How the European Union Corrupted Eastern Europe

By Dalibor Rohac

May 26, 2014

Editor's note: The results of the European Union elections are in, and parties opposed to further European integration or the eurozone or the European Union membership full-stop made stunning gains at the expense of the established political forces. One of the more intriguing examples is the Alternative for Germany, a new center-right political party that narrowly missed making it into Germany's Bundestag in the last elections, yet which secured 7 percent of the vote in the E.U. elections held this weekend. The Alternative has been characterized as an "out-of-the-mainstream" party, yet it makes the simple, and obviously sound, claim that Europe's common currency has proven to be a terrible mistake, which has ravaged the economies of the European economy and which has proven a millstone around Germany's neck as well, not least because of the pressure on German taxpayers to contribute to successive rounds of bailouts. Just in time for the results, Perry Anderson has published a survey of the contemporary Italian political scene in the *London Review of Books*, which opens with a denunciation of the European Union. Among other things, Anderson points to the work of the economists Andrea Boltho and Barry Eichengreen to suggest that the economic impact of European integration have been smaller than advertised, and outweighed by the devastation caused by the financial crisis and its aftermath and exacerbated by the rigidities imposed by monetary and fiscal union.

But perhaps this isn't a strong enough case against the European Union for your taste. One of the chief achievements of European integration, or so we've been told, is the consolidation of liberal-democratic norms in Europe, and in particularly in Europe's periphery, including in the new member states of central and eastern Europe. The trouble is that as Jan-Werner Mueller recently argued in *Foreign Affairs*, liberal-democratic norms appear to be collapsing in central and eastern Europe, with Poland standing as a (perhaps fragile) exception. Mueller, being a good liberal, is convinced that if the European Union only been a bit more aggressive about enforcing its rules, and if only western European politicians had been more welcoming towards eastern European migrants, this democratic decay might have been avoided. Mueller is an excellent intellectual historian, but his reading of contemporary European affairs neglects the central importance of political economy. What were the incentives created by membership in the European Union, and how did these incentives shape the political culture of the new member states. Mueller's internationalist orientation leads him to frown upon the fact that electorates in Britain and elsewhere have been skeptical about the wisdom of opening their borders to large numbers of Bulgarian and Romanian migrants, partly because of their experience with the first wave of migration from the new central European member states. Yet is it at least possible that the "escape valve" of migration has reduced the political pressure on eastern European elites to follow a reformist path?

Or, more broadly, might the enormous transfers to the new member states have led to a more corrupt politics in the region? There is a longstanding view, rooted in the rise of the centralized fiscal state in early modern Europe and, more recently, in the rise to affluence and power of states like South Korea, that states often adopt growth-enhancing policies when they've run out of other options, e.g., when they face a formidable military threat and find themselves unable to extract aid, or enough aid, from allied states, thus forcing them to rely on internal resources. (Nicholas Eubank's work on Somaliland offers a distillation of some of this literature.) Yet when states have an easily-accessible resource at their disposal, like point-source natural resources (oil and gas) or government-to-government transfers, they don't necessarily have to adopt growth-enhancing policies, as political elites can take the easy root of just turning on the spigot and skimming off their cut.

Dalibor Rohac, a policy analyst at the Cato Institute, has thought deeply about this question, and when I asked him to write something for The Agenda on the subject, he kindly agreed to do so. If Dalibor is right, the European Union hasn't just failed to prevent the deterioration of liberal-democratic norms in central and eastern Europe. *It has exacerbated the problem.* Dalibor calls this "the curse of European structural funds," and I think he makes a rock-solid case. You'll find his essay below.

***

Thanks to the funding from the European Union (EU), the countries of Eastern Europe are an increasingly attractive destination for cyclists. In the Czech Republic, hundreds of millions of Euros, predominantly from EU's structural funds, have been used to create a network of some 25 thousand miles of cycling trails. In Slovakia's Northern region of Orava, a brand new network of 155 miles of cycling trails set in a picturesque countryside connect the local villages with those in neighboring Poland.

While a boon for cyclists, the inflow of EU money into Eastern Europe is playing a more questionable role in narrowing the gap that new member states in Eastern Europe and the more affluent parts of the EU. Critics of development aid, such as William Easterly of New York University, have long argued that foreign aid directed to badly governed countries in the developing world can worsen corruption and cronyism, and foster authoritarian rule. Although the magnitude of the problem is different, EU funds are exercising a similarly nefarious effect on governance and politics in Eastern Europe.

Between 2014 and 2020, the EU is planning to spend over €350 billion to help narrow the disparities between member states. It does so through several 'funds': the European Regional Development Fund, which is the largest of them and which supports the building of infrastructure and job-creation; the European Social Fund, which purports to help the unemployed and the disadvantaged, mostly by providing training programs; and the Cohesion Fund, which was set up in 1994 to provide funding to the poorest member states.

