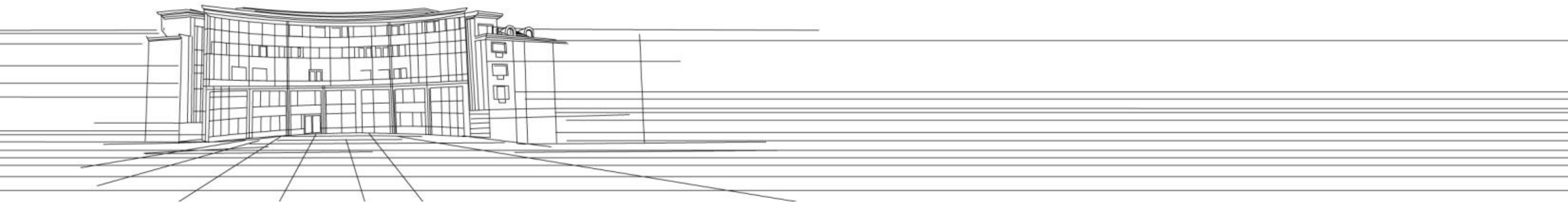

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EU Funds Assistance and the Quality of Institutions in the Member States:

The twofold relationship

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Abstract

A question how effective European Union Cohesion Fund and Structural Funds are in promoting economic growth and speeding up the process of convergence has attracted an interest of international community and a broad circle of scientists. While some authors claim that only for countries with the "right" institutions these funds bring benefit, some research on international aid shows that financial assistance is likely to reduce quality of institutions in the recipient countries. This thesis is exploring *how the absorption of EU Funds support and the quality of institutions in EU Member States affect each other* by first measuring how great is the impact of public institutions quality on the EU Funds absorption (namely, the EU Funds actually received compared to the amount allocated) in a cross-country perspective, and then conducting informant interviews to find out possible effects of the EU funding (absorbed via EU co-financed projects) on institutional quality in the Member States. Study combines both quantitative and qualitative research methods thus showing that *each additional increase in quality of public institutions raised absorption of EU funds by 0.59 in the scale, given 2007-2013 EU Funds support period*; but paradoxically EU funds just as other development aid were in a risk of legal corruption and similar practice, having *negative effects on institutional quality, when EU-supported projects issue contracts for suppliers via public tendering*. Results from the study can be beneficial for rethinking EU Funds management strategy and implications, and also contribute to the debate on overall impact of foreign aid interventions on the quality of government.

Key words: *EU regional and cohesion policy, EU funds absorption, EU co-financed projects, quality of institutions*

List of tables, illustrations and annexes

Table of Contents

1. Introduction

In recent years, there has been a wide-ranging debate on the results of the European Union (EU) Structural and Cohesion assistance to the Member States. To begin with, EU Structural funds together with the Cohesion fund are the most intensively used policy instruments by the EU to promote economic growth as well as social development and to reduce welfare differences within the Member States.[1] The EU Structural Funds contain almost 1/3 of EU budget and around 2/3 of Structural Funds money are granted for regions with GDP per capita less than 75% of the EU average (Becker et al., 2010). Since most of the countries with the mentioned GDP level are among the ones with the lowest *Quality of Government*[2] *(QoG),* the European Commission decided that in order to receive financial assistance from the EU Funds the Member States are obligated to co-finance their regional projects, meaning that all the supporting payments from the EU are granted on specific conditions. This implies that *the country's institutional capacity to distribute, invest and absorb the EU grants efficiently has become an essential determinant of European cohesion process* and has attracted considerations of the international scientific community.

While a wide variety of literature is trying to answer a question how effective EU Funds are in promoting economic growth and speeding up the process of convergence, another piece of debate emphasize that only for countries with *"right"* institutions any international aid is effective[3], what suggests that institutional quality is a foundation-stone for regional and cohesion aid effectiveness as well. According to Ederveen et al. (2002) study, the latter result is obtained for a wide range of conditioning variables, such as openness, institutional quality, low corruption and other indicators for good governance. However, there is also a substantial body of evidence found by scholars of the international aid, showing that foreign aid is in some cases likely to reduce quality of institutions in the recipient countries.

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[1] With this goal on mind, all Member States receive assistance from the EU Structural Funds to solve their social and economic problems in addition to promoting further development. There are several Structural funds, among which the European Regional Development Fund (ERDF), started in 1975, is the largest. To strengthen and uphold EU's political and economic role in a global community, European Cohesion Policy was created. Only less developed regions are eligible to receive assistance from the Cohesion Fund. See: http://ec.europa.eu/regional_policy/index_en.cfm

[2] For the European Quality of Government index, see Charon et al. (2012)

[3] See for example Burnside and Dollar (2000), Ederveen et al., (2002), Collier and Dollar (2002)

On the EU level, a recent Transparency International Europe report on the EU Integrity System (2014) revealed that 70 % of EU citizens believe corruption as a signal of low QoG is strongly present in the EU system. Report also raised a concern that *"the range of controls to prevent public money falling into the hands of corrupt individuals risks being undermined by the weak way in which the European Commission is currently using its powers to exclude and deter corrupt companies from participating in public tendering by EU institutions."* It is likely to be a case not only in the central institutions governing EU, but also in EU Member States, which receive extensive support from the EU Funds and are widely procuring products and services needed to implement EU-supported projects.

Consequently, it might not only lead to inefficient use of EU budget, but also have the adverse effect on the process of convergence. This is why the aim of this paper is not to evaluate the effectiveness of the EU regional and cohesion policy (what is continuously done by different scholars and European Union institutions as well), but rather ***to analyze the relationship between the absorption of EU Funds assistance and the quality of public institutions in the EU Member States.*** This goal is to be reached in two ways: first, by measuring to what extent quality of public institutions matter for the absorption of EU Funds (in other words, the EU funding received in relation to the allocation planned), and then by conducting informants' interviews in one of the EU Member States (Lithuania) to explore what effects EU funding absorbed (naturally, via EU co-financed projects) possibly have on the quality of public institutions. In this part, public procurement aspects analyzed in previous research are taken into consideration and tested. Institutions here are understood as formal and informal structures guiding the behavior of individuals involved in the implementation of EU Structural and Cohesion Funds programmes.

Based on results from previous research on foreign aid as well as recent studies on relationship between EU Funds and legal corruption, hypothesis of this study is that ***quality of public institutions has a significant impact on the absorption of EU Funds, yet EU funded projects may also have side effects on the quality of institutions*.** If given the current strategy and policies the EU Funds aid indeed has more negative effect on institutional quality (while it is crucial to have good institutions in order to absorb aid), financial support in some cases could be self-destructive: funding might not only be absorbed in an inefficient way, but also the goal of regional cohesion and development may be never reached. Consequently, it would be essential to reorganize the way assistance is managed or the way conditions for receiving it are set to avoid the paradox as the well-known ***"aid curse"***, leading to the regression instead of development, and consequently to the divergence instead of convergence. This is a very relevant question since regional inequalities are/will be only increasing with the time in case EU structural and cohesion aid as it is and the way it is distributed now contribute to lower quality of institutions in the Member States.

The results of this research are beneficial for further planning and implementation of Structural and Cohesion programmes for the new funding period 2014-2020, because there is still no cross-country research measuring how great is the impact of institutional quality for the EU Funds absorption by using the most recent data; and given that studies exploring not only positive, but also negative effects that the EU funding absorbed (via EU co-financed projects) have a potential to bring for the quality of institutions in the Member States are only emerging. Therefore, this paper provides new insights and extends current ideas about the twofold complex relationship between EU Structural and Cohesion aid and institutional quality. Furthermore, this study contributes to the discussion on international aid impact on the Quality of Government (QoG).

1.1. Disposition

The paper is structured as follows: the first chapter (theoretical part) consists of an overview of key arguments in the literature; the second chapter explains the research design. It is followed by two chapters of research where the hypotheses are assessed, each with methodological approach as well as analysis and results. Then, in the concluding discussion findings are summarized, conclusions are drawn from the empirical study and further research directions are offered.

2. Theoretical discussion

Before the empirical part, earlier research around the question of concern is overviewed, to create a theoretical model and develop hypotheses of the study. This part will shed some light on how the institutional quality and EU funds absorptions can be understood, how international aid and institutional quality are related to each other, what is the role of institutional quality in absorption of the EU Funds and what institutional problems are noticed to occur around the EU-supported projects.

2.1. Defining the institutional quality

To begin with, institutionally oriented research is stressing the importance of institutions for development, by analyzing interaction between economic, social variables and institutional framework. According to the development economist Dani Rodrik, institutions can be described as

> *"a regulatory apparatus curbing the worst forms of fraud, anti-competitive behavior, and moral hazard, a moderately cohesive society exhibiting trust and social cooperation, social and political institutions that mitigate risk and manage social conflicts, the rule of law and clean government"* (Rodrik, 2007).

In short, institutions in the framework of EU Funds can be understood as formal and informal structures which guide the behavior of individuals involved in the implementation of EU Structural and Cohesion Funds programmes. For instance, these are institutions managing EU Funds in each country as well as each local and regional public institution involved in EU Funded projects: including Ministries, Municipalities, other public and semi-public organizations. Meanwhile, the general government structure of a country models social behavior and creates perspective of collective action, determining sanctions and incentives, all with a goal of further development (Alonso and Garcimartin, 2009).

Some authors provide evidence that institutional quality is a foundation stone in determining different level of development in societies and economies (Rothstein, 2008), but to understand this importance one has to know what is meant by the term *quality of institutions* first.

In particular, institutional quality is a concept which can be constrained from different ingredients and there is no prescription of it as a certain concrete norm. Thus, over the last years the scientific community has argued a lot about what can define and determine a good quality of institutions as precisely as possible, and the difficulty rests in the relative understanding of “good” and “bad” in every country or region, raising a question how can it be measured internationally.

For example, it is an ongoing trend to include measures for institutional quality such as *favoritism and corruption, transparency of government policymaking, efficiency of bureaucracy, intellectual property protection, diversion of public funds, public trust in politicians, wastefulness of government spending, burden of government regulation, efficiency of legal framework in settling disputes and challenging regulations* as well as g*overnment's services for improved business performance* (World Economic Forum Global Competitiveness Report, 2012). These can go in line with determinants such as *income distribution, development and education level, international openness and tax revenue* (Alonso and Garcimartin, 2009). As some of these variables still can be understood differently in every country, there is an obvious need of adding a commonly understood norm characterizing institutional systems as it is clear that specific array of institutional settings cannot define the quality across the world.

In order to make the definition more complete one has to recognize that a concept of institutional quality is very much linked to a quality of government (QoG), which can be in short defined as *having impartial government institutions for the exercise of public power* (Rothstein, 2011). One of the most frequently used definitions of good governance also includes the role of institutions and was given by the World Bank Research Institute (Kaufmann, Kraay & Zoido-Lobatón, 1999):

> *“The traditions and institutions by which authority in a country is exercised, what makes the relationship between institutions and government clearer. This includes (1) the process by which governments are selected, monitored and replaced, (2) the capacity of the government to effectively formulate and implement sound policies, and (3) the respect of citizens and the state for the institutions that govern economic and social interactions among them).*

From all the measures mentioned above, it is convincing enough that *impartiality* can be considered as the most important ingredient of what good quality of institutions can be, because it is understood similarly regardless economic performance or social, cultural differences (Rothstein, 2012). Hence, to capture the essence of concept more conscientiously, in this thesis definition of ***impartial, credible, transparent, incentive-compactible institutions with high level of adaptability, rule of law and effective bureaucracy****,* is considered capturing the institutional quality in the most complete manner. One can see that these aspects are based on the World Economic Forum description, merging some of its variables into one.

In this thesis the term *quality of institutions* is intentionally used instead of its' sibling *quality of government (QoG)*, given that it is public and private institutions that in many levels implement EU-funded programmes and projects. However, considering these two close concepts: the government quality and institutional quality in the EU context, Dijkstra (2012) wrote that many of the EU countries are confronted with problems related to QoG, regardless the level of their development: *"Some of the founding members and countries that joined the Union before 2004 still score poorly on several issues related to QoG. Neither is low QoG limited to the less economically developed countries of the EU: some countries with a relatively high GDP per head still score low on several of the dimensions of QoG"*. It raises a question if EU Funds aid interventions can in some way be affecting the QoG and separate institutions, as it is not the country's initial economic development itself as a determinant, also if institutional quality matters at all for better absorption of EU financial commitments.

2.2. Relationship between aid and institutional quality

In the meantime, the academic debate has also provided diverse results on whether international aid has a positive impact on growth and the institutional development. For example, a research by Svensson (2000) found that foreign aid is to a large extent associated with higher levels of corruption due to increased rent seeking activities in aid recipient countries. Likewise, Rajan and Subramanian (2008) study revealed the negative effect of aid on institutional quality in developing countries. Authors used the *International Country Risk*

Guide for measuring the quality of institutions and found that coefficient on the aid-policy interaction terms is significant, yet never is positive.

Additionally, even though international aid has quite often been used as a tool for encouraging democracy, Djankov et al. (2008) found that higher levels of foreign aid actually harm a recipient's political institutions instead of strengthening it. Similarly, Heckelman and Knack (2008), Knack (2001) analyzed aid's impact on economic institutions and found that instead of fostering marked orientated form, international financial assistance is disturbing it.

Young (2012) contributed to this debate by showing that aid distributions are linked to decreased property rights and the legal structure of a recipient nation; which are, in turn, correlated with growth. In particular, his estimations revealed that, via its negative effect on legal structure and property rights, a standard deviation increase in aid leads to a 2.3% decrease in the recipient country's rate of income growth per capita. Even his control for foreign aid interventions only as an additional (to institutional quality) determinant of growth, the expected effect of aid is proved to be still negative. Author emphasized that if controlling aid effects on institutional quality, it is not at all associated with higher growth rates.

