

Public Funding and Ensuring Public Project Efficiency: Micro-Economical Perspective of the EU Funds Management Frame in the Republic of Latvia

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Introduction

In the 2014–2020 programming period Latvia will have access to investments from five European Structural and Investment Funds (ESIF) structural policy financing instruments: European regional Development Fund (ERDF) – to use investments in research and innovation, information and communication technologies in order to support development and structural adjustment of economies for purposes of increasing competitiveness of SMEs, Cohesion fund (CF) – in order to promote integration in common market of the EU and to promote application of environmental standards and construction of main transportation infrastructure, European Social Fund (ESF) – for improvement of employment possibilities, strengthening of social integration, decreasing poverty, promoting education opportunities and lifelong learning and developing active, comprehensive and sustainable social integration, EAFRD – to promote agricultural competitiveness, to ensure sustainable management of natural resources and actions in the area of climate policy, as well to achieve a balanced territorial development of rural economies and communities, inter alia by creating and maintaining employment that is competitive, economically viable and sustainable from the social and environmental point of view, as well as facilitating balanced and inclusive territorial development of fishery regions.

Purpose of investments from ESI funds is to strengthen competitiveness of Latvia and to ensure economical, territorial and social cohesion with smart, sustainable and inclusive growth and balanced territorial development based on balanced macroeconomic and fiscal policy. In general the investment strategy of ESI funds is developed so as to ensure concentration of resources and critical mass of investments in order to achieve desired changes in Latvia considering defined needs, which would provide direct contribution to the achievement of objectives of „Europe 2020” strategy and implementation of recommendations of the EU Council (Partnership Agreement for the European Union Investment Funds Programming Period 2014 – 2020, Ministry of Finance, 2014). The ESI investment strategy is based on development areas and challenges set in the Latvian national strategic development plans.

Challenges for the Public Sector

Having grown progressively following the Second World War, the public sector, throughout the world, began, during the early 1970’s, to experience significant pressures for change. A primary focus was ‘reducing expenditures while at the same time improving government operations’ (De Montricher, 1998). According to the OECD (OECD, 1995 p.7), catalysts for change have included:

- need for increased efficiency and cost-effectiveness to control and reduce public spending
- reduction in national differences in public sectors and increasing desire to enhance competitiveness of national economies as a result of globalisation
- rising service quality expectations from individuals and business
- need to respond flexibly and strategically to external changes opportunities offered by new information Technologies

Since the early 1980's, common themes have emerged in the responses by national public sectors to the need for change:

- emphasis on strategic management and planning (Peters and Savoie, 1998 p. 15) efforts to increase service quality and become more responsive through debureaucratisation', allowing initiatives such as integrated service delivery (Rockman, 1998 p. 37; Aucoin, 1998 p. 311-12; 322; Caiden, 1998 p. 265; NSW Premier's Department, 1999)
- increased public consultation in design and execution of policy introduction of performance measurements associated with emphasis on and accountability for results
- attempts to replace the 'tradition of predictability and regularity that was the trademark of old public administration' (Peters and Savoie, 1998 p. 35) with adaptability and flexibility

Public investment – role and importance

Investments can be seen as a bridge between generations, both for creating jobs for the young generation, and for inheriting the fixed assets, which it receives from previous generations. Also, investments are the material support for introducing the technical progress in all sectors of activity, while systematic updating allows maintaining them within the superior performance parameters.

The concept of economic sustainable development means both resource protection in terms of raw materials, and environmental protection and restoration of ecological balance in order to provide equal opportunities to the future generations. Any investment project has an environmental component on which the investment decision will be built (A. Grigorescu, *Management of public sector investment projects*). Public investments are defined as funds allocated by the authorities of the central or local public administration to achieve objectives or works of general interest in a certain administrative unit. Public investments are designed to ensure the development of the society in general, seen as a whole. The effects of the public investments can be found in the social, cultural, health, science, public order, etc. fields.

Public investment funds are limited through budget restrictions, however consuming and exceeding the limits granted in the originally approved budget can be made only by obtaining additional allowances or by redistributing the funds within the budget.

The whole community benefits directly or indirectly by the effects of public investments because they are designed to improve infrastructure, relationships, and services, all of them being available to all citizens.

Due to the complexity, role and importance of the public investment in the economic and social development, the concept has been interpreted in different forms and has acquired different

meanings:

- Economic - investment is all mobilized resources, necessary to complete it, in order to achieve a higher economic performance in the future;
- Financial - investment represents all costs incurred for creating items that will generate additional revenue for a long time in the future and whose depreciation will be made gradually, during the same period of time;
- Accounting - investment consists of all movable and immovable, tangible or intangible assets, acquired or produced to remain in the same form and that participates in several production cycles.

