Principal Agent Problems in EU Funds: A Case Study of Patronage in Hungary

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Abstract

EU Funds have been linked to high levels of corruption even given substantial levels of administrative and regulatory requirements and extensive domestic monitoring. We posit that this divergence in actual outcomes and preferred policies can be attributed to the co-optation of the auditing and monitoring processes by member state governments. We outline the importance of the auditing process and flow of information to the European Commission using a delegation model and then test what occurs when this process is co-opted in Hungary. We find that the co-optation of the auditing process results in high levels of patronage/corruption.

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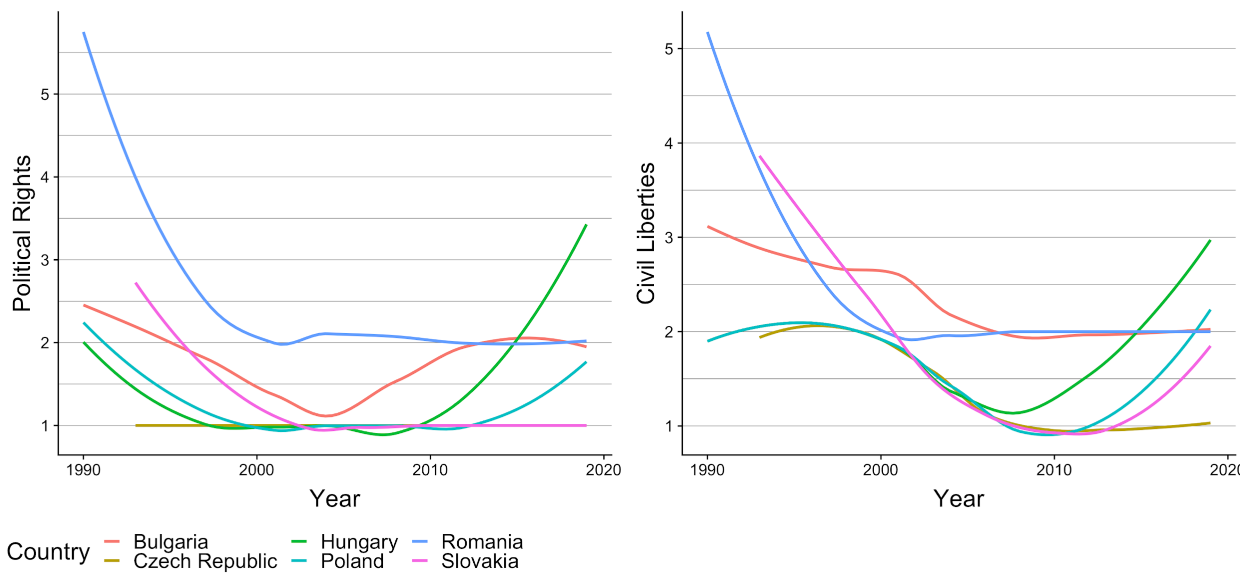
(1) Introduction

Delegation by policy makers to bureaucratic agencies is a prevailing feature in all political systems. This study focuses on the delegation of large public investment programs, which directly impact the distribution of this aid and consequently political competition and democracy. In the European Union (EU), policy makers delegate implementation authority of European Union Structural Funds (from here on EU Funds) to the member states' national administrations and the European Commission. The administrations of individual member states control the distribution of these funds within bounds set by the European Council and the European Parliament. Given that member states often prefer to use these funds for political gain, the European Commission is given the authority to oversee and monitor these funds using information provided by domestic auditing organizations. We set out to test if the level of patronage and corruption increases once these auditing organizations are co-opted by the political party in power in 2014. To this end, we focus on the delegation of the implementation of EU Funds in Hungary, where a change in control over the information flow to the European Commission shifted from an independent organization to the party-in-power (*Fidesz*) in 2014. We find that this shift precipitated a large increase in the level of patronage within EU Funds in Hungary.

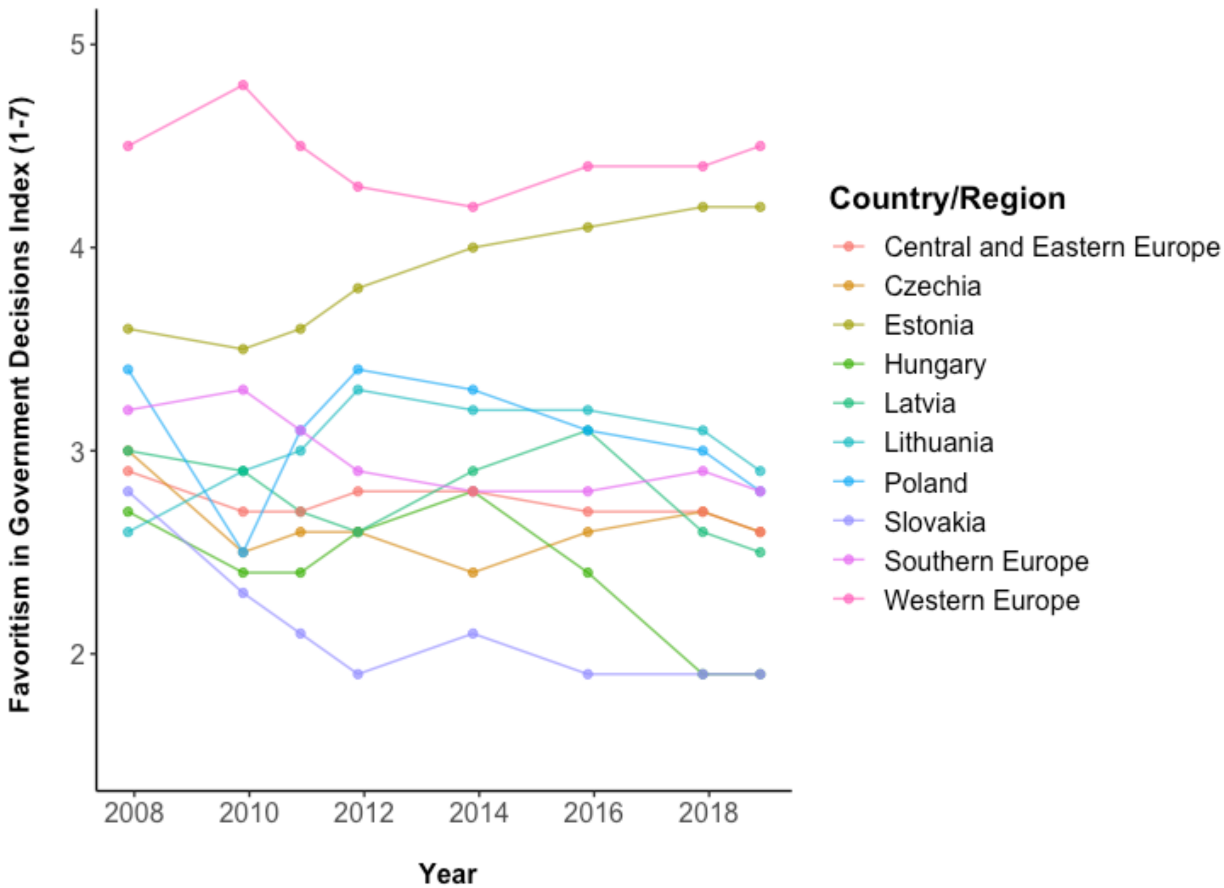
We test our theory in Hungary as it is one of the largest beneficiaries of EU Funds in Central and Eastern Europe (CEE). The region has received unprecedented levels of development funding from the EU over the past fifteen years. EU Funds amount to around 3% of annual GDP in Central and Eastern Europe (KPMG 2016) and almost equal the level of public investment from domestic governments. Corruption in these funds has been identified in other work and has been linked as a factor driving democratic back-sliding. Since joining the European Union Hungary has witnessed significant democratic back-sliding. Figure 1 shows Freedom Ratings on Political Rights (PR) and Civil Liberties (CL) from the annual Freedom in the World surveys from 1990 to 2019 for CEE countries. Both of these ratings are measured on a one-to-seven scale, with one representing the highest degree of Freedom and seven the lowest. It is no surprise that Central and Eastern Europe was considered a democratic success story in the 1990s, given how rapidly their democracies consolidated. However, since the 2010s the region has faced some serious democratic difficulties, more evidently so in the one-time democratic front-runners, Hungary and Poland. Since *Fidesz*'s rise to power in 2010, *Viktor Orbán* has successfully managed to eliminate checks on the Hungarian executive, by undermining the separation of powers, the independence of the judiciary, and the freedom of the media (Kornai 2015). As shown in Figure 1, Hungary represents the sharpest drops in levels of political rights and civil liberties, and it was the first country of the CEE group to be downgraded to Partly Free by the Freedom in the World Survey in 2018. Perceived corruption as measured by favoritism of Government Officials in Hungary, presented in Figure 2 also appears to have worsened the most in Hungary and Slovakia.[2]

Figure 1: Freedom Ratings on Political Rights (PR) and Civil Liberties (CL) from the annual Freedom in the World surveys from 1990 to 2019 for CEE countries. PR and CL are measured on a one-to-seven scale, with one representing the highest degree of Freedom and seven the lowest. Smoothed lines aid the identification of patterns in the presence of overplotting.



[2] A more comprehensive line chart is provided on page 7 (Figure D1) in the Supplementary Materials

Figure 2. Favoritism by Government Officials (Collected from the WE Forum Competitiveness Reports)



Pre-accession, these funds induced democratization and economic development (Kelley 2004; Simmons 2011; Vachudova 2005), but since then, increased corruption within these development funds has connected high-level politics to organized crime. This has eroded democratic institutions, by distorting political competition, and fueled the removal of checks on power (Fazekas and King 2019, Mungiu-Pippidi 2014). Corruption in EU Funds is high even though there are heavy levels of regulatory requirements, including extensive domestic monitoring of EU Funds (European Commission 2003; European Court of Auditors 2012, 2013), and an additional venue, the Court of Justice of the European Union, is responsible for judicial review (Dávid-Barrett & Fazekas 2016). This should raise the costs of corruption and limit its prevalence, but surprisingly corruption is still abundant. We posit that one overlooked factor, the control a member state holds over the information available to the European Commission, can explain the marked increase in patronage within EU Funds. This is a departure from the literature that predominantly blames corruption on weak institutions that already exist in these countries. While it is true that we would not see corruption within EU Funds, if corruption was not already prevalent in these countries these arguments ignore the role of the European Commission. The Commission is key in mitigating patronage (as shown when they suspended funds in Hungary and Romania), but only if they are provided effective information from domestic auditing organizations, which is not always the case. We derive our hypothesis from a delegation model and test this hypothesis using a research design that leverages a reform in the auditing process in Hungary. Utilizing contract and grant information from all projects partly funded by the European Union in Hungary we find that co-opting the auditing, monitoring and reporting of EU Funds leads to a significant increase in common indicators of corruption and patronage within these funds.