On the EU level, studies focusing on interaction between institutional quality and absorption of aid from the EU Structural Funds and the Cohesion Fund are still in its infancy. One of the most recent and relevant studies by Fazekas et al (2013) finds a significant impact of EU financial assistance on institutionalized grand corruption in public procurement during 2009-2012 in three countries: Czech Republic, Hungary, and Slovakia. This is one of the problems (arguably) increasing in the framework of the EU Funds' investments. More on this and other institutional problems are to be discussed in 2.5. part of this theoretical discussion, where problems and mechanisms of *how* aid can weaken institutions are discussed in more detail.

Literature discussed here raises a question if effect of EU financial support on institutional development could be similar as in studies focusing on other development aid. It is very important gap in the literature of European Regional and Cohesion aid issues as there is a growing scholarly consensus on why institutional factors are important for better absorption of aid, thus studies exploring interaction between the absorption of EU funds financial assistance and the institutional quality in recipient countries are only emerging. To fill this gap, this study aims to explain how absorption of the EU Funds support and institutional quality in the Member States affect each other.

It is thus essential to clearly understand why quality of public institutions plays a role for reaching the goals of EU regional and cohesion policies first. To explain it, one needs to start by looking closer to the main measure of the EU funding received – the EU Funds absorption rate.

2.3. Defining the EU Funds absorption

In perspective of EU Funds assistance, a measure of the EU Funds budget received in proportion to the available aid allocation is the ***EU funds' absorption rate,*** which is widely used in studies analyzing EU assistance. It shows *how much of financial support (allocated via EU Structural and Cohesion funds) the EU Member State has actually received,* and this expenditure is expressed as percentage of the total amount of money allocated.

$$\textbf{\textit{Absorption rate}} = \frac{\text{amount of money received}}{\text{amount of money allocated}} * 100\%$$

The absorption rate is a unique characteristic which also does not require constraining additional proportions as amount of money received to the size of GDP or government budget, as these are already taken into consideration when planning *EU Funds allocations*. Measure is also renewed every quarter, allowing to trace the progress of receiving planned funding until the end of funding period.

To be more explicit about this measure, a certain amount of money is allocated to every Member State in the beginning of funding period, given country's *development needs* and *macroeconomic capacities.* This does not mean that the allocated budget is directly transferred to respective Funds managing authorities in each Member State, but it rather is a maximum amount of budget which from country can potentially fund its drafted projects. As an example, allocation from EU Structural and Cohesion Funds to Romania to use during

2007-2013 funding period was 19 213 mln. €[4], and it was a budged on which EU agreed already before 2007. However, only 45.2 % of this amount was actually paid to Romania until the end of 2013. Here, 45.2 % is a measure showing percentage of *EU Funds allocated per Member State actually paid by the Commission*, or the so-called ***Funds absorption rate***. It shows how much money country received and invested via EU co-financed projects based on various priorities, out of the maximum amount which was planned to transfer by EU. This measure is well linked to the EU-funded projects' management level, explaining how well country was been able to implement projects, as EU assistance is received by co-financing projects from EU Structural and Cohesion Funds' programmes on different priorities. This for example means that in Romania only 45.2 % of the planned budget was actually received.

As EU Funds absorptions is very sensitive to country's institutional capacities, already in 1997 scholars started analyzing why this rate is usually not high: *"the absorption of EU commitments by the Member States for instance was in some cases rather low, which has been blamed partly on the lack of efficiency of the national administrations"* (Tsoukalis, 1997). EU commitments here are understood as financial allocations via EU Funds to the EU Member States.

As a case, in theory low absorption of such funding is heavily blamed on administrative factors: inability of local public and private institutions to distribute and invest by planning, implementing and managing EU-funded projects. And further, scientific studies emphasize the presence of a ***direct causality between low EU funds absorption and the uneven development of EU regions***[5]. To develop a further analysis, the next part of this paper digs into why institutional factors matter for the absorption of the EU Funds assistance.

2.4. Importance of the institutional quality for the EU Funds absorption

Talking about institutions in the framework of EU Funds management, both formal and informal institutions are particularly important because they help countries to both *"adjust*

[4] http://ec.europa.eu/regional_policy/thefunds/funding/index_en.cfm

[5] See for example Opritescu Elena Madalina (2012), *Evaluation of the Structural Funds absorption rates by means of HERMIN Model*

and react to change by generating a substantial degree of adaptive efficiency, which highlights the capacity and willingness of domestic actors to adopt and promote new knowledge, to engage in creative and innovative activities" (North, 1990)[6]. In attempt to explore the causes of the relatively limited returns of development aid across different regions around the world and in the EU, increased attention has been paid to estimate the influence of institutions on development, not only from the economic perspective. In terms of economic integration, its' impact on regional growth is strongly dependent on the regional ability to compete successfully in order to benefit from open markets. While more regions with more competitive advantages are expected to benefit more from economic integration, less advanced ones may even experience a net loss (Petrakos, 2012; Kallioras and Petrakos, 2010).

As an argument in favor of institutional quality bringing added value for absorption of development aid, endogenous growth theory (Romer 1986, 1990) considers that positive and long-term effects from aid are possible only given certain focus. Namely, in case the regional economic or political interventions promote research and technical development (R&D), in addition to public, human and social capital. Following that, the research on variables such as trust (Knack and Keefer, 1997; Knack, 2003; Beugelsdijk et al., 2004; Bengtsson et al., 2005) and social capital (Putnam, 2000; Beugelsdijk and van Schaik, 2005) has flourished, leading some scholars to recognize and felicitate the new "kid on the block" – institutions. It was stated then, that institutions matters as much, if not more, for political, social and economic development than traditional, long-established settings like technology transfers, human and physical resource endowments and trade (Acemoglu et al., 2001; Rodrik et al., 2004).

Since then, the impact of the EU Structural Funds on the growth rate (and variables related to it) in EU Member States and the interaction terms with institutional variables turned to the center of attention of various studies (Katsaitis and Doulos, 2009; Ederveen et al., 2002; Ederveen et al., 2006). Reviewing the most significant results of the research, studies state that institutional factors have a major influence for the effectiveness of funding. For example, using country-level data some recent studies investigated whether the impact of Structural Funds payments is dependent on institutional settings of the country (Ederveen et al., 2006; Bähr, 2008). One on the most concrete explanations was given by Rodriguez-Pose (2010):

[6] Cited in Rodriguez-Pose (2010)

"If ***a)*** *the returns of the European regional development effort since the reform of the Structural Funds are controversial and contested; if* ***b)*** *researchers are finding that institutions matter more and more for economic growth and development; and if* ***c)*** *European development strategies have, by and large, overlooked the institutional dimension, ergo institutions matter for regional economic development in the EU and therefore should become an essential part of the European regional development effort in order to improve its effectiveness. It's the institutions, stupid!"*

A good contribution to the debate on institutions affecting the absorption efficiency of development aid is provided by Olsson and Ahlerup (2009) who analyze how growth is influenced by investment in social capital and in formal institutions. Their research proves that countries with low levels of institutional quality have the most to obtain from social capital improvement, while countries with low social capital can benefit the most from better formal institutional quality instead. This idea is also supported by Grootaert (2001), as well as Guiso, Sapienza and Zingales (2004), who show that social capital matters less for the non-poor than the poor.

In the scope of EU regional development programmes and given that to reach the higher funds' absorption the possible is one of the top priorities for every Member State, it feels important to remember the three aspects influencing it (NEI, 2002):

1. ***Macroeconomic factors,*** representing a percentage of EU transfers in relation to the national economic performance. The more transfers in comparison to national performance exists, the less is the number of effective investment possibilities for EU funded projects in the country. Transfers therefore currently are limited to 3.8% of GDP in every country respectively.
2. ***Financial factors,*** expressing country's own ability to co-finance projects supported by EU money.
3. ***Institutional factors, representing the ability of public institutions to administrate, manage and supervise funding between local organizations and the European Commission.*** The absorption rate measure is therefore very sensitive to institutional quality, as administrative factors are essential for better absorption.

In this thesis, implications of *macroeconomic* and *financial* factors are not further analyzed, as it is in a great focus of various economically oriented studies over the years of EU Funds aid presence. On the contrary, *institutional* factors have been neglected until the recent years and it is therefore in the main scope of this thesis.

Yet literature discussed in 2.2. part suggests that aid is in many cases harming the government settings in recipient countries, which then might lead to increasing inequalities within the EU countries instead of reaching its' main goal – to reduce welfare differences and increase cohesion within the EU countries. This question is in a great need to be answered by new, extensive research, especially because even though funding from the EU has had a positive effect on growth, a wide spectrum of research (Canova, 2004; Petrakos et al., 2005, Vojinović and Próchniak, 2009; Artelaris et al., 2010) and examination of regional data shows that inequalities between regions of the EU are actually increasing, followed by some institutional problems.

2.5. Institutional problems raising around the EU-funded projects

Here, some evidence on the side effects of the EU funded projects for different institutional structures in aid recipients (EU Member States) is discussed.

2.5.1. Promotion of "institutional sclerosis" and institutionalized grand corruption

To start with, institutionally thin environments, such as less developed EU Member States, often end up dominated by elites in what Olson (1982) called *"institutional sclerosis"*. This process is interrupting struggles of sustainable development in a way that Structural Funds payments may provide comfortable opportunities for rent seeking by public administrative bodies on both regional and national level (Ederveen et al., 2006). This means that public officials can be involved in a decision-making process based on partnership in order to allocate financial transfers in a ways that would pursue their own interests and strategies in the first place (Katsaitis and Doulos, 2009). It implies partiality when defining the directions of national development, specification of the projects' targets and choosing suppliers.

It is basically the same context as of the previously mentioned *"institutional sclerosis",* which tends to spread distrust and dissatisfaction in the local public policy-making process and, most importantly, drives local responsible actors away from the development process (Rodriguez-Pose, 2010). This, in turn, contributes to creation of a downward spiral of remarkable underdevelopment in Member States.

Considering most recent studies on this matter, findings of the Transparency International Europe report on the EU Integrity System (2014) revealed that 70 % of EU citizens believe corruption is strongly present in the EU system. It also pointed into flaws in the public procurement practice under EU funded projects, where the possibility of rent-seeking and corrupt behavior is relatively high:

*"The Commission has discretionary powers to exclude (or 'debar') companies for 'grave professional misconduct', yet only one was excluded for this reason at the time of writing. Moreover, only six entities were debarred for convictions of fraud, corruption, money-laundering or involvement in a criminal organisation, raising questions on **how well member states and the Commission are sharing relevant information**."*

Some of the most striking results on this matter come from a recent study on EU Funds fuelling corruption in Central and Eastern Europe by Fazekas et al (2013), who were using data on the individual public procurement transactions a unique database on public procurement in Slovakia, Hungary and Czech Republic calculate a composite corruption risks indicator. Their preliminary findings indicate that EU funds impact institutionalized grand corruption:

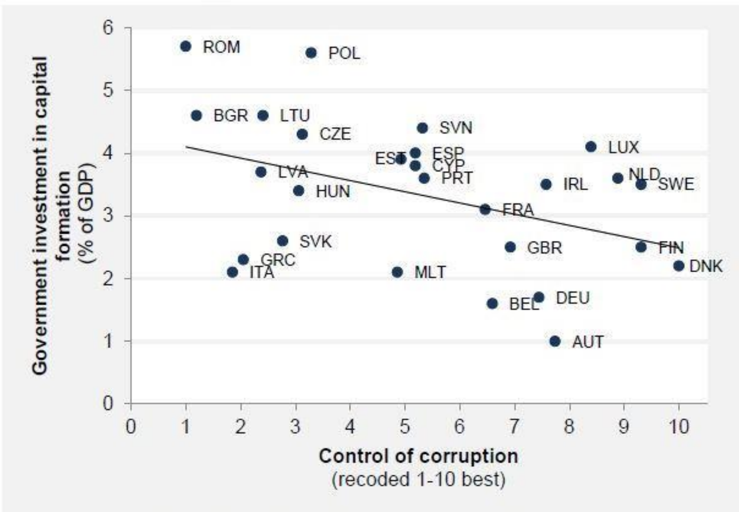
"First, by providing additional public resources available for corrupt rent extraction; second, by changing the motivations for and controls of corruption for the additional resources. Preliminary calculations indicate that the first effect increases the value of particularistic resource allocation by up to 1.21% of GDP, while the second effect decreases it by up to 0.03% of GDP".

Also, author presents an innovative way to explore the cases of institutionalized legal corruption by analysis the process of awarding public procurement contracts, which can be applied in all Member States. In the research done, analysis of bypassing procurement competition in foreseen to have three primary forms, each corresponding to a phase of the public procurement process:

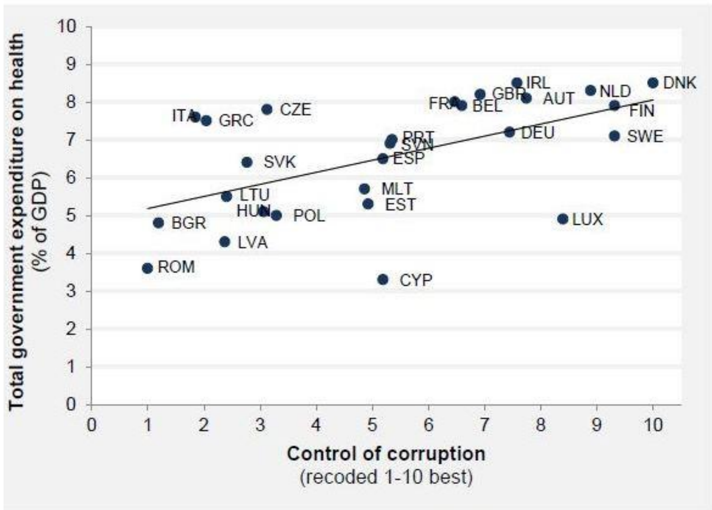
1. *Limiting the set of bidders:* submission phase;
2. *Unfairly assessing bidders:* assessment phase; and
3. *Ex-post modifying conditions of performance:* delivery phase.

