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*Impact of the Enlargement on the
Protection of the Financial Interests
of the European Community against
fraud*

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Impact of the Enlargement on the Protection of the Financial Interests of the European Community against fraud

by Agnieszka Murawska, LL.M., LL.M.¹

1. Introduction

"Fraud is something that does not respect borders at all"

D. Schmidt-Brown, the Eurostat whistleblower

The European media report almost everyday about new fraud, nepotism and corruption scandals, which harm the budget of the European Union². With the enlargement of the EU there emerges a need to look more carefully at the issue of the protection of the Community financial interests and to think about the new anti-fraud policies. Therefore the aim of this article is to show the problem of Community fraud and to analyze current anti-fraud strategy within the enlarged Union.

2. Problem of fraud within the European Union

The problem of fraud has accompanied the European Communities since the moment of their creation. Fraudulent activities increased however after the establishment of the Common Market, the abolition of internal border controls and after the creation of a complicated system of subsidies. This problem gained further importance after the increase of the EC budget, and consequently the scale of fraud amounted in the year 2000 a record level of two billion euro (2.45% of total Union expenditure)³. Still, the exact amount of fraud remains unclear due to lack of information from the Member States⁴. According to estimations done by the Keele University⁵, irregularities affect even ten percent of the Community budget and affect both revenues (cigarette smuggle), as well as expenditures (fraud in the agricultural sector and structural funds) of the EC budget.

Fraud has serious consequences, not only resulting in losing Community (or more exactly: EU taxpayers') money from the EC budget. Another results are disturbances on the Community market, decrease of the economic morals⁶ and decrease of EU citizens' trust towards the European Community. In

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² Osborn, Andrew "EU auditor spells out scale of fraud", The Guardian, 4.11.2003, <<http://www.guardian.co.uk/eu/story/0,7369,1077252,00.html>>; Kopeinig, Margaretha „Den Subventions-Betrüger auf der Spur, Treffen von EU-Fahndern am Wörther See: Strategien und Vernetzungen im Kampf gegen die Korruption“, Kurier, 10.9.2003, <<http://www.herbertboesch.at/content/content.php?ID=422>>; Kirwin, Joe, "Fraud Haunts E.U. Anew, Eurostat's Franchet has been forced to step down", Time Europe, 21.07.2003, <<http://www.time.com/time/europe/magazine/article/0,13005,901030721-464409,00.html>>.

³ Draft Report of the Committee on Budgetary Control of 4 October 2001 on the Commission annual report 2000 on the protection of the Communities' financial interests and the fight against fraud (COM(2001) 255 C5-.../2001 2001/0254 + 2001/0255(COS)) and on the Commission action plan for 2001-2003 (COM(2001) 254 C5-.../2001 2001/0254 + 2001/0255(COS)).

⁴ E.g. Luxemburg didn't report any fraud cases, which is very suspicious and brings smiles to the faces of Eurosceptics.

⁵ See: <<http://www.keele.ac.uk/socs/ks40/lfraud.htm>>.

⁶ See: Tiedemann, Klaus „Wirtschaftsstrafrecht als Aufgabe“ in: Tiedemann, K. (ed.) „Die Verbrechen in der Wirtschaft“, Neue Aufgaben für Strafjustiz und Strafrechtsreform, Karlsruhe 1970, p. 19.

the long term fraud infringes the whole idea of the European integration and the Community consciousness of all, who belong to the EC⁷.

Though many declarations of the Community institutions about the priority of combating fraud, corruption and crime, legal and organizational efforts in this field have in practice yielded modest results⁸. The Community institutions and the Member States are obliged under article 280 TEC⁹ to effective protection of the Community financial interests against irregularities and fraud, however the whole system is showing many weaknesses. The main problem lies on the national level, since about 80 percent of the EU budget is administered by the national authorities. The Member States show an unwillingness to take the necessary initiatives to deal specifically with fraud involving EU funds. On the Community level, the Anti-Fraud Office (OLAF) has to deal with the 25 national legal systems and it to carry out numerous investigations in the firms and by other economic operators. Also the anti-fraud system within the EC institutions themselves is not safe enough and shows weaknesses e.g. with regard to protection of whistleblowers against victimization.

