the EU money, while a lot less attention is given to the efficiency of the developments themselves. This attitude in itself already decreases the chances of the fight against corruption, since stricter controls could slow down the selection and implementation of the projects. Especially toward the end of the programming period, there is a possibility that uncovering abuse will spoil the statistics on the use of funds, as at that point there is less chance of finding new projects to make up for the lost commitments. The government protects against losing funds by “overextending” itself, which means that the managing authorities

assume more commitments than the amount of EU funds available, and if the European Commission calls for a correction, then they charge the costs of the “backup” projects. If some of these reserves are not needed, then the central budget covers their cost. This practice also promotes the use of funds as opposed to the efficiency of the developments.

Thus, the abundance of funds leads to absorption pressure, which pushes considerations of efficiency to the background and favors among others the spread and preservation of corruption. The biggest possible use of funds takes precedence over efficient developments, and rent that can be gained through corruption is also looked upon more leniently compared to the problem of a formal loss of funds occurring in the given period.

The efficiency of Hungarian development programs is generally low. A good example of this is the area of state subsidies provided for businesses. Over the past more than a decade, Hungary has spent 2.7 times the EU average on state subsidies for businesses, while its competitiveness indicators have remained below average. The level of neither employment, nor investments has increased (the latter has actually decreased), the innovation activities of Hungarian players have not improved in an international comparison,⁷ and the country’s overall competitiveness has decreased as well,⁸ despite the use of funds in a volume that is significant even on a national economy level (Kállay, 2014).

The abundance of funds and the absorption pressure also increase corruption through the managers of the funds overplanning the amount of money to be allocated to individual calls for proposals, determining generous rules on eligible costs, and setting low rates of own contribution wherever possible. As a result, the opportunities for rent-seeking are increased, as it is worth it for beneficiaries to carry out the project even after relinquishing part of the funds they have been awarded. **Thus, the abundance of funds generates a sphere of corruption in which rent-seekers may appear on various levels of the system, often even without the knowledge or approval of those on higher decisionmaking levels.**

When the owner of the EU funds (Hungary) pays more than is justified for a procurement or a service then in an economic sense it is paying rent to players that are able to establish its institutional environment, and as a result opportunity cost is incurred. Therefore, it is in the interest of society that EU funds be spent on implementing objectives that have gone through the best selection process, with the least amount of corruption, in which the various forms of social control can play an important role.

These comments attributed⁹ to János Lázár could even be considered as an acknowledgment that the abundance of funds, absorption pressure and rent-seeking behavior exist:

“We really rushed this. The most important task now was to get the money out there, but this is not what we want to do in the next 7 years.” He also said that “there is money for everything except for what we want to do; not for preparation, not for implementation, but for acquiring the funds, or, let’s be clear, for stealing the money.” (Origo, 2015. 06. 17.)

⁷ (European Commission, 2013).

⁸ See the World Economic Forum Global Competitiveness Report and IMD’s World Competitiveness Scoreboard.

⁹ It is important to note that the information comes from a secondary source, as the news portal reported János Lázár’s comments based on information provided by one of the participants of the event.

6. Corruption in Hungary

The indicator most frequently used to measure corruption is Transparency International's annual Corruption Perceptions Index (CPI), which measures public sector corruption in countries on a scale of 1 to 100, where 100 corresponds to a total lack of corruption in the public sector and 0 corresponds to total corruption. In 2014, the index was calculated for 175 countries.

Based on its CPI, Hungary can be considered a moderately corrupt country in a global comparison. Its score in 2014 was 54, which is above the global average of 43, but in its own region (European Union and Western Europe) it is near the bottom of the field, lagging well behind the regional average of 66 points (Transparency International, 2015). Within the region, 23 countries place higher than Hungary while only seven have a lower CPI.

The CPI presents overall corruption in the public sector. Regarding problems associated with EU funds, the already mentioned report by OLAF (European Anti-Fraud Office, 2015) presents a clearer picture.

6.1. Audits by the State Audit Office

The State Audit Office of Hungary (ÁSZ) examines the use of EU funds each year during its audit on the execution of the state budget. ÁSZ primarily seeks answers to the question of what rate the commitment and payment of funds is progressing at, and it deals less with questions of regularity. Audits on regularity are focused mainly on the system of the use of funds, and analyses on the rules and, in part, compliance with the rules. They usually do not look at individual cases, thus they cannot uncover the possible transactions involving fraud that the European Union's controlling bodies could later voice objections to.

During the course of its audit on the execution of the 2012 budget, ÁSZ made the following findings regarding the regularity of the use of EU funds: "Our supplemental audit carried out under the framework of the audit on the execution of the budget found that the internal control system of NFÜ does not provide sufficient guarantees that only transparent organizations be able to receive EU and related budget funds. This is supported by the fact that until October 23, 2012, the internal procedures of NFÜ did not call for the checking of ownership data against databases – by intermediate bodies –, thus the enforcement of the relevant provisions of the State Budget Act was not ensured" (State Audit Office, 2013).

The ÁSZ carried out a comprehensive audit on the system of the use of EU funds in 2015 (State Audit Office, 2015). This report also focuses on the progression of the use and payment of funds and the risks of possible loss of funds, and less on regularity. Its main findings are the following:

"... typical irregularities included irregularities caused by improperly implemented projects due to public procurement or economic difficulties. In the period under audit, there were a total of 6,179 irregularity decisions related to 72,727 entities receiving funds. The number of irregularities increased from 5 in 2008 to 1,623 in the year 2013. In the period under audit, the amount of financial correction determined by the Member State was HUF 8,646.5 million, and the amount of financial

correction determined by the European Commission was HUF 75,940.4 million, which corresponds to 0.9% of the entire National Strategic Reference Framework (NSRF). Actual loss of funds as a consequence of irregularities found by the European Commission has not been realized by the end of 2013, and the Managing Authorities (MA) took measures on the re-use of funds affected by the financial correction.¹⁰

The establishment and operation of the internal control systems of the Intermediate Bodies (IB) in the period under audit were overall in accordance with the provisions contained in Paragraph 5, Section (2) of Government Decree 281/2006. (XII. 23.) and in Paragraph 12, Section (I) of Government Decree 4/2011. (I. 28.). Measures were taken to establish audit trails, procedures on managing irregularities and risk management, as well as public procurement and claims management procedures” (State Audit Office, 2015).

It can be seen from the report that in Hungary the amount of financial correction determined by the Member State is only one-ninth of the amount established by the European Commission, which raises the suspicion that domestic authorities are much less stringent in their audits than EU institutions. This fact is especially interesting in the context of the report’s other important finding, which is that the internal control systems of the intermediate bodies meet the necessary requirements. Accordingly, it follows that the regulatory framework (laws, decrees, internal regulations) form only one element of combating fraud, and do not in and of themselves determine effectiveness. The behavior, attitude and preferences of the users of the law and the managers of the funds have a decisive effect on the extent of corruption.

6.2. Controlling Authority: Kehi and EUTAF

Under EU regulations, the use of funds originating from common funds must be overseen by a controlling authority assigned with this task. The Government Control Office (Kehi) handled these duties until December 31, 2009, after which they were taken over by the Directorate General for Audit of European Funds (EUTAF). The office and the directorate general do not publish primary information on the results of their own audits, with the information that is available gained from an article on the Napi.hu news portal.

When interpreting the data, we have to keep in mind that the concept of irregularity as defined by law is not equivalent to corruption, and that the statistical data refer to the totality of the detected cases. There is no specific information available on whether the irregularities included cases in which empowered persons participated actively.

¹⁰ A correction means the amount of funding that is withdrawn from a Member State as a penalty for irregularities committed. The correction does not result in a loss of funds if the Member State replaces it with a lawful commitment.