Most importantly, the author was able to control for and compare between EU funded and non-funded public procurement contracts. This omits the drawback of other scientists' approaches where one could argue that procurement under EU funded projects depends on the initial corruption in overall procurement setting in a given country.

Likewise, some scholars found that more corrupt EU countries tend to spend more investments on various abstract fixed assets projects other than improvement of concrete services, ex. health services, efficiency of which is easier to measure. On the left we see that greater government investments in capital formation (consisting of *"outlays on additions to the fixed assets of the economy plus net changes in the level of inventories. Fixed assets include land improvements (fences, ditches, drains, and so on); plant, machinery, and equipment purchases; and the construction of roads, railways, and the like, including <...> commercial and industrial buildings."*[7]) are related to weaker control of corruption, whereas governments investing more in exact services such as health sector improvements tend to control the corruption more efficiently.



Data source: World Bank Database, Gross capital formation (% of GDP)



ta source: Eurostat, "General government expenditure by function (COFOG)"

Illustration 1. *Project spending and corruption vs health expenditure and corruption (Miungiu-Pippidi, 2013)*

Paradoxically, the report on the EU Integrity System (2014) also found a lack of common integrity and transparency rules in the EU institutions themselves. As one case of the point, information on the expenses of individual MEPs is not made public by the EP, meaning that

[7] http://data.worldbank.org/indicator/NE.GDI.TOTL.ZS

there is *“the lack of common integrity rules for representatives from national authorities when exercising functions at the EU level”*. On the Member States level, information management in the process of implementing the EU funds projects it has a lot of formal, binding requirements for publicity with a goal of transparency and public awareness on how the financial support is used, thus there is not much evidence if the required publicity was enough to reach citizens.

2.5.2. Political instability

In addition to what has been discussed, in some Eastern Europe countries political parties started to compete over who is more efficient manager and better administrator of the EU funding rather than over the existing content of public policy. Such a competition was intensive in Hungary and Poland, where ex-communist parties began using these claims for their own competitive advantage (Grzymala-Buse and Innes, 2006). Author points that in countries with relatively worse economic and political conditions for reforms which were needed to receive funding from the EU, nationalism and populism has been used as a strategy by competing politicians. It only furthered the opportunities for rent seeking at the cost of efficient distribution of the public goods. According to this study, corruption, trivial disputes between political actors, personal competence and property restitution emerged in the center of country leaders’ attention, whereas the core public policy issues that were important for building up a strong state remained stagnant. Consequently, this kind of practice destabilized electorate’s sense of agency. In addition, persistent battles between political elites had done little to promote stable partisanship or at least increase respect for the government, it rather escalated into further destabilization of region[8].

Talking about analysis of effective use of the EU Funds, last year the European Commission released the report *Cohesion policy: Strategic report 2013 on programme implementation 2007-2013*. It named not only administrational capacity, but also political stability as one of important obstacles in implementing cohesion programs: *“an underlying lack (or even decline) in administrative capacity, <…> changes in legislation, inconsistent political*

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[8] Surprisingly, it was initially assumed that the enlargements of the EU are going to stabilize the Balkan region in the same way as it has stabilized Portugal and Spain. (Kun-Buczko, 2004).

ownership (changes in national and regional government, changes to institutions) and the effects of national sectoral reforms". Additionally, a quantitative study of Italy revealed that political stability was to a great extent related to public institutions ability to contribute to the greater absorption of EU Funds (Milio, 2008). There, lack of political stability demolished coherent coordination needed for long-term planning and implementation of EU Funds programmes.

Some other studies show that at the national level, institutional factors are related not only to the stability and professionalism of public institutions, but the structure of political system (federal versus central) as well (Zaman and Georgescu, 2009, Bähr, 2008). This might also explain why even in countries (or regions) with similarly developed institutions, absorption rates are not the same.

Summing up, although scholars are considering why institutional factors are important for better absorption of aid, there is still no cross-country study estimating the extent to which quality of public institutions can foster absorption of the EU Funds. It is very important gap in the literature of European Regional and Cohesion aid issues which needs to be filled, also by taking into account other explanatory variables such as political stability and structure of the political system.

2.5.3. Convergence or divergence?

In addition to what has been discussed, public institutions had to develop many new features in order to receive and absorb EU Funds more efficiently, including training new staff, developing management systems. At the national level EU assistance pushed for many changes and expanded investment possibilities and economic development the way it would not be possible without the EU aid. The weighted coefficient of variation of regional GDP per capita has increased in most EU countries during the last decade, but despite that regional inequalities also have increased since introduction of the EU Funds. Inequalities are measured at the NUTS[9] II or the NUTS III level, and show a decreasing trend (Petrakos, 2012).

[9] A *Nomenclature of Territorial Units for Statistics* (NUTS) is instrumental tool used in the European Union's Structural Fund delivery mechanisms http://epp.eurostat.ec.europa.eu/portal/page/portal/nuts_nomenclature/introduction

Additionally, income levels variation between EU regions seems to be also increasing at the European scale. *"Although in terms of GDP per capita the top 10 European NUTS II regions have improved their comparative position, during the same period European bottom10 regions have faced a relative decline. Progress is made at both ends of the European scale, yet success is more obvious in the leading regions, rather than in the less developed ones"* (Petrakos, 2012). This result could be explained by various causes. According to Petrakos (2012), one of the reasons (but not the only one) is that regional policies are not only designed, but also implemented badly and this is mostly caused by *centralized and space-blind delivery system* in regions, which is limiting the ability to correctly respond to regional problems. Researcher emphasizes that cases of policy failure, where the identification and prioritization of regional goals and needs, the proposed policies and their implementation have been altogether inappropriate, are quite common. Those badly designed and implemented regional policies is a chronic problem that is usually not related to the available resources level, but rather to the *management mechanisms* and *planning cultures* that dominate in different places. According to this study, problem is even more serious in constantly underperforming regions, where traditional policy prescriptions usually do not work. Hence, those *regions in which policies are more problematic to implement are also the ones that need positive changes in their development the most.* One can also remember here that there is a direct causality between the uneven development of EU regions and low absorption of EU funding.

This short overview of increased inequalities highlights the need for better understanding of what have caused them, despite the fact that so much effort and budget of the EU has been vastly spent on regional cohesion. Overall, there are different views on the EU Regional and Cohesion policies both in the EU reports and academic literature. Summing up the examples of the institutional problems (arguably) raising from the EU funded projects, it is important to emphasize that EU funding absorbed by the Member States is ***not the only reason*** for the higher or lower institutional quality within the EU countries. This study does not have the intention nor to claim so, neither to test if EU funding is the only reason contributing to the problems mentioned. The evidence collected has rather raised the question to which extent institutional quality is capable of fostering the level of EU Funds absorption. Likewise, it feels necessary to see if EU Funds, all of which are absorbed via EU co-financed projects, in turn might have not only positive, but also negative impact for the institutional quality within the Member States, as then it may not only be problematic to efficiently use funding, but also lead to further increase of inequalities between more advanced and lagging regions of EU.

These two questions go hand in hand in exploring the twofold relationship between quality of public institutions and the absorption of EU Funds assistance, as the overall picture of this complex relationship would not be complete if one of the questions was left unanswered. By presenting research on these matters, this study will also bring implications for further strategy of EU funding and will leave space for discussion if EU should continue providing aid the same way, or maybe even do something else to enhance the prosperity levels in the Member States.

3. Research design

As it was already stated, the aim of this paper is not to evaluate the effectiveness of the EU regional and cohesion policy, but rather *to understand the relationship between the absorption of EU Funds assistance and the quality of public institutions*. To undercover this complex relationship, this research aims to answer two questions:

***<u>Question 1:</u>* To what extent does institutional quality matter for the absorption of EU Funds support?**

Institutional quality → EU Funds absorption

Answering the first question requires measuring the size of effect by analyzing concrete data and numbers. Therefore, a quantitative approach is chosen, namely conducting *multivariate OLS regression on EU level*, which exactly measures to what extent public institutions' quality can foster absorption of EU Funds aid.

***<u>Question 2:</u>* What impact does EU Funds assistance absorbed possibly have on the quality of public institutions?**

EU Funds absorbed → Institutional quality

The second question is descriptive and trying to undercover the possible effects EU funding absorbed (via EU co-financed projects) has for the institutional quality, and here the qualitative approach is chosen, namely *conducting informant interviews in one of EU Member States, Lithuania*. Data for analysis is drawn from *interviews with experts who work/have been working with EU funded projects and their procurement from several sectors*, and bringing their experience into the light.

Justification of the choice of different methods

One can misunderstand why different methods are used to answer each of the research questions raised. Before describing the methods in detail, it is therefore important to justify the idea of applying both quantitative and qualitative approach in the same study.

To begin with, the goal of this study, which is *to understand the twofold relationship between EU Funds aid absorption and the quality of public institutions*, is reached by answering two research questions that were stated before. These questions require variant approaches in order to make fruitful analysis and draw reasonable results. For instance, to fully answer the second question, regression analysis would not bring similar results as it does for the first question. Unfortunately, it would be almost impossible to apply any methods/techniques of the quantitative approach for the second question due to lack of data on every Member State, and especially on variables of EU funds assistance that could be influential. The only way to still do it without changing the method would have been to analyze a public procurement database of a chosen country as Fazekas et al (2013) did, what would require in the first place building up the database from raw data files using data-mining techniques and special crawler algorithms. This would be exceeding time given for this paper, even though I have contacted the European Commission on this matter and received raw data files[10] on at least Lithuanian public procurement under bigger EU funded projects. Nevertheless, it seemed beyond the scope of this study to work with such data, and actually the approach of analyzing EU Funds impact on public institution via public procurement data still would not bring people's experience from the field into the daylight. In fact, it may also have high risk to be misleading due to the long standing traditions and shades of public procurement regardless the existence of EU Funds. It is however recommendable track for future research on the topic. Consequently, only qualitative approach is a way to move forward to answering the second research question by capturing experts' experience and providing lively analysis of it; but to have a stronger focus and not exceed time and space given for thesis, only one country (Lithuania) was chosen for analysis.

As choosing a certain method is a matter of research question, it was decided to take a risk of changing the methods to have a complete picture of the relationship analyzed and reach the goal of the study. ***However, both approaches chosen are different only in style, not in quality.*** Likewise, the benefit of combining two methods is that paper represents findings from both data analysis and experts' experience, making this study a unique conjunction of qualitative and quantitative research and hence showing a complete picture of the topic.

[10] Containing more than 43.000 public procurement contracts and approximately 16 variables on each of them, and being raw data with strong need to review each case before working with it.

4. To what extent does institutional quality matter for the absorption of EU Funds aid?

4.1. Method

Literature discussed in 2.4. part suggests that institutional quality along with macroeconomic and financial factors have an impact on EU funds absorption capacity. There were also intriguing yet small quantitative studies represented, showing that political stability and political system sometimes plays a role in public institutions readiness and capacity to contribute to more effective use of EU funding (p.18-19). Still, there is no cross-country study on this matter. Accordingly, this part is meant ***to estimate to what extent quality of public institutions matter for the EU funds absorption*** *(namely, the EU funds received in proportion to EU funds allocated)*. Following this idea, there are two hypotheses:

H1. ***Quality of public institutions has a significant effect on EU Funds absorption rates in the EU Member States***

H0. ***Quality of public institutions doesn't have any significant effect on EU Funds absorption rates in the EU Member States***

To perform analysis, a method that works the best at explaining phenomenon given these hypotheses and problem's formulation is needed. As there is data on every EU country's institutional quality, EU Funds absorption rates and similar variables, the multivariate OLS regression method will be applied on EU (cross-country) level. The scope of data is 27 EU Member States *(Croatia, being the 28th Member State is not included because it entered the EU only in 2013)*, taking into account the 2007-2013 funding period. As there is data on EU Funds absorption rates only for the overall period, it is unfortunately not possible to conduct a time-series analysis.

To be more precise about the chosen method, regression analysis is a statistical tool widely used for exploring relations between set of variables, therefore it is expected to be suitable here the best. Likewise, OLS *(Ordinary Least Squares)* multivariate regression is a technique allowing additional variables to enter the analysis and estimate effect of each (Tabachnick and

Fidell, 2001). A chosen regression model is multivariate, as level of EU Funds absorption may have more than one cause. Typically, the OLS technique produces easily interpretable results from both small and big data sets. The *multivariate OLS regression* method is chosen due to its' capability of exactly measuring the impact of institutional quality on the absorption rates whilst producing quantitative information for analysis, to answer the first research question.

Nevertheless, this method needs to be applied with cautiousness, as there are several pitfalls on a way. First of all, the method is very sensitive to outliers and can perform very badly if they are not identified. Indeed, the problem of outliers haunts not only the OLS regression, but also other types, both linear and non-linear regressions (Tabachnick and Fidell, 2001). Another important thing is that many relationships between variables are non-linear, whereas this method is mainly applicable for linear relationships. There are more matters of concern, such as wrong choice of variables, multicollinearity and similar issues, that need to be checked before analyzing results.

4.2. Operationalization of variables

Based on the hypotheses raised in order to ***estimate to what extent quality of public institutions matter for the EU funds absorption***, the following variables were chosen.

4.2.1. Dependent variable

The overall percentage of funds allocated per Member State paid by the Commission (the so-called ***funds absorption rate***) is chosen as a dependent variable for analysis.

$$\textbf{\textit{Absorption rate}} = \frac{\text{amount of money received}}{\text{amount of money allocated}} * 100\%$$

Variable is expressed in the percentage from 1 to 100%, where 45.2 % (Romanian rate) is the lowest and 84.5 % (Estonian) is the highest rate. European Commission updates absorption rates every quarter and the newest update was released on 15/04/2014, representing the overall 2007-2013 funding period. Unfortunately, it is not a time-series data, but rather an overall rate for all the 2007-2013 programming period. The variable is recoded to scale from 1 to 10 instead of 1 to 100.