Strategies, represented by the goals of the public projects, are a need for local authorities which have the possibility to implement investment projects based on the following: election programs, making a poll of the public opinion, establishing a long- or short-term thinking, establishing the way forward so that the relationship authority - community can run in the most harmonious manner possible. Public investment projects provide a direct correlation between the fundamental objectives, which take the form of capital expenditure, which in their turn, lead to producing public assets (Peter Philip, *Local public administration management - a practical approach*, 2007).

Although there are differences in administrative and political tradition, the experiences of Ireland and the UK can be useful for other countries in Europe. This note suggests the following recommendations for the EU countries:

- Public investment strategies need to be closely linked to budgets. Strategies need to be periodically reviewed for relevance, including by relying on external experts.
- Capital projects need multi-year funding commitments that cover the duration of the project or the project phase.
- Cost-benefit assessments of competing projects should be the key tool for selecting individual projects to ensure value for money.
- Evaluation of past project experiences should be required and needs to be built into future planning, guidance and regulations. Evaluations could be undertaken by any number of institutions, including ministries of finance.
- Effective audit and reporting processes are needed to facilitate transparency and encourage feedback to improve the quality of the decision making and management process.
- Project planning and management skills need to be enhanced and retained within the civil service.

Management of EU Structural and Investment funds, project oriented approach

The ESIF are jointly managed by the European Commission and the Member States in accordance with the principle of subsidiarity. This principle means that the EU does not take action unless it is more effective than action taken at national, regional or local level. To avail of funding, there are various eligibility criteria:

- Time period: there are limits on the period during which operations and expenditure can take place.
- Scope of intervention: there are restrictions on the types of activities that can be co-

financed.

- Cost categories: certain cost categories are excluded.
- Geographical location of operations: only certain locations are eligible.
- Durability of operations: investments may have to be maintained for a minimum period after the operation is completed.
- Types of beneficiaries: only certain enterprises, bodies or economic actors are eligible for support.

In 2014-2020, Latvia will manage one operational programme for the European Regional Development Fund (ERDF), the Cohesion Fund and the European Social Fund (ESF) under EU Cohesion Policy. For 2014-2020, Latvia has been allocated around € 4.51 billion in total Cohesion Policy funding:

1. € 3.04 billion for less developed regions (the entire country is classified as a less developed region)
2. € 1.35 billion through the Cohesion Fund
3. € 93.6 million for European Territorial Cooperation
4. € 29 million for the Youth Employment Initiative Of this, the ESF will represent a minimum of € 629 million. The actual share will be set in light of the specific challenges the country needs to address in the areas covered by the ESF (Figure 1).

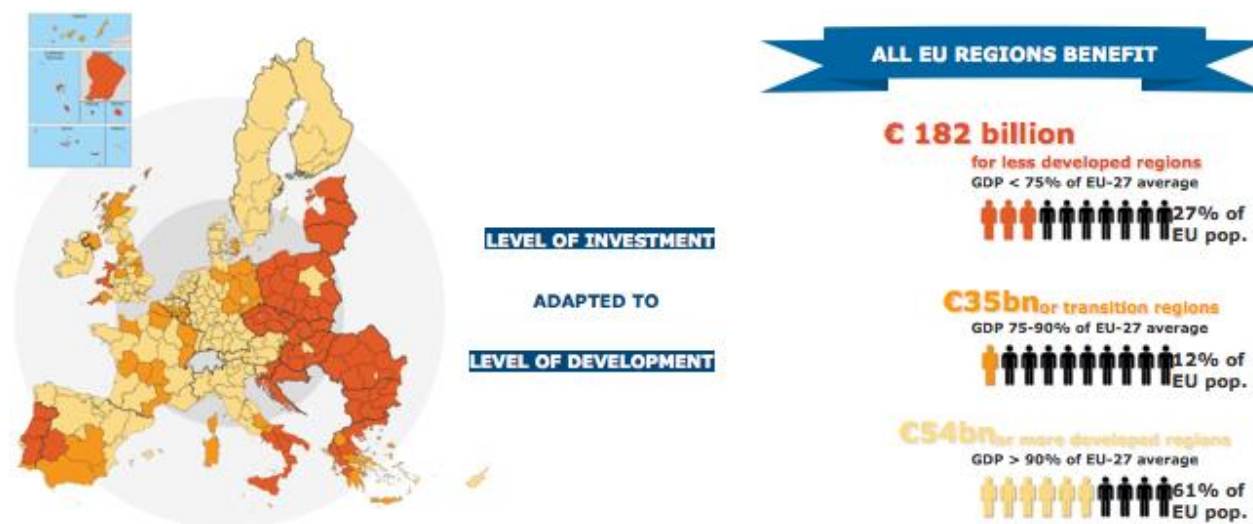


Figure 1. European Structural and Investment Funds

Source: Directorate-General for Regional and Urban Policy, European Commission, 2014