The remainder of this manuscript is organized as follows. We present the current state of the art on corruption in EU Structural Funds in Central and Eastern Europe. We then discuss EU Structural Funds using a delegation model and outline how the control of information made available to the European Commission increases the level of patronage in EU member states. We then describe EU Funds and specifically how these funds are structured at the distribution and auditing stages. The case study of Hungary is then investigated by detailing the changes to these stages in 2014 that ultimately gave the political party in power control over information flows to the European Commission. We test if levels of corruption increased in Hungary after Fidesz, the political party in power, gained control over the information flow to the European Commission. We find that it is not until *Fidesz* successfully co-opted the monitoring and auditing stages of the distribution of EU Funds in 2014, fully controlling the information provided to the European Commission, that these funds became an effective source of patronage. We conclude by evaluating how current EU proposals will impact the outlined issues inherent with EU Funds and how the case of Hungary can be generalized to other CEE states.

(2) EU Funds as Sources of Corruption

Corruption within EU Funds has been well-documented in the literature. Recent work suggests that EU Funds are associated with increased levels of corruption (Bachtler & Gorzelak 2007; Bodensten & Kemmerling 2012; Bouvet & Dall'Erba 2010; Dellmuth, Schraff & Stoffel 2016; Dimulescu et.al. 2013; Dumčiuvienė & Adomynienė 2014; Fazekas & Tóth 2016; Fazekas & King 2018; Muraközy & Telegdy 2016). Bouvet and Dall'Erba (2010) look at several NUTS I and II regions in 12 EU countries between 1989 and 1999 and find that regions that are politically aligned with the national government get more structural funds compared to regions governed by the opposition.

Muraközy and Telegdy (2016) obtain similar results for Hungarian municipalities, especially when the applicant is a public entity or the purpose of the project revolves around construction. Similarly, Dellmuth Schraff and Stoffel (2016), analyzing data from France and Italy, find that electoral institutions provide politicians with incentives to use structural funds to buy votes in NUTS 3-level counties. Bodenstein and Kemmerling (2012) find that the official allocation criteria are not sufficient determinants to explain the distribution of structural funds and that politics at the regional level plays a strong role in explaining the deviations from the official criteria. Other critiques show that EU Funds are distributed to wealthier areas that supported coalition parties in the previous election (Bloom & Petrova 2013). Fazekas & King (2018) take these critiques one step further, examining the effects of EU Funds on corruption in the Czech Republic and Hungary, and by proxy, institutions themselves.[3] They estimate that EU Funds increase corruption risk up to 34%. The vulnerability of EU Funds to corruption has been blamed on a milieu of factors in the development and Europeanization literature such as lack of constraints or mechanisms of punishment (Dimulescu et. al. 2013; Fazekas & Toth 2016; Innes 2014 ; Donno 2010; Smith 2013), increasing the pool of public resources available for rent-seeking where widespread corruption issues already exist (Dimulescu et. al. 2013 ; Fazekas & King 2018; Mungiu-Pippidi 2014), the discretionary nature of EU Funds (Mauro 1998; Tanzi & Davoodi 2001), and overly formalistic compliance (Fazekas & King 2018). While it is true that we would not see corruption within EU Funds if corruption was not already prevalent in these countries, these arguments ignore the role of the European Commission. The Commission is key in mitigating patronage (as shown when they suspended funds in Hungary and Romania), but only if they are provided effective information from domestic auditing organizations, which is not always the case. We argue that the increased divergence between the policy preference of the European-level's governance and the policy implemented at the member state level is caused by a co-optation of the auditing process by political parties in power. This mitigates the ability of the European Commission to effectively oversee the distribution of EU Funds and occurs when the monitoring and auditing of these funds is controlled by the national administration of the implementing member state. The next section outlines how control over this flow of information to the European Commission affects the policy outcomes of EU Funds.

[3] In the language of Acemoglu & Robinson, Fazekas & King conduct a study of what happens when exogenous funds are injected into a region with (relatively mildly) 'extractive' institutions.

(3) Theoretical Framework

The study of the implementation of EU Funds has been dominated by the multi-level governance framework, which claims that decision-making competencies in the EU are not the responsibility of any one single actor, but are shared among actors at different levels (Hooghe & Marks 2001). However, this model fails to specify which actors and which levels are causally important and when. We focus on how member state control of auditing and the information flow to the European Commission allows for policy drift from the preferred outcomes of the European Council and European Parliament. This results in an increase in the level of patronage in EU Funds. To outline this, we examine a delegation model in an environment that mimics the relationship between the European Council, European Parliament, European Commission, and member states regarding the implementation of EU Funds. This allows us to develop and test the following prediction: (1) member state control of information flow to the European Commission increases the level of patronage within EU Funds.

Delegation models have become a popular paradigm used to analyze the relationship between policy makers and those tasked with its implementation. In a delegation model, there exist two types of decision-makers, a principal (policy maker) and an agent (the potential implementer of the policy—usually a bureaucratic agency). The principal chooses whether to delegate the implementation of a policy to an agent or not. The principal may delegate to an agent because of asymmetric information about how to reach policy goals, with agents holding more expertise than the principal. The principal wishes to draw on this expertise, but is also wary that the agent may have a different preferred policy than the principal. Many models use a simple, unidimensional spatial framework to implement these two assumptions. One point along this unidimensional space represents the policy preference of the principal and the other represents the policy preference of the agent. As this distance grows, the principal becomes increasingly worried that delegating more authority to the agent will lead to a policy outcome far from the principal's preferred policy. Even if an agent's preferred policy is not identical to the principal, the principal may still delegate, because of the agent's informational advantage. Often, this is modeled as the principal having uncertainty over the effect of a policy on the eventual outcome, while the agent has full information and can hence implement a policy that equals their preferred outcome. If this preferred policy of the agent is too far from the principal's preferred policy, this informational advantage is not beneficial to the principal, who will choose to implement the policy on their own. We can then build a set of alternative policies circumscribed by a threshold beyond which a principal will not grant discretion to an agent. This is called a delegation set and varies in size, but usually depends on the information-intensity of the policy. As the complexity of a policy increases, so does its information-intensity. With this general model in hand, we can set out to answer two basic questions: (1) When do policy-makers choose to delegate? (2) Who does a policy-maker delegate to? Answers to these questions help us understand policy outcomes. For example, using a delegation model, Franchino (2004) finds that the European Council and European Parliament are more likely to delegate implementation to member state national administrations if an issue area requires specialized and technical knowledge (aka the member states hold a large informational advantage over the European Council and European Parliament). Therefore, in specialized areas, a policy outcome is likely closer to the policy preference of the member state and further away from the preferred policy outcome of the European Council and European Parliament.

In the past three decades, EU Funds have been used to promote economic and social cohesion amongst European regions. The primary objective of these funds from the perspective of the European Council and the European Parliament is to make European regions more competitive (Blom-Hansen 2005; Dellmuth, Schraff & Stoffel 2016). At the same time, EU regulations prescribe a set of institutional guarantees regarding both the distribution of funds and the control of the process, to make sure that the financial interests of the EU are not violated by fraudulent or corrupted practices (Kallay 2015; Muraközy & Telegdy 2016). The sheer volume of these funds raises concerns over whether their implementation is in line with EU goals. If domestic actors have discretion when distributing EU Funds, this increases the likelihood of corruption to enter the allocation process, potentially affecting the effectiveness of such funds (Dellmuth, Schraff & Stoffel 2016). Even if only a small part of such funds were affected by corruption, the negative consequences would likely be quite pervasive in terms of misallocation and distorted economic incentives, harming the entire EU cohesion project (Fazekas & King 2018; Muraközy & Telegdy 2016). The effects are likely to be even more severe if corruption is linked to high-level politics, potentially affecting democratic backsliding (Fazekas & King 2018). Therefore, higher levels of corruption and patronage break away from the preferred policy of the European Council and European Parliament, which is the focus of this paper.

The case at hand, EU Funds, differs from some of the canonical theories of delegations in that the agents can credibly commit themselves to a policy that is *not* their preferred policy. This arises when a member state's national administration has a preferred policy that is far from the policy maker's preferred outcome. There is a fear that the agent will not implement the policy decided by the policy makers and instead implement their own preferred policy. Indeed, under certain conditions member states who disagree with decision outcomes do not comply when implementing policy (Zhelyazkova and Torenvlied 2009). To solve this issue, policy makers delegate authority to an independent agency. An independent agency can allay concerns that an agent will fail to enforce decision outcomes that are not in line with their preferences. Within the European Union, the European Commission usually acts as this independent agency that has pro-integration preferences that are very close to those of policy makers (Majone 2001). By delegating the authority to monitor and sanction member state administrations to the European Commission, policy makers can be sure that the implementation of the EU Funds does not stray too far from their own policy goals (Thomson & Torenvlied 2011). This allows policy makers to delegate implementation to a member state, even if their preferred goals are outside of the policy maker's delegation set, as they are constrained by the monitoring and possible sanctioning by the European Commission. The European Commission is not toothless as they have suspended EU Funds in Hungary and Romania. This credible commitment has limited policy conflict between member states and the European Council and European Parliament. This is not always the case though and we argue that if the information that the European Commission receives is co-opted, the Commission is no longer able to limit policy conflict, and policy drift occurs.

We can use the principal-agent framework to understand the importance of this credible commitment and map out the outcome if this credible commitment were to fail, because of a failure in auditing and monitoring. In the case of EU Structural Funds, the principal (policy makers) are the European Council and European Parliament who choose to delegate authority to an agent, the member state. We can reasonably assume that each has preferences over the policy outcome/implementation of funds, which may or may not be aligned with one another and that the member state always prefers delegation over no delegation. Previous work on delegation tells us delegation will occur when the "delegation set" is non-empty – that is, there exists an agent whose preferences are such that the policy they will implement if delegated the authority to do so, will result in a policy outcome the principal finds at least as desirable as the outcome if they had not delegated at all. In short, if the member state's preferences are sufficiently similar to the European Council and European Parliament, we will observe delegation and implementation without the need for any prior policy commitment on the member state's behalf. If the principal had an infinite number of agents, their ideal choice would of course be with one with identical preferences, an ally, but in this case, there is only one possible agent for each country's EU Structural Fund implementation.

But what happens if the preferences of the member state and EU are not sufficiently similar and the initial delegation set is empty? Absent the opportunity for the member state to commit themselves to a policy, no delegation would occur. Recall that for the member state, this is the worst possible outcome – they would always rather the European Council and European Council delegate authority to them. Consider an extension of the baseline delegation model in which the potential agent has the option to cede authority to an independent agent, which can serve as a credible policy commitment to the principal prior to their decision of whether to delegate. In our case, this is the member state ceding the authority to sanction to the European Commission. In terms of the model, this amounts to the agent committing itself to the policy it most prefers that falls within the delegation set, meaning the principal prefers accepting its commitment and delegating authority over not delegating at all.

