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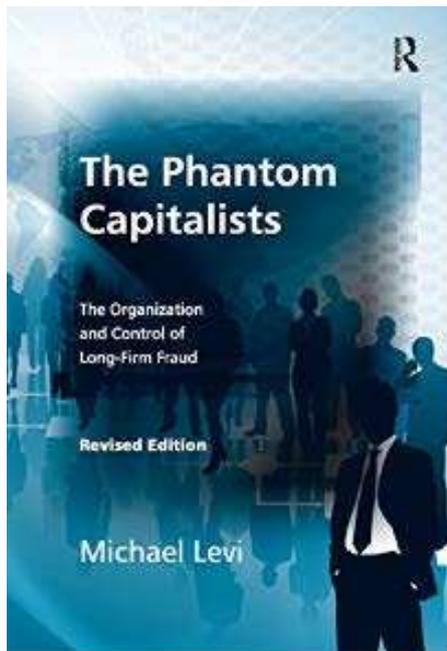
# Fraud and corruption in the EU - the need for a more multi-faceted approach

By Professor Michael Levi, Cardiff University

Do we take fraud as seriously as we should and are all means properly exploited to effectively reduce fraud and corruption? Michael Levi, Professor of Criminology at the School of Social Sciences of Cardiff University, has an international reputation in basic and policy-oriented research on money laundering, corruption, cybercrimes, transnational and white-collar crimes. Below he gives his views on what the focal points in the EU in this policy area are and could be, pleading for a more multi-faceted approach and looking beyond merely criminal investigations.

## Crime prevention and crime reduction

Are there similarities between auditing fraud and the procedures of criminal justice systems? Perhaps an unusual approach to this topic, but let's see in more detail. First, both audits and justice occur at some distance to the commission of crime, if they happen at all. Also, the probability of an audit may be more readily predictable than the interventions of criminal justice, and it tends to occur with more warning (and with different consequences). However, we shall see how useful the analogy is as we go.



In this book, published in 2008, Professor Michael Levi analyzes in detail how and why people become involved in long-firm (planned bankruptcy) fraud, the similarities and differences between long-firm fraud and other crimes, the links between bankruptcy fraudsters and other professional and organized criminals, the techniques that fraudsters use, and the social and commercial relationships that exist within the operational world of the long-firm fraudster, and how these have evolved historically.

Research – including fraud surveys by auditors and professional services firms - shows that external audit is an uncommon way by which corporate fraud is detected. But such observations neglect the counterfactual: what would the level of fraud be if there was no audit at all. We might think about this by conducting a thought experiment about what would happen if the audit function was totally corrupted or absent. Or, by looking around for countries where fraud and corruption are allegedly systemic on a national, regional and/or sectoral basis. Admittedly, this is an extreme way of thinking about the issues, since usually, what we are interested in are issues such as 'more or less audit' or 'more or less policing and prosecution.' The British phrase 'crime reduction' captures the pragmatic spirit of managing crime down better than the more absolutist and binary 'crime prevention:' a corruption or fraud-free society is implausible or would be likely to have far too high a cost in controls.

### **Objectives in fighting corruption and fraud?**

In the particular case of fraud and corruption, it also may matter what type of crime is committed by what status of offender. Looking at recent anti-corruption demonstrations in some EU Member States such as Romania and Slovakia, the perception – true or false – that elites are getting away with it needs to be addressed in its own terms, and is not likely to be mollified easily by official data about the number of frauds prosecuted or the amount of corruption prevented.

Indeed, those of us who believe in a rational world need to confront the ‘fake news’ mindset that resists what we might consider to be ‘authoritative data,’ whether on corruption or on more easily tested phenomena such as violent crime. This ties into a central issue of what our objectives are in the range of control mechanisms. Are they solely about plugging gaps in the control system, about financial savings targets (which tend to be quite complicated to measure but are possible with a basket of indicators), or is there some other objective such as enhancing the legitimacy of the European Union in the eyes of citizens by demonstrating that expenditure is properly controlled and – more difficult to test – is achieving the objects intended.

If it is legitimacy we are aiming for, what evidence are we using or ought to be using to assess the extent of ‘success.’ These lie outside the normal audit processes and are properly in the province of social sciences, including potentially the use of the Eurobarometer to illuminate public and sub-group perspectives, as used in cybercrime research<sup>1</sup>.