Undoubtedly, as an alternative path one could possibly use the data on *amount of budget received in proportion to the GDP of country or size of government budget*, yet the variable *funds absorption rate* is more suitable here for two reasons. Firstly, it automatically includes macroeconomic and financial measures in the proportion, as allocated budget is decided on considering these aspects given that they are essential for measuring countries' development needs and tracing the progress later on. Secondly, the *amount of budget received* would not be able to have a link to the effectiveness of public administration to draft and implement projects in any other proportion than to the funding allocated, whereas the absorption rate does. Additionally, it is the absorbed funding, and not the allocated one, which is in need to be analyzed, what makes a link to the second part of this study more logical (as the effect of the EU funding actually absorbed is representing public institutions' capacity to draft and implement EU-funded projects, managers of which are later interviewed). It would also make no sense to use the *amount of allocations* instead of *absorption rates* variable as it is not be money that country got but the money that were available for the given country to use, hence it is unpredictable in advance to know how much of the planned money country would use.

One could be willing to check here if the greater budget reaches countries with the lowest QoG rates, to see if institutional quality factor is taken into consideration when planning EU Funds allocations. Nevertheless, if we remember Dijkstra (2012), who found that low QoG is not limited to the less economically developed countries of the EU, as some countries with a relatively high GDP per head still score low on several of the dimensions of QoG, and given that EU Funds aid goes more intensively to the less developed EU countries with GDP per capita less than 75 % of EU average, this approach becomes not theoretically convincing for further analysis. Moreover, both research questions of this thesis are strongly focused on the implementation and management of EU Funds' investments, not just the budget planning level.

4.2.2. Explanatory variables

Independent variable 1: ***Public institutions*** score from the World Economic Forum Global Competitiveness Report (2012) dataset. As public institutions are a key management body of EU Funds and many of EU-funded projects, the public institutions quality score is chosen as an independent variable. It captures the *public institutions quality* instead of a broader concept the *quality of government*, and it is chosen intentionally. Institutional quality is a bit more narrow concept and having closer relationship with EU Funds management, as there are many public, semi-public and even private institutions involved in EU funded projects, which not necessary are country's government bodies. However the concepts are very close as discussed in the theoretical part.

Score is expressed from 1 to 7, 1 being the lowest quality of institutions. The Global Competitiveness Report portraits various aspects of country's economic environment and potential to achieve proper prosperity and growth. Economic Forum Global Competitiveness Index for ***Public institutions*** part is determined by: 1.02 *Intellectual property protection* 1.03 *Diversion of public funds* 1.04 *Public trust in politicians* 1.05 *Irregular payments* 1.06 *Judicial* 1.07 *Favoritism in decisions of government officials* 1.08 *Wastefulness of government spending* 1.09 *Burden of government regulation* 1.10 *Efficiency of legal framework in settling disputes* 1.11 *Efficiency of legal framework in challenging regs*1.12 *Transparency of government policymaking* 1.13 *Gov't services for improved business performance.* The World Economic Forum data is collected from international organizations, national sources and its own annual Executive Opinion Survey. This variable is believed to capture aspects of public institutions efficiency important for effective management of EU funding.

Independent variable 2: ***Political stability*** (from World Bank World Governance Indicators project, 2012). The project reports aggregate and individual governance indicators for 215 economies over the 1996–2012 period for six dimensions of governance. This variable is added as an additional independent one, because there is some literature suggesting that political stability also matters for better absorption of EU Funds *(see p.18).* Of course, the first independent variable is still the only one essential for answering the research question, but it was decided to not exclude possibility of other variables being more significant in explaining the dependent variable. ***Political Stability*** combines several indicators which measure perceptions of the likelihood that the government in power will be destabilized or overthrown by possibly unconstitutional and/or violent means, including domestic violence and terrorism. Variable is expressed in ranges from -2.5 (weak) to 2.5 (strong). To proceed, this variable is recoded to scale from 1 to 5. One could argue that in EU context destabilization of government by unconstitutional means is not very common. Indeed, it would have been more convincing to use a variable capturing for example a consistency of the political ownership, but there is no such variable available. However, there definitely is variation in the chosen variable if one compares data from 2007 and 2012:

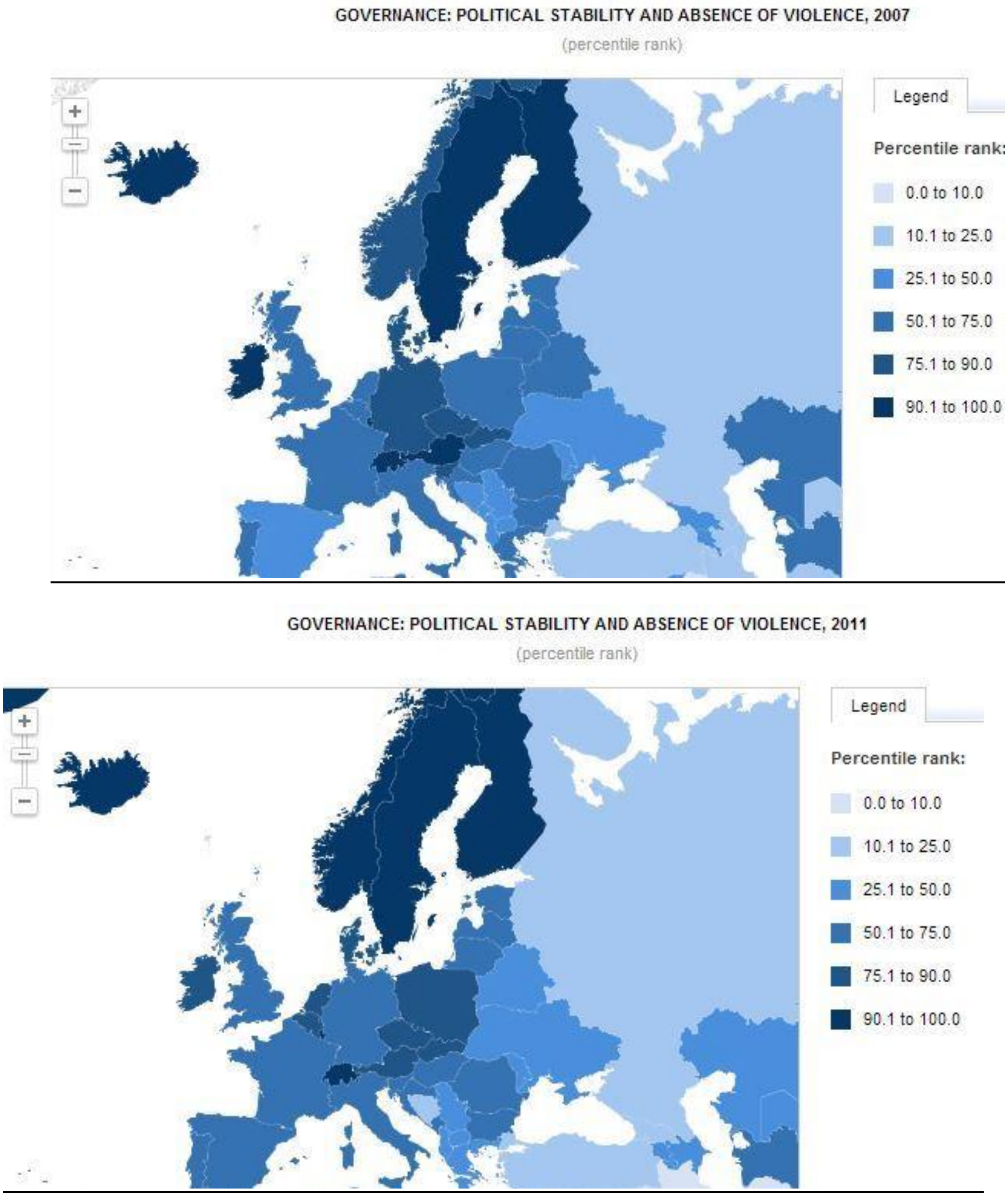

Illustration 2. *Political stability in Europe: 2007 compared to 2012*

Control variable: ***Structure of political system*** (federal or not), from QoG standard dataset, where 1=federal, 0=other. This variable is chosen as a control one according to sources stating that federal versus central structure of political system also matters for absorption of EU funds *(see p.19).*

4.3. Analysis and results

Frequency distribution. To begin with, a frequency distribution of the dependent variable was checked. In a normal distribution both skewedness and kurtosis values are 0. Kurtosis value (-0,33) of the dependent variable is just slightly below 0 (if it was more negative one could indicate that a distribution is relatively flat, meaning that there are too many cases in the extremes). According to the histogram *(see Annex 1),* frequency distribution is just slightly skewed to the left, however almost perfectly bell-shaped, therefore the variable is not log-transformed.

Normality. While running regressions, residuals against the predicted values (using standardized predicted values (ZPRED) on the X axis and standardized residuals (ZRESID) in a plot on the Y axis) were considered. It showed that any of the OLS-regression assumptions are violated, because there was no clear or systematic pattern to residuals. Also, none of standardized residual values exceed 3.3 or is less than -3.3 in the scatterplots, meaning that there were no outlying residuals. Additionally, the Mahalanobis distances check did not show any leverage problems. The Normal Probability Plot indicated no major deviations from normality as well, since all points lied in a reasonably straight line *(see Annex 1).* Considering these results, there were no unusual cases concerning the output.

Outliers. Since multiple regressions are very sensitive to outliers, check of every variable revealed no extreme outliers. As a case, countries having the highest absorption rate or the lowest absorption rate do not differ a lot from the remaining cluster of scores (*see Annex 1*), therefore they were not a matter of concern. Hence, those countries that are very good in absorbing EU Funds and the ones where absorption is considerably low are an interesting source for case studies, especially counties that are able to receive most of the funding despite the low institutional capacity, such as Greece, Portugal or Lithuania.

Multicollinearity. To check the presence of multicollinearity, the tolerance and VIF scores were checked. As we see, the variance inflation factor value is not above 5, and tolerance value is not below .20, therefore we have not violated the multicollinearity assumption. Moreover, correlations between DV and IVs do not show any problem (no correlations above 0.8, and strength of the relationships are only very weak, weak or moderate), *see Annex 1*.

Regression results. Regressions are conducted in a sequential order and results are put results to the regression table, starting with the bivariate regression results followed by more elaborative models. Information about the incepts/constants, the standard errors, the amount of explained variance (R2), including the number of cases and significance measures.

Table 2. OLS regressions.

The effect of public institutions quality on the absorption of EU funds

DV: EU funds absorption (1-10)	Model 1 (bivariate)	Model 2 (two IVs)	Model 3 (three IVs)
Public institutions (1-7)	.59**	.53*	.56*
	(.20)	(.22)	(.23)
Political stability (1-5)		.28	.27
		(.40)	(.42)
Control variable			
Presence of federal system (0-1)			.90
			(.51)
Constant	4.10***	3.35*	3.38*
	(.92)	(1.41)	(1.46)
R square	.26	.27	.27
N	27	27	27

*p<.05, **p<.01, ***p<.001. Standard errors within parentheses.

Evaluation of the model and analysis of the results. To begin with, each of the Model 1 explains 26 % and each of the Models 2 and 3 explains 27 % *(R square*100)* of the variance in absorption of EU funds. There is a statistical significance at .01 level of F value in Model 1. Also, in Model 1, the predicted value of Y (value at which the fitted line crosses the Y axis) is equal to 4.10, compared to 3.35 and 3.38 in Model 2 and 3 respectively. From the Beta value in Model 3 we see that *quality of public institutions makes the strongest unique contribution to explaining the absorption of EU funds* (Beta=0.46, while only 0.1 and 0.03 for the other two variables). Thus, only coefficients of public institutions variable reach statistically significant unique contributions to the equations. On the contrary, any other variable does not show it. Most importantly, we can see that ***each additional increase in quality of public institutions raise absorption of EU funds by 0.59 in the scale.*** Here, high values of DfBetas and Standardised DfFit were checked and did not indicate any extreme cases (biased coefficients).

According to the Part correlation coefficients we see how much of the total variance in absorption of EU funds is uniquely explained by each independent variable and by how much R squared would drop if it wasn't included in the model. In Model 2, *public institutions quality uniquely explains 17.3 % (0,416* 0.416*100) of the variance in total EU funds absorption rates, and 16.9 % (0.412*0,412*100) in Model 3.*

As it was only the *Model 1* showing significant results, the following regression variables plot illustrates the relationship between the absorption of EU funding and the quality of public institutions, considering 2007-2013 programming period.

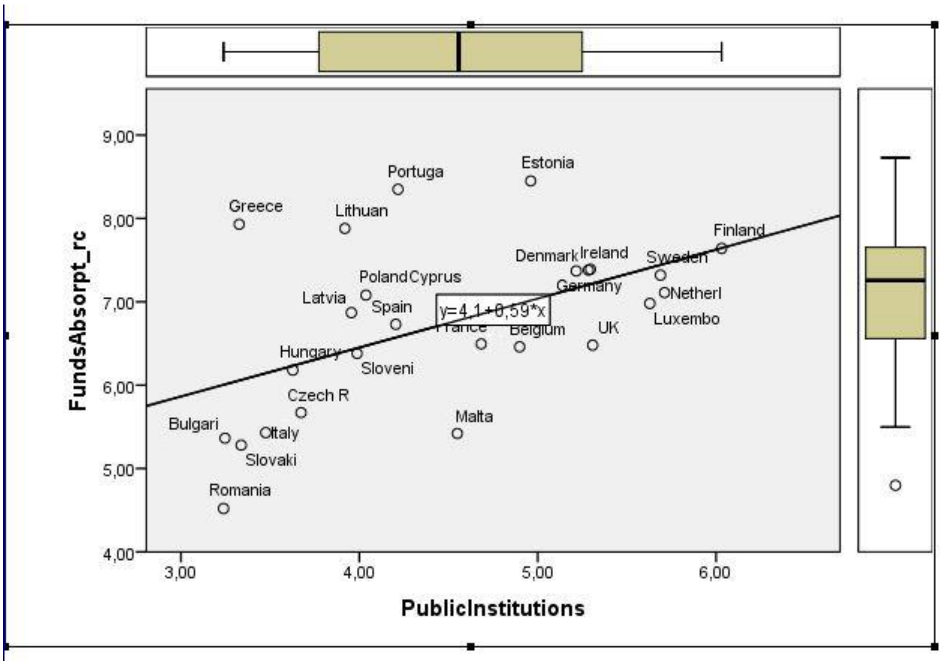

Illustration 3. Regression variables plot *(Model 1)*

Interaction term. The results of the OLS-regression, especially Model 2 which did not support the idea raised in theory that political stability also can explain absorption of the EU funds, raised a suspicion of indirect causal relationship, namely that political stability might have an impact on the relation between public institutions and absorption rates. To check this, an interaction term was introduced.