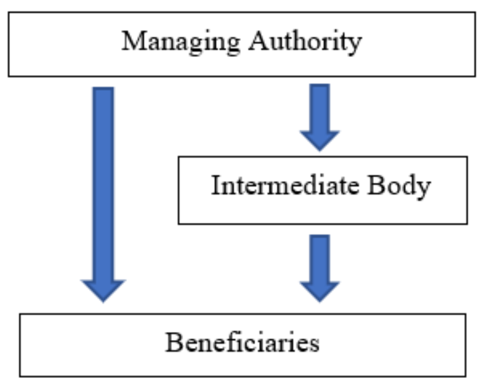
This simple baseline model tells us how and why the ability of member states to commit can facilitate delegation that would otherwise not occur. However, this basic model of European Union delegation ignores that often the European Commission can only sanction based on information that it receives from auditing organizations within the member state. If these auditing organizations are co-opted by the member state government, it is likely that they will not audit in good faith. This will allow the member state to slowly move further away from the preferred policy outcome of the European Council and European Parliament and closer to their own policy. Given that ministers in the European Council are often not well informed about the particular administrative conditions in their own country and far less informed about conditions in other countries (Franchino 2007) it is not surprising that once the European Commission is usurped, member states can implement their ideal policies. Essentially, the sanctioning process within EU Funds is not always a credible commitment, although it is viewed as one by the European Council and European Parliament. Once member states co-opt auditing organizations, member states are no longer committed to this policy and are able to drift towards their preferred policy.

We test if this is the case in Hungary, where *Fidesz*, the political party in power, was delegated the implementation of EU Structural Funds between 2010-2014, but did not control auditing and the information reported to the European Commission until 2014. By 2014, the auditing process was reformed and the government co-opted the flow of information to the European Commission. We find that the level of patronage and indicators of corruption significantly increased after *Fidesz* gained control of the auditing process, signaling a shift towards the preferred policy of *Fidesz*, the ruling political party in Hungary, and away from the preferred policy of the European Council and European Parliament.

(4) The implementation and Auditing of EU Funds

Although the priorities for EU Funds are decided by negotiations between the European Commission and national governments, the implementation and auditing of these funds are controlled solely by member states. Member governments are required to maintain a structural funds office in Brussels and submit annual reports and audits to relevant EU bodies, but only projects with costs totaling over €50 million are subjected to a thorough EU approval process (a check to be eliminated in the 2021-2027 period) – a very high threshold in light of the scale of the overall budget and weaknesses in local governance capacity (Kállay 2015). Projects below this cost threshold, i.e., the majority of initiatives funded through these windows, are only required to adhere to a loose set of guidelines designed by Brussels, but run exclusively by the domestic managing authorities and intermediate bodies. The managing authority serves a planning role and sometimes a distributive function, while the intermediary entity distributes funding and oversees implementation, with a certifying body to perform audit functions. In terms of fund utilization, the managing authority and the intermediate bodies'[4] control are displayed in Figure 3 below.

Figure 3: Line of Fund Implementation



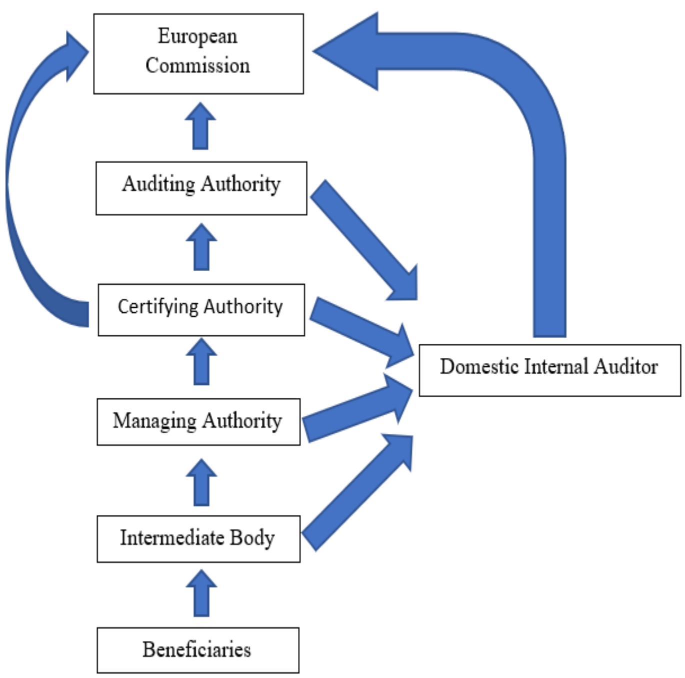
Given that the distribution of EU Funds is run exclusively by managing authorities and intermediate bodies controlled by the national or regional administration of the member state, the European Commission's only authority lies in its ability to suspend the funds given information received from domestic auditing organizations overseeing this distribution directly and receiving information from these bodies.

[4] Intermediate body defined as 'any public or private body which acts under the responsibility of a managing or certifying authority, or which carries out duties on behalf of such an authority, in relation to beneficiaries implementing operations.' (EU Regulation No 1303/2013, Article 2).

In terms of auditing, European Union law mandates that ‘it is necessary for member states to designate a managing authority, a certifying authority and a functionally independent auditing authority for each operational program’.[5] The certifying authority draws up and submits to the Commission payment applications, draws up the accounts, certifying their completeness, accuracy, veracity, and that the expenditure entered in them complies with applicable European and national rules. 'The law allows the tasks of the certifying authority to be carried out by the managing authorities … The law [also] allows member states to designate intermediate bodies to carry out certain tasks of the managing or the certifying authority' (Kállay 2015, p. 26).

The structure of distribution is approved at the European level, but member states are given significant autonomy when choosing the systems by which funds are ultimately distributed and the auditing process itself is controlled solely by domestic agents who inform the European Commission. The structure of domestic monitoring and auditing with which the European Commission depends on is displayed in Figure 4.

Figure 4: Auditing Structure (line of auditing)



[5] EU Regulation 1303/2013 of the European Parliament and the Council.

Figure 4 illustrates how the European Commission depends on the certifying authority, auditing authority, intermediate bodies, and domestic internal auditor to acquire data on fund distribution within recipient member states. Given that the auditing authority receives most of its information from the certifying authority, the certifying authority defines what the auditing authority sends to the Commission. The certifying authority and the domestic internal auditor have primary control over the information the Commission receives. The intermediate bodies also play an important role in the auditing process as they report information to these authorities and are closest to the actual distribution of these funds.

There is also European auditing mechanism that allows the EU to conduct their own independent audits through the European Anti-Fraud Office (OLAF). Once OLAF finds a case of fraud or misuse, they cannot prosecute corruption themselves, rather they rely on the national prosecutor, to whom the information is transferred. If the national prosecutor decides not to prosecute, OLAF cannot sanction the member state independently.

Within the auditing process, three positions are essential within the framework of EU Funds: Certifying Authority, Domestic Internal Auditor, intermediate bodies, National Prosecutor. These three positions define the information shared with the European Commission. In the following section, we explain the process with which *Fidesz* co-opted the three institutions tasked with auditing EU Funds (Certifying Authority, Domestic Internal Auditor, and National Prosecutor).

(5) EU Structural Funds in Hungary: Budapest's Reforms of Auditing, Monitoring, and Indictments

Without control of auditing, a machine of patronage would be constrained by the European Commission overseeing this process, as it was in 2013. To mitigate the risk of European Commission intervention, *Fidesz* transferred the management of the auditing processes of co-funded EU projects to its loyalists. During both the 2007-13 and 2014-20 funding period, only one certifying and audit organization existed in Hungary (Nyikos & Talaga 2015). Therefore, in Hungary, the only bodies that reported directly to the European Commission were the one certifying authority, the one auditing authority, and the one domestic internal auditor. Placing these institutions under the directive of long-standing *Fidesz* loyalists was relatively simple for *Fidesz*, but stands in stark contrast to neighboring countries. In Poland, for example, there are 17 certifying and audit organizations, which makes shielding this process from the EU Commission much more difficult. The centralized system inherited by *Fidesz* made the co-optation process less complex than in other member states.

The first level check on EU Funds is the certifying authority who submits expenditure declarations to the Commission. In Hungary, the State Treasury, under the authority of the Minister of National Economy, is assigned to act as a certifying authority. The State Treasury, run by *Fidesz*-loyalist *József Mészáros*, is under the purview of the Finance Ministry until recently directed by *György Matolcsy*, former Member of Parliament for *Fidesz* (2006-13), and subsequently governor of the National Bank of Hungary. Authority over the Finance Ministry was transferred to *Mihaly Varga* in 2013, who has been a member of *Fidesz* since its origins in 1988 (serving as its vice president in 2005-13) and a member of the National Assembly from 1990 until the present.

The auditing authority is responsible for carrying out system audits and individual audits to ensure program efficiency and effectiveness. These documents are then submitted to the Commission through annual control reports and annual opinions. This authority is placed in the hands of the Directorate General for Audit of European Funds, an entity also under the authority of the Finance Ministry (Fortvingler 2013).

Both of these institutions are also under the oversight of the State Auditor's office, the agency that directs internal audits of the auditing authorities and certifying authorities.[6] The State Audit Office is currently led by former *Fidesz* lawmaker *Laszlo Domokos*, who prior to this appointment served as a *Fidesz* member of the National Assembly for twelve years.[7,8]

Starting in 2014, Figure 5 shows that all three entities within the auditing system became managed by *Fidesz* loyalists who have a long history of serving *Fidesz*. These are the only domestic organizations that can formally prepare audits for the European Commission's use, thereby all official reporting on possible EU Funds misuse to Brussels runs through the *Fidesz* 'chain of command' (Fortvingler 2013).[9] This severely hampers the ability of the EU Commission to effectively monitor EU Fund distribution starting in the 2014-2020 EU Fund Distribution period, which is the first period of EU Fund distribution in which the auditing process was co-opted by *Fidesz.*

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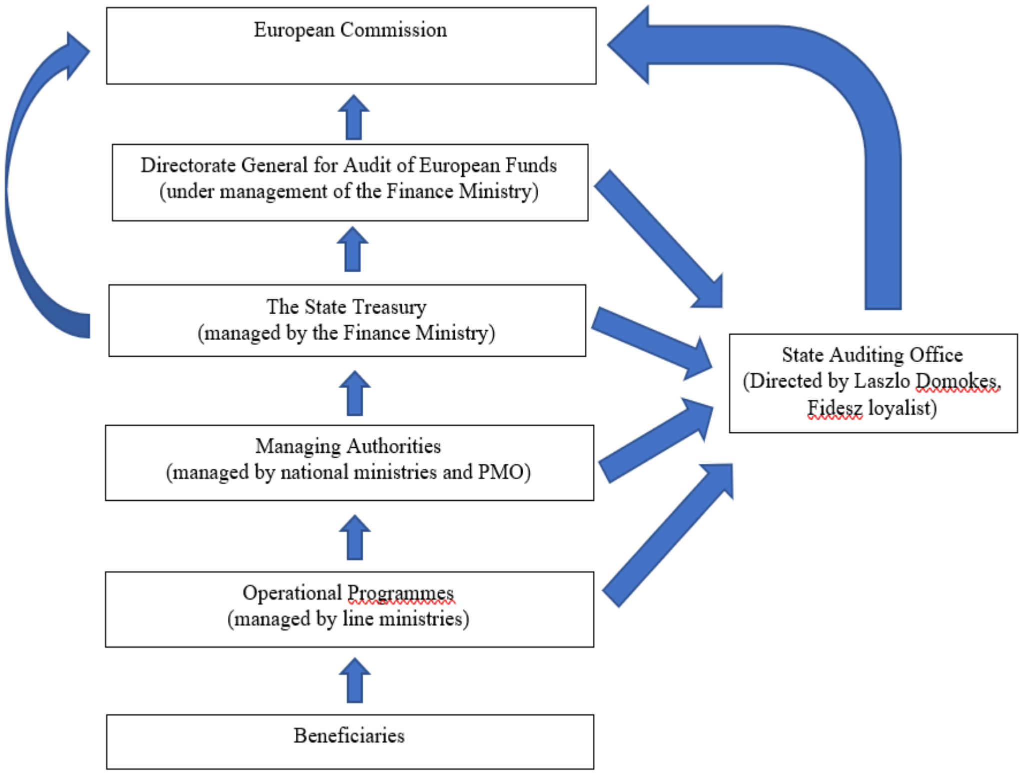
[6] 'The structural funds institutional system in Hungary', available at: https://www.palyazat.gov.hu/the_structural_funds_institutional_system_in_hungary, accessed December 2019

[7] ' Domokos László', available at: http://www.parlament.hu/internet/plsql/ogy_kpv.kepv_adat?p_azon=d003&p_ckl=39, accessed December 2019.