Table 1**Irregularity procedures related to the use of EU funds during the 2007–2013 programming period**

OP	Number of irregularity procedures	Amount involved in the irregularity procedures	Number of irregularities involving clawbacks	Total amount of funds to be clawed back	Amount of reclaimed funds	Reclaimed funds as a percentage of the clawback
		<i>HUF bn</i>		<i>HUF bn</i>	<i>HUF bn</i>	<i>%</i>
ÁROP	76	0.4	41	0.4	0.4	95
DAOP	293	1.4	100	1.0	0.3	30
DDOP	338	1.2	94	1.2	1.4	113
ÉAOP	614	7.1	153	6.4	1.0	16
EKOP	73	0.8	31	0.5	0.4	93
ÉMOP	337	1.7	136	1.6	0.2	14
GOP	2555	19.2	1251	20.9	1.8	8
KDOP	320	0.9	46	0.6	1.0	157
KEOP	289	1.9	78	0.6	0.5	83
KMOP	1039	4.4	426	4.7	0.9	19
KÖZOP	93	3.8	65	3.0	2.9	94
NYDOP	116	0.3	43	0.4	0.1	23
TÁMOP	1325	3.2	599	1.7	0.6	36
TIOP	260	2.4	110	1.2	1.3	112
VOP	30	0.1	29	0.1	0.1	89
Total	7758	4.8	3202	44.3	12.9	29

Source: Prime Minister's Office, as reported by Napi.hu, February 15, 2015

Definitions:

Concept of irregularity:¹¹ what is contained in Article 2, Section (7) of Council Regulation (EC) No. 1083/2006, plus violations of provisions of national law and commitments undertaken by the parties in the support contract, by which Hungary's financial interests would or could be prejudiced (for more details, see the section presenting the legal framework).

Number of irregularity procedures: the number of irregularity procedures involving EU projects. A project may be affected in several procedures, for example submitting ineligible invoices, public procurement irregularities, etc.

Amount involved in the irregularity procedures: the portion of the funding support that is affected by the irregularity. The amount includes both the EU and the domestic co-funding.

Number of irregularities involving clawbacks: the number of irregularities that are affected in a clawback procedure due to the harming of financial interests or a violation of law (funder aims to recover the unduly paid amount).

Total amount of funds to be clawed back: the total amount of funds involved in the clawback.

Amount of reclaimed funds: the amount of funding paid back to the funder by the project during the course of the claims management procedure.

Reclaimed funds as a percentage of the clawback: the proportion of reclaimed funds compared to the total clawback amount, in percent.

¹¹ Considering that the data in the table refer to the 2007–2013 programming period, the definition of irregularity is also the definition contained in the law at the time.

6.3. European Commission

6.3.1. Directorates-general responsible for the use of funds

The European Commission conducts regular controlling activities on the use of structural and cohesion funds. It is the duty of the directorate-general managing the given fund to monitor the activities of the managing authorities, the selection and implementation of the projects, and to take action in case of irregularities. The findings and rulings of the Commission, until the audits are completed, are made public only to a limited extent, but in some cases the content of proceedings that are still ongoing are also made available. One such case was the most recent decision on the Economic Development Operational Programme (European Commission, 2015). The detailed decisions are usually made available for irregularities that occurred several years prior.

6.3.2. European Anti-Fraud Office (OLAF, AFCOS)

The European Anti-Fraud Office (OLAF) publishes regular reports on the implementation of Article 325 of the TFEU, with two kinds of reports prepared each year. One type of report deals with the legal framework and procedural questions relating to the fight against fraud (OLAF, 2014). As the office's activities in general, this report also encompasses various areas, but the largest sums involved are related to the use of structural funds. In 2014, half of the funds recommended for recovery related to projects financed from these funds.

In 2014, Hungary reported 30 cases of fraud that affected the use of cohesion funds, in the total value of EUR 2.1 million. This corresponded to 10% of the total number of cases in the EU, but only 0.7% in terms of value. However, the report notes that this figure should not be taken as an indicator of committed fraud in the given country. It should be considered that the figures only partially reflect even the activities of local authorities, because there is no first-hand information on the intensity of fraud in each country.

Information on the outcome of specific cases is contained in the office's activity report (European Anti-fraud Office, 2015). Table 2 shows that OLAF launched a relatively large number of investigations in Hungary. While there was typically one investigation carried out in most of the Member States and other supported countries in 2014, there were 13 in Hungary, with more conducted only in Romania.

Table 2

OLAF investigations into the use of EU funds managed in whole or part at national or regional level concluded in 2014

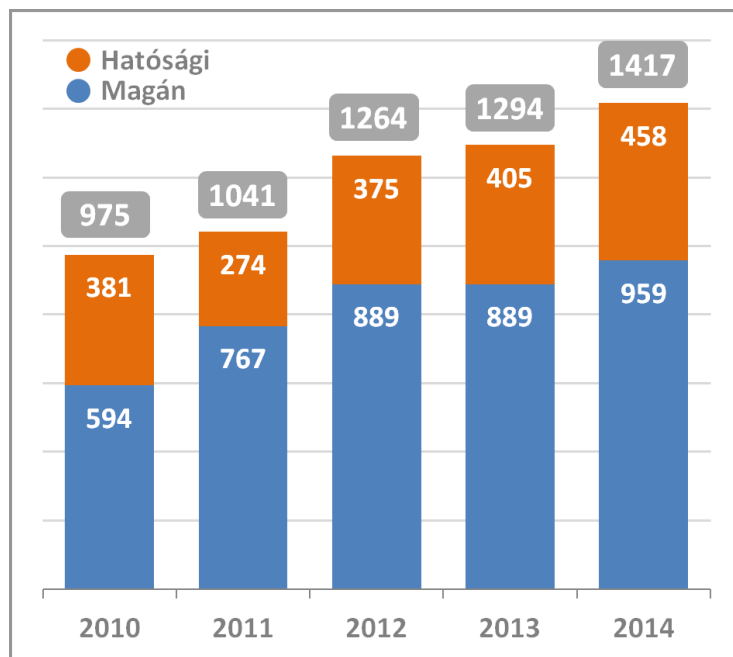
Country	Number of investigations
Romania	36
Hungary	13
Bulgaria	11
Czech Republic	8
Italy	7
Spain	5
Greece, Slovakia	4
France, Lithuania, Moldova, Germany, Syria	3
Afghanistan, Kazakhstan, Congo, Poland, Morocco, Mauritania, Senegal, Serbia, Turkey, Tunisia	2
Albania, Belgium, Bosnia and Herzegovina, United Kingdom, Ivory Coast, Estonia, Philippines, Ghana, Haiti, Netherlands, Croatia, Ireland, Israel, Cambodia, Cameroon, Kosovo, Lesotho, Latvia, Macedonia, Malta, Namibia, Nigeria, Pakistan, Palestine, Paraguay, Peru, Portugal, Saint Lucia, Saudi Arabia, Slovenia, Somalia, Thailand, Vietnam	1

Source: *The European Anti-Fraud Office (The OLAF Report 2014)*

The report reveals that incoming information to OLAF in recent years has come from private and public sources in the proportion of two-thirds to one-third in the favor of the former (Graph 1).

Graph 1

Incoming information to OLAF by source



Source: *The European Anti-Fraud Office (The OLAF Report 2014)*

OLAF opens investigations based on reported allegations of fraud. Table 3 shows that Hungary is among the Member States where public authorities did not report any cases of fraud, but where OLAF received relatively large amounts of information from private sources. These data in and of themselves do not reflect directly the anti-fraud activities of authorities, as it is possible that they handle the detected problems within their own competence. However, we know from other OLAF

reports and other sources (such as the earlier mentioned reports of the State Audit Office) that the value of cases of fraud detected by Hungarian authorities can be considered low.