The inflow of EU money into new member states has been estimated at around 4 percent of their GDP. It is not a free lunch, however. European countries are co-financing the projects and provide the bulk of the administrative support to the program. Slovakia's Institute of Economic and Social Analyses (INESS) estimated in 2011 that each euro coming from EU's structural funds is matched by up to 90 cents coming from the national budget.

The economic effects of such aid are not obvious. Even if one believes that the inflow of funds helps stimulate aggregate demand, "it is unclear whether the EU funds are crowding out or augmenting domestic spending," as an IMF study put it. Crowding out is a serious concern in areas of transport and logistics, where private companies that have been doing profitable business without any government support suddenly face competition from new, EU-funded firms.

Many of the EU-funded projects seem to be of marginal value and are overpriced. With €16 million spent on each mile, the short, just 12-mile Lyulin highway connecting the Bulgarian capital Sofia with the nearby city of Pernik counts as one of the most expensive roads on the continent. The construction of the road – which required digging numerous tunnels because of the inauspicious terrain – was delayed and marked by corruption allegations. At some point, the European Commission temporarily froze the funds because it suspected embezzlement.

Or, as CEE Bankwatch, a public watchdog, reported, in the city of Kolín in the Czech Republic the EU provided support to the reconstruction of a railway bridge in order to facilitate water navigation on the river Elbe. According to the watchdog, "too little water transport is expected to justify the project, construction costs are prohibitively high, and the sole company participating in the tender procedure was awarded the contract."

Last year, Slovakia's Ministry of Social Affairs spent €100 thousand of an EU grant to combat unemployment for the purchases of pens and disposable raincoats. While relatively trivial in size, it seems representative of the waste that has been unearthed by journalists.

The inflow of EU funds into countries with weak institutions does not mean just wasteful spending but also breeds corruption. The impact may be hard to quantify but is very visible. Before joining the EU, Eastern European countries had made significant progress in reducing cronyism and corruption – mainly because of the numerous reforms they had to adopt in order to qualify for EU membership in the first place. After the accession, not only did the progress come to a halt but some measures of corruption actually deteriorated.

Slovakia, for example, ranked 57th on the 2004 edition of Transparency International's Corruption Perception Index. By 2013, it moved down to 61st place. The Czech Republic, in turn, fell from 51st to 57th place. The situation is even worse in Romania and Bulgaria, where checks on corruption and outright theft are weaker. In 2008, the European Commission had to suspend the disbursement of any aid because of the extent of corruption and organized crime that surrounded the inflow of EU funds.

Identifying and proving specific instances of corruption and embezzlement of EU funds is often difficult, yet the anecdotal evidence is telling. According to a report by a group of Eastern

European think tanks, in the Czech Republic, companies with bearer documentary securities – in which ownership is anonymous – tend to be 23-70 percent more profitable than other joint-stock companies. Between 2008-2013, such companies were awarded public procurement contracts worth at least € 5.6 billion, including EU funds. Also, around € 7.3 billion were awarded to companies in jurisdictions with high levels of privacy protection – so-called 'tax havens' – some of which had traceable connections to local politicians.

While Aleš Řebíček was the Czech Minister of Transport from 2006-2009, the construction company Viamont, which he had founded, received over € 500 million from the EU structural funds to improve railway infrastructure around the country. Viamont's shares are anonymous and the Minister did nothing to refute the allegations that he had a stake in the company at the time when the tender was awarded. Similar cases – involving politically connected companies, botched procurement tenders, or sometimes outright fraud – can be found throughout the region.

Eastern European politicians say that they are determined to fight corruption surrounding the disbursement of EU funds. Such statements often strain credulity, as the region has made little progress in improving the mechanisms of control that would be independent of political control. With an inflow of money that can be used for patronage, governing politicians in member states are the biggest beneficiaries of the status quo. That is consistent with the observed degree of politicization of the EU funds. Instead of permanent secretaries, the disbursement funds are typically controlled by political appointees who are replaced after every election.

Cynics say that the status quo also benefits those who advocate tighter forms of European integration. Richard Sulík, former Speaker of Parliament in Slovakia and a vocal euroskeptic, does not mince words. According to him, "[political elites are] being corrupted by the EU funds in order to shut them up and make sure they pass any stupid piece of legislation that comes here from Brussels."

Whether the funds are a plot to buy loyalty to the European project in Eastern Europe or just a well-intentioned but mismanaged program, they do not seem to be working. The funds neither seem to be creating economic prosperity nor are they effective at fostering popular support for the European idea. Public confidence in the EU is at historical lows in many Eastern countries and, throughout the continent, anti-EU populists are expected to make significant gains in the forthcoming European election. Maybe it is time for a rethink.

(Dalibor Rohac is a policy analyst at the Center for Global Liberty and Prosperity at the Cato Institute. He tweets at @daliborrohac.)