European Union public fund management system in Latvia, lessons learned

The total allocation Cohesion Policy funding for the 2007-2013 period was € 4.6 billion. Since the beginning of the 2007-2013 funding period, amongst other achievements, EU Cohesion Policy investments have produced the following main achievements:

- 1 632 new jobs have been created;
- 123 research projects have been completed;
- 160 companies have successfully put in production new products or technologies;
- 984 projects assisted Latvian companies entering the international trade markets;
- Energy efficiency in 146 residential multi-apartment buildings has been increased;
- 389.1 kilometers of TEN-T roads and 1st class roads have been reconstructed;
- 45 % of secondary school students are benefiting from modernized science classrooms;
- 8 169 people with functional disabilities and 1 597 persons with eyesight or hearing disabilities received improved social rehabilitation services;
- Occupational risk assessment has been performed at 100 000 work places;
- More than 21 000 young people with disabilities or at risk of social exclusion have been attracted to education institutions and/or received support for their studies;
- More than 58 000 young people have been supported during their studies in vocational education institutions;
- More than 16 000 employed people have been trained thus increasing competitiveness of enterprises.

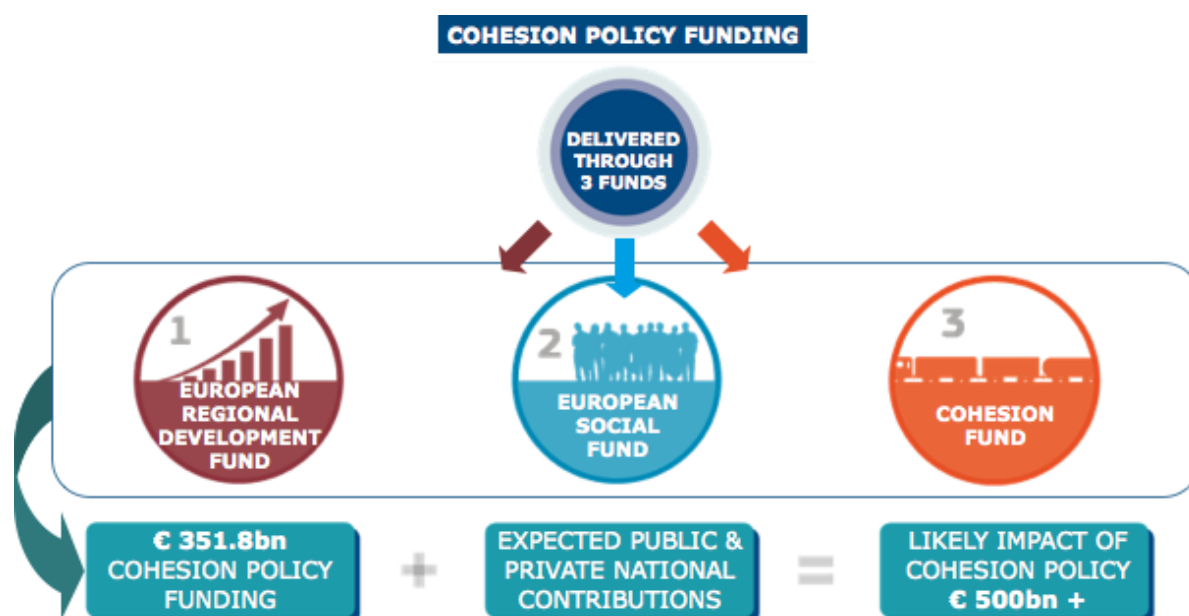


Figure 2. Cohesion policy funding explicit

Source: Directorate-General for Regional and Urban Policy, European Commission, 2014

Investments of ES funds will help to introduce five of EU Council recommendations, which are concerned with long-term and youth unemployment, scope of social services and measures for activation of beneficiaries of social assistance benefits, reforms of higher education and research institutions, energy efficiency and increase of efficiency of judicial system. Implementation of the 3rd Recommendation of the EU Council (regarding reforms of social assistance) will be

based on changes in tax and benefit policy and improvement of social security system (within framework of state budget), as well as expansion of state budget supported approach to childcare services and reimbursement of education costs. ESF support is planned for improvement of professional social work and monitoring of poverty and social exclusion risk and situation. The linking of particular investments for achievement of objectives of „Europe 2020” strategy and implementation of EU Council recommendations is given in descriptions of action programme specific objectives. Considering the analysis of above listed sources, the main challenges hindering the development of Latvia’s competitiveness and economic, social and territorial cohesion within context of ESI funds investment are the following:

- low economic productivity and dissatisfactory achievements in innovation, research and science;
- quality of transportation infrastructure, which is hindering economic development;
- inefficient use of resources;
- high poverty and unemployment rate, especially youth and high long-term unemployment;
- insufficient quality and unconformity of education with the requirements of labour market;
- territorially misbalanced economic development.