Table 3

Incoming information to OLAF from Member States by source, 2014

Member State	Public source	Private source
Austria	2	2
Belgium	28	25
Bulgaria	5	54
Cyprus	2	3
Czech Republic	4	17
Denmark	0	2
United Kingdom	4	14
Estonia	0	0
Finland	0	3
France	5	14
Greece	4	27
Netherlands	3	6
Croatia	0	9
Ireland	0	5
Poland	2	50
Latvia	0	5
Lithuania	2	1
Luxembourg	2	2
Hungary	0	28
Malta	0	1
Germany	10	25
Italy	7	35
Portugal	2	7
Romania	6	73
Spain	4	52
Sweden	0	0
Slovakia	1	11
Slovenia	1	2
Unattributable source country	486	–

Note: 12 information items came from non-EU countries and international organizations

Source: The European Anti-Fraud Office (The OLAF Report 2014)

6.3.3. European Court of Auditors

The European Court of Auditors – the EU’s most important controlling body – published a comprehensive report in 2014 on the more efficient use of EU funds, covering among others policy and budget aspects as well. From the perspective of our topic, the risks identified in the areas of fraud, irregularities, corruption and public procurement are the most relevant. The report (European Court of Auditors, 2014) does not contain country-specific findings, identifying in general the following problems:

Fraud, irregularities and corruption

- Low priority given to fraud prevention, detection and correction

- Lack of resources to fraud-proof budget
- Activities involve large amounts of cash or high-value goods
- Loss of assets
- Difficulty in identifying final beneficiary

Public procurement

- Complex procurement or contractual rules
- EU procurement procedures are not followed (splitting to avoid thresholds for competition requirements, advertising, award criteria, contract terms and signature, etc.)
- Inappropriate tendering procedures used (contracts frequently awarded without competition, contracts for additional works, etc.)

Based on local studies, in the case of Hungary the first problem in the area of fraud, and all of the problems in the area of public procurement, can be considered relevant.

6.4. Supervisory Institutions Controlling Public Procurement

Public procurement plays a large role in the use of EU funds, as many high-value projects are implemented. The issue is especially important considering that the overwhelming majority (95%) of community investments are covered from EU funds, therefore EU-financed projects comprise a significant portion of public procurement procedures in Hungary. At the same time, the public procurement system is not formally part of the organizational system responsible for the use of EU funds.

Public procurement – regardless of the sources of financing for the procurement – is regulated by Hungarian laws that are determined by EU directives. The Public Procurement Arbitration Board (KDB) was created by the Act on Public Procurement to settle legal disputes arising in public procurement procedures. According to the act, the KDB, which operates alongside the Public Procurement Council, is an independent body with national jurisdiction (Article 176 of the Act). As a guarantee of its independence, the law stipulates that the public procurement commissioner shall not be given instructions in relation to remedy proceedings or decisions. At the same time, the institutional independence of the KDB is questionable, primarily due to the Public Procurement Council's right of nomination, as well as budgetary matters.

The Office of the Deputy Secretary of State of the Prime Minister's Office Responsible for Public Procurement Supervision oversees all public procurement procedures, including ones conducted under the framework of EU-financed projects. The Office does not function as an authority, as its declared goal is to aid in securing the regularity of proceedings. Its taking a role in a proceeding does not limit the responsibilities of either the contracting authorities or the bidders.

Managing authorities do not have direct influence over supervisory activities related to public procurements, or decisions with regard to disputes. Following project selection, the conducting of procedures is the task and responsibility of the beneficiaries.

7. The Decisionmaking Process of the Use of EU Funds

The analysis is based on the assumption that the reasons behind corruption taking place during the use of EU funds are complex. Problems that represent corruption risk arise on every decisionmaking level.

7.1. The Process and Aspects of Defining Development Objectives

There is a long road that leads to specific decisions in the course of the use of EU funds. Decisions are made on four levels, which we will briefly present below.

7.1.1. EU level

The first phase of the planning process is the result of political negotiations on the highest level. Although it is a fundamental principle of the European Union to also provide aid to less developed regions and countries in the form of budget transfers for developments with the goal of convergence, the funds to be used in the seven-year programming periods are decided by the Council and the European Parliament based on consultations with the Member States and the Commission. It is also on this level that the structure of the possible types of objectives is decided. EU funds are provided by the following five funds: the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund, the European Agricultural Fund for Rural Development (EAFRD), and the European Maritime and Fisheries Fund (EMFF). Together, these are called European Structural and Investment Funds. (REGULATION (EU) No 1303/2013 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL (17 December 2013))¹²

The objectives of use of the various funds are different. The Cohesion Fund finances projects related to environmental protection and the development of trans-European transport networks. The goal of the ERDF is to strengthen European social and economic cohesion by reducing regional inequalities, therefore it primarily finances measures to improve competitiveness. The main objective of the ESF is to improve the employment landscape, create and keep jobs, and to create more and better jobs.

Under the framework of its partnership agreements, the European Union expects support for the following thematic objectives in the 2014–2020 planning period (REGULATION (EU) No 1303/2013 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL (17 December 2013)):

1. Strengthening research, technological development and innovation
2. Enhancing access to, and use and quality of, infocommunications technologies
3. Enhancing the competitiveness of small and medium-sized enterprises, of the agricultural sector (for the EAFRD) and of the fishery and aquaculture sector (for the EMFF)

¹² Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013, laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006.

4. Supporting the shift towards a low-carbon economy in all sectors
5. Promoting climate change adaptation, risk prevention and management
6. Preserving and protecting the environment and promoting resource efficiency
7. Promoting sustainable transport and removing bottlenecks in key network infrastructures
8. Promoting sustainable and quality employment and supporting labor mobility
9. Promoting social inclusion, combating poverty and any discrimination
10. Investing in education, training and vocational training for skills and lifelong learning
11. Enhancing institutional capacity of public authorities and stakeholders and efficient public administration

7.1.2. National level

Member States are required to draw up Partnership Agreements (in previous periods, these were called National Strategic Reference Frameworks or National Development Plans) that have a specific structure and content, which is then finalized following consultation with the European Commission. The elements of the Partnership Agreements have to focus on the thematic objectives set by the European Commission for the 2014–2020 period. Thus, the contents of the national programmes are much more set than previously, although the range of thematic objectives is wide enough so that it does not limit the Member States in achieving their own objectives. As mentioned earlier, EU Member States that are in a similar situation as Hungary (former Socialist countries that joined the EU in or after 2004) now have access under the EU's cohesion policy to external funds that are very significant even in an international comparison. The Hungarian Partnership Agreement was signed by representatives of the Hungarian government and the Commission on August 14, 2014 (Government of Hungary, 2014).

7.1.3. Programme level

Based on the Partnership Agreements, the Member States draw up the Operational Programmes, which have to be approved by the European Commission.

The Operational Programmes approved by the European Commission for Hungary for the 2014–2020 period are the following:

- Human Resources Development Operational Programme (EFOP)
- Economic Development and Innovation Operational Programme (GINOP)
- Integrated Transport Operational Programme (IKOP)
- Environmental and Energy Efficiency Operational Programme (KEHOP)
- Food and/or Basic Material Assistance Operational Programme (RSZTOP)
- Territorial and Settlement Development Operational Programme (TOP)
- Competitive Central-Hungary Operational Programme (VEKOP)

The structure of the funds allocated to the programmes are partly determined by the approval of the funds that provide the financing and by the planning guidelines, but Member States have significant maneuvering room in defining their own development objectives. In the case of Hungary, the government's decision to set a particularly high (60%) proportion of funds used for direct economic development results in absorption pressure, as well as fraud and corruption risks in this area.

7.1.4. Project level

The lowest level of the decisionmaking process is the selection of projects. There are several different kinds of project selection procedures. Chapter IX of Government Decree 272/2014. (XI. 5.) on the Procedures of the Use of Funds in the 2014–2020 Programming Period From the Various EU Funds lists the kinds of selection procedures. According to this, the evaluation of project support requests submitted for calls may follow

- a) priority,
- b) standard,
- c) simplified,
- d) regional, or
- e) community-led local development (CLLD)

procedures.

We will discuss the specific risks of the project selection process in the next chapter.

7.1.5. Why is the use of EU public funds a special issue?

It is a general rule in the TFEU that Member States shall take the same measures to counter fraud and corruption affecting the financial interests of the Union as they take to counter fraud and corruption affecting their own financial interests. On the other hand, in the use of EU funds, the primary interest of Member States is in spending the amount previously allocated to them: if they do not use this money then no savings are created for them that they can use in their own budgets. As a result, they have less incentive in uncovering fraud and abuses. This is especially true near the end of an accounting period, when it is more difficult to use the funds that have to be paid back due to irregularities in other projects, and thus these funds are lost to the country. In the early phases of the operational programmes, the attitude often prevails that strict management is not important because we are not spending our own funds.