Table 3. *The effect of political stability on the relation between public institutions and EU funds absorption*

DV: EU funds absorption rates (1-10)	Model 1 (bivariate)	Model 2 (with an interaction term)
Public institutions (1-7)	.59**	.79
	(.20)	(.49)
Public Institutions*Political stability		.06
		(.49)
Political stability (1-5)		-.29
		(2.10)
Constant	4.10***	3.64
	(.92)	(1.96)
R square	.26	.29
N	27	27

*p<.05, **p<.01, ***p<.001. Standard errors within parentheses.

Evaluating the model. Firstly, we see that Model 1 and 2 explains 26 % and 27 % respectively (R square*100), of the variance in absorption of EU funds. However, in a small sample like this it is better to check the adjusted R square instead of normal R square (which can overestimate the true value if a sample is rather small, according to Tabachnick and Fidell, 2001). Then, we see that 23 % and 20 % is explained by model 1 and model 2 respectively.

Analysis of the results. The included interaction term did not make an expected change in the results of the second model in comparison to the first model. We can see that the values of public institutions coefficients increased, but lost statistical significance when interaction term was introduced. Indeed, there is no significant difference in the effect of public institutions quality on absorption of EU funds between more and less politically stable countries. The interaction term does not make a statistically significant unique contribution to the prediction of EU funds absorption and we can say the same about the political stability variable.

Summing up, a null hypothesis was denied and, most importantly, concrete result was reached, namely that ***quality of public institutions reaches statistical significance and makes the strongest unique contribution to explaining the absorption of EU funds, and each additional increase in quality of public institutions raise absorption of EU funds by 0.59 in the scale, given absorption rates on the overall 2007-2013 assistance period.***

5. *What impact does EU Funds assistance absorbed possibly have on the quality of public institutions?*

On the other hand, it is clear that the relationship between EU regional and cohesion aid ,absorbed via the EU co-funded projects, and quality of institutions is twofold, meaning that not only public institutions affect the absorption of the EU Funds, but EU Funds absorbed can also have various effects on institutions, as discussed in part 2.5. Accordingly, the effect can be positive, negative or neutral, but also it can vary depending on a sector to which EU Funds are transferred. However, only one study has gone deeper to analyze this relationship and found negative effect in some of the less developed EU Member States (Eastern and Central Europe): a quantitative research analyzing a large-scale public procurement database by Fazekas et al (2013). A study has indicated several factors related to promotion of institutionalized grand corruption in chosen countries. Since this is the most recent research which produced convincing results, it was decided to conduct informant interviews using factors indicated by Fazekas et al (2013) as some of the variables.

Considering data given by European Commission on regional and cohesion funding, there is a possibility to see for what sectors in each country EU Funds were allocated and how much of it was absorbed, but there is not much of the qualitative explanation on the outcomes. More specifically, that data has a limited potential of explaining how exactly the money spent contributed to further development and cohesion, and what other implications did financial assistance have. Indeed, there are many forms of feedback and reports collected by the EU Funds managing agencies, as well as information on media as a part of required publicity of each project, however it is collected from people who have a *direct interest to give as positive feedback as possible*, because no funding can be given for projects proven to be unsuccessful or having bad implications. It is therefore highly important to increase the number of independent research on this topic.

Accordingly, to answer an open question ***what impact does EU financial assistance absorbed possibly have on the quality of public institutions in Europe***, the following approach is chosen.

5.1. Method

I believe that the most appropriate way forward for answering the second research question is a qualitative approach, with help of which it is possible to test theories represented in 2.5. part on this study's empirical data (Hesse-Biber, 2011). To do that, semi-structured interviews with professionals from one of EU Member States who are/have been working with EU-funded projects were conducted. Interviewees are selected from organizations in several sectors *(business and import development, social welfare/education, IT, public relations)* which were participating in public procurement competitions under EU-funded projects, as well as some people working in one of the local institutions managing EU regional and cohesion programmes and projects.

Semi-structured interviews guarantee more flexibility and interaction between expert and interviewer, also act as a reasonable tool for collecting more details and aspects undiscovered in theory yet. Also, it allows interviewees to express their thoughts in a free manner and leves space for explaining the answers. This is highly important considering the sensitivity of the topic. Some interviews were conducted by meeting selected professionals directly, others by *skype* conversation. Results bring both good and bad practice to the daylight and compare experience in different sectors, to fulfil the need for multiple sources of evidence. Interviews helped to fulfill the ambition to generate new theory through research data and to capture findings that reach beyond the previously discussed theory.

Interview questions were designed considering the main indicators of institutionalized grand corruption in public procurement competitions phase of the EU-funded projects (Fazekas et al, 2013). With reference to the discussion held in part 1.4.1, there are three of them: *1) Limiting the set of bidders (in the submission phase);* 2) *Unfairly assessing bidders: (in the assessment phase);* and 3) *Ex-post modifying conditions of performance (in the delivery phase).* Nevertheless, the interview questions are more explicit and additional questions based on theory were introduced naturally from one interview to another, depending on things discussed. This was done also to make discussion more interactive and to understand if aspects of EU funded projects and their public procurement can act as good variables explaining variation in institutional quality. List of questions is to be found in the *Annex 2*.

5.2. Case selection and data

Lithuania is chosen as an area of inquiry due to several factors. First of all, a strong factor motivating to choose this country for analysis is my own professional experience in Lithuania, where I was working as a Projects Manager in a company offering assistance for preparation of project proposals to get EU funding as well as it also participated in public procurement competitions under various projects co-financed by EU. Then, I was directly observing some aspects in the interaction between the EU Funds assistance projects and institutions that I believe need to be captured and analyzed deeper. In addition to that, as a member of Lithuanian Project Management Association (LPVA) I was able to invite interviewees needed more easily.

Despite that, this country catches an eye while analyzing to what extent quality of public institutions matter for the absorption of EU Funds assistance, where together with Greece, Portugal and Estonia it is one of the EU Funds absorption leaders (78,8% rate) while scoring below average on the institutional quality. Also, in the recent report of the Economist on the 10^{th} anniversary of joining the EU Lithuania showed the greatest change in GDP per person compared to all the other countries which joined EU in 2004 as well. It means that there are factors other than institutional quality affecting the absorption of EU Funds and steady growth of GDP per person. Similarly, EU Funds can also have undiscovered angles of impact on the institutional quality, other than it is already captured by Fazekas et al (2013) in some of the Central and Eastern European countries, namely Slovakia, Hungary and Czech Republic.

At the same time, the Lithuanian case *matches the rationale of a typical case* as the chosen case is an example of EU Member State among others and could therefore serve as an example of how EU-funded projects affect the quality of public institutions. One drawback in this case is the *transferability* of these results. Also, the method chosen is itself criticized for its inability to make generalizations as the conclusions are drawn from very limited number of cases (Geddes, 2003), so a larger analysis could be needed in order to apply the analytical findings to other countries foreseen to be similar enough to Lithuania. It is however noteworthy that two of the aid absorption leaders in 2007-2013 were Baltic countries (Lithuania and Estonia), what implies that this case study has a potential of explaining a phenomenon of this region on a given question. Given all that, this case study is expected to be capable to explore possible effects that EU-funded projects have on quality of institutional framework.

Empirical data is drawn from ***9 interviews*** with local (Lithuanian) experts, namely project managers who are/have been working with EU funded projects and have/had duties related to public procurement. Even though ***gender*** is not a factor to take into consideration, it may be interesting to know that there are five woman and four men interviewed. Four of these experts were chosen due to their experience and position held and another five showed interest to participate themselves, after receiving an invitation for interviewees sent by email to all of the LPVA members. Although one of these people (infrastructure project manager) refused to participate in the discussion after receiving preliminary questions, one respondent was recommended by LPVA members. This recommendation is a process we could call a "snow-ball" effect. The following table represents informants' profiles.

Table 4. *Profiles of the interviewees*

Sector of expertise	***Referred to as***	***Profile of the informant (company / activities)***	***Years of expertise***
Business and import development / consultancy			
	A	Project Manager at *Enterprise Lithuania*, business and exports promoting agency in Lithuania, which is sometimes issuing contracts via public procurement. This specialist has been previously working at *Projektų Vadybos Institutas*, a private company supplying various institutions and public organizations, mainly related to education and social welfare.	2.5
	B	A consultant project manager for preparing proposals and administrating EU funded projects at one of the biggest business consultancy firms in Baltics. *Full anonymousness is given to this informant.*	2

Lithuanian Business Support Agency (LVPA)[11]			
	C	*LVPA* - Project Manager for Energy Sector	4
	D	A former Project Manager at *LVPA* who worked with business development projects (such as business management systems installation) and implementing management methods, quality management certification (ISO), also certificating products.	3
IT products and infrastructure			
	E	A Project Manager at Alna Software, company focused on IT projects production and implementation. Around 80% of this firm's clients are government organizations.	4
	F	Computer equipment and maintenance, electronic systems manufacture and development firm, majority of which clients are public institutions as well. *For this respondent full anonymity was guaranteed, therefore company name again is known only for researcher.*	7
Social welfare / education			
	G	A freelance project manager, who has previously worked at *Projektų Vadybos Institutas*, a company which was mentioned by one of the previous experts.	3.5
	H	A Project Manager at IT company which is not implementing EU-funded projects, but specialist has previous experience in educational sector projects funded by EU, namely a private college *Vilniaus Kooperacijos Kolegija* (3 years) and in IT sector projects supported from EU Funds (1 year).	4

[11] one of the agencies disbursing EU Funds in Lithuania For the scheme of EU Funds administrating institutions in Lithuania, visit http://www.esparama.lt/administravimo-sistema

Public relations			
	I	A Project Manager at public relations and strategic communications firm *BVRG Burson-Marsteller*	7

Experience of specialists varied from 2 to 7 years. One could argue that less than 5 years of expertise is arguably little. Nevertheless, even after two years of experience in a field one already has an understanding of the processes happening, as well as witnesses the "rules of work", yet is still critical and conscious enough as not soaked into the treadmill, so speaking about details of work does not become uncomfortable yet. It felt exactly this way when talking to younger professionals, whereas the older ones were a bit more apathetic, more worried about interview's anonymousness due to the placement they have, and not willing to share details about the "underground waters" until full anonymousness was guaranteed.

Length of the interviews was 40 minutes on average, shortest being approximately 25 minutes and the longest one exceeding 1.5 hour. Four of the interviews were done via *skype video conference* (as interviewees' and my location differed: most of the people were in Lithuania, one in United States, and I was in Sweden) and these discussions were recorded by special software with possibility to store files in mp3 format for later transcription. Another five were held by meeting experts "tête-à-tête" in Lithuanian capital Vilnius, and taking notes. As both I and interviewees had Lithuanian as a mother tongue, ***language*** of all the interviews was Lithuanian. It has minimized the possibility of misunderstandings due to language barrier, however I had to translate every word to English what was in risk of misinterpretation. As soon as possible interviews were transcribed in order to capture all the impressions that might fade away if time between interview and transcription is too long. Also, only one interview was transcribed at once, to remain concentrated and be able to find insights and make comparisons on points discussed in the previous interviews. This helped for analysis to flow more smoothly as well.

Unfortunately, semi-structured interviews never guarantee full honesty of participants, but for collecting facts and capturing unique experience from the field it is still a reliable approach. It also felt different interviewing people who held the same position for more than 5 years compared to people talking about the workplaces they already left. These seemed to be less afraid to talk about sensitive aspects of this topic and have less direct personal interest of giving non-truthful answers; by guaranteeing full anonymousness for some of informants this problem was reduced. Additional factor encouraging people to speak openly about sensitive aspects was their willingness to contribute to possible change by this independent research, to add publicity for the rooted practice in the field and just to speak up and express their thoughts based on experience in the field.

5.3. Analysis and Results

As there were specialists from several different sectors interviewed, analysis of questions has a comparative manner where possible. In order to begin interviews and proceed to discussion, some general questions were asked about expert's perception of EU Funds projects; later more elaborative questions followed, that were meant to discuss the possible impacts on institutional qualities, and also to discuss the aspects of EU supported projects public procurement. Specialists are often quoted here to improve the reliability of findings.

How would you describe your general opinion about EU-funded projects in Lithuania? What evidence do you have for that?

Asked to express opinion about EU Funded projects respondents were convinced that they were and are very beneficial to Lithuania, hence some experts critically pointed that even though ES funded projects do their job, money lacks being spent efficiently. Views on this question were very similar regardless the sector, it was only the examples that varied.