On the basis of the above listed factors hindering the development of competitiveness, the following overall priorities of ESI funds development are set in the Partnership agreement (PA):

- increase of economic productivity, value added, quality of innovation, research and science;
- sustainable and efficient transportation infrastructure;
- sustainable use of natural and cultural resources;
- high employment rate in inclusive society;
- high quality and efficiency of education system;
- balanced and sustainable territorial development.

The ESI regulation proposals and the EC position paper emphasize the coordination, complementarity and synergy of the ESI Funds and other EU and other foreign financial instruments. There is a need to have versatile coordination of investments in order to secure that they do not overlap, are complementary and conducive to the achievement of strategy „Europe 2020”, strategy for the Baltic Sea Region and objectives defined by the EC. Development of planning documents for ESI Funds for year 2014–2020 shall be performed on the basis of priorities and objectives set by National Development Plan (NDP) 2020, and implementation instrument thereof shall be state and municipal budget resources, investment of Cohesion Policy and Common Agricultural Policy Funds, and other investment instruments of the EU budget, EU and other foreign financial aid instruments, and private funding.

In addition, to provide the supervision of the NDP 2020 and compliance with coordination principles in respect of ESI Funds and other foreign financial instruments and aid, and integrated territorial development, the managing authority shall establish a partnership agreement Management Team. Within it planning, attraction and supreme level supervision of appropriate financing of activities provided by the PA and being under implementation shall be ensured, providing involvement of ministries of all industries, the State Chancellery, partners of planning

regions and cooperation.

Operational programs of the Cohesion Policy Funds is created by the Monitoring committee (MC), which allows providing coordination of the planned investments by concentrating information regarding all three Cohesion Policy Funds at one spot. In order to ensure administration, more efficient implementation and supervision of priority axis, a Monitoring committee subcommittee shall be established. The objective of the subcommittee/-s shall be to ensure cooperation, exchange of information and involvement of line ministries, planning regions and cooperation partners, in planning of objectives, determining criteria for project applications, drafting of legal acts, implementation and supervision thereof, to ensure timely solution of identified planning and implementation problems, by promoting efficiency. The State aid at the moment of granting thereof shall correspond to the effective state aid procedures and terms, by identifying to which EC document related to the state aid the activities correspond to.

Micro-economical frame of administrative capacity of public institutions implementing EU funded projects

“Mid-term assessment of the implementation efficiency of NSRF priorities, measures and activities of Cohesion policy funds for „2007 – 2013 programming period (2011)” sets forth that the management system of Cohesion policy funds in general successfully ensures carrying out of their implementation, management and monitoring function and provides an opportunity to timely react to changes in external environment and economic situation. The evaluators at the same time point out that the factors which should be taken into consideration when developing management system of ESI funds, are linked to increasing the centralization level, determining the procedures for operative actions of institutions more precisely, centralizing and expanding the use of information system to the beneficiary, and more efficiently coordinating activities carried out in the scope of control function.

Auditing authority in the audit report states – „We recommend to seriously assess the necessity for so decentralized function delegation and involvement of so significant number of establishments in the management of Cohesion policy funds, when performing the changes in the existing management and control system of Cohesion policy funds as well as upon developing management and control system of Cohesion policy funds for the next programming period. We would like to point out that all employees involved in the management of Cohesion policy (CP) funds must maintain appropriate qualification, methodological management and monitoring by MoF as the Central Authority, and we recommend strengthening the role of the Managing Authority in adopting decisions regarding the implementation of the delegated functions.”

Author’s research shows that staff involved in project management processes in public sector in Latvia is well experienced as 61% of respondents has project management experience five and more years. 26% of respondents have been involved in project management for three till five years, which is explained by the available different public funds (such as European Union structural funds, European Economic Zone and Norwegian cooperation programs, Latvian – Swiss cooperation program etc.).