8. The Organizational Framework of the Use of Funds

According to EU law, “it is necessary for Member States to designate a managing authority, a certifying authority and a functionally independent auditing authority for each operational programme” (REGULATION (EU) No 1303/2013 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL (17 December 2013)), a requirement that was set by other legislation in previous programming periods as well.

According to the law, the **managing authority** bears the main responsibility for the effective and efficient implementation of the funds. Its main tasks are

- programme management and monitoring,
- financial management and controls,
- project selection.

The **certifying authority** draws up and submits to the Commission payment applications, draws up the accounts, certifying their completeness, accuracy and veracity and that the expenditure entered in them complies with applicable Union and national rules.

The law allows the tasks of the certifying authority to be carried out by the managing authorities.

The **audit authority** should ensure that audits are carried out on the management and control systems.

The law allows Member States to designate intermediate bodies to carry out certain tasks of the managing or the certifying authority.

In the three programming periods so far (2004–2006, 2007–2013, 2014–2020), Hungary has chosen three different solutions for providing the above functions.

The managing authorities operated within the relevant ministries between 2004 and 2006 – with development policy coordinated centrally –, and within the National Development Agency between 2007 and 2013, while the relevant ministries continued to be (partly) responsible for formulating policy. As of 2014, the managing authorities were placed once again at the relevant ministries, with the Prime Minister’s Office handling central coordination tasks. In the 2004–2013 period, Hungary exercised the opportunity of designating intermediate bodies to carry out certain tasks of the managing authorities, but since 2014 every task is being performed by the managing authorities, i.e. the relevant deputy state secretary offices of the ministries. Since 2010, the functions of the certifying authority have been carried out by the Hungarian State Treasury, and that of the audit authority by the Directorate General for Audit of European Funds (EUTAF).

The changes made in 2014 are characterized partly by decentralization, with the managing authorities being moved to the ministries, and in part by centralization, i.e. the strong coordinating role of the Prime Minister’s Office. Direct state and government control has strengthened, as every function has been moved to within the administration.

9. Corruption Techniques and Methods

In this chapter, we will present the techniques and methods with which certain players of the process of the use of funds attempt to acquire a part of the funds in a corrupt manner. We collected the information on the various methods partly from players that participate in the implementation of funds, with most of them requesting anonymity. At the same time, we also used publicly available information from the controlling authorities, as well as specific cases of fraud and abuse.

It is not the goal of this study to expose specific cases. Our goal is to attempt to describe the various types of corruption in order to help that more and more people be able to recognize them.

We examined the types of methods with which certain players in the process are able to acquire remuneration that is either disproportionately high or without them providing any services in exchange. In the course of the analysis, we took into consideration that funds can only be used for justified costs, which means that technically there is a report of expenditure behind each item paid.

Accordingly, we looked for methods that make it possible to account for products or services at a price that is significantly above the market price.

We will present the corruption techniques sorted according to the logic and order of the development policy decisionmaking process.

9.1. Selection of Unjustified Development Goals

One group of the corrupt use of funds is the selection of development goals that are socially unjustified and that give preference to certain beneficiaries unjustifiably.

The basic documents that define the framework of the use of EU funds (previously the National Strategic Reference Framework, now the Partnership Agreement and the Operational Programmes) do not contain specific development projects. Despite the fact that Hungary currently has access to large amounts of EU funds, there are much more development goals to be achieved than what these funds can finance. The projects implemented affect citizens, businesses, organizations and municipalities in different ways and to a different extent. If those that have influence over the selection of development goals represent their own personal or organizational interests at the expense of others, then they are perpetrating corruption, even if there are no problems in the management of the projects. One example could be a kind of infrastructure or project development compared to which there would be objectives that are more important or useful to society.

During our interviews with executives we heard examples that local governments or companies carrying out large infrastructure developments often lobby for projects that are significantly larger – and of course costlier – than justified, and that they also use their powers of authorization to achieve their goals. This category includes the modernization and expansion of the train stations in Székesfehérvár and Vác, as well as the much talked-of stadium development program.

Another possible way that the selection of development policy preferences can affect corruption is if programme-level allocation decisions are made. Government Decree 1600/2012. (XII. 17.) specifies that 60% of the funds of the 2014–2020 programming period must be used for economic development. In the 2007–2013 period this proportion was 24% and various data seem to indicate that they were used only with very low efficiency. The significant increase in the amount and proportion of direct economic development funds increases absorption pressure in this area substantially, which contributes to the increase in corruption risks.

9.1.1. How can it be recognized?

Naturally, assessing the importance of the developments is partly subjective, therefore their justifiability can always be disputed. However, there may be cases where it is clear that the establishment of the development objective serves the interests only of specific persons or groups.

9.1.2. How can it be detected?

Verification can be performed, beyond the reasons that are clearly visible, with a cost-benefit analysis.

9.2. Exercising Influence in the Process of Project Selection

According to the programming logic, project selection must serve the objectives defined in the operational programmes. If projects that are not aligned with the objectives also receive funding, or if beneficiaries are selected whose operations are not aligned with the objectives, then resource allocation is also distorted. In certain cases, the Commission published audit results indicating the possibility that project selection took place as a result of some kind of external influence. This is especially likely where companies belonging to the same ownership group receive funding in similar types of calls for proposals. In these cases it is not just that the decisions do not conform with the framework rules for funding – such as the prohibition of providing funds to troubled companies or the requirement to consider the aggregate indicators of affiliated companies –, but also that these decisions were made by the responsible authorities in the interest of the beneficiaries, in a controlled manner.

Átlátszó.hu reported the following case: “Investments using renewable energy are supported around the world, but decisionmakers were even more generous than usual with Hungary’s Pannergy Nyrt. It was announced last week that the National Development Agency will provide funding support for three applications associated with the company under the KEOP-2012-4.10.0/B application call: DD Energy Termelő és Szolgáltató Kft will receive a HUF 1 billion grant for a large investment in Győr, while the EU will contribute HUF 980 million to a project by Geo-Wendung Zrt in Kistokaj. (The latter company is directly linked to a large project being carried out by Pannergy in Miskolc.) Two days earlier, Kuala Kft, also owned by Pannergy, was awarded a HUF 1 billion grant by the decisionmakers of the NFÜ.” (Átlátszó.hu, 2013)

One form of exercising influence is when experts who previously worked at organizations exercising control over funds (managing authorities, ministries, intermediate bodies) continue their work in the private sector in a consulting, and especially in a proposal-writing role. The situation is unique, because the periods when the given expert is in an empowered role and when he or she assists applicants take place at different times. However, there is a view that these kinds of situations can be considered a conflict of interest, since the opportunity for specific knowledge and influence is there even if someone formally no longer works at one of the organizations that manage funds.

9.2.1. How can it be recognized?

The list of supported projects is public, as is the amount of funding approved and a short description of the project. Using other sources, such as company databases or press reports, information can be gathered based on which it can be determined whether businesses belonging to same shareholder group received large amounts of funding under certain application calls.

It is more difficult to gain information on persons and organizations involved in the revolving-door effect, thus these cases can only be identified on a case by case basis.

9.2.2. How can it be detected?

In this method, decisionmakers are definitely involved, therefore internal controls are likely not enough. It is necessary for external controlling bodies (including national security bodies) to identify

the application of this method, which assumes on the one hand that this area is also covered in their investigative plans, and on the other that they possess information on the interrelations between beneficiary businesses and organizations.

Those involved in the revolving-door effect can be identified by a method whereby controlling authorities study the contracts of service providing companies contracted by the beneficiaries, as well as the list of workers participating in implementation. There is not much possibility of intervention, since there are no formal rules on conflict of interest.