[8] 'The State Audit Office of Hungary - An Introduction', 2013, available at: https://www.aszhirportal.hu/en/presidential-greeting/the-state-audit-office-of-hungary-an-introduction, accessed December 2019.

[9] 'The structural funds institutional system in Hungary', available at: https://www.palyazat.gov.hu/the_structural_funds_institutional_system_in_hungary, accessed December 2019.

Figure 5. Reporting Lines for Auditing in Hungary (Managing Ministries/Directors)



Outside of these domestic audit organizations the EU's anti-fraud watchdog OLAF can investigate cases of funds misuse or corruption. Ultimately reports are given directly to the member state in secrecy to protect the identities of the individuals involved. Therefore, it is up to the Hungarian government to decide whether to publish an OLAF report or not.[10] OLAF has raised concerns about specific European-funded projects in Hungary, but it relies on national prosecutors to investigate. In the 2017 OLAF report, Hungary had 49 investigations closed with recommendations to the national government, second only to Romania in numbers of investigations and more than double the 20 investigations conducted in Poland (a much larger recipient of EU Funds). Of the 49 cases referred to the Hungarian government, no action was taken by local judicial authorities on 20 cases; 9 cases were dismissed; and only 8 were prosecuted. These developments are particularly disconcerting in light of the realities of the elimination of judicial independence in Hungary. Most misuses of funds found by OLAF are left unprosecuted by the judicial branch in Hungary.

[10] 'The OLAF report 2017', 2017, available at: https://ec.europa.eu/anti-fraud/sites/antifraud/files/olaf_report_2017_en.pdf, accessed December 2019.

There was also a dramatic reduction in funding to support these auditing organizations. Table 1 demonstrates that before *Fidesz* took control, just under €69 million of EU Funds was designated to support auditing and monitoring organizations of EU Funds within Hungary. This was 81.5% of all EU grants allocated to aid the distribution of EU Funds.[11] After *Fidesz* took control of the ministry in 2010, despite similar funding levels, no EU Funds were used to support auditing and monitoring.

Table 1. EU Funds Allocated to for Intermediate and Auditing Organizations (in € - number of grants in parentheses)

Years	Total Grants Distributed to the EU Funds Distribution Process	Support for Monitoring and Auditing
2007-2009	84,566,857 (5)	68,982,175 (2)
2011-2013	77,818,247 (8)	0 (0)

Source: https://www.palyazat.gov.hu/tamogatott_projektkereso ; Authors' classifications

In addition to these formal auditing lines, intermediate bodies are also responsible for reporting misuse of funds. We find that *Fidesz* has gained control of EU Funds through both the centralization of the distribution system and placing *Fidesz* loyalists in leading positions of the managing authorities and intermediate bodies tasked with overseeing the distribution process.

(6) EU Structural Funds in Hungary: Budapest's Reforming Oversight at the Distribution Level

Since its election, *Fidesz*'s centralization of the EU Funds distribution system has been exceedingly thorough and has allowed for the funds to be co-opted, but also allowed them to control the oversight of this fund distribution at the ground-level. Upon their rise to power, *Fidesz* was able to increase the level of centralization by strengthening both the role of the various line ministries in Budapest and the overall oversight of the Prime Minister's Office (PMO), while reducing the role of regional operational programs. Before *Fidesz*' rise to power, the *Results of the Negotiations of Cohesion Policy: Strategies and Programmes 2007–13* (published by the EU)[12] stated that regions still 'played an important role at the national level with participation in project selection and monitoring as managing authorities.

[11] Detailed information about these grants is provided on page 1 (Table A1) in the Supplementary Materials

[12] 'Results of the negotiations of Cohesion Policy strategies and programmes 2007–13', EU Cohesion Policy, available at: http://ec.europa.eu/regional_policy/sources/docoffic/official/communic/negociation/country_hu_en.pdf, accessed December 2019.

Figure 6. Hierarchy of Operational Programs in 2007-2013 Funding

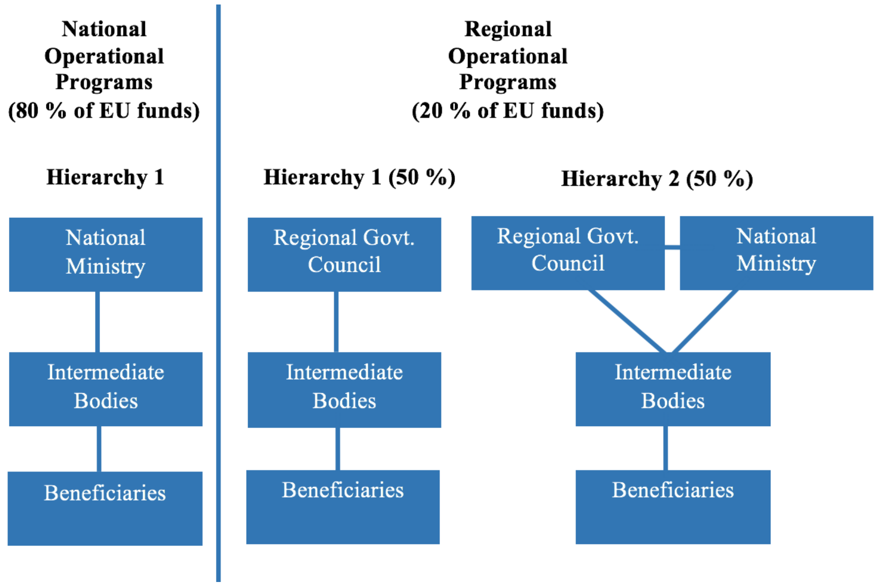
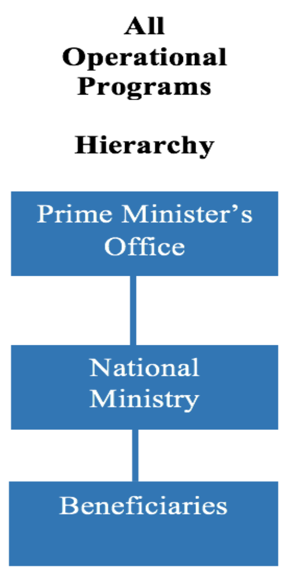


Figure 6 illustrates the organizational structures utilized during the 2007-2013 funding cycle, whereby national ministries maintained influence over approximately *90*% of EU structural funds and possessed sole oversight over *80*% of those funds. It is essential to note here that *Fidesz* inherited this institutional structure upon entering office. However, the party subsequently expanded its control over the distribution and overseeing of EU Funds by increasing the central government's role in the bidding process; overhauling the administration in charge of EU structural funds; replacing staff with *Fidesz* partisans; and repealing transparency laws (Nyikos & Talaga 2015). Each of these measures is discussed in turn below.

Fidesz streamlined and centralized the EU Funds process, eliminating independent agencies, and consolidating central coordination of EU Funds in the PMO. In 2010, the regime decreased the number of intermediate bodies that oversaw bidding processes for national operational programs to centralize the system into the hands of *Fidesz* supporters (Nyikos & Talaga 2015). In 2011, *Fidesz*-controlled government departments placed more than a dozen administrative functions in the hands of party officials and eliminated the role of decentralized institutions, e.g., local government councils, in the Structural Funds process (Buzogány & Korkut 2013). The new '*Szechenyi* Plan' placed the independent NFU (National Development Agency), the main overseer of public procurement in Hungary, in a subordinate position to the *Fidesz*-controlled Ministry of National Development. This reform was completed in tandem with a 'house cleaning' of staff, mass lay-offs across all levels of the bureaucracy, completing the party's overhaul of the EU Funds process. By 2012, the National Development Agency found itself under the direct control of the PMO and the regional development councils were eliminated (Magyar 2016). Brussels' interpretation of this change, in the previously cited 2007-13 summary report noted: 'At the end of 2012, the supervision of the NSRF implementation became part of the Prime Minister's office, under the control of a new State Secretary. This institutional change implied a further centralization and a greater speed of expenditure.'[13] This addressed concerns regarding low absorption rates, but gave the national government more control overseeing these funds.

In addition to the centralization of these funds, all regional and national operational programs were by 2014 operated by *Fidesz*-controlled national ministries in Budapest. In 2014, central coordination efforts previously in the hands of the National Development Agency were placed directly under the responsibility of the PMO. This meant that for the 2014-2020 funding cycle, all EU Funds were implemented by *Fidesz*-staffed ministries (intermediate bodies). Only three of the ten operational programs were operated by ministries other than the Ministry of National Economy, Ministry of National Development, or the PMO. The 2014-2020 period looked exceedingly different from the 2007-2013 structure, as illustrated in Figure 7. The number of managing authorities and intermediate bodies was significantly reduced and those organizations were subsequently run exclusively by *Fidesz* loyalists.

Figure 7. Hierarchy of Operational Programs in 2014-2020



[13] 'Ex post evaluation of Cohesion Policy programmes 2007-2013, focusing on the European Regional Development Fund (ERDF) and the Cohesion Fund (CF): Task 3 Country Report Hungary, p. 15. Available at: https://ec.europa.eu/regional_policy/sources/docgener/evaluation/pdf/expost2013/wp1_hu_report_en.pdf, accessed December 2019.

The Ministry of National Development has taken on a significantly larger role in the process as described above. To take the central role in directing these funds it needed to increase its capacity to deal with the allocation of these funds. This increase in capacity was co-funded by EU grants displayed in Table 2 (listed and discussed in more depth in the appendix). Once *Fidesz* came to power, EU grants were utilized to support the centralization of the EU Funds process.

