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Gabriela GHEORGHIU*, Cerasela Elena SPĂTARIU

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Combating Fraud in the European Union and in Romania

Gabriela GHEORGHIU*¹, Cerasela Elena SPĂȚARIU²

Abstract

The present research paper aims to evaluate the level of expansion and the impact of actions undertaken at European level to combat fraud against the European Union's financial interests, a phenomenon that has been growing in the recent years, especially as a result of the latest financial crisis. In this respect, the paper analyses the results of the activities carried out between 2008 and 2015 by two competent institutions – one at the European Union's level, the European Anti-Fraud Office (OLAF) and the other one at a Member State's level, the Romania's Anti-Fraud Department (DLAF) (as Romania is a full member of the European Union since 2007) – to detect, investigate and penalize fraudulent actions affecting European Union's financial interests. More specifically, on the one hand, to assess the level of expansion of the EU's actions to combat fraud, the research paper presents how evolved the numeric variation of new open investigations and those concluded by these institutions during the given period, and, on the other hand, to appreciate the impact of these actions, the indictment rate of the decisions taken by national authorities following OLAF's recommendations is determined and the financial recoveries/implications are identified.

Keywords: *fraud, European Union's budget, financial interests, investigations.*

1. Introduction

The process of European integration has led to a closer integration of the economies of all Member States, with high volumes of cross-border

¹ Faculty of Economic Sciences, „Ovidius” University of Constanta, Romania, gabriela3110@yahoo.com

² Faculty of Economic Sciences, „Ovidius” University of Constanta, Romania, ebarbu2001@yahoo.com



transactions, as well as a reduction in the costs and risks of these transactions. The process has generated enormous benefits for European citizens and businesses, but instead has created additional challenges for national tax administrations in terms of cooperation and information sharing against corruption and fraud. Experience has shown that Member States can effectively cope with these challenges only if they act together, not unilateral, on the basis of an agreed EU framework. Within the single market, in a globalized economy, inconsistencies and gaps in national legislation are too easily exploited by those seeking to evade especially tax obligations.

In reality, fraud in general and tax evasion in particular deprive the public budget of billions of euros of revenue each year, distort competition between businesses and erode fair and equitable market conditions to the detriment of all taxpayers. These are the reasons why combating fraud becomes important to ensure both income protection and citizens' confidence in the correctness and effectiveness of financial systems are ensured. But only a coordinated approach at EU level can strengthen the collective capacity to combat fraud and promote high standards of global financial governance.[5]

In recent years, the legislative texts and recommendations on the protection of the Union's financial interests in general and on fraud in particular, have become more numerous, which also expresses the need for effective action at Union level and the increased attention paid by the European legislator to the citizens' concerns about spending public money. As an estimate, European Commission appreciates, for example, that tax fraud in all its forms amounts annually to EUR 1.000 billion in the European Union, or EUR 2.000 per European citizen.

2. Problem Statement

Although the early scholars Cesare Beccaria in 1767 and Jeremy Bentham in 1789 developed several concepts that would later be associated with the economic theory of criminal behavior, we owe Gary Becker the first coherent theorizing of the *Economics of crime* in 1968 [2]. Actually, Becker's theory changed the way of thinking about criminal behaviour by demonstrating that not so much mental illness and social oppressions, but individual rationality, determines whether a person engages in criminal activities or not, as the criminal, perceived as a rational person, decides whether or not to commit crimes based on a analysis of costs and benefits of legal and illegal opportunities, aimed at maximizing utility. This rational-crime theory makes it possible to further predict how changes in the

probability and severity of sanctions and in various socio-economic factors may effect the amount of crime. [4]

Later, several types of economic models of crime have been developed, all of them drawn on the theory of supply and the theory of behavior towards risk. The authors that have constructed such models for tax evasion, where the individual is confronted with the problem of deciding what proportion of income not to report to the tax authorities, in this case the income of criminal activity being a function of the proportion of the exogenous income not reported.

Although a declared advocate of the theory of rational allegations, Becker's *criminal oeconomicus* was not divested of the attacks from those who mistrusted its practical existence. Thus, its opponents support that human behavior in general and criminal behavior in particular would be the result of an unstable and irrational complex of actions, impulses, instincts, habits etc., that pushes through.[9]

As a special form of criminal behavior, the one giving birth to *economic crimes*, is nonviolent and generates an economic loss, referring to illegal acts committed by an individual or a group of individuals to obtain a financial or professional advantage. From fraud, tax evasion, illicit capital heavens, money laundering, corrupting state officials and many other such illegal acts, in these crimes the offender's principal motive is economic gain.

As a particular type of economic crime, *fraud* has received significant attention from regulators and the public, as it affects both the economy and society.