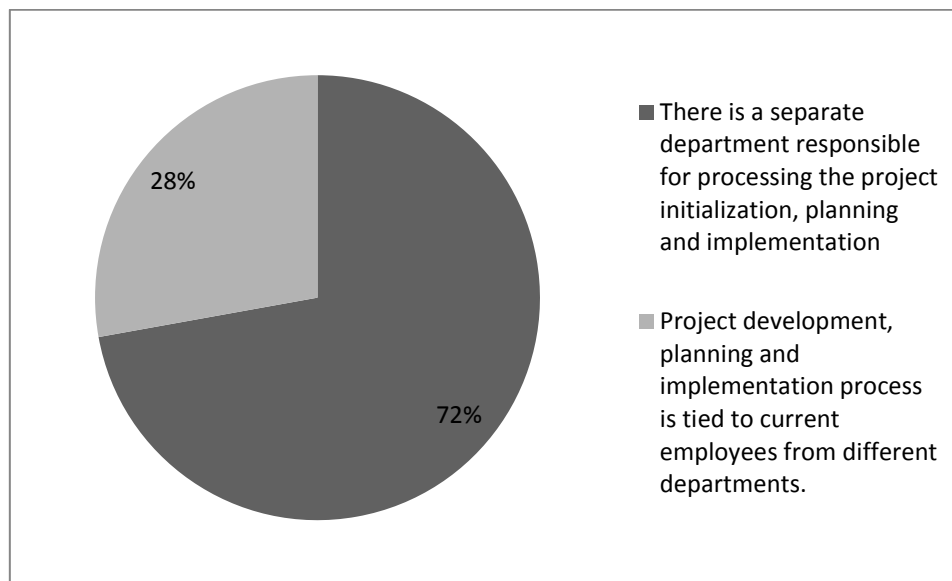


Figure 3. Organizational structures of project management in public sector (n=97)

Source: author's empirical research

In project management practice there can be identified different types of project organizational structures. Research shows that 72% of respondents has pure organizational project management structure or signs of it. Meanwhile 28% of respondents has matrix or mixed project management organizational structure.

Ultimately, project management directors seek organizational methods that facilitate teamwork, can maximize the use of limited resources, efficiency and quality in the way a project is completed and how goals and objectives are achieved. Public sector organizations are often complex with internal and external relationship intertwine with each other and difficult to apprehend.

The rationale of organizational management is to facilitate the application of knowledge, skills, tools and techniques to project activities to meet project requirements in terms of Scope, Cost, Time, Quality, Participant satisfaction.

Organizational strategy is the way in which resources are used in the achievement of a purpose. Strategies are at the same time action plans for laying down instructions for the coordination of resource use through an employment program, projects, policies, procedures and organizational design, as well as the definition of execution standards. Organizational structure is the placing of human resources in the function of the organization. When speaking about project planning, it can be said that plans represent merely good intentions, until they degenerate at the moment they are transformed into hard work (P. Drucker, 1991).

The author evaluated the public sector practice in project development and initialization process. In the frame of research evaluation of project problem and goal definition has been done.

Study shows that in public sector project management there is lack of deep problem and situation analysis. 45.78% of respondents elaborated project proposals based on local municipal

development programs and policy planning documents and don't provide deep analysis of problems. 26.05% of respondents accepted that they don't use situation analysis methods but project proposals are elaborated based on desired situation. Still 28.17% of respondents showed that they used project management methods such as current situation analysis and research, case study methods by clarifying the factual situation and the desired situation.

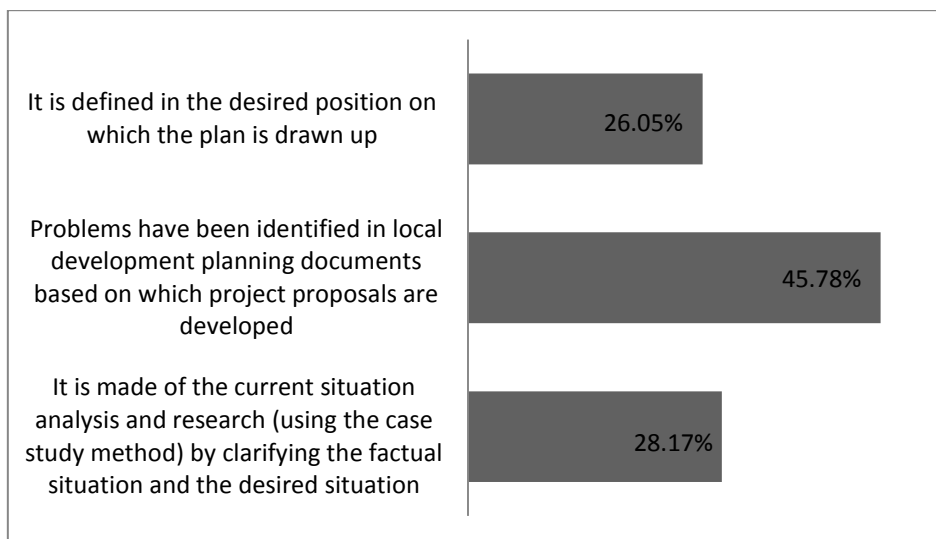


Figure 4. Problem definition practice in public sector in Latvia (n=97)