For instance, (G) noticed that ***intellectual property*** in Lithuania increased as there were many projects to develop teachers´ and other professionals´ competence. As it was said by (B), business market has grown, *"More consultants, more suppliers, automatically more business development and more workplaces."* Likewise, experts interviewed discussed increased requirements for ***implementing new management methods***, standards such as ISO in organizations, also attention to impact for environment. "*Institutions such as Ministry of Environment ask for certain certificates related to* **good environment practice***, to reduce harm for environment." (F).*

Other respondents talked about ***economic benefits*** of these projects as well: *"One simple thing is that EU funded projects helped Lithuania to stand on its own feet."* Same was noticed in IT sector and infrastructure: *"Lithuanian budget itself would not be able to invest in development of IT and other infrastructure so well".* (E)

Nevertheless, there were more critical views expressed by (F): *"EU funded projects bring benefit only until organizations think about the future while spending money. But around 80% of them in Lithuania don't do that, and here is where the problem comes from".* This comment was given talking about public procurement of firm´s clients that are public organizations. Accordingly, we could say that some institutions ***lack strategies ahead and orientation to future***, what requires more critical assessment from institutions involved in EU Funds administration, as they are meant to guide behavior of individuals and organizations working on EU funded projects.

There were also more global aspects of EU assistance discussed by (D): *"<…>EU funded projects initiate changes. They create an impulse to act, to do something new, to search for new solutions. The drawback is that there still are organizations and companies that just want to get and then* **diverse funds** *without any focus on product."* Then, respondent pointed to some problems causing this, namely that such a behavior is a matter of people's mentality, which I not easy to change just as other ***collective action*** problems. Expert concluded that having more strict *"rules of the game"* and control of institutions indeed does a slow, but constant positive change in Lithuania.

Generally, respondents agreed that EU funded projects have ***high control which minimizes lawlessness***, however some experts were more skeptical on this matter and spoke about some specific problems they noticed: *"Talking about back sides… That is a fact that forms of* ***corruption exist*** *within EU Funded projects. It is like a public secret: everyone knows it. And it exists in all EU."* (G) Corruption is a sign of impartiality which is essential determinant of institutional quality. Therefore, it is very important to undercover if there are more impacts of such a kind on institutions, and if it is somehow related to EU assistance. This leads us to analysis of the next question.

Have you ever thought of/noticed any effects EU-funded projects have for the institutional framework in a country? *Examples: corruption, organized crime, or maybe on the contrary: better development of institutions in order to be able to manage EU funded projects, other positive/negative experience.*
Would you say that some sectors are more prone to be affected this way? Why?

Some specialists firstly made a comparison between public and private institutions development during the years of EU assistance, and the overall manner of working. Based on experience of (D): *"Business and its' institutions have faster reaction and adaptability to changes <...> whereas in Ministries and other public institutions there are still many problems with responsibility. <...> Search for responsible ones takes time and this is a problem that there are no exact people assigned to take the final decision."*

On an institutional level some respondents did not notice big development due to practice of ***outsourcing external specialists*** for projects: *"<...>There were many institutions and public organizations that had nice and smooth projects implementation, but did not develop themselves. For example "Education Development Center", I wouldn't say that there were new competences developed at this public organization, <...> there were many external freelance specialists employed to deal with projects and they were gone after a certain project was over, leaving institution with the same level of development as before."*(G).

Same specialist also made comparisons between the size of projects. "*I can guarantee 100 % that the bigger the budget and the greater support for the projects the more secret deals there are between organization and suppliers. It is like a public secret. <...> But the projects I worked with are not that big and therefore I think they are not prone to be affected that way." (G)* This was interesting enough to hear, considering that director of the company where this specialist worked was going to unofficial meetings and ***paying the bribes to win public procurement competitions***, according to interview with his ex-colleague, informant (A).

Although it was the majority of respondents who felt that the greater the budget for a projects, the higher the risk of funds diversion, (H) expressed different view on that*: "Even with small projects under 30 000 euros corruption exist, I have seen and witnessed it myself. But in the bigger projects, were money is even more seductive, situation is even more intense."*

Nevertheless, the majority of specialists pointed to ***building and infrastructure sectors*** that may have more "underground waters" while working with EU contributions. An expert (B) who worked as a consultant interested only to win the administration of EU funded projects and preparation of analytical parts, but also helped with some preparation for public procurement, has witnessed interesting processes: *"In building projects <...> they want someone specific to win, who could build cheaper than it is stated in the documents, as budgets are huge; and to divide the rest of money between themselves. <...> I have witnessed the project owner calling to some supplier and willing to meet in another town as it was risky to speak about it by phone."* The collision of public and private organizations in networks based on favoritism is known as ***legal corruption*** (Kaufman and Vicente, 2005), leading to appropriation of public power for private gain in a ways that do necessary obey the official legislations. Example given was illustrating the presence of such a practice in Lithuania.

Another example on building sector was given by (C). *"We go to an object which is has already been built. We see that there are many mistakes done by builder. But it is Technical Supervision that is responsible for that. And we, seeing those mistakes cannot do anything: neither to deny the certificate, nor apply penalties then. We can only inform the Ministry of Environment about someone doing a bad quality work, the Ministry who actually also cannot do anything",* indicating limited power of legal framework to punish companies for low quality of outcomes.

In addition to these aspects, there was a link between how much of the project is co-financed and diversion of funds identified. As a case of the point, (B) said: *"When 100 % is financed by EU it is like a dessert for some organizations. The cases of cheating that I have seen is in first of all* ***infrastructure****, and secondly when the percentage of EU support is greater, namely 90 % and more.* ***And so consequently it happens mostly in public sector, as I haven't seen that business getting more than 60 % support."*** Expert specified that business development projects as the ones co-financed from LVPA *(Lithuanian Business Support Agency)* administrated EU Funds usually receive 50% assistance and another half is covered by a project owner, so then there is less motivation for project owner and supplier agree to increase prices without logical explanation, as it automatically increases the part project owner has to co-finance. Interestingly enough, the only specialist who refused to participate in interview after reading the preliminary questions was the one from infrastructure sector.

There was an expert (C) interviewed from LVPA as well, who confirmed that greater assistance is reducing responsibility for efficiency of spending money and likewise increasing the rent seeking activities in public and semi-public organizations. There was also another example given related to building sector. *"Those cases when almost 100% funding is given, if we talk about renovation, energy sector, make changes in market. There is not such a big motivation to find the most effective offer, as it will however be covered. Prices are made greater by suppliers, some pre-agreements and other games occur. Usually it is* ***still perfect on the paper and hard to proof any deflections****. Whereas those who have for example* ***50 % funding are more eager to find better price and performance combination, more oriented to quality.***" (C)

To support the link found under this question of the interview, namely between greater funding and motivation to diverse funds, number of recent studies indicate that any integration is not a space neutral process leading to Pareto efficient outcomes as it may lead to a serious relocation of resources, wealth and income (Cuadro-Roura and Parellada, 2002; Puga, 2002; Barrios and Strobl, 2005; Kallioras and Petrakos, 2010; Petrakos et al. 2012). As an illustration from one of the crisis-smitten countries, a senior Greek official in Brussels pointed to the controversial effect of the EU structural funds in Greece, even before the crisis: *"The best thing the EU could do for Greece is to cut off the structural funds immediately; anybody who works hard at a regular business is regarded as an idiot, since it's much easier to set up a project to draw in European subsidies".* (The Economist, 2003). Similar point was also made by (G): *"I am sure that when money comes not from the government's pocket, it is* ***more "tasty money" then, especially for the big whales of business.****"*

To make it more clear, there is some evidence that the EU support for projects encouraged public and private environment to concentrate on activities which possibly are in a higher risk of legal corruption. Taking into account the examples experts in Lithuania shared, it gets not that easy to argue that the more projects the EU support, the more it contributes to reaching social and economic development and cohesion. Hence, the main focus of this research part is to find more links between EU assistance and institutional quality in Member States, and so far there were not enough explicit examples on the impact on institutional environment discussed. Therefore, we move to the more specific questions.

From your experience, do EU-funded projects have positive, negative or none effect on these features of public and private institutions: impartiality / credibility / adaptability / transparency / efficiency of legal framework and the bureaucracy ?

Asked about these features, respondents´ opinion divided into two poles and answers varied to a large extent, not depending on sectors:

1) One part agreed that financial support such as from EU Funds can push for mostly *positive changes* in public institutions.
2) Another part argued that these features were *not affected* during the years of EU Funds assistance.

Concluding discussions supporting the first opinion, respondents were very explicit explaining positive effects of EU support on public institutions. Many experts have witnessed institutional development, told that public sector is in a positive track due to more control and a need to improve its management and strategies. For instance, it was claimed that ***bureaucratic burden increased***, but together with it bureaucratic apparatus also started developing due to great workload and lessons from the past mistakes, also as discussions on what could be better solution, how to minimize the burden appeared.

According to (D)**,** there is a high working tempo, great control and innovations in many of institutions administrating EU Funds. **"***Competences of people working really increased as at first there were experts hired who trained us on various aspects of administration and management. So,* ***competences increased*** *and increased a lot. I believe that if not EU funding there wouldn't be for example boost of Lean Management culture. <…> That Lithuania is one of the leaders of EU funds absorption can be partly related to* ***greater control****, but there was also big rapidity and concentration what improved the competences of everyone involved."*

Expert (H) also added, *"Institutions really had developed new features in order to coordinate projects more successfully, for example* ***new management systems were possible to implement****",* giving examples of advanced document management, accounting systems and databases. Informant (B) believed that these factors initiate constant positive changes what can be interpreted as a reasonable effect on institutions' ***adaptability***, and that it is more significant than possible disadvantages, as there always is some drawback together with things that help to develop.

Another important aspect discussed was ***transparency***. Respondents claimed that there are more ***initiatives to increase transparency of public sector,*** but it is still far from a perfect condition. Although it was argued that not only the EU co-financed projects and the control of EU institutions was a factor motivating improvement, but also because new generation of Lithuanians has a different mindset than the ones who grew up under communist regime of Soviet Union.

Yet another case of the point expressed by interviewees was that additional control ***removes some of the partiality due to more checking and requirements,*** as EU co-financed projects are under a greater attention of authorities**.** As it was stated by (D)*, "From institutional side, the* ***effect on impartiality only increased****."* It was claimed by many specialists that effects on impartiality and credibility varies, depending on organizational culture of people working in institutions.

On the contrary, views of another group of experts were much more skeptical, arguing that even though the number of projects and control on many levels has increased, but it left institutional features untouched: *"There were many projects for ministries and agencies, <...> municipalities and other institutions started rethinking their strategies, needs <...> more analysis of possible investments <...>* ***But impartiality or similar things… It did not decrease or increase."*** (ideas supported by C, F, H, I and D). Experts pointed to some examples such as that there was more financial support for people with disabilities, elderly, orphans, other sensitive social groups, what helped to decrease inequality and some sorts of imparity in Lithuania, but for ***impartiality of institutions there was no impact noticed.***

Asked about impartiality of institutions in EU funded projects environment, (C) explained that institutions disbursing and administrating EU funding are always impartial, as they do not have any additional interests. "*About Ministries and similar institutions, it is hard to judge... If there are some underground waters, we cannot see them. If there are some agreements between public and private organizations or rent-seeking, we don't know about them. If there are some political decisions, we don't reach any information. <…> Talking about corruption in Lithuania,* ***it didn't decrease or increase,*** *it stayed as it was before EU funded projects.*"

Those who pointed that institutions did not change too much at all had the same opinion even when interview turned into questions related to corruption. For instance, (D) commented: *"I would think that there was* ***no effect of EU funded projects on a general corruption*** *and similar issues. But I saw some possible favoritism, namely when public organizations had to choose suppliers."*

Overall, there were only positive or none impact on institutional quality discussed. However, (C) raised an important detail about possibly adverse effect: "***EU projects can be increasing corruption, but only those projects where organizations are issuing contracts via public procurement."*** Expert explained that it is due to the public procurement legislations with many flaws and gaps which are very hard to control. It was stated that sometimes it is really visible that there are certain agreements between organization and suppliers, but in the documents one cannot find any evidence, as everything is made legally right. This is again pointing to the presence of ***legal corruption***, which is sometimes impossible to capture referring to existing legislations.

Given that part of the experts noticed no impact on impartiality, credibility, adaptability, transparency, efficiency of legal and bureaucratic framework, and another part found these characteristics improving, one could say that it is rather positive impact of EU assistance on institutional framework in general. However, there was a valuable argument made that public procurement under EU co-financed projects is likely to have a higher risk to effect institutions in a negative way, as for example encouraging legal corruption, thus decreasing impartiality as a main ingredient of institutional quality. This concern was discussed under the next question, based on the main findings of Fazekas et al (2013) in three Eastern European countries.

While preparing public procurement proposals for organizations managing EU-funded projects, have you ever noticed (in the submission phase) that organizations calling for tenders:

a. ***Have modified the call for tenders?***
b. ***Haven't published calls for tenders in an official journal?***
c. ***Were limiting the set of bidders by requirements that are possible to meet only by one company/person in all the country?***

Have you ever seen any forms of unfairly assessing bidders (ex., favoritism for a specific company) in the assessment phase? (If you worked in organization calling for tenders, have bidders tried to contact you offering unofficial meetings, etc.?)