9.3. Positive Tender Evaluations in Exchange for a High Rate of Payment for Proposal Writers

Preparing project proposal documentation and meeting content and form requirements is often a complex and difficult task, which most potential applicants are either unable to meet, or only with a disproportionately high effort. Since large amounts of development funds can be accessed in Hungary, the market of proposal-writing services has emerged. In a normal case, proposal-writers help in the preparation of proposal documentation, and in the event of success, they often aid in completing implementation, accounts and reports in a lawful manner. This service has become widespread despite the fact that most proposal calls do not include the remuneration of proposal-writers among eligible costs.

Proposal-writing activity is considered corrupt if it has direct influence on the project selection decision, and this influence is also incorporated in its fee. Especially serious are the cases where only proposals prepared by corrupt proposal-writers can win and proposals prepared in a different manner are excluded from the competition.

Interview subjects with experience in the use of funds (who requested anonymity) mentioned cases when proposal-writing companies had insider information on the launch or suspension of proposal calls, or had a "budget" allocated to them for some proposal calls, to the extent of which they could guarantee winning proposals even for lower-quality project proposal documentation.

It is an important question, but not one that can be answered with the tools at our disposal, how the extra income gained in exchange for the influence is distributed among the players. There may be cases where the political influence of the proposal-writers is so strong that they can control project selection decisions, but it is also possible that those making the selection decisions receive a share of the higher payment.

There may be different variations of the method, depending on which of the players receive a share of the income gained from corruption, and what overall influence they have on decisions related to the fund distribution system. Another question is whether this kind of decisionmaking is institutionalized. It would be especially dangerous if project selection decisions influenced by proposal-writers would become a recognized, widespread and partly accepted practice. According to our information, there are certain types of proposal calls where the spread and evolution of this method, and in some cases even its becoming exclusive, can be observed.

9.3.1. How can it be recognized?

This method is usually visible only to its participants. Recognition is made more difficult by the fact that during project selection the identity of the proposal-writing company is not formally made public in most cases. However, the method can be recognized by fund managers and empowered controlling bodies if they study the budgets of the projects, with particular attention to subcontractors.

9.3.2. How can it be detected?

The fee paid to the proposal-writing company cannot be charged as an eligible cost of the project, therefore auditors would be unable to find invoices that directly prove a link between the proposal-writer and a positive decision. In certain cases there may be a kind of contractual relationship in which the proposal-writer receives a remuneration at the expense of the project's budget, but under a false title. In these cases, the problem can be easily detected (even after the event), since the proposal-writing company appears in many, in extreme cases all, of the projects of the call for proposals, thus it is possible to thoroughly investigate the contractual relationships. Among others, it is possible for auditors to compare the company's specific contribution with its remuneration, which may reveal the strong overpricing of the formally indicated services. Next, it is also necessary to find the connection between the proposal-writing company and those that have influence on the project selection process. This relationship may exist between the persons or bodies that conduct the pre-evaluation of projects in terms of form and content, or those that make the actual decisions.

9.4. Positive Tender Evaluations in Exchange for Using Overpriced Services

This method is similar to the one described in the previous section, as in this case as well the awarding of the funding is tied to the use of a strongly overpriced service, but in this case it is not the proposal-writer but some other service provider that acquires the rent. In this method, those who launch and evaluate the call for proposals make winning funding subject to the condition that the funds must also be used to give a contract to a participant to be specified by them during the course of project implementation, usually at a price that is well above the market price.

One of the examples mentioned during the interviews was when in a project that included a training component, those announcing the invitation named a specific business with which it was "recommended" to sign a contract in the value of HUF 8 million, whereas the actual market price of the service was around HUF 1.5 million. The subcontractor that was intended to be used for implementing the component had to be named in the proposal documentation, thus it was known at the time of evaluation which business each applicant intended to sign a contract with.

9.4.1. How can it be recognized?

Outside of its participants, it is difficult to directly recognize this method, as only those implementing the project have direct knowledge of the content and price of the services. The bodies conducting the settlement of accounts (previously the intermediate bodies), and now the managing authorities could be able to recognize the method if they systematically analyze the accounting of the projects.

However, if the managers of the fund are also involved in the process, then there is only a negligible chance of recognition.

9.4.2 How can it be detected?

If the controlling bodies find the contracts containing the overpriced services, then their systemic comparative analysis could reveal that one or several providers received unjustified compensation. An examination of the relationship between such providers and the organizations or people that play a role in project selection can indicate whether corruption took place.

9.5. Recognizing Costs at a Price Significantly Above Market Prices

Most calls for proposals make it possible to procure functionally defined assets and services. The conditions usually refer to the stipulation that only procurements that are necessary for achieving the objectives of the project can be declared as costs. The price of the services and assets cannot be determined precisely beforehand. At the same time, the accounting of costs occurs item by item, backed by invoices. One method of seeking rent is when the beneficiaries purchase the assets or services at a price that is significantly above market prices. The application of this method requires the participation of the subcontractors and suppliers, since the rent that is generated at their level in the first step must be shared in some form with the other players.

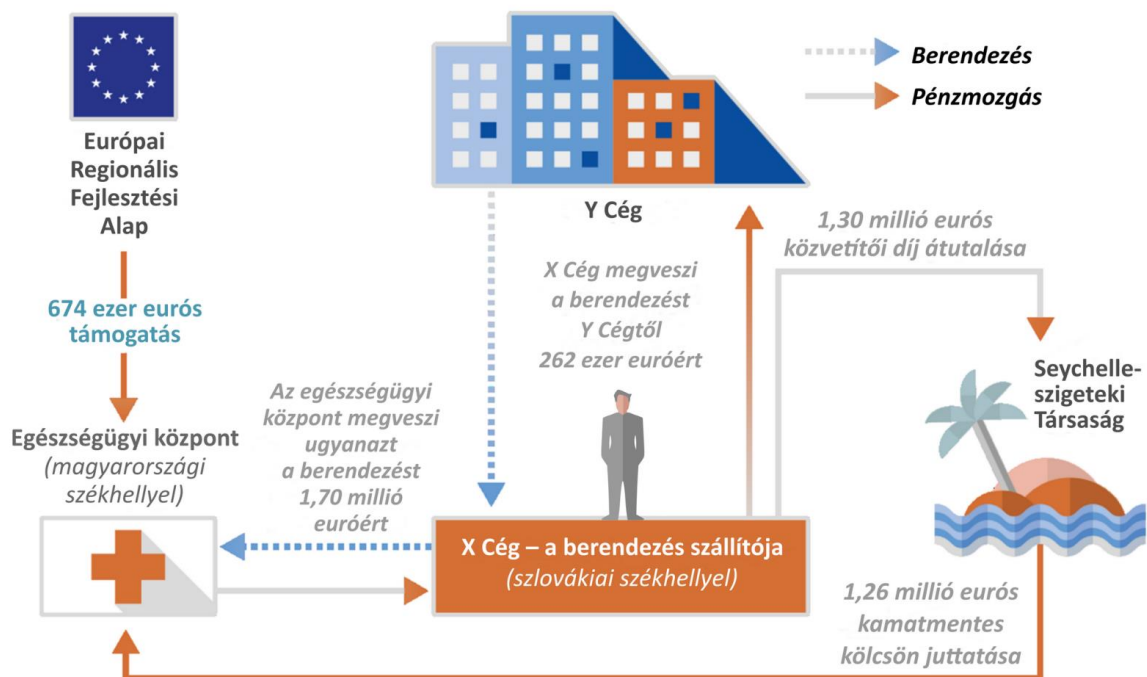
In the course of its investigations, the European Commission found several cases that employed this method (European Commission, 2015). In one example, equipment with market value of around EUR 40,000 was purchased and charged as expenditure at a price of EUR 200,000. In this transaction, HUF 48 million in rent was created and it is unlikely that its sole beneficiary was the trader who sold the equipment. It is quite possible that those who implemented the projects also received a share of the rent, but the officials carrying out project selection and the accounting of costs may have also been involved.