Source: author empirical research

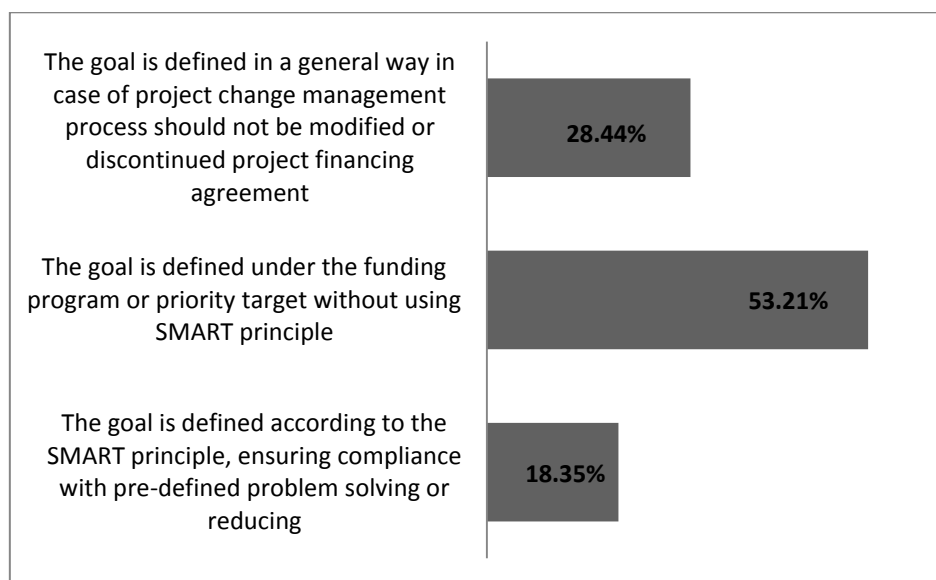


Figure 5. Project goal definition in public sector (n=97)

Source: author's empirical research

Goals and objectives are statements that describe what the project will accomplish, or the business value the project will achieve. The study shows that public sectors not using appropriate goal definition methods and don't use a SMART principles in definition of project

goals (only 18.35% of respondents use SMART method to define their project goal). 53.21% of respondents define their project goals under the funding program or priority target without using SMART principle. Also the 28.44% of respondents define their project goals in a general way to avoid of further changes in project submission or project financing agreement.