The whole EC anti-fraud system is brand by inefficiency, lax scrutiny, lack of transparency and flood of complicated and complex legal norms, which stimulate and encourage the perpetrators to commit fraud. Fraudsters often avoid criminal responsibility, they are well organized, use modern technologies and misuse the greatest achievement of the EU - the Common Market and its freedoms.

The European Union needs reform, however there are already new and difficult challenges, which make this reform much more important, namely the process of enlargement.

3. Enlargement – bigger risk for EU budget?

With the biggest enlargement in the history of the European Communities, the Community budget grew about € 5,1 billion and it will continue to increase. From 2000 until 2004 the accessing Member States have received on an average € 3 billion per year, and since the enlargement until 2006 the new Member States will receive about € 16 billion. Also the population of the new EU increased from 379 to 453 million and the Community institutions have to cope with ten new legal systems (and ten new languages). Already these numbers show that the enlargement will not improve current situation.

The Members of the EP and the Community auditors have already expressed their concern about the increase of fraud after the enlargement¹⁰. However, the question whether this risk is real, cannot be answered just by explanation that that the new countries are used to defraud and corrupt or that it is a part of their mentality. It is much more necessary to have a look at the efforts made by OLAF and the administration of the new Member States to minimize this risk and their progress in adapting *acquis communautaire* in the field of protection of the Communities' financial interests.

⁷ See: Pache, Eckhard, *Der Schutz der finanziellen Interessen der Europäischen Gemeinschaften*, Berlin 1994, p. 23.

⁸ See: Callies, Christian/ Ruffert, Matthias (ed.), *Kommentar zum EU – Vertrag und EG – Vertrag*, Darmstadt 1999, p. 2044.

⁹ "The Community and the Member States shall counter fraud and any other illegal activities affecting the financial interests of the Community through measures to be taken in accordance with this article, which shall act as a deterrent and be such as to afford effective protection in the Member States".

¹⁰ See: *Süddeutsche Zeitung*, 10.04.2004, "Mehr Betrug nach EU-Erweiterung", *Neue Krone-Zeitung*, 11.04.2004, „Brüsseler Haushaltskontrolleure schlagen Alarm“.

3.1 Enlargement and *acquis communautaire* with regard to the protection of the EC financial interests

Before the accession the candidate countries were not bound by Article 280 TEC nor by other EC Regulations or Directives. However already before the accession the candidate countries were required to create an efficient anti-fraud system protection with respect to the funds provided in the framework of the Accession Partnership, as the programmes PHARE, ISPA or SAPARD¹¹.

The accessing countries were also obliged to comply their legal systems with the *acquis communautaire* as a part of their preparation to the accession in the EU. As already stated in the introduction, Community measures about protection of Community's finances are quite modest. The first pillar instruments consist of three EC Regulations:

- Council Regulation (EC, Euratom) No 2988/95 of 18 December 1995 on the protection of the European Communities financial interests¹²;
- Council Regulation (EC, Euratom) No 2185/96 of 11 November 1996 concerning on-the-spot checks and inspections carried out by the Commission in order to protect the European Communities' financial interests against fraud and other irregularities¹³;
- Regulation (EC) No 1073/1999 of the European Parliament and of the Council of 25 May 1999 concerning investigations conducted by the European Anti-Fraud Office (OLAF)¹⁴.

Moreover, the most important third pillar mechanism in the field of fraud and irregularities that had to be incorporated into the national legal system is the Convention drawn up on the basis of Article K.3 of the Treaty on European Union, on the Protection of the European Communities' financial interests¹⁵ with its two protocols¹⁶.