### **Perceptions of fraud and organised crime: social stereotypes play a role**

One of the paradoxical issues in how we view fraud and corruption is that they are often seen as separate issues from organised crime or even from each other. Most corruption involves false accounting, yet those who look at crime statistics on corruption seldom consider this overlap (which might require access to detailed case files to test). Since money laundering legislation applies to the proceeds of any crime, how do we differentiate the laundering of organized crime from other criminal activities, which include procurement fraud, tax evasion and grand corruption – all of which can sometimes involve committing ‘organized crime’ offences.

For example, the funnelling of billions of dollars stolen from the Malaysian sovereign wealth fund in the global 1MDB scandal (some of which, ironically, was used to fund the well-received fraud movie *Wolf of Wall Street*) was well organized. It is simply that the principal people involved – allegedly the Malaysian Prime Minister and his entourage, on trial there in April 2019, plus senior former Goldman Sachs staff - would not be viewed (at least then) by many respectable elites or by many police as ‘organized crime actors.’

We might extend this boundary problem to the ‘diesel-gate’ falsification of emissions, by the Volkswagen (VW) Group and other car makers. Arguably, this involved several actors planning how to commit crimes and get away with them over a long period of time for the pursuit of profit and power: criteria that meet the UN Transnational Organized Crime Convention 2000. Yet notwithstanding the criminal aggravated fraud charges in 2019 in Germany against the former chief executive officer and four managers of [VW](#), many readers would balk at the idea of labelling senior executives of major corporations as ‘organized criminals,’ though others might complain if we did *not* so label them for their allegedly intentional deception<sup>2</sup>.

1 Williams, M. (2016) Guardians Upon High: An Application of Routine Activities Theory to Online Identity Theft in Europe at the Country and Individual Level, *The British Journal of Criminology*, 56(1): Pages 21–48, <https://doi.org/10.1093/bjc/azv011>

2 Levi, M. (Forthcoming). Theoretical Perspectives on White Collar Crime. In *Oxford Research Encyclopedia of Criminology and Criminal Justice*, ed. Henry Pontell. New York and Oxford: Oxford University Press. doi:10.1093/acrefore/9780190264079.013.266

To some extent, the issue is our stereotypes of social class and status. Whether or not the European Central Bank chooses/is allowed to do anything much about it to coordinate supervision (as was done globally after the Bank of Credit and Commerce International collapse in 1991), the investigative media exposure of 'Operation Laundromat' and subsequent scandals such as Danske Bank and Swedbank, shows cross-ties between politicians, organized criminals, professional crime enablers and bankers in Russia, the Baltic States, and other neighbouring countries and international finance centres, including London and New York.

These ties could offer some possible points of intervention after the fact, without necessarily needing to prove what particular crimes - if any - the suspected criminal funds came from. The U.K.'s adoption of Unexplained Wealth Orders in the Criminal Finances Act 2017 is one possible route for intervening against fraud and corruption funds, though it has been used in very few cases so far and there is a risk that it will only be used in sensational overseas cases.

### **Symbolism and effectiveness: criminal and administrative measures**

There is a need for holistic thinking about the prevention of fraud and corruption in which both criminal and administrative mechanisms are merely tactical tools of control alongside others. Of course, one cannot ignore the symbolic meaning of the criminal law – at least to campaigning groups and NGOs - and within the EU and elsewhere, the different formal criteria and administrative paths that criminal and noncriminal routes require. This includes the thorny question of the exchange of administrative data within the EU. If companies and individuals – in their own names or as beneficial owners - have poor track records of performance including cost overruns and insolvency, any rational commercial contractor would want to know that.

Given the global preference for administrative and regulatory measures to deal with possible 'white collar crimes' (even in legality principle countries), most sanctions will not be criminal and the question arises of whether such data can be properly communicated within the EU. We must also bear in mind that some of these sanctions as well as criminal ones can be subject to politics and to resource constraints. Negative stories about companies in the media – which *are* taken into account by banks in the due diligence procedures of anti-money laundering – can be true, but they can also be distorted and planted as 'spoiling tactics' by influential oligarchs who own newspapers in some EU member states.

### **Fighting fraud and corruption requires better data**

In the public procurement or EU grant making process, previous administrative sanctions (including tax violations) in principle have to be declared by the person themselves in the same way as criminal convictions, etc. Persons have to confirm and sign that they have no such impediment. However, there is no central data base for administrative exclusions and penalties, so this cannot be checked other than by a media search, which will not yield all sanctions, and may not be routinely undertaken anyway.