Asked questions related to procurement, none of the experts interviewed have witnessed modification of the call for tenders, pointing to heavy regulations and monitoring. However, less than half of interviewees have noticed organizations or institutions calling for tenders limiting the time for proposals or not publishing calls in official journals. *"With exception of some public procurement methods <...> all calls for tenders need to be published officially, but of course there are magazines and newspapers in which it is hard to find these calls if they are not put to the central public procurement information system (CVPIS)*[12]*. One could hide them actually even in that system.* (G)

Surprisingly, all the respondents claimed to have seen company calling for tenders setting requirements possible to meet by one supplier only, however some emphasized that these cases can be reasonable when very specific product is needed, also may be affected by experience of previously having unfair suppliers. As a case of the point, (F) commented: "*Public organizations learned their lessons from suppliers, who made it through the procurement competition and then provided the lowest quality products from China. Some companies even manage to get proof from those Chinese that products meet the technical specifications even though they do not. <...> After such cases public organizations became more cautious and this is a natural thing that they are willing to work with firms they can trust, and that the service or product is meeting expectations, to not get a cat in a box.*"

Orientation towards quality is the justification of arguable favoritism for specific supplier that was heavily stressed by all the respondents; yet taking actions in favor for a specific supplier is absolutely against the principle of equal and unbiased competition. Still, this practice seems to be rooted in Lithuania, as (B) added: "*I have spoken to many colleagues and they say that it is almost impossible to win any public procurement competitions that are not known in advance, regardless if they are under EU funded projects or not. Usually before procurement calls appear in CVPIS,* ***potential suppliers are informed in advance and sometimes even help to prepare the procurement documents to make it easier to limit the set of bidders****."* According to (B), this practice is the same not depending on EU projects presence, as it is affected by trusting certain firm's service and quality in general. Moreover, (H) claimed to

[12] Central Public Procurement Information System, www.cvpis.lt

have seen companies agreeing in advance about prices: *“It is both the bidders and organizations calling for tenders initiate that, but not necessary within one specific sector.”*

The more heavy practice of favoritism discussed by (B) was bringing attention to governing elite: *“The real bad practice it when for example when there are big projects in municipalities,* ***when interests of municipality board members arise.”*** A unique example of such incentives was given by (A):*“In the competitions by Education Development Centre*[13] *one and the same company was constantly winning, because a person responsible for public procurement there had opened a private company (not on his name officially) and then influenced that company to win.”*

Specialist interviewed was working in that firm and has left a job after realizing machinations that occur there. According to (A), after getting enough experience for the company to be competitive for more projects than from Education Development Centre, many of which were actually co-financed by EU funds, the official quit job at institution. Expert (A) added: “*While working there I saw official* ***director forced to go and unofficially meet people from private organizations and institutions with money in an envelope.****”*

One of the most important aspects pointed by one of the most experienced informant is prooving existence of legal corruption and a trend of high level polititians benefiting from public tendering: *„I cannot say that some institutions are more developed and having different work principles. It is just politics. Our country`s politics. All these procurements arrive directly to politics. Politicians protect some firms. There were many cases when such firms were winning even though they had 7th place in competition, but then suddenly all the others are omitted for some reasons. But what can one do then? To complain that it is unfair? Such things are done* ***legally; in documents you cannot find any unfairness****.”*(F)

Potential favoritism and forms of legal corruption was noticed in public relations sector as well, as (I) told *“I have suspicions of organizations being biased and unfair. There are even discussions in media about some agencies constantly winning for some institutions.”* Additionally, as (H) had experience both in education/social welfare projects and IT, expert

[13] A state educational institution providing support for students, teachers and schools, www.upc.smm.lt

was able to comment on differences between these sectors: *"In IT sector there were same pre-agreements in procurement as in social sector."*

Despite these striking facts, majority of specialists emphasized the limited possibilities to find evidence of institutional and legal corruption, especially of the unfair assessment of bidders in public procurement. *"What is the most annoying is that it is* ***legally impossible*** *to kick such companies away from the procurement as they know their rights and their documents usually are prepared perfectly. There is no obvious evidence of their actions"*, (A) complained. Accordingly, (C) added that sometimes when it is visible from a human perspective that something is being agreed, or that results of projects are not according to the plan, it is nothing that can possibly be done, and not because it is missed from the outlook, but because documents are prepared without any misconduct one could find: *"<...>****Big transgressions are very hard to prove.*** *<…> When some small and unexperienced organizations do mistakes in procurement because of lack of knowledge, we are applying financial corrections to them. They receive less funding than the services that they purchased cost. These are the ones I pity. And these are actually more frequent cases, because* ***those who plan in advance some rent seeking activities, they usually know how to prepare perfect documents.*** *Those who make more mistakes are usually the ones who just have no experience."*

One specialist shared an example of limited responsibility for setting penalties for firms obeying the law. For instance, when institution was informed about certain violations of law, but did not take action to penalize the supplier. (A) was very open about experience in such a case, when institution did not react due to „lack of time", as it was told. *"<...>In the Ministry of Economy, there was an obvious violation in the procedures of public procurement once, but I was told that they don't have time to take care of that."* Expert explained that Ministry was procuring some services and her previous workplace (Projektų Vadybos Institutas, previously discussed for corrupt behavior), was winning the competition. Then it turned out expert's CV was sent by that supplier with ***falsified signatures and without any permission.*** (A)`s friend working in the Ministry noticed it and asked if (A) was working in two companies or as a freelance specialist somewhere. *"Then I have sent two official complaints to this Ministry saying that the bidder that was violating law. That supplier was at least* *rejected in some way; first I was informed that they will put that case forward to their lawyers and finally I was told that they will keep them in mind as an unfair company, that's all.***"**

This brings us back to the Report on EU Integrity System (2014), which indicated similar processes in the high level of EU government, namely that: *"The Commission has discretionary powers to exclude (or 'debar') companies for 'grave professional misconduct', yet only one was excluded for this reason at the time of writing. Moreover, only six entities were debarred for convictions of fraud, corruption, money-laundering or involvement in a criminal organisation, raising questions on how well member states and the Commission are sharing relevant information."* Again, if this practice is present in EU central institutions as well as every country, the fact of being unpunished for obeying the law can motivate further development of transgressions in all levels of public and private sector.

Have you ever faced the ex-post modifying conditions of performance on the delivery phase by organization calling for tenders? *(If you worked in organization implementing EU funded projects, then have you faced that agency managing corresponding EU Funds was modifying conditions of performance on the delivery phase?)*

There were no examples given on public organizations or institutions modifying conditions on the delivery phase. As it was expressed by interviewee (E), in Lithuania is the opposite – to change any details in agreement is nearly impossible, as the project owners are afraid to be penalized by EU Funds managing institutions. This was heavily criticized by (E), giving examples of IT sector projects where there may be certain useful corrections of IT solutions and infrastructure, that supplier could recommend. It is however usually impossible to change any conditions set in the call for public procurement, as everything needs to be implemented without any change. "*Due to very big CPVA control, nobody is willing to get into conflict with institution, so technical specifications are being changed only in veeery rare cases when production according to those specifications is really impossible. <...> Everything became more strict during recent years. Some years ago it was possible to reason and implement some small changes due to better solution, now at least our clients don't risk getting into trouble and arguing with CPVA; the production just follows the description. Now their position is very strict.*" (E)

On one hand this practice can be understood as forced inflexibility of institutions issuing calls for tenders and being not incentive-compactible, but given that public spending needs strict rules to avoid rent seeking, an improvement in control by EU funding disbursing agency witness positive changes.

Discussing this question, (H) was the only one to point to some controversial facts regarding the attitude of one of EU Funds administrating institution. First, expert noticed that Lithuania is one of the top countries with very high EU funds absorption rates which can be consequence of the scheme public organizations issuing contracts via procurement are using for increasing the prices. Then, interviewee explained that while working with structural funds aid and implementation of EU supported projects not only in terms of procurement, and was working a lot with ESFA (European Social Fund Agency); agency was requiring and asking to spend all the money allocated, because absorption of money means that later agency will not have to give the unspent budget back to the EU budget, as well as in the next funding periods country will not have many difficulties to get more money as they are successful in using them. Expert emphasized: *"I believe Lithuanian EU Funds absorption is good really not due to machinations, corruption in public procurement, or at least not due to that only, but also because* ***institutions controlling funds are encouraging and pushing organizations to absorb as much as possible."*** The expert gave an example of educational trainings organized. Under this activity there was some budget left, and then *"college was asked by the agency to organize one more, additional training session to absorb the money that was planned for this project. Neither was it due to corruption nor was it public procurement issues, but due to willingness to absorb more money allocated*."

Asked about similar practice of being encouraged to modify the scope of project spending when less money is spent compared to what was planned in the beginning, other specialists claimed to not have experienced it. (B) commented, that it is absolutely unlikely that similar practice is present in EU funds administrating institutions, as the ones he was in contact with (LPVA, CPVA, NMA) are very strict and usually encouraging to spend money in the most efficient way and even asking to save some if possible, as saved money would still be possible to issue new calls for projects. (B) also described differences between Funds administrating institutions: *"I haven't heard of agencies, at least not from LVPA any encouragements to spend all allocated even though where is nothing else to do with the projects, I would say that at least LVPA and CVPA has a principle of saving money if* *possible, not spending more. <...> If money is saved then Lithuania doesn't lose money, agency just issues calls for new, additional projects."*

Here, there was an example given on how institutions administrating EU Funds may encourage project owners to spend more money and increase absorption. On one hand, it is understandable, as the greater absorption the possible is a goal of every Member State. On the other hand it can serve as an example of increased wastefulness of public money spending, in cases when project goals are reached without spending all budget allocated. Hence, it is arguable if example given about more educational trainings is pointing to it, as additional education as an output did not benefit anyone else than the target group of the projects. There is still more evidence that strict behavior of the majority of EU Funds managing institutions lead to a positive trend of decreasing lawlessness and incentives for rent-seeking in public and private sector. It is however unclear if this and other aspects discussed so far differ compared to projects funded by government itself.

Would you say that (arguable) partiality/legal corruption in public procurement is specifically related to the framework of EU-funded projects, or would it be the same regardless the existence of EU-funded projects?

The goal of the qualitative part of this study is to capture the possible effect of specifically EU funded projects via their procurement nuances, but one has to be cautions and not forget that things as public tendering existed far before EU funded projects came, consequently the EU supported projects' effect can be influenced by the overall trend of "doing business" in a given country. If that was a case, it would be tough to argue that the impact of EU-funded projects discussed with informants is authentically coming from the EU funded projects compared to ordinary projects in a given country.

Here, the majority of respondents claimed there was negative opinion created by media in society, and an impression that only procurement under EU funded projects is related to corrupt behavior or increasing it, whereas it happens as often as from ordinary procurement by public organizations. The only difference identified by majority of informants was only the greater control.

“Comparing projects funded by EU and not funded by EU there are ***more control mechanisms****. It is we, institutions administrating EU funds, also government control watchdogs such as Public Procurement Office. And of course European Auditors Court and similar institutions on EU level. It may not catch all the transgressors, but there is a great attempt to do it.”* (C)

Discussing this question, many pointed to the overall problem of public procurement legislation, its` gaps and flaws, and local government settings. As it was expressed by (H), *“Procurement existed far before EU supported projects started, and then due to their publicity there were more talks and scandals, and people got a vision that corruption and other bad governance practice is only related to those projects, but in reality one has to look to a wider picture, our government is using money in the same, if not even in more unfair ways. <...> Some institutions might have experienced corruption and other forms of impartiality, but most of them tightened themselves up and started working more as they should. I cannot say how was it in other sectors, but in social, competences development sector it was like that.”* Accordingly, the majority of interviewees felt constant positive changes in the Lithuanian institutional setting regardless the EU assistance.

“It is really not the case that with EU funded projects people found new ways to cheat. If the EU support would end there will still be the same problems, just less money for good projects. However ***there is no difference if money came from EU or country’ budget****, the only difference for business is the profit they can have and source of income does not matter.”* (B)

“All we discussed is just an overall trend in public procurement, *in my opinion ES supported projects do not accumulate more of this. They are just put into an ongoing trend.”* (A)

Surprisingly, this view was also expressed by both specialists who had 7 years of experience (one in IT, another in public relations). As stated by (I):*“There is* ***no difference between procurement under EU financed projects and without****, it is absolutely the same process, laws and settings. All procurement is the same.”*

Then, (F) added striking fact based on experience: *"When I started working in IT 15 years ago, there were people running with bags full of money to politicians; same thing is nowadays, just there is more money. It became a usual working method.* ***Firms are changing, but owners are the same.****"* This quote strikingly reminds the beginning of Kaufmann and Vicente (2005) paper on legal corruption, and supports the same view: *"The menus change, the presidents change. What never changes is the dinner guests"*[14]

Discussing this question, (C) was one who have noticed the great difference between projects funded by EU and not, stressing the change of attitude toward project and its budget. "*There is immeasurable difference between projects from EU Funds and from other sources. The essential thing is that when one is buying for own money, there is more interest in maximum benefit. Free money makes no difference. Then, one is also buying, but the price does not hurt and does not make big difference. Should one have renovated the school for a million when the real cost was 800 thousand or 900 thousand Litas, there is no difference for the project owner, because it is not his own money then. And it is a fact that* ***for the EU funded projects law does not change, but the attitude towards project changes."***

Summing up, the majority of informants were convinced that legal corruption and other activities leading to decrease of public institutions' quality are a general problem in Lithuanian institutions, and this practice was just successfully adapted by some EU funded projects owners due to different attitude towards "free money" and accordingly less motivation to be incentive-compactible. There were still significant examples given of positive changes in institutional framework in Lithuania during the recent years, what could also be explained by high EU Funds absorption rates.

[14] According to Kaufnamm and Vicente, it was originally extracted from Luis Moreno Ocampo, "En defensa Propia, Cómo salir de la corrupción", Editorial Sudamericana, 1993

Additional matters of concern

Concluding what has been discussed, all professionals shared thoughts about what is fueling the situation and how it can be changed. They referred mainly to collective action problems that exist in Lithuania, aspects related to social capital, as well as the generation which has been previously raised under communist regime, where involvement in practices lowering the institutional quality was inevitable; it was mentioned by all the respondents.