3.2 OLAF's role in the preparation of the new Member States for the accession

Apart from checks and investigations in the candidate countries¹⁷, OLAF contributed to the accession negotiations by evaluating the progress made by candidate countries in the adoption and implementation of the *acquis communautaire* in the field of the protection of the Communities' financial interests. It was responsible to ensure a good administrative operational co-operation between the Office and national authorities and to reinforce institutional capacity to prevent and detect irregularities. For this purpose, OLAF has supported the idea of creation of independent anti-fraud co-ordination structures or services on the national level in the candidate countries. Such structures are aimed to coordinate legislative and administrative measures dealing with EC-fraud policy in the Member States. Finally, OLAF provided

¹¹ Within this "pre-accession aid" the applicant countries received € 3,240 Mio. just in the year 2001, <<http://europa.eu.int/comm/budget/pdf/budget/syntchif2001/pdf>>, see also Farkas, Akos/ Petro, Rita, Problematic issues of Hungarian criminal law related to the protection of the financial interests of the European Communities, Agon 2001, No. 31, p. 2

¹² OJ L 312, 23/12/1995 p. 0001 – 0004.

¹³ OJ L 292, 15/11/1996 p. 0002 – 0005.

¹⁴ OJ L 136, 31/05/1999 p. 0001 – 0007.

¹⁵ OJ C 316, 27/11/1995 p. 0049 – 0057.

¹⁶ Protocol drawn up on the basis of Article K.3 of the Treaty on European Union to the Convention on the protection of the European Communities' financial interests - Statements made by Member States on the adoption of the Act drawing up the Protocol, Official Journal C 313, 23/10/1996 p. 0002 – 0010, Second Protocol, drawn up on the basis of Article K.3 of the treaty on European Union, to the Convention on the protection of the European Communities' financial interests, OJ C 221, 19/07/1997 p. 0012 – 0022.

¹⁷ See e.g. Article 11 para. 3 of the ISPA-framework regulation 1266/99 and Article 9 para. 3 of the regulation 1268/99.

training and was engaged in the communication projects. Although the resources used for this purpose increased just before the accession, it is still not enough with respect to the tasks to be done in the accessing countries¹⁸.

One of the examples of an early cooperation of the Community and national institutions with regard to the protection of the EC financial interests against fraud, was a project called "OLAF Poland". It was a special anti-fraud coordinating service, established in 2001 and financed by PHARE (cost of € 3,5 million) with help of Community officials. Within this project Polish authorities, assisted by OLAF carried out investigations within the framework of the PHARE programme. Result of these investigations was recovery of the PHARE funds, review of the national procedures, as well as an opening of criminal procedures by the Polish Prosecutor's Office against former Polish officials.

Another example, based on the experience with OLAF Poland, was the establishment of a multi-country PHARE programme (with a budget of € 15 million). The aim of this project was the support of all ten candidate countries in creation of anti-fraud coordinating services or structures, establishment of communication links, anti-fraud database and exchange of operational know-how. Again, in this programme, OLAF played a significant role in defining the main aims within each candidate country and providing technical support and training¹⁹. Especially the latter one is very important in order to improve skills of civil servants and anti-fraud experts. All these activities were conducted in close relation to the DG Enlargement.

Moreover, in 2003 the candidate and acceding countries established a central Anti-Fraud Co-ordination Structures (AFCOS), which should co-ordinate the implementation of legislative, administrative and operational preparation. The general capacity of AFCOS is still rather weak, but at least there exist the basic structures. AFCOS organizes coordination and training meetings (e.g. training of prosecutors, which are responsible for anti-fraud work or technical training in the use of the Anti-Fraud Information System (AFIS)).²⁰

Finally, the acceding countries participate in an ad-hoc group called OLAF Anti-fraud Communicators Network (OAFCN), which was created in 2001²¹. This network is composed of the Spokesman of OLAF and national spokespersons and information officers and its basic tasks are: the dialogue of OLAF with the national investigation services, education of the EU citizens and giving information to the public opinion (i.e. the media) about the fight against fraud and irregularities to the detriment of the European Union's financial interests and their risk for taxpayer²².

4. Further problems within the new Member States

The problems in the new Member States comprise various aspects. First of all the administrative structures in the new Member States are not as developed as those in the old Member States. New

¹⁸ Brunner, foreword to the Report of the European Anti Fraud Office, Fourth Activity Report for the year ending June 2003, <http://europa.eu.int/comm/anti_fraud/reports/olaf/2002-2003/en.pdf>.