Table 2. Funds Allocated to the Ministry of National Development (in € - number of grants in parentheses)

Years	Total Grants Distributed to the EU Funds Distribution Process	Funding to Centralize Operations to Ministry
2007-2009	84,566,857 (5)	0 (0)
2011-2013	77,818,247 (8)	9,525,380 (5)

Source: https://www.palyazat.gov.hu/tamogatott_projektkereso ; Authors' classifications

Ultimately these practices outlined by *Fidesz* co-opted the auditing process, in that all oversight, monitoring and auditing that the European Commission depended on were controlled by party officials with incentives to not disclose patronage or corruption to the European Commission. In the next section we tested what effect lower transparency had on the level of patronage within EU Funds.

(7) Results

In this section, we set out to test if corruption and patronage rise within EU Funds after *Fidesz* co-opted the auditing process and the information flow to the European Commission. To this end, we measure corruption using one approach and measure patronage using three different approaches.

First, we measure general levels of corruption within contracts awarded to Hungarian firms from projects partly funded by the European Union using three common procedural indicators of corruption in all three periods. (1) Award decisions not based on the lowest price of the bid. The simplest indication of restricted competition is when bids are not chosen based on the criteria of the lowest price. This allows institutions to award contracts above-market prices and eases the extraction of corrupt rents. It also complicates the auditing process as it is difficult to determine if the contract was rightly awarded. Hence, the incidence of this type of bidding is one of the most basic corruption proxies. This is also specifically important in the Hungarian case as audits of European Union funded projects in Hungary have accused contracts and grants of being drastically overpriced (European Parliament 2018: 5). (2) The number of days between the initial call for proposals and the deadline for applications. If the application period is too short to prepare an adequate bid, it can serve perverse purposes. It limits those that can apply and allows for the issuer to informally tell a well-connected company about the opportunity before others. (3) Lower number of applications. This allows institutions to award contracts at above-market prices and makes the extraction of corrupt rents more likely. Measuring these procedural indicators allow us to identify when levels of corruption generally increase.

Second, we develop three distinct approaches to measure the incidence of patronage by investigating grants and contracts (for projects that receive EU Funds) awarded to firms with connections to *Fidesz*. We measure: (1) The proportion of grants and contracts partly funded by the European Union that were awarded to firms with connections to *Fidesz*, (2) The proportion of contracts awarded to these firms from the same source, and (3) Three common procedural indicators of corruption (as described above) in contracts awarded to firms with connections to *Fidesz*. Integral to these measures is the identification of firms that are connected to *Fidesz.* Some firms have already been identified for us: firms that sponsor the football club in *Felcsút*, *Orban*'s hometown.[14] Although there are multiple strategies by which *Fidesz* and their allied economic elites funnel EU money for their own gains, we note with particular interest one of *Orbán*'s main hobbies and sources of wealth: the Foundation for the Upbringing of *Felcsút* Youth Athletes (FUNA). In 2004, *Viktor Orbán* established this foundation in his home village. The foundation not only dovetailed with *Orbán*'s passion for football but also provided a means for the PMO to receive kickbacks from economic elites who receive preferential tax or regulatory policy and national procurement and EU co-funded grants from *Fidesz* (Magyar 2016). In return for preferential treatment, firms contribute tax-free donations to FUNA. While as previously noted, *Fidesz* made contributions to all football clubs tax-free, FUNA has benefitted the most from these contributions. This advantage is not the subject of this section, but we can use these firms to measure patronage by identifying grants and contracts awarded to these firms. This method of selecting firms may suffer from selection bias issues given that some of the firms that sponsor FUNA are actually very large companies (*Magyar Suzuki*, *MOL Nyrt.*, *Coca-Cola*, and *STRABAG Általános Építő Kft.*), but we find that excluding these firms does not change our results.[15]

To create these measures of corruption and patronage we collect EU Funds contract data from the EU Open Data Portal[16] and grant data from the official EU Structural Fund database that documents all grants co-funded by the

[14] A list of these firms is provided on page 2 (Table B1) in the Supplementary Materials
[15] To account for this we present all of the figures and tables in this section excluding these four large firms on pages 8 through 11 in the Supplementary Materials.
[16] https://data.europa.eu/euodp/en/data/dataset/ted-csv

European Union[17] across three distinct periods: **2008-2010:** when *Fidesz* was out of power, **2011-2015:** when *Fidesz* was in power, but the auditing programs had not yet been co-opted (it takes two years for the new EU funding period to begin effectively distributing grants and awarding contracts). **2016-2018:** *Fidesz* is in power and the auditing process has been co-opted. We are specifically interested in the change in our measure of general corruption and patronage between each period. A change in corruption and patronage 2008-2010 and the 2011-2015 period could be attributed to *Fidesz* coming to power. A change in corruption and patronage between the 2011-2015 and the 2016-2018 period could be attributed to the co-optation of the auditing organizations.

(7.1) General Corruption within EU Funds in Hungary

Between 2008 and 2018, 13,935 contracts were awarded to Hungarian firms from projects partly funded by the European Union. We present the proportion of award decisions based on the lowest price of the bid, the average time period between the initial call for proposals and the deadline for applications, and the number of applications per 1,000,000 Euros awarded in Table 3.

Table 3. Procedural corruption indicators by time period

Measure/Period	2008-2010	2011-2015	2016-2018
Percentage of bidding criteria based on the lowest price	49.9	50.4	22.6
Average Duration of Call for Proposal (days)	43.85	44.7	38.6
Average Number of Applications (per 1,000,000 Euros awarded)	1.55	0.52	0.16

We find that two of the three indicators for procedural corruption do not change when *Fidesz* comes to power, but red flags arise after the auditing process is co-opted. The proportion of contracts without low price criteria increased slightly after *Fidesz* came to power, but decreased significantly after the auditing process was co-

[17] https://www.palyazat.gov.hu/tamogatott_projektkereso

opted by *Fidesz*.[18] Average application periods do not change once *Fidesz* enters power, but they decrease 13.6% after the auditing process was co-opted by *Fidesz*.[19] The average number of applications per 1,000,000 Euros decreased once *Fidesz* entered power and after the auditing process was co-opted by *Fidesz*.[20] Although there is an increase in procedural irregularities once *Fidesz* comes to power in one measure, there is a large increase in procedural irregularities across all three measures after the auditing process is co-opted.

(7.2) Contracts and Grants Awarded to Firms with Connections to Fidesz from projects partly funded by the European Union

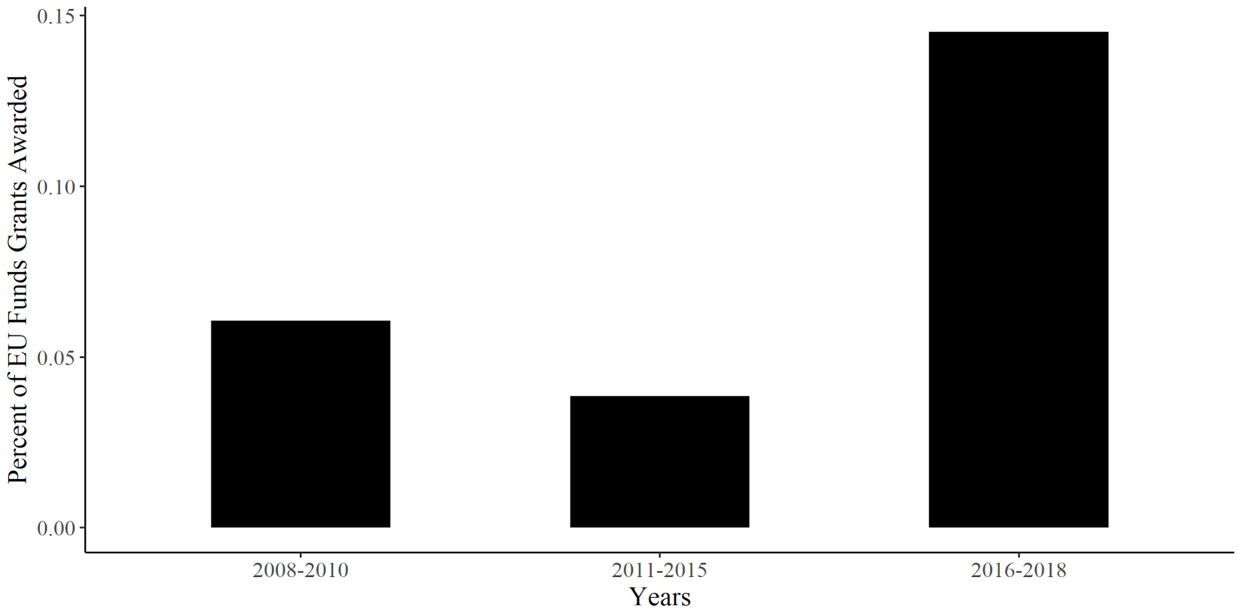
We measure patronage using three distinct approaches. Our first approach measures the proportion of grants and contracts partly funded by the European Union awarded to firms with connections to *Fidesz*. Between 2008 and 2018, 43 grants were awarded to firms that FUNA sponsors from projects partly funded by the European Union. Below, Figure 8 presents the number of grants distributed to FUNA sponsors as a percentage of all EU Funds distributed in the three time periods outlined earlier. There is a slight decrease in EU Funds awarded to these firms after *Fidesz* comes into power, but a large increase (over three times the previous period) once the auditing process is co-opted by *Fidesz*.

[18] We run a simple linear regression and control for the number of awards offered per contract and the type of contracts (work, service, or supply), but find similar results. Results from this model are provided on page 4 (Table C1) in the Supplementary Materials.

[19] We run a simple linear regression and control for the number of awards offered per contract and the type of contracts (work, service, or supply), but find similar results. Results from this model are provided on page 5 (Table C2) in the Supplementary Materials.

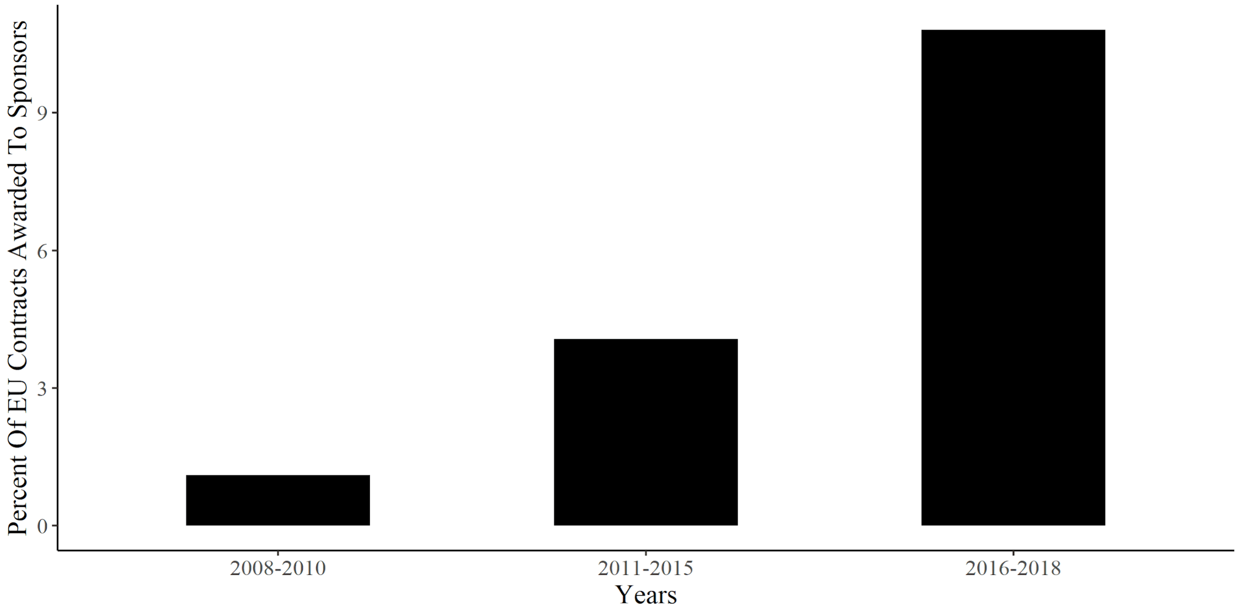
[20] We run a simple linear regression and control for the number of awards offered per contract and the type of contracts (work, service, or supply), but find similar results. Results from this model are provided on page 6 (Table C3) in the Supplementary Materials.