There are also complex versions of the recognizing of overpriced products and services as costs, where these are carried out in several, sometimes even cross-border stages.

An example of this is a case revealed and described by OLAF, in which a medical center established in Hungary received EUR 674,000 in funding as a beneficiary, and under its project that was implemented partly from EU funds, the center purchased medical equipment from a company in Slovakia for EUR 1.7 million, while the original purchase price paid by the supplier (likely at actual market value) in Slovakia was EUR 262,000. Although the account does not reveal what proportion of the project was covered by EU funds – thus we are unable to precisely determine the amount of EU funds involved in the fraud –, it is clear that the uncovered fraud served to cover at least two items of unjustified costs. Part of the rent acquired by the overpricing was paid to those involved in the form of intermediary fees, while the rest was used to cover the own contribution for the project. The report does not mention whether the managers of the funds were involved in carrying out the transaction, thus we cannot be certain that corruption, strictly speaking, took place. Nevertheless, the question of whether the purchase of the high-value equipment was carried out in a sound manner definitely arises. The flow chart of the case can be seen in Graph 2.

Graph 2

Overpriced asset procurement in a cross-border cooperation



Source: The European Anti-Fraud Office (The OLAF Report 2014)

Domestic investigations have also revealed cases where drastic overpricing was carried out in a way that they tried to cover up the fraud partly with the international movement of goods and funds. A case report by Kehi:

“In one investigation, the beneficiary committed itself to purchasing a new paper bag production line in the value of HUF 559 million, for which it won HUF 233 million in funding. The company submitted the necessary documents about the project’s implementation and was transferred the funds. However, Kehi subsequently found that the beneficiary did not purchase the declared new machinery, instead buying a used production line that cost merely HUF 50 million. During the transport of the machinery across several countries, the beneficiary falsified the delivery notes, the printing machine was painted over, its serial and model numbers removed and replaced by a new number that is not even used in practice. The office filed charges on the suspicion of fraud causing an especially great damage, and also took measures toward the full repayment of the funding provided.”

A special case of overpriced procurements is when the same asset (or service) is charged as an expenditure in two separate supported projects, thus acquiring rent. Kehi’s investigations also found examples of this:

“In another investigation concerning funding from the Hungarian budget the office found during an on-site check of the machinery that was purchased from the domestic support that there was a sign on it indicating it was purchased from EU funds. Following an examination of

this, as well as of the beneficiary's domestic and EU applications and support contracts, it was determined that the company used funding simultaneously from domestic and EU sources to purchase the machinery, and it charged the costs as expenses to both funding contracts. Kehi filed charges in the matter, and also initiated the repayment of the funds."

The 444.hu news portal reported on a method of fraud built on the support application possibilities of local governments, which also carries the risk of corruption. A local council representative shared his experiences concerning a tender invited for the building and renovation of playgrounds in the following way:

"A company will take care of everything, and the investment will cost us nothing. And that was what happened, but when we saw the cost of some of the toys we were surprised. In response, the mayor swore and asked us, 'What, you don't trust me anymore?!' We left it at that."

The numerous occurrences of unrealistically overpriced playgrounds has been noticed by OLAF as well, which has called for a repayment of the funds. The case is also illuminating because the state (the central budget) practically assumed the obligation to repay the funding, without investigating those responsible for the fraud or the suspicion of corruption. With this behavior, the state increases the risk of fraud and corruption, since those involved could draw the lesson that even getting caught results in no negative consequences.

In the overpricing of procurements, beneficiaries are an active participant of corruption, while in the former two methods they take part in the process as an involuntary participant.

One form of overpricing is when the budget is not exceeded during the project's implementation, but the technical content of the completed investment falls short of what was in the original documents.

In the interviews with executives, the directors of the managing authorities called attention to the fact that in the domestic practice, contracting authorities do not apply the sanctions that are available by law and in the contracts: penalties, enforcing performance and good performance guarantees. Thus, contracting authorities practically accept the fact that projects are implemented in an overpriced manner in the cases where contractors do not perform their duties in accordance with the contract.

9.5.1. How can it be recognized?

Recognizing overpriced products or services is possible even by outside observers in simpler cases. The budget of the project and its short description is public information, which anyone can read from the information signs. If the project is relatively simple and there are not many items of charged costs then there is a chance that overpricing will be noticed. Of course, even in these cases it is the fund managers who have the best opportunities of uncovering the abuse.

9.5.2. How can it be detected?

Calls for proposals generally contain detailed stipulations on the eligible costs of projects, and in some cases the assets to be purchased have to be selected from a closed list. It is usually easy to find a reference value for the realistic price of purchased assets or services, as is demonstrated in the

published investigation reports. Although in some of the implemented investments they purchase machines and equipment that are sold only by a few vendors, the relevant information is easily accessible even so. In the case of unique construction projects it may be quite difficult to find reference values, but the task is not impossible if there is a firm will.

With this method, it is fund managers who can do the most to uncover fraud, but if they are also involved in the corruption then it is actually the cover-up of the fraud that they can efficiently promote.

9.6. Public Procurement Tailored to a Specific Bidder

Similar to the fine-tuning of calls for proposals, the goal of this method is for a pre-selected bidder to win the public procurement contract, but in this case the directed parameters refer not to the content of the bid but to the organization submitting the bid. Its most frequent form is when the contracting authorities define expected references in a way so that only the selected organization can meet them, even if the experience that is expected is not actually required for completing the task. In its negative version, exclusions are defined in a way that they apply to unwanted competitors but not the intended winner.

Another tool of directed public procurement is when in the case of complex invitations, the contracting authorities and those assessing the bids treat certain details selectively. For bidders they intend to exclude, they look for elements that provide grounds for exclusion, while in the case of other bidders they do not take such a strict approach. We encountered a case where the contracting authority took the construction capacity provided by a bidder under close scrutiny and found a discrepancy that had no substantial effect of the project's implementation, but nevertheless provided grounds for excluding the bidder from the procedure.

The best-known such case is when the North Transdanubian Water Directorate (Eduvizig) excluded Közgép Zrt from the public procurement procedure invited for the further development of the Győr-Gönyű port on the grounds of providing false data, claiming that the area of the covered platform of the ferry that the company planned to use for implementing the project did not reach 500 square meters, as it was only 452.6 square meters. Earlier, Közgép was exceptionally successful in winning public procurement projects and was not subject to such strict scrutiny.

The method limits competition and one its consequences is that projects and services are implemented less efficiently.

9.6.1. How can it be recognized?

Directed public procurement can be recognized already in the invitation phase, as the requirements to be met by bidders are contained in the invitations. Experts familiar with the given market can usually determine who the favored bidder is that meets the conditions that are unjustified from the viewpoint of the project's implementation.

9.6.2 How can it be detected?

Detecting the method is relatively easy, especially in the case of high-value public procurements. The difficulty may be in proving intent.

9.7. “Fine-tuning” a Public Procurement Invitation in Order to Restrict the Market

This method involves the setting of parameters (formally based on expert opinions) during the invitation of the public procurement, which are then used as reference values during the evaluation process. Some of the parameters diverge significantly from what would be justified professionally, and the preferred bidder is informed of this. Thus, those that prepare their bid documentation on a purely professional basis stand no chance of “hitting” the reference value, and the success of the preferred bidder can be easily guaranteed.

Our interview subjects that know how the system works, and who requested anonymity, mentioned several cases where the preferred bidders of the contracting authorities gained access to “key information” that helped them win the contract – usually long-term, high-value consulting work. Although this project was not financed from EU funds, there is the suspicion that a similar technique was used by the National Bank of Hungary when it invited bids for a tender to conduct public opinion polls on economic processes, in the total of value of HUF 1.8 billion over three years. The two bidders in the process were the Századvég Political School Foundation and Kopint–Tárki. The former hit the estimated value of the contract precisely and also submitted a bid that was better in every element of the assessment criteria than its competitor’s.

9.7.1. How can it be recognized?

This method can usually be recognized following the publication of the tender results, since the guaranteed success requires that one or more parameters be set at an unrealistic value. However, during the competition phase, there is no way for outside players to notice the built-in traps, as the parameters set in advance by the experts are not made public.