¹⁹ Report of the European Anti Fraud Office, Third Activity report for the year ending June 2002, http://europa.eu.int/comm/anti_fraud/reports/olaf/2002/en.pdf

²⁰ Report of the European Anti Fraud Office, Fourth Activity Report for the year ending June 2003, <http://europa.eu.int/comm/anti_fraud/reports/olaf/2002-2003/en.pdf>.

²¹ At: <http://europa.eu.int/comm/anti_fraud/reports/olaf/2002-2003/en.pdf>.

²² See : <europa.eu.int/olaf>.

Member States also do not have enough financial resources for an effective and skilled personal. There are not many qualified and well prepared investigators, which could guarantee the detection of irregularities and fraud cases. Moreover, the officials and the civil servants on the national level are not well paid. Therefore there exist a risk that they will go to the private sector and then use the inside knowledge for the benefit of their new employers. This is especially worrying, since the education and training of the new officials requires time and resources. Of course one cannot underestimate the price differences and worse economic situation in the new Member States, which may be an incentive for committing fraud and abuses of law, especially if the prevention, detection and sanction mechanisms either on the Community or on the national level will not be efficient and deterrent enough.

However, in my opinion, all these factors and problems are not new to the problems already present in the EU. Enlargement therefore does not mean causing of new problems, but certainly the increase of quantity of these, which are present today²³. This situation will require another, more peremptory and decisive measures and changes. Enlargement may be thus a very important incentive and necessary impulse for reform and improvement of the protection of the Communities' financial interests. This process may put pressure on the EC in order to enact new and effective "anti-fraud" legislation. Also the European judicial area will further be fragmented, the number and complexity of administrative bodies involved in the management of Community funds will increase and the difficulties in judicial cooperation between the Member States will remain. Thus, one may assume that in case of further inefficient detection and insufficient sanction also the risk of fraud will increase.

5. New strategies for the protection of EC's financial interests in the enlarged EU

According to the EC Treaty it is possible, at least in theory, to guarantee financial interests of the EC in the future in two ways. First, by taking the point of view that problems arising from the common fight against fraud belong mostly to the intergovernmental sector (and remain within the competencies of the Member States), it would be possible to create a separate convention according to Article 34 para. 2d TEU. Such Convention would have a status of multilateral convention (like any other convention established according to the public international law) that would form part of the so called third pillar of the EU. But if one, on the other hand, takes the point of view that the fight against fraud is, or rather in future be an exclusive competence of the European Community, this financial interests, as well as fundamental rights should be developed as Community law, belonging to the „*first pillar*” (with character of supranational law).

The Member States are of the opinion that all improvements in the field of the fight against fraud and fundamental rights should happen in the third pillar - that means on the intergovernmental basis²⁴. The European Commission, on the contrary, remains by the opinion that the new provisions dealing with the protection of the Community financial interests should be mainly introduced into the first pillar.

²³ One should be aware of the fact that as "pre-accession aid" the applicant countries have received €3,240 Mio. just in the year 2001, see <<http://europa.eu.int/comm/budget/pdf/budget/syntchif2001/pdf>>.

²⁴ See e.g. Sweden's comments on the European Commission's Green Paper on criminal-law protection of the financial interests of the Community and the establishment of a European Prosecutor of June 10, 2002, or United Kingdom response to the Commission Green Paper on Criminal-law prosecution of the financial interests of the Community and the establishment of a European Public Prosecutor.

5.1 Commission Draft Directive of 23 May 2001 on protection of EU funds under criminal law

One of the initiatives of the Commission that was aimed to give a new impetus to the fight against fraud, corruption and money laundering, because of the incomplete ratification of the 1995 Convention on the Protection of Financial Interests and its additional protocols by the Member States, was the Draft Directive of 23 May 2001. This draft has been introduced by the Commission on the basis of the Article 280 para. 4 of the EC Treaty, and should be adopted in co-decision by the Council and the European Parliament²⁵.