Figure 8. Percent of EU Grants Awarded to FUNA Sponsors



Directly winning EU bids is one tool to support patrons, but a more hidden and nuanced approach adopted by the regime has been to award sub-contracts for these projects. Between 2008 and 2018, 230 contracts were awarded to firms that FUNA sponsors from projects partly funded by the European Union. Figure 9 displays the percent of all EU-supported contracts that were awarded to FUNA sponsors from 2008 to 2018 across the three periods of interest. Although there is an increase in contracts awarded to FUNA sponsors once *Fidesz* comes to power, there is a larger increase after the auditing process is co-opted by *Fidesz*. To address confounding explanations, an analysis of when sponsors were founded indicates that all of these firms were established before 2005 (except for one in 2011, *Búzakalász* 66 *Felcsút* Kft.). Given that this company received no EU grants or contracts, this firm's later founding cannot explain the spike in EU grants or contracts awarded to these firms over this period.

Figure 9. Percent of EU Funds Contracts Awarded to FUNA Sponsors



Our second approach measures the proportion of contracts awarded to these firms from the same source. In competitive markets, it is unlikely that the same companies win all of the contracts of a given issuer, hence the very high share of the winning company within all of the contracts awarded by the issuer in a given period can indicate rigged competition. This has been identified as one of the most reliable "red flags" in the literature (Kenny & Musatova 2010). Two of the largest distributors of contracts from projects partly funded by the European Union are *NIF Zrt.* and *Magyar Kogzut Nonprofit*, two state-owned construction firms that are in charge of most large transportation infrastructure projects. Given that many firms that sponsor Felcsút are viable subcontractors for these projects (*Mészáros és Mészáros, Duna Aszfalt, STRABAG Általános Építő Kft.*, and *R-KORD Kft*) we analyze if the percentage of contracts awarded to FUNA sponsors from these two state-owned firms increase over these periods. These percentages are presented in Figure 10. We find a dramatic increase in the percentage of contracts awarded to sponsors of FUNA when *Fidesz* comes to power and after auditing was co-opted. In fact, between 2016-2018 77% of all contracts to sponsors of FUNA were awarded from the *NIF Zrt.* or *Magyar Kogzut* Therefore, this accounts for the majority of the increase in funds to FUNA sponsors over this period. In addition to these contracts, grant money received by FUNA sponsors came from only a few organizations after auditing was co-opted. Grants awarded to FUNA sponsors in the 2010-2015 period were awarded from a plethora of different EU Funds programs: GOP, KMOP, TAMOP, KDOP, DAOP, KEOP. While grant money post-2015 came from only two EU Funds programs: GINOP and VEKOP. It appears irregularities surrounding the source of contracts/grants awarded to FUNA sponsors increased both after Fidesz came to power and after the auditing process was co-opted.

Figure 10. Percentage of EU Funds Contracts Awarded to Felcsut Sponsors by *Magyar Kogzut* (MK) and *NIF Zrt*. (NIF)

Our third approach to measuring patronage presents common indicators for corruption (same as described above) in the 230 contracts awarded to FUNA sponsors between 2008 and 2018 (Table 5). We find that two of the three indicators for procedural corruption do not change when *Fidesz* comes to power, but red flags arise after the auditing process is co-opted. The proportion of contracts without low price criteria increased slightly after *Fidesz* came to power, but are almost never awarded to FUNA sponsors after the auditing process was co-opted by *Fidesz*. Average application periods do not change once *Fidesz* enters power, but they decrease 23.9% after the auditing process was co-opted by *Fidesz*. The average number of applications per 1,000,000 Euros decreased once *Fidesz* entered power and stayed the same after the auditing process was co-opted by *Fidesz*. Although there is an increase in procedural irregularities once *Fidesz* comes to power in one measure, there is a large increase in procedural irregularities across two of measures after the auditing process is co-opted. When we compare these results to the common indicators for corruption in all contracts (presented in Table 4) we find that procedural irregularities only surpassed general contracts after the auditing process was co-opted in two of the measures (low-bid contracts and average duration of application period). In the 2016-2018 period there are much more procedural irregularities in contracts awarded to FUNA sponsors than in general contracts.

Table 4. Procedural Corruption Indicators For Contracts Awarded To Felcsút Sponsors

Measure	2008-2010	2011-2015	2016-2018
Percentage of bidding criteria based on the lowest price	61.9	53.4	**7.6**
Average Duration of Call for Proposal (days)	51.6	49.45	**37.69**
Average Number of Applications (per 1,000,000 Euros awarded)	0.50	0.10	**0.10**

In sum, we find that some of our measures of corruption and patronage became slightly more concerning when *Fidesz* entered power in 2010, but all of the measures of corruption and patronage increased and to a greater extent after the auditing process was co-opted. This indicates that the auditing process being co-opted likely had much more of an effect on corruption and patronage then *Fidesz* entering power.

(8) Discussion

In this paper we argue that a simple model of delegation of EU Funds fails to account for the capability of member states to co-opt the auditing organizations that report to the European Commission. This allows policy drift to take place, which in turn increases patronage and corruption. We set out to test if the level of patronage and corruption increases once auditing organizations are co-opted by the political party in power in Hungary, where a change in control over the information flow to the European Commission shifted from an independent organization to the party-in-power (*Fidesz*) in 2014. We find that this shift precipitated a large increase in the level of corruption and patronage within EU Funds in Hungary.

How should the EU regain control over the information flow within the process of implementation of EU Funds? Once the EU realizes that the co-optation of information and of auditing organizations from member states may expand the policy set considerably, allowing for actors much further away from the EU's ideal point to implement their ideal policy, they may try to reaffirm the position of the Commission as an independent arbiter, forcing member states to credibly commit to the policy closest to the EU's ideal point once again.

One option would be for the EU to fully control the audit, certifying, and managing authorities. Our illustration of the process of EU Funds distribution in Hungary outlines the current problems with structural fund distribution: full control by member states over distribution and auditing detaches the EU from the process and increases information-intensity within the member states. Given best practices in the foreign aid literature, it is important that the EU has a capacity to evaluate funds based on feedback from the intended beneficiaries and scientific testing, which can then be used to reward success or penalize failure. Drawing upon this literature, we would suggest moving to audit, certifying, and managing authorities that have been co-opted by *Fidesz* to the European Commission, restoring their role as a credible commitment that locks the member state into a policy that the European Council and European Parliament are satisfied with. Although a neatly written proposal, this would result in a drastic shift of power from member states to the European Union, a reform unlikely to be easily agreed upon by the member states.

Another option, closely following the example of other neighboring countries, like Poland, would be to decentralize these authorities. Hungary's centralized system contrasts with nearby member states. Hungary maintains only one certifying/audit organization with twenty oversight organizations managing fifteen operational programs. This stands in stark contrast with its Visegrad counterpart, Poland, which has seventeen certifying/audit organizations, and seventy-four organizations overseeing twenty operational programs. In Poland sixteen of the seventeen certifying/audit organizations are controlled by regional governments (many of which during Law and Justice's reign have been controlled by the opposition party). This puts forth more obstacles to the creation of a patronage machine for the current government in Poland. The decentralization of audit organizations may be an option available to the EU that would be more easily agreed upon by member states. Most EU member states are like Hungary in that they have one auditing organization and one certifying organization. 19 of the 27 EU member-states during the 2007-2013 funding period maintained only one certifying organization and one auditing organization (Nyikos and Talaga 2015), so they are likely to suffer from similar issues as Hungary. Western European countries on the other hand are less likely to witness the same type of co-optation due to the presence of stronger long-standing democratic institutions and containing much fewer regions entitled to EU Funds. Most regions in CEE fall below the EU Structural Funds threshold of 75% of EU GDP, hence creating more incentives to capture these auditing organizations and ultimately EU Funds.

Finally, we argue that, although the EU has taken steps to address recent cases of democratic backsliding, the new rule of law conditionality proposal does not address the inherent principal-agent problem underlying EU Funds, which, as our evidence clearly showed, has worsened corruption, which in turn has contributed to eroding political competition and to democratic back-sliding. Democratic back-sliding and a series of threats to the rule of law in EU countries (most notably Hungary and Poland) have led the EU to recognize that a generalized culture of lackluster monitoring of EU Funds by member states should be revisited. Hence, the proposed plan for the 2021-2027 period of EU Structural Funds aims to further expand and consolidate the use of conditionalities, including the addition of a novel rule of law conditionality, applicable to all EU budget expenditure (Viță 2018). In its current form, the EU lacks sufficient means to uphold respect for the rule of law.[21] Furthermore, the proposed reform aims to punish offending nations in the wallet, by withdrawing EU Funds to countries found to violate EU founding values, including respect for human rights, the rule of law, judicial independence, and freedom of expression. Given the breach of any of these measures, the European Commission would impose appropriate measures that include suspending, reducing and restricting access to EU funding in a manner proportionate to the nature, gravity, and scope of the deficiencies until they cease to exist. That leverage would appear to address issues with these funds and use these funds to affect behaviors from member states, a distinct shift from previous EU regulations. Unfortunately, the issues of EU Funds that we raised, first and foremost the ability by member states to co-opt the flow of information to the European Commission, are largely untouched by these EU regulations.

[21] There is the 'nuclear option' of the so-called Article 7 TEU procedure, which allows for the suspension of voting rights of member states found to be in 'serious and persistent breach' of EU values, however, this has to be unanimously supported, and especially in the case of Hungary and Poland this is unlikely to lead to any actual sanctions since they can count on each other's vetoes.