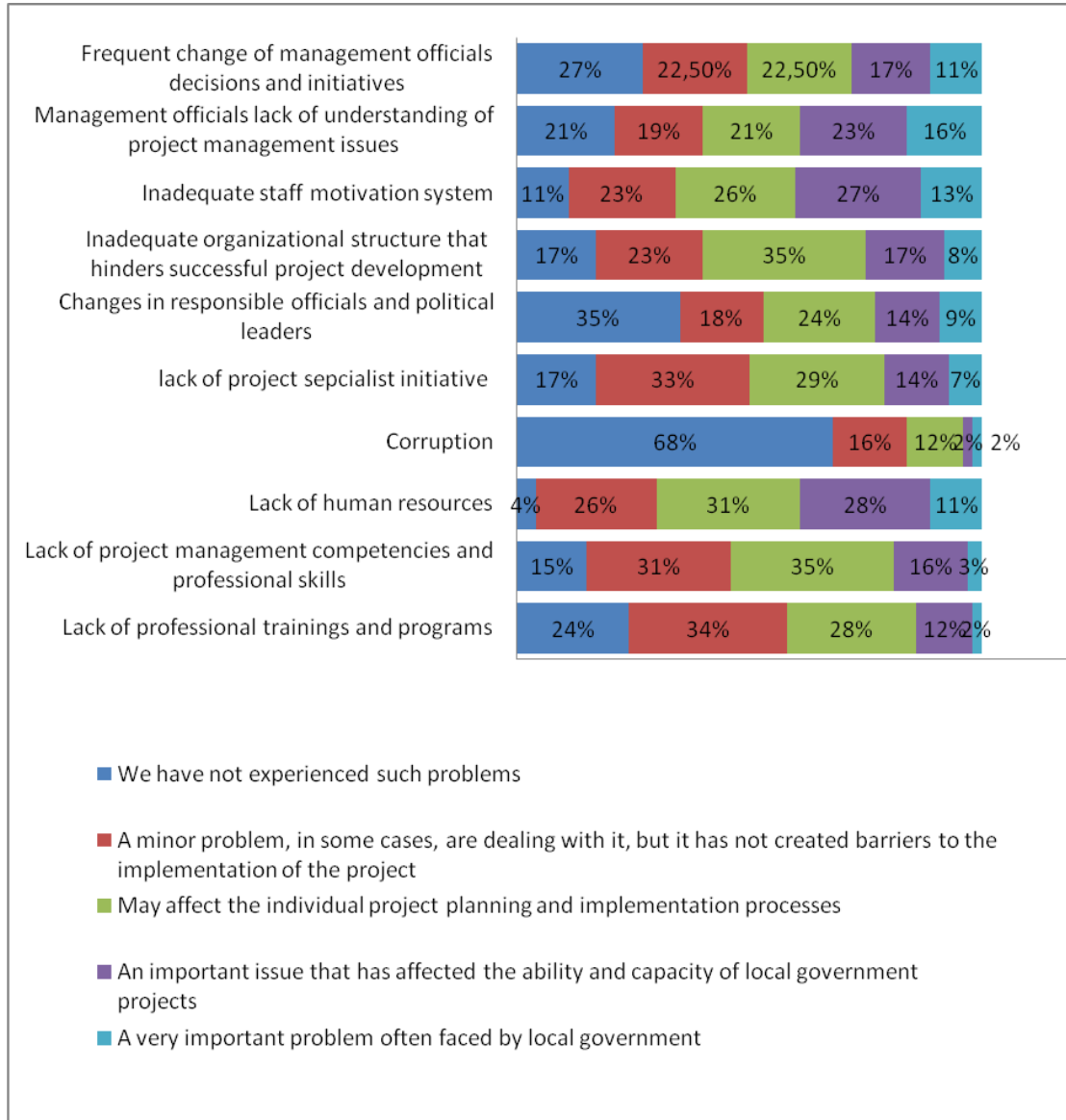


Figure 6. Problem aspects of project definition and initialization in public sector (n= 97)

Source: author’s empirical research

Managing Authority (MA) has prepared guidelines for determining indicators of CP funds and design of performance framework, based on guidance documents prepared by „Directorate-General for Regional Policy” and „Directorate-General Employment, Social Affairs and Inclusion” for monitoring and evaluation. The guidelines establish the main principles for determining the indicators and their objectives, as well as the criteria for the development of performance framework. These guidelines have been developed based on draft implementing act on the arrangements to ensure a consistent for determining milestones and targets in the performance framework.

The basic principles for determining the indicators and development of performance framework provided in these guidelines may be applied also to EAFRD and EMFF. The indicators in respect of EAFRD and EMFF, as well as their values of the intermediate objectives have been determined in cooperation with evaluators. Determining of performance framework targets/indicators is based on the situation in the sector of the national economy of Latvia in general and taking into consideration also the priorities set by Latvia, which must be reached in mid-term, as well as by evaluating the results of the 2007–2013 programming period.

The objective for reduction of administrative burden is to increase the efficiency of implementation of ESI funds and simplify implementation of the projects of Cohesion policy funds for the beneficiary. In order to reduce administrative burden, a combination of such measures will be ensured in the 2014 - 2020 programming period, which might ease the burden for the beneficiaries already from the beginning of the planning stage of the projects, and continuing with their implementation and ensuring sustainability.

A range of significant measures for improvement of management and control system have already been carried out in the scope of the 2007-2013 programming period. The main measures towards streamlining, directed to reduction of administrative burden for the authorities involved in administration of CP funds and beneficiaries:

1. Role of control, supervision and internal audit of the Managing Authority in the system of CP funds is strengthened and national procedure for stopping the declaration of costs in EC is established, ensuring greater assurance to EC about the security of control system in Latvia.
2. Optimized and harmonized practice for carrying out inspections at the locations of project implementation, allowing combining inspection of disbursement orders with inspection at the site of the project implementation.
3. Unified practice in administration of discrepancies and corrections of inadequately performed tasks, for example, unified guidelines were developed for application of corrections for one type of violations.
4. Simplified preparation of the project applications, by developing standard templates, and the accelerated implementation of the projects, reducing the time for signing the agreements and coordination of amendments to the project.
5. A fixed rate for project overheads has been set, thereby eliminating the need for detailed explanation of individual costs and their reporting to the institutions involved in the administration of CP funds, as a result ensuring, easing the administrative burden for the beneficiary and speeding up the receipt of funding.
6. Burdensome requirement is eliminated for the beneficiaries, who implement the projects and have received support for commercial activity to open account with the Treasury for making the project disbursements, thereby reducing the administrative burden for enterprises, creating an opportunity to use the funding more efficiently and receive the advance payment much faster.
7. Accelerated disbursement flow in the projects, by shortening the deadlines for reviewing the disbursement orders.
8. Beneficiary has smaller financial and control burden, by planning for an opportunity to perform random inspections of the disbursement orders, as well as clearly setting requirements in relation to supporting documents of eligible costs. Implementation of all recommendations in relation to reduction of administrative burden could be achieved by raising efficiency of the system implementation of CP funds and simplifying the

implementation of projects of CP funds for the beneficiary.