The above mentioned draft directive requests all Member States to adopt common definitions of offences (fraud, corruption, money laundering) that damage the Community's finances, as well as common rules on liability, penalties and co-operation with the Commission. The directive does not regulate the judicial co-operation between the Member States, which remains under 'third pillar' provisions. This Directive affords the benefits that go with the 'first-pillar' (i.e. Community legislation *per se*). Community law offers supervisory mechanisms not available under the 'third pillar' (i.e. mainly judicial co-operation between the Member States), namely the powers conferred on the Commission, and the powers of the Court of Justice in this context. As they relate to the protection of Community financial interests, these powers can be used to ensure correct transposal and application of Community law in national legislation. These benefits should also be taken into account when it comes to having the applicant countries take over the '*acquis communautaire*'.

By laying down objectives to be reached by transposition into domestic law by the Member States, the draft directive matched the legal practice and language of the existing PFI instruments. This is why it was able to take over the provisions of the PFI instruments concerning alignment of Member States' substantive criminal law as regards fraud, corruption and money laundering damaging the financial interests of the Community. The relevant provisions of the PFI instruments have therefore been put into this Draft Directive.

The main purpose of this initiative has been to press on with the entry into force of at least some of the provisions in the existing PFI instruments. Moreover the draft directive had the basic advantage of avoiding protracted debates on what is to be in it, since the provisions are ones that have already been adopted by all the Member States under the Third Pillar.

5.2 Draft of Article 280a TEC (European Public Prosecutor)

Another proposal of the Commission was the revision of Article 280 and establishment of Article 280a TEC that could have been taken at the Inter-Governmental Conference in December 2000. This amendment was intended to overcome the barrier of national sovereignty over the application of criminal law and administration of justice.

Article 280a outlined the terms of appointment of European Public Prosecutor in order to contribute to the attainment of the objectives of Article 280 para. 1. He should be responsible for detecting, prosecuting and bringing to judgment the perpetrators of offences prejudicial to the Community's financial interests. He should exercise the function of prosecutor in the national courts of the Member States in

²⁵ The European Parliament and the Council have already delivered their own draft directive on the criminal-law protection of the Community's financial interests, 25 June 2001, 501PC0272, available at <http://europa.eu.int/eur-lex/en/com/dat/2001/en_501PC0272.html>.

relation to offences relating to fraud and any other illegal activity prejudicial to the Community's financial interests. Article 280a para. 3 TEC stated that further conditions governing the Prosecutor's functions and rules determining criminal offences, admissible evidence and penalties should be created by the Council in accordance with the co-decision procedure in Article 251 TEC.

During the Nice Summit the Member States couldn't come to an agreement concerning the proposed text amendments to Article 280 TEC and they were withdrawn. However it is to expect that similar proposals will be put forward by the Commission for the Intergovernmental Conference due in 2004. Whether this proposal will find the unanimous support of the Member States, which is necessary for every revision of the Treaties according to Article 48 TEU, is rather doubtful in regard to the discussions of the past.

5.3 Corpus Juris

The project of Corpus Juris²⁶ has been launched by the European Commission as a part of the European Legal Area Project. Already in 1996 a group of scholars²⁷ has prepared the first research report, and then they continued to improve the draft in a "follow-up" study in 2000. The main aim of the draft was to develop a better system for combating EU fraud in the Member States²⁸. Nevertheless, Corpus Juris has also introduced rules on criminal procedure, particularly those that deal with the common European investigation phase regarding EC fraud.

The first innovation of Corpus Juris is a proposal for the appointment of a European Public Prosecutor (EPP) responsible in the field of activities detrimental to Community's financial interests for overseeing investigations and proceedings, presenting the prosecution case at trial and ensuring the execution of sentences. According to this draft, offences should be prosecuted by the competent judicial authorities in the Member States that should then apply the penal provisions set out in the Corpus and, at a lower level, in national provisions. According to the amended proposal of the Corpus Juris, the activity of the EPP should be subject to review in the national courts, which would be especially responsible to secure human rights and fundamental freedoms²⁹. However, it is questionable, if the national courts should in such cases respect only procedural rights contained in a quite general way by the Corpus Juris, or if they should apply national procedural law. Corpus Juris contains no provisions concerning this matter.