9.7.2. How can it be detected?

This method can also be detected only through external controls, as it is in fact the intent of the contracting authorities that is being realized with its use. It is relatively easy to expose the purposefully distorted parameters, but it is very difficult to prove that a bidder had advance knowledge of these. Nevertheless, the existence of bid documentation containing the unrealistic parameter can in itself provide cause for suspicion.

9.8. Awarding Contracts in Exchange for Providing an Own Contribution

Most calls for proposals cover only part of the eligible costs. The rate of support ranges on a wide scale, from support levels of more than 90% to rates of less than 20%. The portion of the costs of a

project that are ineligible is usually referred as the own contribution, which the beneficiary has to cover from other sources. There are many types of organizations – such as local governments or budgetary bodies – which are unable to cover this own contribution, or do so only with great difficulty, and thus run the risk of losing out on the opportunity to carry out the development.

A good example of this problem is the earlier mentioned case when the local governments of small settlements were allocated EU funds for the building of playgrounds, but were unable to cover the own contribution, therefore they accepted the bid of a contractor who built the amount covering the “own contribution” of the local governments into its costs through overpricing (Hargitai & Ungár, 2015).

Operating in collusion, sometimes the beneficiaries and the contractors use the method where the latter transfers the amount covering the own contribution to the beneficiary organization in advance, which then plans and implements the project with the pricing set at a level that makes it possible for the support portion alone to be enough for the contractor to carry out the work. The higher the rate of support, the easier it is to use this method. If the own contribution is set high, then exceptionally unrealistic project budgets would be need to build the own contribution into them. As presented earlier, businesses may also use this method to save themselves the own contribution of the project.

9.8.1. How can it be recognized?

In order to recognize this method, information is required that is available only to those directly involved. It may provide cause for suspicion if there are overlaps between the supporters of an organization and the businesses that carry out the projects.

9.8.2. How can it be detected?

Controls of the finances of budgetary bodies and local governments may reveal what sources they received support or donations from, and this can be compared with the companies that carry out the projects.

9.9. Complex Methods

Various corruption methods are often used combined with one another. The directed selection of the winner of a public procurement is often combined with relative or absolute overpricing. For one, less efficient bidders can implement the project only at higher cost, therefore it is necessary that the price be above the market price. Second, usually the goal of directed public procurement is precisely to divide the acquired rent between the players vis-à-vis the designated company.

The overpricing of services is a necessary byproduct of covering the own contribution. The setting of development objectives may also serve to achieve the goal of awarding contracts to the businesses preferred by the decisionmakers, through public procurement procedures that are directed in some way.

Table 4
Corruption techniques – Summary table

Method	Phase affected	Decisionmaking level affected	Tool of social control
Unjustified selection of development goals	National level of formulating development policy	Government	Public consultation of development policy
Exercising influence in the process of project selection	Project selection	Managing authorities	Active participation in Monitoring Committees, public analysis of questionable projects
Positive tender evaluations in exchange for a high rate of payment for proposal writers	Project selection	Managing authorities	Active participation in Monitoring Committees, public analysis of questionable projects
Positive tender evaluations in exchange for using overpriced services	Project selection	Managing authorities	Active participation in Monitoring Committees, public analysis of questionable projects
Recognizing costs at a price significantly above market prices	Project implementation, accounts	Managing authorities, beneficiaries of high-value projects	Much higher than required level of publicity for questionable cases
Public procurement tailored to a specific bidder	Project implementation, public procurement procedure	Beneficiaries of high-value projects	Publicity for the entire process of public procurement procedures
“Fine-tuning” a public procurement invitation in order to restrict the market	Project implementation, public procurement procedure	Beneficiaries of high-value projects	Publicity for the entire process of public procurement procedures
Awarding contracts in exchange for providing an own contribution	Project implementation, public procurement procedure	Beneficiaries of high-value projects	Publicity for the entire process of public procurement procedures

10. Conclusions, Recommendations

In this chapter, we will present the conclusions drawn from the results of the study and make recommendations on reducing corruption risks.

10.1. Summary Conclusions

Based on the results of the study, we have reached the following conclusions regarding fraud and corruption risks in the use of EU funds:

C1. A rent is built into the system of the use EU funds, one that is accepted by all the players and is realized in the overwhelming majority of developments that are carried out.

The European Commission's information note on the topic models the problem with the "fraud triangle" (European Commission Directorate-General Regional Policy, 2009). According to this, in order for fraud to be perpetrated, an **opportunity** must be given, which may be provided by slack controls. It is a crucial consideration for the fraudster what the likelihood of the fraud not being detected is, or what the likelihood of punishment is should it be detected. The weakness of controls may be systemic or based on individual decisions.

During the course of **rationalization**, fraudsters can develop a justification for themselves and the outside world by rationalizing their rent-seeking. They formulate reasoning that makes the acquisition of the formally illegal income acceptable, for example by saying that the rent is compensation for other grievances, or that others do it as well.

Financial pressure, incentive or motive may arise due to need or greed. If opportunity and internal rationalization is already there then this element of the triangle also takes shape for many players.

We can find the elements of the fraud triangle in various areas of the Hungarian system of EU developments. In what may at first glance be a contradictory approach, but is actually quite understandable, the controlling bodies of the European Commission employ a tolerance limit of around 20% – according to those familiar with the practices – when evaluating overpricing schemes. Although with this, they *de facto* accept smaller-scale fraud, an approach stricter than this would lead to many difficult to prove cases, which would no doubt fragment the controlling process. Based on our interviews with executives, we can say that Hungarian authorities do not strive to apply stricter norms than this, as the cases of state aid provided to companies, the large infrastructure investments or the smaller developments of local governments show. EU audits lead to a correction if the overpricing is exceptionally high, and since the correction is usually relatively small, an overall overpricing rate of 15–25% is realized on a systemic level.

We cannot consider it to be a natural approach that the managers of the program that spends such a large amount of money accept a certain rate of overpricing, since business logic would dictate just the opposite. Parties that are large contractors, carry out large-scale procurements, or offer suppliers advantages in terms of economies of scale, could actually ask for lower prices, which would indirectly also contribute to improving efficiency.

Every element of the fraud triangle can be found on a systemic level in the implementation of EU developments in Hungary. The controlling system accepts a certain amount of overpricing, thus the risk of detection is small, and overall the size of the punishment is well below the rent that can be obtained. Thus the opportunity for fraud is given. Economic policymakers, the managers of the funds, including the bodies responsible for exercising controls, and the beneficiaries themselves, **rationalize** overpricing – pointing in part to the scarcity of funds and in part to competitive disadvantages. A

wide range of **motivations** prevail, such as developments that are implemented from EU funds but are not in line with their objectives, higher profits for businesses, or simply hedonistic rent-seeking.

The acceptance of fraud on a systemic level is well illustrated by the case of the exceptionally expensive playgrounds built in small settlements. Following the detection of the fraud, the central budget compensated the local governments for the funds they had to repay, thus legitimizing as it were the fraud whereby the own contribution and the rent of the contractor were both built into the overpricing scheme.

We can consider the rent that is built into the system to be the acceptance of a certain level of fraud in the classical definition, which does not require individual corruption transactions. The empowered persons do not make decisions that make it possible for specific persons or organizations to acquire rent – it is the system itself that allows rent-collection.

C2. The legal environment and new organizational system for the 2014–2020 period has (also) centralized corruption risks.

There have been several changes in the legal environment and its procedures that reduce the opportunity for “decentralized” corruption and fraud. One such example is the limiting of the cost proportion of soft services and regulating their payments. Certain corruption risks are reduced through the special treatment of budgetary authorities. In the case of relatively smaller-value calls for proposal, which there are a large number of, pricing controls will be applied during the 2014–2020 period. The elimination of intermediate bodies and the organization of their tasks into the ministries will make it less possible for workers on the lower levels of the hierarchy to perpetrate corruption of their own accord.