„The attitude is related to mentality I believe. Many understandings are left from Soviet times, older people still believe that without envelopes they cannot do anything. And I believe thinking of people have to change. New generation has really less of that in their heads."(A)

"Of course, it is moving slowly to a better side, but with old methods, it is a fact that corruption and pre-agreements are present and maybe even a few more generations are needed to change it, to change the overall mindset and attitude of people. So far the old generation is still alive and have raised children in such a setting.<…> If people could be able to change the attitude and understanding about such a things, then the attitude towards all projects and spending would also change." (C)

For improvements, there were suggestions to ***revise the public procurement law***, ***increase transparency and publicity***, also to ***increase the financial burden*** for project owners and minimize the extent of EU co-financing. To illustrate, (C) shared insights regarding possible pushes for change:

"<...>There needs to be **more penalties and more publicity.** *<…>If there was more publicity, I believe people would be more conscious and afraid of being caught. And* ***fear is a thing which could bring more order****, <…>Now, it is* ***too easy to not get caught, too much tolerance for unfair behavior. Not only in public procurement, in all the areas.*** *A lot of publicity with heavy penalties would make also doctors, builders as well as public procurement specialists think before taking a bribe. When we will stop talking and start taking action, we will see changes in the consequences."*

More than half of the experts stressed that if bad practice was more public, making effect on company's or institution's image, potential shame and disgrace could initiate all institutions to think more before taking the high risk. Unfortunately, nowadays even on the central EU institutions level *"**information on debarred companies is not made public**, reducing the potential deterrent effect of 'naming and shaming' offenders".* (EU Integrity System report, 2014)

To make it more clear, many experts pointed to problems within information related to EU funded projects management. Interviewee (A) told that there is a lack of publicity that does not allow to judge if some institutions are doing better than the others *"I don't know much about other institutions, maybe **due to a lack of publicity.** <...> Information is hard to find and usually **barely comprehensible even for professionals**."*

According to (C): *"It is very rare that media would gladly write about projects that have been implemented, about services or products that were purchased cheaper, unless it is a part of required publicity measures for which media is paid."*

It can be partly explained by changes in media market, that were also confirmed by (I): *"It is impossible to get services from media for free. When they see that it is financed by EU you always pay because you need to use EU support logo. To spread the info about nice initiatives for free therefore is impossible."* As a case of the point, Nevinskaite (2009) represented how projects financed by EU structural funds have reinforced the tendency in the local media to expect public institutions and companies to pay for publications instead of relying on ethical relationships with project owners in Lithuania.

These additional findings were extracted by going beyond micro interactions to wider social structures, conditions and consequences and brought attention to problems related to information management of EU funded projects, what have adverse effect on publicity and transparency of public sector.

Looking more specifically to the results of these discussions, many problems identified here point to the accustomed manners based on which public and private sector interact with each other. It is however noteworthy that legal corruption in EU co-financed projects is present and reaching highest government bodies, including politicians and public officials with their incentives to benefit from using their power to support certain firms participating in public procurement competitions; although it was argued that EU funded projects are just disgorged into the ongoing trend of the overall tendencies of the overall public procurement. Thus, there is also a positive perspective on current and future development of public institutions quality drawn by many informants, stressing the changes that higher control of EU Funds projects implementation have already brought, and the changing mindset of citizens. Unfortunately, there is no evidence that these positive changes are strong enough to limit the legal corruption and other processes demolishing quality of public institutions; basically due to flaws in law, lack of publicity and efficient penalties.

Low institutional quality limits the absorptive capacity of EU Funds, thus one can say that institutional quality in Lithuania should have increased during the last years. Hence, there still are many imperfections in general institutional framework that require further considerations and investments. The quality of public institutions in turn implies that there is greater effectiveness of EU funds assistance, which can be successfully translated into further development and cohesion.

6. Concluding discussion

Overall, the results of this study contribute to much deeper understanding of the twofold relationship between absorption of the EU Funds assistance and the quality of public institutions in the Member States.

Using the most recent data, significance of the public institutions quality for greater absorption of EU Funds was estimated, revealing that each additional increase in quality of public institutions was raising absorption of EU funds by 0.59 in the scale. It confirmed that institutional component is a foundation-stone for EU Funds absorption, given the significant influence of public institutions quality variable for the EU Funds absorption in 2007-2013 period, although it is not the only important aspect (as it was noted in theory, macroeconomic and financial factors matter as well). Results of this thesis support previous institutionally oriented research which provided a broad circle of evidence of the importance of institutions for development of recipient countries. Yet in EU perspective it is also noteworthy that only 2.9 billion euros out of 347 billion euros of total funding for Regional and Cohesion policy in 2007-2013 was spent on this important objective[15], which is so important for development of public institutions. How such a self-neglect can be explained is another matter of concern, however the results imply that institutional quality should be given more attention in the process of managing and implementing EU Structural and Cohesion programmes, in order to foster the absorption of EU financial commitments what are meant to bring more convergence to the region.

And further, by answering the second research question impact which EU financial assistance absorbed via EU-supported projects possibly has on the quality of public institutions in Europe was analyzed, bringing diverse examples. With all the respect to the positive influence on institutional quality discussed (less lawlessness, development of new competences and management systems, etc.), there is also evidence found that legal corruption in EU co-financed projects is present and reaching highest government bodies, including politicians and public officials with their incentives to benefit from influencing outcomes of public tendering competitions; although it was argued that EU funded projects are just disgorged into the ongoing trend of the overall tendencies in the public procurement. It is thus arguable if the

[15] http://ec.europa.eu/regional_policy/thefunds/funding/index_en.cfm

positive effects on institutional development discussed are steady and strong enough to be capable of overcoming and limiting the legal corruption and other processes demolishing quality of public institutions in the long term. The main reasons to that being *flaws in law, lack of publicity* and *lack of efficient penalties,* three aspects that are in a strong need to be revised by EU government. Given the aspects discussed in light of second research question, EU should consider tailoring financial support with stronger mechanisms of monitoring, control, penalizing and publicity, all focusing on qualitative assessment of products and services procured under EU co-financed projects. It is also each country's own responsibility to guarantee that the money absorbed do not create an *"EU aid curse"*, but given that in some countries legal corruption and rent seeking is reaching the high level of politics, EU should also act as a more influential watcher. Another track is even to contemplate alternative ways for enhancing the prosperity levels in EU, founded on different policies and approaches.

Certainly, taking into account institutional conditions in every EU Member State and establishing consistent strategy on how institutional quality can be improved is an inevitable element for any development to be successful, especially talking about such extensive programmes as from EU Structural and Cohesion policies.

Bringing focus on the research methods used in this study, there are several directions for the future research. As a first path, similar quantitative study could be more valuable if a time-series data was used for regressions, namely comparing the OLS-regressions results from the funding period 2007-2013 and previous periods, to see how great the change was. Institutional quality variable could also be broken down to separate determinants, to find out which of them are the most significant for the equation. Talking about the qualitative analysis, the results from informant interviews have limited transferability; hence, findings support the previous research on the topic and bring new aspects into the light. One of these is an aspect revealed that business market is also affected by the EU co-financed projects, and it may be that in the long term institutions started to corrode due to the market distortion in the first place. To test and accept or reject this suspicion, a new and deeper analysis would be needed. This thesis also has a potential to encourage further research on the same topic, especially the quantitative research in every Member State, similar to what was already done in Hungary, Czech Republic and Slovakia by Fazekas et al (2013).

Overall results of this study stress that Member States need high quality of public institutions in order to absorb EU Funds more efficiently, thus fostering growth on national levels and real convergence in EU. The challenging task posed by the context of this thesis is for EU authorities to avoid the possible negative implications of EU Funds assistance on quality of public institutions, which can paradoxically lead to the European “aid curse” in Member States, and consequently derangement instead of development. With a fresh start of new EU funding period 2014-2020 and given the growing euroscepticism in the EU, it is essential to revise the management of EU public money, yet changes should first of all start from the central EU institutions’ level.

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Data sources

1. ***EU Funds absorption rates***. Data stands for overall 2007-2013 funding period absorption
http://ec.europa.eu/regional_policy/thefunds/funding/index_en.cfm
[accessed on 01/06/2014]

2. ***Public institutions score*** from the World Economic Forum Global Competitiveness Index, 2012
http://www.weforum.org/issues/competitiveness-0/gci2012-data-platform/
[accessed on 02/01/2014]

3. ***Political stability score*** from the World Bank Worldwide Governance Indicators (WGI) project, 2012 http://info.worldbank.org/governance/wgi/pdf/wgidataset.xlsx
[accessed on 03/01/2014]

4. ***Presence of federalism***: 1=federal, 0=other. QoG Standart dataset, variable "h_f"
http://www.qog.pol.gu.se/data/datadownloads/qogstandarddata/
[accessed on 03/01/2014]

Annexes

Annex 1. Descriptive statistics and diagnostics

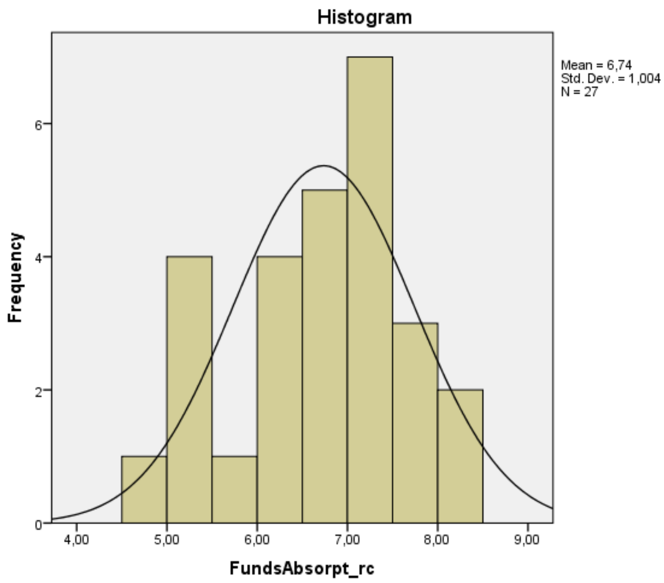
Frequency distribution statistics of the DV: EU Funds absorption, recoded

Statistics

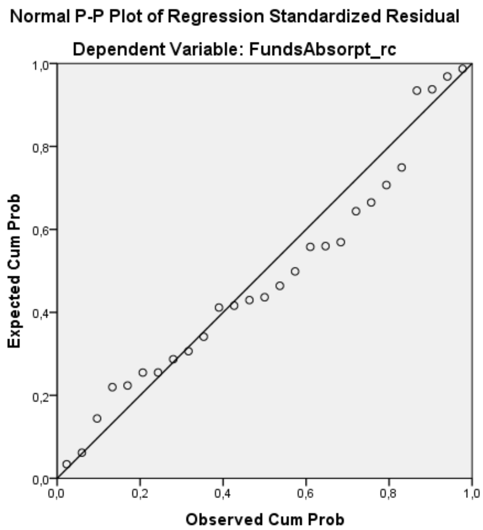
FundsAbsorpt_rc

N	Valid	27
	Missing	0
Mean		6,7359
Std. Error of Mean		,19313
Median		6,9800
Mode		4,52[a]
Std. Deviation		1,00353
Variance		1,007
Skewness		-,418
Std. Error of Skewness		,448
Kurtosis		-,335
Std. Error of Kurtosis		,872
Range		3,93
Minimum		4,52
Maximum		8,45
Sum		181,87

a. Multiple modes exist. The smallest value is shown



Standartized normal probability (P-p) plot



Extreme cases of the DV: EU Funds absorption

			Case Number	Country	Value
FundsAbsorpt_rc	Highest	1	7	Estonia	8,45
		2	21	Portuga	8,35
		3	11	Greece	7,93
		4	16	Lithuan	7,88
		5	8	Finland	7,64
	Lowest	1	22	Romania	4,52
		2	3	Bulgari	5,22
		3	18	Malta	5,24
		4	23	Slovaki	5,28
		5	14	Italy	5,43

Collinearity Statistics.
DV: EU funds absorption rate (1-10)

	Tolerance	VIF
Public Institutions	.801	1.250
Political Stability	.799	1.248
Federal system	.927	1.078

Correlations between DV and IVs

		FundsAbsorpt_rc	PublicInstitutions	PS_rec	Federal0_1
Pearson Correlation	FundsAbsorpt_rc	1,000	,505	,134	,018
	PublicInstitutions	,505	1,000	,568	,149
	PS_rec	,134	,568	1,000	,210
	Federal0_1	,018	,149	,210	1,000
Sig. (1-tailed)	FundsAbsorpt_rc	.	,004	,253	,465
	PublicInstitutions	,004	.	,007	,229
	PS_rec	,253	,007	.	,146
	Federal0_1	,465	,229	,146	.
N	FundsAbsorpt_rc	27	27	27	27
	PublicInstitutions	27	27	27	27
	PS_rec	27	27	27	27
	Federal0_1	27	27	27	27

Annex 2. Interview questions

General part:

1. Your name, age?
2. Name of a company you are working/worked for and its` business sector?
3. Your position held and years of experience with EU-funded projects?
4. How would you describe your general opinion about EU-funded projects in Lithuania? What evidence do you have for that?
5. Have you ever thought of/noticed any effects EU-funded projects have for the institutional framework in a country? *Examples: corruption, organized crime, or maybe on the contrary: better development of institutions in order to be able to manage EU funded projects, other positive/negative experience.*
6. Would you say that some sectors are more prone to be affected this way? Why?
7. From your experience, do EU-funded projects have positive, negative or none effect on these features of public and private institutions: impartiality / credibility / adaptability / transparency / efficiency of legal framework and the bureaucracy?

More specific questions (based on findings of Fazekas et al (2013)):

8. When preparing public procurement proposals for organizations managing EU-funded projects, have you ever noticed (in the submission phase) that organizations calling for tenders:
    a. Haven‘t published calls for tenders in an official journal?
    b. Have modified the call for tenders?
    c. Were limiting the set of bidders by requirements that are possible to meet only by one company/person in all the country?

9. Have you ever seen any forms of unfairly assessing bidders *(ex., favoritism for a specific company)* in the assessment phase? (If you worked in organization calling for tenders, have bidders tried to contact you offering unofficial meetings, etc.?)

10. Have you ever faced the ex-post modifying conditions of performance on the delivery phase by organization calling for tenders? (If you worked in organization implementing EU funded projects, then have you faced that agency managing corresponding EU Funds was modifying conditions of performance on the delivery phase?)

11. Would you say that (arguable) partiality/corruption in public procurement is related specifically to the framework of EU-funded projects, or it would be the same regardless the presence of EU-funded projects?