There might be strong lobbying against such a data base. The impact of the administrative penalty/exclusion has to remain proportional, and it could be argued that it may no longer be so if it spreads from one Member State to the whole EU. From Member State to Member State, personal data exchanges are governed by relevant data protection legislation. The EU directive sets out rules for transfers within the EU and outside the EU. An administrative agreement might not be required as long as data protection rules are respected, but regime differences do not make this seamless. It seems likely that the European Court of Justice would not prioritise data protection over fraud prevention – the UK has always had a specific exemption for crime prevention - but there might have to be an appeal to clarify this at an EU level.

Data about fraud and corruption as a whole are difficult to generate, let alone about individuals. And when the EU had embarked to produce a biennial Anti-corruption Report, it was abandoned after its first edition issued in 2014. Moreover, this first and only edition

was a regrettable symbol of the reluctance of EU institutions to evaluate themselves and their Member States.<sup>3</sup>

### **No time for institutional battles over legal competencies**

But so much energy is taken up in fighting institutional battles over legal competency and symbolism that we risk losing sight of the practical differences that criminal and administrative measures generate (or not). In terms of the punishment of offenders, corporations of course cannot be sent to jail; individuals can, but only if they can be tried and convicted which, in politically connected cases, may require independent investigators, prosecutors and judges as well as well-designed criminal legislation. The expertise within the prospective European Public Prosecutor's Office (EPPO) will be welcomed by those bodies motivated to pursue fraud against the European Union. Significantly more difficult is the situation in which the EPPO considers that there are strong grounds for prosecuting but the local/national prosecutors (and perhaps political elites with a personal and/or party financial interest in the proceeds of corruption) do not.

There is also the serious matter of how scarce investigative and prosecutorial resources are going to be allocated between EU fraud, other forms of fraud, and other crimes. There are no parallel audits in other countries to draw on, but recent British studies have emphasised the dire state of online and off-line fraud investigation and prosecution in the UK.<sup>4</sup> By what criteria and mechanisms then can it be decided (and by whom?) that EU frauds should take priority in those jurisdictions over other frauds or non-fraud crimes? Even legality principle countries have to decide on their priorities between different types of case: the question is whether they do so explicitly or not.

### **Prosecution and sanctions vs. administrative measures: what is more effective?**

What evidence is there for considering that prosecution and particular forms of sanctions are more effective than administrative measures? In legitimacy terms, the argument appears to be more strongly in favour of criminal measures because those are the measures that people most commonly associate with harmful wrongdoing. This might be true even if there were evidence - *and this was accepted by the public* - that this leads to longer investigations and less redress of harm to victims, including the EU budget itself.

In practical terms, the arguments are weaker, especially for corporations that anyway cannot be imprisoned. One of the problems is the absence of criminal (and administrative violations) careers data for fraud and corruption offenders compared with other mainstream offender data.<sup>5</sup> So this makes it more difficult to assess the relative impacts of formal interventions. Randomisation of sanctions also would not be politically palatable. The famous regulatory sanctions pyramid, developed by Ayres and Braithwaite,<sup>6</sup> was designed to minimise pointless punitivism and maximise cooperative change, and UK equivalents such as Deferred Prosecution Agreements were not designed for what I termed 'pre-planned fraudsters'<sup>7</sup> who need to be prevented from contracting or closed down rapidly rather

<sup>3</sup> Yet it remains politically feasible to produce a supra-national assessment for the EU as a whole, without specifying particular countries, on "the risks of ML and TF affecting the internal market and relating to cross-border activities". See <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017DC0340&qid=1523880011076&from=EN>. The only mention of corruption in all the documentation (SWD(2017) 241 final) refers (at p.270) to the 4MLD relevant risks in *third-party* "countries identified by credible sources as having significant levels of corruption or other criminal activity".

<sup>4</sup> HMICFRS (2019) *Fraud: Time to choose - An inspection of the police response to fraud*; Levi, M., Doig, A., Gundur, R. Wall, D. and Williams, M. 'Cyberfraud and the Implications for Effective Risk-Based Responses: Themes from UK Research', *Crime, Law and Social Change*, 67 (1): 77-96.