On the other hand, the centralization of the selection of high-value projects and the subsequent selection of contractors carries the risk of corruption in the area of public procurement. An important consequence of this is that during the course of the possible corruption the empowered persons do not make decisions that are favorable to certain players in exchange for a direct remuneration, but indirectly gain advantages that are difficult to detect.

One possible model of centralized corruption is the following: businesses or business groups with links to the decisionmakers often win high-value public procurement contracts that are overpriced, and thus grant them extra profits. The profit is used (partly) to finance activities that are in the interest of the decisionmaker. Typical examples include operating politically oriented media, sports financing, or participation in projects that are deemed important by the state. Of course, the extra profit can also be used to provide financial compensation to the decisionmakers directly or in a hidden manner. For the purposes of our subject, it is not the specific organizations and persons that are important, but the institution itself. Developments relating to the Közgép corporate group indicate that the players in this corruption model can change, but this does not necessarily mean the termination of this institution.

C3. Most of the corruption and fraud risks associated with public procurements appear outside of the framework of the institutional system responsible for the use of EU funds.

In the case of high-value projects, the government makes the decision on project selection, while the public procurement is carried out by the beneficiary, which does not exclude the opportunity for influence to be exercised informally.

The execution of public procurement procedures is the task and responsibility of the beneficiaries. The managing authorities play only a controlling role in this, they cannot override the decisions of the relevant authorities. The problems relating to public procurement do not depend on the source of the procurement's funding. EU-financed projects are special cases only because these are controlled especially strictly by the Commission bodies, thus problems of irregularities may occur more frequently.

The public procurement procedures serving the implementation of high-value projects are not carried out under the direct control of the EU's institutional system (the managing authorities). The Office of the Deputy Secretary of State of the Prime Minister's Office Responsible for Public Procurement Supervision, as well as the Public Procurement Arbitration Board, carry out general tasks, based on general rules (that apply not only to procurements financed from EU funds).

C4. The main goal of the Hungarian system is to provide the minimum level of regularity that can be accepted by EU institutions, and to reduce the burden on the national budget in the case of irregularity procedures. The prevention and detection of fraud and corruption appears in this context, as an activity that reduces risk for the Hungarian budget.

The fundamental objective of domestic organizations, managing authorities and controlling bodies is for the use of EU funds to place the least possible burden on the Hungarian budget. In the event of irregularities, they try to reach a favorable agreement with the European Commission, and tolerate if domestic players provide own contributions at the expense of the funding using overpricing techniques. The experiences of our interviews with executives uniformly confirm that in the view of the domestic organizational system, its main task is the minimizing of budget risks.

C5. Measures affecting fraud and corruption in the 2014–2020 period are the following:

Organizational changes. Relocating managing authorities to the relevant ministries has no substantive effect on corruption risks. The level of central control over the process has not changed substantively, and the functions of the National Development Agency (NFÜ) have been taken over by the Prime Minister's Office. The elimination of intermediate bodies does not increase corruption risks.

Cost control during the period of project selection. This measure plays a role in the case of economic development programmes. It may reduce fraud and corruption risks (Government Decree 1731/2013. (X. 11.)). The planned objective may be attractive for beneficiaries, but it also represents risks. A frequent form of fraud is overpriced expenditure reports. One of the consequences of simplified reports may be that the frequency of this form of fraud increases.

Limiting consulting costs. The government is trying to limit, and in certain areas eliminate, consulting and proposal-writing activities.¹³ The opportunity for beneficiaries to price a corruption rent into project budgets will decrease somewhat.

Selecting large projects on a government level. This provides an opportunity for the government to exercise individual preferences and treat project selection as an element of backroom deals.

The mandatory use of simplified project selection procedures for public sector bidders (Government Decree 1731/2013. (X. 11.)). This measure eliminates the need for certain proposal-writing and consulting activities, but project documentation will have to be prepared even in the case of simplified procedures, thus public sector organizations will need assistance from experts.

Social control, integrity agreements. There are no specific experiences yet, but this provides an opportunity for stronger social control. Not only the launching of specific projects is needed, but also that NGOs and the government reconcile their views on important economic policy priorities and how these are interpreted.

The public procurement system. There are no experiences yet on the effects of the new regulations. Another important question is whether there is a willingness for controlled public procurements. The complicated, detailed regulations also provide opportunities for abuse.

10.2. Recommendations

R1. Making public procurement procedures fully and automatically public.

These measures would have several important consequences. For one, the results, decisions and contracts would be open for analysis and comparison, and it would be possible to quickly identify parameters that stand out. Second, it would be possible to define reference values for certain tasks. For example, it would be possible to calculate unit costs for road or railway construction relating to projects implemented under similar conditions.

In addition to the provisions contained in the new act, we recommend that it be required to publish the following data, in searchable form, in the public procurement database:¹⁴

- a. Data related to self-cleaning procedures (certifications from bidders, their explanation, the decisions and justifications of the Public Procurement Council – or in the case of an appeals procedure, the court –, the facts and circumstances based on which the criteria and rationality of the deliberation can be determined).
- b. Data relating to exclusions and their justification, including the fact of charges being filed because the grounds for exclusion raised the suspicion of a crime.

¹³ *In the case of public sector organization bidders, the current practice of tender invitations will cease. In their case, in accordance with legislation and taking into account the professional and financial objectives of the operational programmes – granting preference to projects that enjoy sectoral priority –, project selection has to be carried out in a simplified selection procedure. These procedures will be based on a preliminary evaluation of the situation and formulated in accordance with the professional support of the Monitoring Committees (Government Decree 1731/2013. (X. 11.)).*

¹⁴ *The sources of the recommendations are the observations made by Transparency International to the draft of the new Act on Public Procurement.*

- c. Decisions relating to conflicts of interest and their justifications.
- d. The fact that only limited access is granted to certain data in the public procurement procedure, citing business secrets.
- e. Data contained in Paragraph 87, section (1) and Paragraph 88, section (6), points b) and c) of the draft, based on which it is possible to determine whether the principles of equal treatment and transparency were respected during the course of the negotiated procedures.
- f. All data relevant to the permissibility of negotiated or concession procedures without prior publication of a contract notice (especially data indicating the objective nature of exclusivity, justifying extreme urgency, and supporting the lack of possible fault for the bidder).
- g. Modifications to the contracts signed as a result of public procurement or concession procurement procedures and which have to be made public in accordance with Paragraph 43, Section (1), points c) and d) of the draft.
- h. The decision of the Public Procurement Council made on the subject of the permissibility of a public procurement procedure to be closed for reasons of national security.
- i. The names of the bidders eligible to participate in public procurement procedures that are closed for national security reasons.
- j. Indication that a procedure by the Public Procurement Arbitration Board has been initiated (taking separately initiatives by clients and those made *ex officio*), as well as on related appeals and their results, including civil suits.

It is recommended that the enforcement of public procurement guarantees, or lack thereof, be monitored separately in cases where the application of this tool would be justified (contracting authorities rarely use this tool).

R2. Avoiding an abundance of funds and high support intensity; the increased use of financial tools.

The transfer of funds from areas where the possibility of reasonable use is not ensured.

There is an opportunity for the increased use of financial tools (credit, loans, guarantees) primarily in projects that target the increasing of energy efficiency. Funds that have to be repaid provide much less room for rent-seeking – especially if interest rates are low –, thus business considerations can play a more prominent role during the decisionmaking process.

R3. Strengthening social control in project selection and implementation.

Written laws are unsuitable in themselves for eliminating corruption; a much higher level of publicity and social control is also required, which among others means more intensive communication by NGOs. It is an important question whether some kind of compromise agreement can be found between the viewpoints of the government and NGOs regarding the topic of preference for domestic economic operators.

R4. Training and informing those involved, with special focus on presenting anti-fraud methods and the mode of reporting.

The information note of the Commission also notes the importance of this: “Ensure awareness of fraud reporting procedures, e.g. the websites of the managing bodies and intermediate bodies could include such information” (European Commission Directorate-General Regional Policy, 2009).

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