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Supplementary Materials

A. EU Funds Grant Details

Table A1. EU Co-Funded Projects for Auditing and Centralization of Distribution During 2007-2013 Funding Period

Grant Number	Date	Award	Description
6.1.1– Financing an Intermediate Body	01/09/09	17,619,437,000 Ft (~68,825,925 Euros)	Financing of project implementation and project level financial and monitoring activities related to the Transport Operational Program
6.2.2 – Support From Managing Authority	02/02/09	3,600,000,000 Ft (~14,062,500 Euros)	Expert Support For Managing Support for Transport Operational Program
6.2.1 – Operation of the Monitoring Committee	06/05/09	40,000,000 Ft (~156,250 Euros)	Supporting the running costs of the Public Monitoring Committee and its subcommittees
6.1.0/C/09 - Promoting campaigns to promote sustainable livelihoods and associated behavioral patterns (awareness-raising, information, training)	07/31/09	128,005,076 Ft (~500,020 Euros)	'Speak to your father!' Campaign
6.1.1– Financing an Intermediate Body	08/26/09	261,673,472 Ft (~1,022,162 Euros)	Finances the activities of KIOP contributing organizational tasks
1.2.6/A-2011 - Simplification of laws and processes	03/13/12	165,109,320 Ft (~644,958 Euros)	Simplification of laws and processes in traffic authority and administrative and energy-related procedures
KEOP 8.1.2/B Az OP – Implementation of Minsitry	06/04/12	16,000,000 Ft (~62,500 Euros)	KEOP Special Operations 2012-2015
ÁROP 1.1.19-2012 - Preparation of Impact Assessments and Strategies	12/12/12	175,000,000 Ft (~683,593 Euros)	Preparation of Impact Assessments and Strategies in the Ministry of National Development
ÁROP 1.2.18/A-2013 - Organizational development program for state administration bodies	11/25/13	34,000,000 Ft (~132,812 Euros)	Implementation of the organizational development of the Ministry
KEOP 8.1.1 Az OP - technical-administrative implementation	07/09/14	17,383,006,971 Ft (~67,902,371 Euros)	KEOP contributing organizational tasks
VOP 1.1.1 - Ensuring the capacity of institutions	04/15/15	1,163,097,414 Ft (~4,543,349 Euros)	Managing of Environmental Programs
VOP 1.1.1 - Ensuring the capacity of institutions	04/15/15	901,290,659 Ft (~3,520,666 Euros)	Managing The Transport Operational Program
KEOP 7.14.0/15 - Preparation of the energy efficiency improvements of the Governmental Offices and Ministries	09/25/15	83,967,000 Ft (~327,996 Euros)	Application by the Ministry of National Development on the proposal for the preparation of the energy efficiency improvements of Government Office and Ministries in the period 2014-2020

B. FUNA Sponsors Details

Table B1. FUNA Sponsors (who received EU co-funding support and contracts)

FUNA Firm Sponsors (32)	**Firm sponsors Who Received EU grants in 2008-2018 Period (12)**	**Firm sponsors Who Received EU Public Procurement contracts Between 2008-2018 (16)**
Mészáros és Mészáros Kft.	Mészáros és Mészáros Kft.	Mészáros és Mészáros Kft.
Strabag Építő Zrt.	Strabag Építő Zrt.	MOL Nyrt.
MOL Nyrt.	MOL Nyrt.	Pharos 95 Kft.
Pharos 95 Kft.	Pharos 95 Kft.	R-Kord Kft.
Búzakalász 66 Felcsút Kft.	Duna Takarék Bank Zrt.	Békés Drén Környezetvédelmi, Víz- és Mélyépítési Kft.
Penny Market Kft.	Coca-Cola HBC Magyarország Kft.	Stadler Trains Magyarország Vasúti Szolgáltató Kft.
Duna Takarék Bank Zrt.	R-Kord Kft.	Magyar Suzuki Zrt.
Puskás Akadémia Sport Hotel	Koch és S Kft.	Diagnosticum Zrt.
FHB Jelzálogbank Zrt.	Sokon Kft.	Duna Aszfalt Kft.
Coca-Cola HBC Magyarország Kft.	Diagnosticum Zrt.	Agro-Felcsút
Békés Drén Környezetvédelmi, Víz- és Mélyépítési Kft.	Magyar Suzuki Zrt.	Fejér-B.Á.L. Zrt.
R-Kord Kft.	Békés Drén Környezetvédelmi, Víz- és Mélyépítési Kft.	R-Kord Kft.
VIVIEN Víz Kft.		Dolomit Kőbányászati Kft.
Stadler Trains Magyarország Vasúti Szolgáltató Kft.		VIVIEN Víz Kft.
Ilzer Italgyártó Zrt.		Olajterv Zrt.
CBA Kereskedelmi Kft.		Strabag Építő Zrt.
Gánt Kő és Tőzeg Kft.		
Alcsúti Arborétum		
Magyar Suzuki Zrt.		
Marchfeldrasen R Gyepgyártó és Forgalmazó Kft.		
Diagnosticum Zrt.		
Koch és S Kft.		
Duna Aszfalt Kft.		
Fejér-B.Á.L. Zrt.		
Olajterv Zrt.		
Sokon Kft.		
Eurovéd Security Team		
JAKO Magyarország Kft.		
Dolomit Kőbányászati Kft.		
Agro-Felcsút Kft.		
Atis-Fa Kft.		

Source: https://www.pfla.hu/?q=static/supporters

Table B2. When were FUNA sponsors founded? (First registered as companies)

Company	**Date First Record of Company**
Mészáros és Mészáros Kft.	**07/24/2001**
Strabag Építő Zrt.	**11/13/2002**
MOL Nyrt.	**01/03/1993**
Pharos 95 Kft.	**01/10/1995**
Duna Takarék Bank Zrt.	**09/27/2001**
Coca-Cola HBC Magyarország Kft.	**12/05/2005**
R-Kord Kft.	**1997 (exact date not available)**
OTP Bank	**11/28/1991**
Sokon Kft.	**01/10/1991**
Diagnosticum Zrt.	**01/06/1995**
Magyar Suzuki Zrt.	**05/05/1993**
Békés Drén Környezetvédelmi, Víz- és Mélyépítési Kft.	**08/22/2000**
Búzakalász 66 Felcsút Kft.	**02/22/2011**
Koch és S Kft.	**11/07/1997**

Source: https://www.ceginfo.hu/

C. Linear Regression Results

Table C1. OLS Regression Results: Decisions based on factors other than the lowest price

	Dependent Variable: EU Funds decision based on factors other than the lowest price	
	(1)	**(2)**
2011-2015	-.0153 (0.009)	-.005 (0.010)
2016-2018	0.266*** (0.014)	0.27*** (0.013)
Works Contract	0.042*** (0.012)	
Service Contract	-0.0899*** (0.0090)	
Contract Award Amount	0.000 (0.00)	

Observations: 12,749
R-squared: 0.04754
F-Score: 128.2***

Note: * p < 0.05 ; ** p < 0.01 ; *** p < 0.001

Table C2. OLS Regression Results: Application Period Duration

	Dependent Variable: Application Period Duration (in days)	
	(1)	**(2)**
2011-2015	1.1745*** (0.310)	0.858** (0.290)
2016-2018	-4.685*** (0.299)	-5.219*** (0.293)
Works Contract	3.25*** (0.306)	
Service Contract	-0.412 (0.268)	

Observations: 8,972
Adjusted R-squared: 0.07452
F-Score: 181.6***

Note: * p < 0.05 ; ** p < 0.01 ; *** p < 0.001

Table C3. OLS Regression Results: Number of Applications

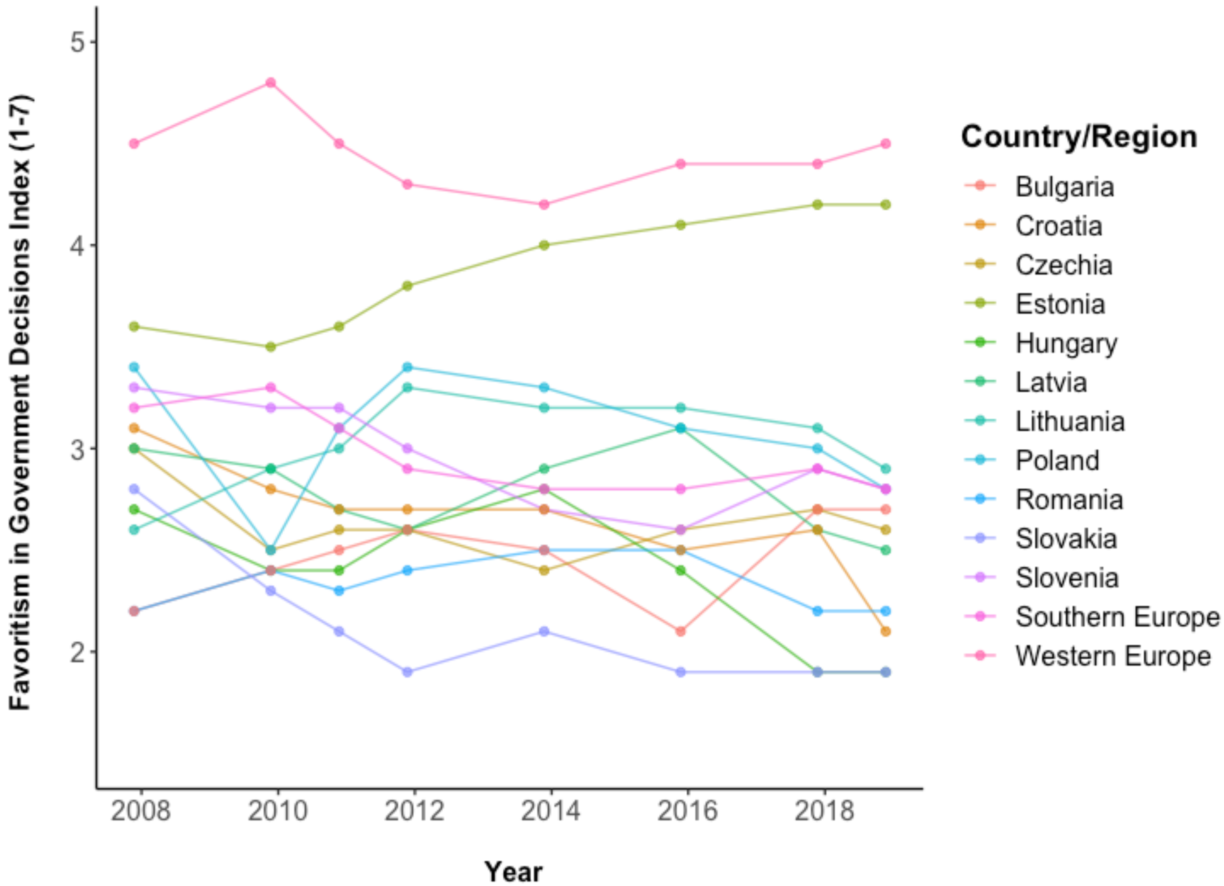
	Dependent Variable: Application Period Duration (in days)	
	(1)	**(2)**
2011-2015	-1.381*** (0.310)	-1.255*** (0.307)
2016-2018	-2.643*** (0.430)	-2.83*** (0.429)
Works Contract	-1.024* (0.401)	
Service Contract	-1.306*** (0.323)	
Number of Awards	0.052*** (0.006)	