The main measures which should be implemented in the 2014 – 2020 programming period are as follows:

1. creation of optimized institutional system. An informative report regarding the government and control system for the 2014 -2020 programming period has been developed and approved on 17 December 2013.
2. prevention of function overlapping, i.e. the laws and regulations clearly establish allocation of functions, which excludes the opportunities for interpretation between the Competent Authority and Cooperation Authority in respect of re-division of functions and responsibilities, thereby achieving a more efficient and safer development of implementation system of CP funds and strengthening the management and control system.
3. implementation of e-administration system. A single central IT system will be developed for all institutions involved in the management of CP funds and project applicants/beneficiaries. It is planned that the system will be developed on the base of already functioning CFCA project management information system, by supplementing it with new models pursuant to requirements specified in CPR regulation and identified by the Member State. By the end of 2014, SIS will ensure an opportunity for the project applicants/beneficiaries to submit online the project application, forecasts of the disbursement request, disbursement requests and supporting documents as a digital document, access the archive of documents, electronically exchange the information with a Cooperation Authority of CP funds, and see the updated information on the project status, disbursements, inspection results and findings. In order to reduce the administrative burden for the beneficiary and the circulation of the paper documents between the beneficiary and institutions administrating CP funds, the information submitted by the beneficiary by using the solution of electronic data exchange, will not have to be submitted also in hard copies.
4. implementation of unified standards. Unified practice and principles will be established among the institutions involved in the administration of CP funds, ensuring unified approach to controls and monitoring, reducing the volume of the supporting documents submitted by the beneficiary, developing standard agreement template, etc., thereby facilitating the work of institutions and the beneficiary and reducing the risk of inadequately incurred costs in the projects of CP funds. Unified administrative and compliance evaluation criteria of the project applications will also be set (unified evaluation criteria of the project applications), in order to reduce administrative burden in the process of development and amending the evaluation criteria of the project applications, as well as to facilitate certainty in their application, each selection will have their own specific compliance and quality criteria. To create unified procedure for reviewing the disputed decisions of the Cooperation Authority, and by strengthening the monitoring quality of the execution of functions delegated to Cooperation Authority, a possibility to develop a separate system for appealing of decisions is considered for CP funds.

5. broader application of the simplified costs, in order to avoid the needs of the beneficiaries to account for each spent euro and submit all documents justifying costs to inspectors. An evaluation (has been started in May, 2014), in the scope whereof application experience of the simplified costs in the 2007-2013 programming period and various types of simplified costs in the areas co-financed by EU CO funds will be analysed, and to prepare methodology for the application of a fixed rate for overheads and methodologies for the use of unit costs and lump sum payments based on the evaluation results (indicatively in the beginning of 2015).
6. use of electronic procurement system (EPS) (will be implemented starting the eligibility period).

Conclusions

There are a lot of evaluation and impact assessment of public expenditure and project macro-economic aspects (usually by impact on GDP growth), but there is lack of appropriate analysis of micro-economical level i.e. at the project level and project planning and implementation stage. Micro-economic aspects are important as they could show the efficiency of public expenditures and value of money for project outputs at certain input amount (investments).

Professional project managers in public administration play a crucial role in promoting and explaining the key principles of project and investment appraisal in their organizations, both to encourage long-term decision-making and to manage uncertainty and complexity.

Cohesion and public sector project realization planning represents a project management phase that encompasses goal definition and the determination of ways and measures for achieving the set goals, i.e., that the project is realized in the planned time, at the planned cost. Study shows that self-assessment of public sector organizations in Latvia is quite high. Project management specialists define them self as very experienced in Project management, but meanwhile the self-assessment of organization project maturity (efficiency) levels shows that organizations is only at the beginning of setting up the appropriate Project management system.

Above identified problems could be solved not only by capacity increasing of project management practice in Latvia but also by integrated cohesion policy planning and establishment of project proposal elaboration technical assistance funds such as JASPER. JASPERS targets assistance on major infrastructure projects costing more than €50 million supported by the EU funds – for example, roads, rail, water, waste, energy and urban transport projects. In the case of small countries where there will not be many projects of this size JASPERS concentrates on the largest projects.

Still there is lack of such technical assistance programs at micro level and projects less than €50 million. Such funds could assist institutions to prepare high quality and viable regional/continental infrastructure projects in the energy, water resources management, transport and ICT sectors, which would be ready to solicit financing from public and private sources under cohesion policy.

Such special fund should be designed as a facility with a distinct role in financing of regional/national project preparatory activities, including advisory services, studies, technical assistance, workshops and seminars. Technical assistance would enhance the quality of regional integration projects/programmes prepared by local municipalities:

- a) Targeting the promotion of quality regional integration infrastructure projects and programmes suitable for private and public sector financing;
- b) Providing grants to the local governments and institutions for advancing the preparation of priority regional integration infrastructure projects and programmes with high probability of implementation by the recipient Government/organisations and/or attracting public/private financing;
- c) Promoting ownership and participation in project preparation, required to generate quality projects suitable for public and/or private sector financing;
- d) Ensuring quick access to funds on a demand-driven basis, and quick disbursement of funds approved to respond to the priority investment programmes and cohesion policy;
- e) Supporting the creation of an enabling environment for private participation in infrastructure, as well as supporting targeted capacity building initiatives in infrastructure development related to current or planned physical/investment activities.

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