<sup>5</sup> Levi, M. (2010) 'Serious tax fraud and non-compliance: A review of evidence on the differential impact of criminal and non-criminal proceedings', *Criminology and Public Policy*, 9(3): 493-513; 'Hitting the suite spot: sentencing frauds', *Journal of Financial Crime*, 17(1): 116-132.

<sup>6</sup> Ayres, I. and Braithwaite, J. (1992). *Responsive regulation: Transcending the deregulation debate*. Oxford University Press.

<sup>7</sup> Levi, M. (2008) *The Phantom Capitalists: the Organisation and Control of Long-Firm Fraud*, 2nd edition, Andover: Ashgate

than be given graduated warnings and advice, which they will ignore and lead to greater victimisation. Administrative measures need to be toughened up and those implementing them need to be bolder and more imaginative if they are to be considered a reasonable substitute for criminal proceedings.

### **Fighting fraud and corruption: a perpetual struggle**

A useful way of thinking about organized fraud prevention is to separate out full-time organized criminals; the procurement processes for contracts and their supervision and auditing; the facilitation of their activities via otherwise legitimate or semi-licit legal and accounting professionals; and transport logistics for crime proceeds. Some sophisticated efforts have been made to test the susceptibility of financial services intermediaries to international requests for different types of laundering.<sup>8</sup> But these have examined only the initial responses to contacts from strangers, and not the full laundering cycle or relationships between *repeat* players, which are more difficult and more expensive to investigate.

There has been very little interest within the money-laundering or the corruption evaluation community in such market survey techniques of vulnerability (or greed), and only intermittent interest in using sophisticated datasets to seek out corrupt relationships in construction and other contracting.<sup>9</sup> Note that this is commended as a way of testing *corruptability*. It is a separate question whether this can be translated into evidence or via proactive 'sting operations' which would be unlawful *agent provocateur* methods in many EU Member States. The data leaked in the Panama Papers and Paradise Papers appear to have been exploited variably by different EU and non-EU Member States, and more systematic studies of the effectiveness of this exploitation are required.

Other favoured areas for development are whistle-blower hotlines and protection, but occupational and social stigma effects on whistle-blowers are legion, and Europe has not yet chosen to advance along the US path of high rewards even for conspirators in tax and corruption cases. Protecting economic confidentiality appears still to be seen as a priority over exposing criminality, for example in Luxembourg. The Organized Crime and Corruption Reporting Project is doing a superb job of illuminating many areas of dark behavior, but aggressive shamelessness among the political classes in some EU and non-EU Member States means that sunlight does not automatically disinfect.

The multi-pronged administrative and criminal approaches highlighted above, to be supplemented by the EPPO even in its partially de-fanged state,<sup>10</sup> need to be part of a perpetual struggle to make EU funds cleaner and enhance their legitimacy.

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8 Findley, M. G., Nielson, D. L., & Sharman, J. C. (2014). *Global shell games: Experiments in transnational relations, crime, and terrorism*. Cambridge University Press.

9 Levi, M., Reuter, P. and Halliday, T. 'Can the AML/CTF System Be Evaluated Without Better Data?' *Crime, Law and Social Change*, 69(2), 307-328. <https://link.springer.com/content/pdf/10.1007%2Fs10611-017-9757-4.pdf>; Fazekas, M., Tóth, I. J., & King, L. P. (2016). An objective corruption risk index using public procurement data. *European Journal on Criminal Policy and Research*, 22(3), 369-397; Fazekas, M., & Kocsis, G. (2017). Uncovering high-level corruption: Cross-national objective corruption risk indicators using public procurement data. *British Journal of Political Science*, 1-10; Reeves-Latour, M., & Morselli, C. (2017). Bid-rigging networks and state-corporate crime in the construction industry. *Social Networks*, 51, 158-170.

10 Geelhoed, W., Erkelens, L. H., & Meij, A. W. (Eds.). (2018). *Shifting Perspectives on the European Public Prosecutor's Office*. TMC Asser Press; Weyembergh, A., & Brière, C. (2018). The future cooperation between OLAF and the European Public Prosecutor's Office. *New Journal of European Criminal Law*, 9(1), 62-82. For an earlier conceptual piece, see Ligeti, K., & Simonato, M. (2013). The European Public Prosecutor's Office: Towards a Truly European Prosecution Service?. *New Journal of European Criminal Law*, 4(1-2), 7-21.