Observations: 12,749
Adjusted R-squared: 0.0122
F-Score: 32.13***

Note: * $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$

D. Favoritism by Government Officials

Figure D1. Favoritism by government Officials Index With More Countries



E. Measures of Patronage Excluding Large FUNA Sponsors

Figure E1. Percent of EU Grants Awarded to FUNA Sponsors (Excluding Large Firms)

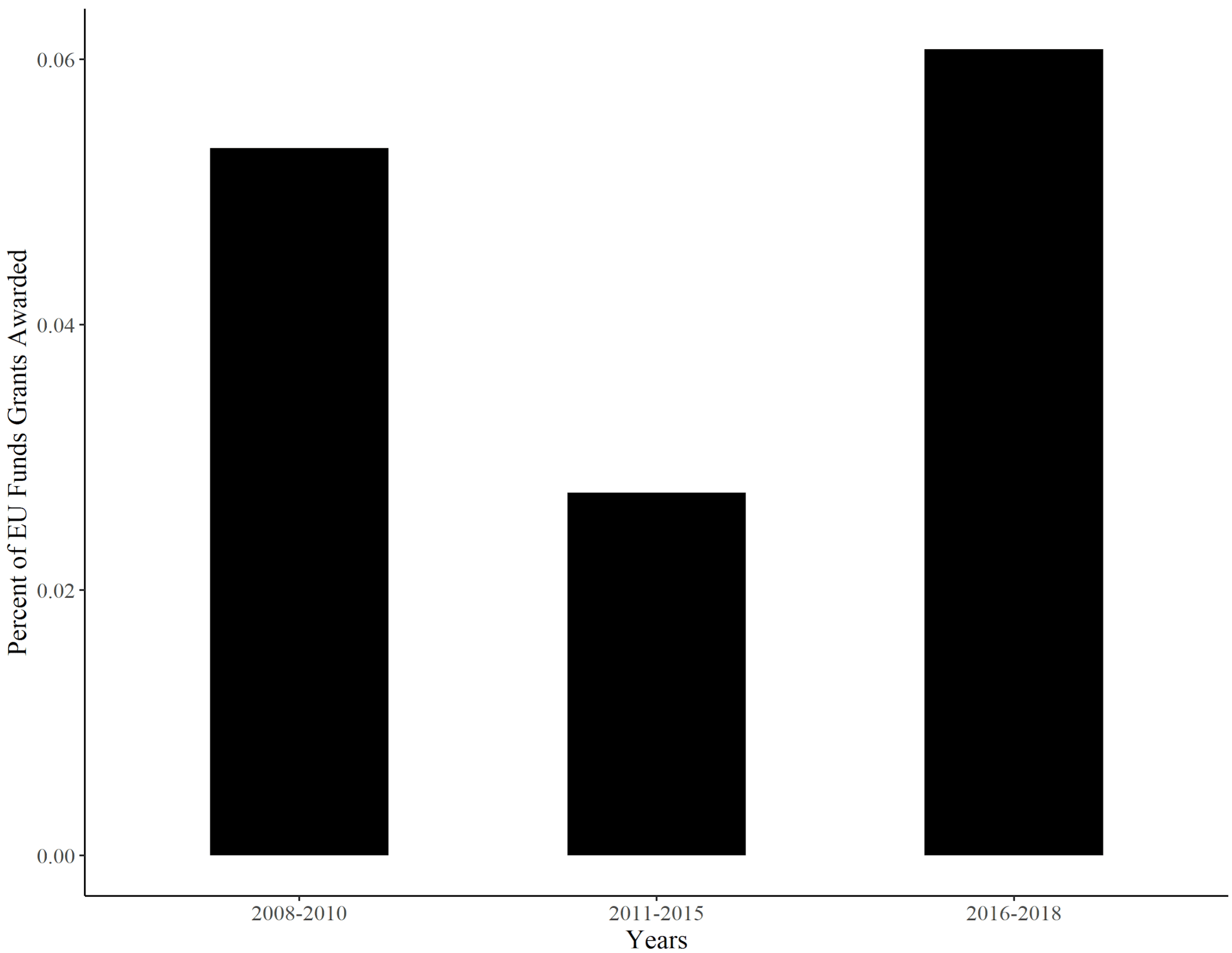


Figure E2. Contracts Awarded to FUNA Sponsors as Percent of Total Contracts Awarded (Excluding Large Firms)

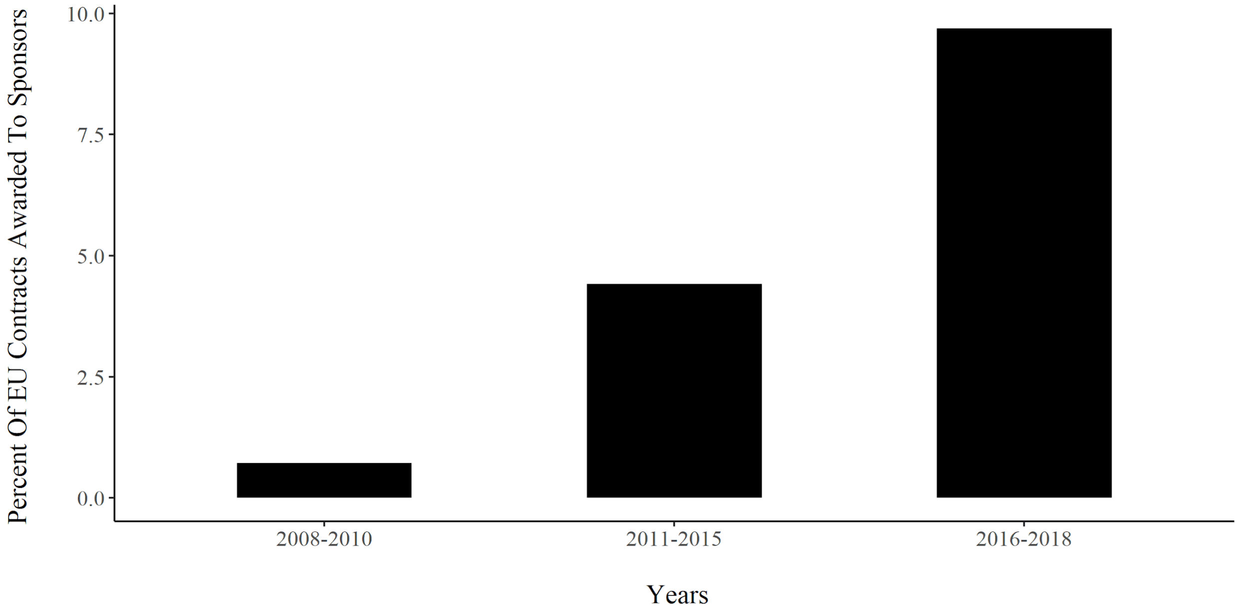


Figure E3. Percentage of contracts awarded to Felcsut sponsors by *Magyar Kogzut* (MK) and *NIF Zrt*. (NIF) (Excluding Large Firms)

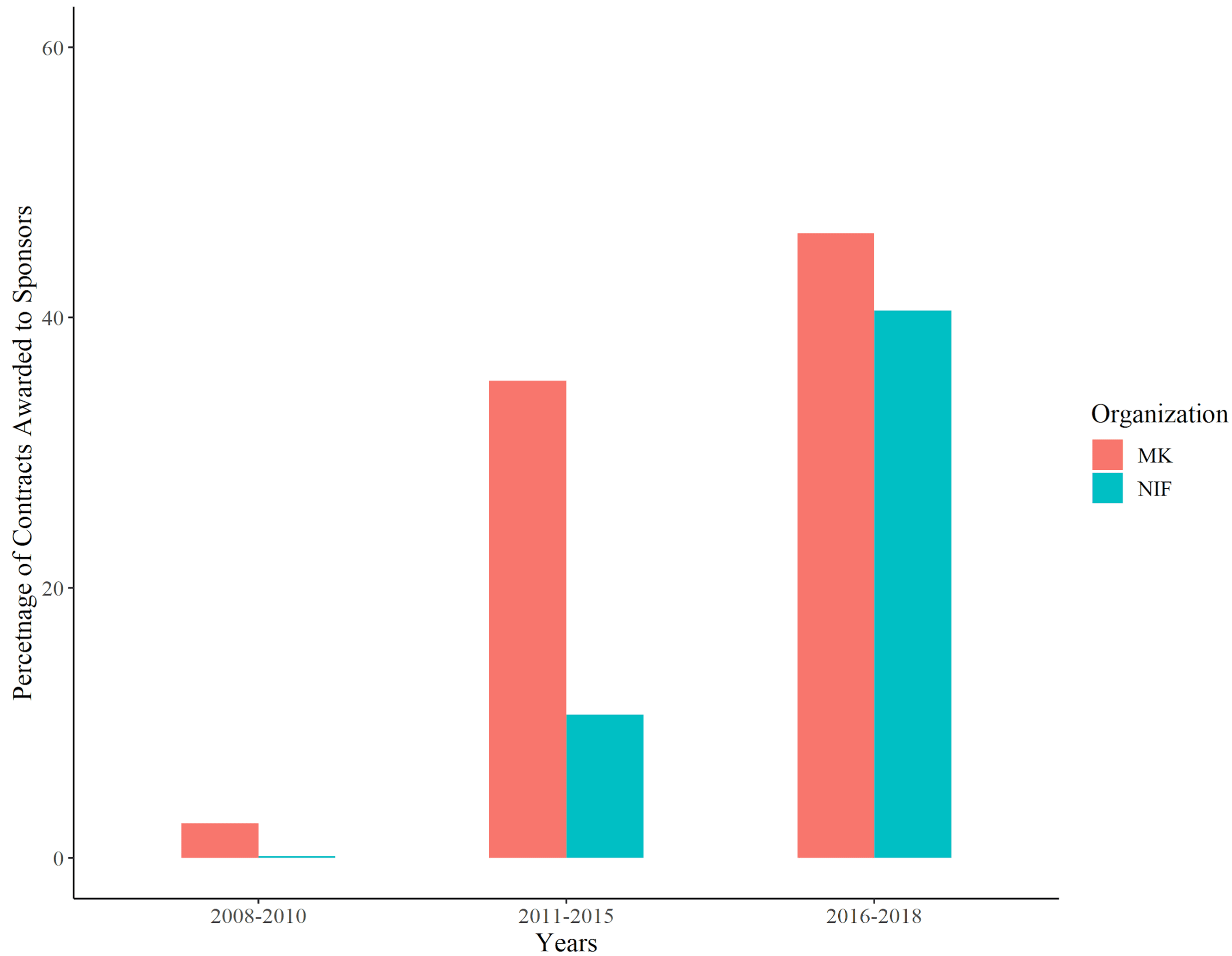


Table E4. Procedural corruption indicators by for contracts awarded to Felcsút sponsors (Excluding large firms)

Measure	2008-2010	2011-2015	2016-2018
Percentage of bidding criteria based on the lowest price	61.9	44.9	9**.6**
Average Duration of Call for Proposal (days)	51.1	48.9	**38.22**
Average Number of Applications (per 10,000 Euros awarded)	0.50	0.09	**0.09**