For the time being, in order to provoke a wide – ranging public debate on this issue, the Commission has published a Green Paper on criminal-law protection of the financial interests of the Community and the establishment of a European Public Prosecutor on 11 December 2001³⁰. There have been already many opinions delivered from the Member States, NGOs, or professionals. These opinions differ quite much from those that support the establishment of the EPP as a possible solution against large-scale fraud within EU (e.g. NGOs), to such that deny the creation of a new organ, as unnecessary (the

²⁶ Text of Corpus Juris available on website <<http://www.euroscop.dircon.co.uk/corpus1.htm#Top>>.

²⁷ This group was composed of M. Bacigalupo (Spain), M. Delmas-Marty (France), G. Grasso (Italy), J. Spencer (United Kingdom), D. Spinellis (Greece), K. Tiedemann (Germany), J. Verwaele (The Netherlands), C. van den Wyngaert (Belgium), see Mireille Delmas-Marty, Guest editorial: Combatting fraud – necessity, legitimacy and feasibility of the Corpus Juris, *Common Market Law Review* 2000, vol. 37, p. 247.

²⁸ Sieber, Ulrich, Auf dem Weg zu einem europäischen Strafrecht in: Delmas – Marty, Mireille (ed.) „Corpus Juris der strafrechtlichen Regelungen zum Schutz der finanziellen Interessen der Europäischen Union“ Vol. 7, 1998.

²⁹ See <<http://EUobserver.com>> of 12/12/01.

³⁰ COM (2001) 715.

Member States). Almost everyone has underlined the burden of problems that will arise by creation of EPP³¹. There arose also doubts, if there is a need to establish a new organ, if there are already institutions (as OLAF), which are aimed to protect financial interests of the EU, and which still need to be improved, before another institutions can be introduced into this system³².

6. Final remarks

After the enlargement it is very important to have a clear and common anti-fraud strategy, which can be introduced within all the Member States. The first step is the reform and simplification of the complex system of subsidies, which attracts fraud³³. It is also necessary to break the "*culture of secrecy*", which magnifies the opportunities for fraud, nepotism and mismanagement with more transparency³⁴ within the EU, and with the increased accountability of its officials (first of all Commissioners). Exactly democratization and transparency of the EU were subject of the discussions of the European Convention that worked on the draft of the European Constitution. It is worth to mention that in this draft the European Parliament should have a stronger position (through co-decision procedure) in the field of subsidies. This could contribute to elimination of mismanagement and fraud within the budgetary expenditures.

The following step should be the creation of an effective system of provisions with investigative and deterrent effects. Therefore, it is necessary to provide for effective, systematic and structural monitoring mechanisms (e.g. investigations carried out by independent organs), in order to find irregularities already when they appear. To achieve this aim, especially within the EC institutions, a necessary protection for the whistleblowers should be ensured, and democratic oversight by the European Parliament should be strengthened. Only if the potential fraudster is aware of the possible control, detection and severe consequences, it is possible to achieve this deterrent effect.

The final step deals with appropriate sanctions. Nevertheless, by reforming the system into more "*punitive*" one (in particular if one considers an establishment of the EPP with far-reaching competencies), it is necessary to provide for the sufficient protection of the procedural rights of the accused persons. Only in such system it will be possible to find a just balance between the necessity of the protection of the EC financial interests and the safeguarding the fundamental rights of the accused individuals.

In all these cases, it is necessary to achieve a consensus among all the Member States. Only by enough political will it is possible to limit the scale of fraud that harms not only the EC, but actually also the Member States and the average taxpayer too. This task is very important in the enlarged European Union, since already some of the eurosceptics postulate shortages of the revenues to the EC budget, if the organization cannot stop the fraudsters.

³¹ All the statements are available at the website of OLAF.

³² See: Haus, Florian, OLAF- Neues zur Betrugsbekämpfung in der EU, EuZW 2000, p. 749.

³³ The legislative and administrative complexity of the Community system of income and payments itself contributes to fraudulent exploitation, see Sherlock, Ann/ Harding, Christopher, Controlling Fraud within the European Community, ELR 1991, vol. 16, p. 30.

³⁴ See the decision of Denmark to publish the information concerning the distribution of Community subsidies, Kirk, Lisbeth, "Danish public gets access to lists of EU subsidies" of 04.06.2004, <www.euobserver.com>.