From the theoretical point of view, the basics were put in this field by the criminologist Donald Cressey, who was the first to examine in 1950 why people commit fraud [3]. Cressey argues that there are three factors leading to fraudulent behavior, namely: perceived unshareable financial need, perceived opportunity and rationalization. These elements have become known over the years as the components of the "Fraud triangle". Later, in 2004, Wolfe and Hermanson added to the triangle a new dimension - the "fraudster's capabilities", introducing the "Fraud Diamond Model" [11], as they believed that many frauds would not have occurred without the right person with the right capabilities implementing the details of the fraud. Not least, Kranacher, Riley and Wells developed in 2010 the "MICE Model" [10], suggesting that motivation of fraud perpetrators, which is one of the sides in the fraud triangle, may be more appropriately expanded and identified with the acronym MICE that stands for: money, ideology, coercion, and ego.

From a practical point of view, detection of fraud requires complex knowledge about the nature of fraud, why it is committed, and how it can be committed and concealed. To some extent, the economic criminality is an

abuse of trust, speculating the good faith of participants in economic life, the credibility and the apparent stability of the financial, corporate, banking circuits, etc. The damage caused by this particular economic crime is not only patrimonial but also non-patrimonial, such as reducing confidence in the state's ability to efficiently manage public money or to ensure a stable economic and financial environment.

But the process of fraud detection becomes even more difficult in the context of globalization of economic activity and markets in general, and of economic integration within the European Union's single market in particular. So, the EU Member States are not out of this reality, as the nature and extent of economic criminal activity, such as corruption and fraud, vary from one Member State to another, but it affects them all. As an example, according to European Commission, the corruption phenomenon causes the EU economy an annual damage of 120 billion euros, representing 1% of the Union's GDP. Therefore, combating corruption and fraud can help increase the competitiveness of the European Union in the global economy.[7]

Member States have the responsibility to fight against fraud at national level and to develop the legal instruments and institutions for preventing and combating this phenomenon. As they manage 80% of European funds, Member States also have the duty to investigate and bring to justice the cases of fraud that harm the European Union's financial interests.

But no matter how public money is used, there is always the risk of fraud, that is why the European Union has developed a comprehensive set of instruments to improve the capacity of Member States to combat fraud, that includes EU legislation (improving transparency, information sharing and administrative cooperation), coordinated actions recommended to Member States (eg aggressive tax planning and tax havens) and country-specific recommendations as part of the European Semester.

In this context, the present research paper analyses the results of the activities carried out during the period 2008-2015 by two competent institutions – one at the European Union's level, the European Anti-Fraud Office (OLAF) and the other one at a Member State's level, the Romania's Anti-Fraud Department (DLAF) (as Romania is a full member of the European Union since 2007) – to detect, investigate and penalize fraudulent actions affecting European Union's financial interests.

3. Research Questions/Aims of the research

The research paper aims to evaluate the level of expansion and the impact of actions undertaken at European level to combat fraud from the European Union budget, a phenomenon that has been growing in the recent

years in the European Union in general and in Romania – as one of its Member State - in particular, especially as a result of the latest financial crisis.

To this end, it is used the analysis of the main outcomes – namely the number of new open and concluded investigations, the indictment rate of the decisions taken by national authorities following OLAF's recommendations and their financial implications - of the most important fraud investigation tools in the European Union and in Romania, namely OLAF and DLAF.

More specifically, on the one hand, to assess the level of expansion of the EU's actions to combat fraud, the research paper presents how evolved the numeric variation of new open investigations and those concluded by these institutions between 2008-2015, and, on the other hand, to appreciate the impact of these actions at European level, the indictment rate of the decisions taken by national authorities following OLAF's recommendations is determined and the financial recoveries/implications are identified.

4. Research Methods

The information covered by the case study presented in the present research paper is collected from the annual reports of OLAF and DLAF and refers to the period 2008-2015.

On the one hand, in order to assess the level of expansion of the EU's actions to combat fraud, the research paper presents how evolved the numeric variation of new open investigations and those concluded by these institutions between 2008-2015, for each of these years, the number of new open and closed investigations of possible fraud cases being identified, compared to each other and finally presented their evolution in graphical form.

On the other hand, to appreciate the impact of these actions at European and national level, the indictment rate of the decisions taken by national authorities following OLAF's recommendations is calculated as a percentage of the number of indictment decisions taken by national judicial authorities in relation to the total number of decisions adopted by them. Also, the financial recoveries/impact of the investigations concluded by OLAF and DLAF during 2008-2015 is determined.

5. Findings

The European Anti-Fraud Office (also known as “OLAF”, from the acronym of its title in French: “Office Européen de Lutte Anti-Fraude”) was

established in 1999, aiming to investigate fraud, corruption and other financial irregularities likely to affect the interests of the European Union. Although part of the European Commission, OLAF is an independent body that helps EU countries and organizations investigate cases of fraud and contributes to the development of anti-fraud policies and legislation. Its main objectives are:

- protecting the financial interests of the European Union by investigating fraud, corruption and other illegal activities;
- detecting and investigating serious deviations from the professional obligations of members and employees of the institutions and bodies of the European Union, which could lead to the initiation of disciplinary or criminal proceedings;
- supporting the European Commission in framing and implementing fraud prevention and detection policies.

According to its annual reports from the period 2008-2015 [6], the peak of OLAF’s activity on open investigations was registered in 2012 (see Figure 1), the year in which a major reform of the office took place, with significant changes being introduced to its internal organisation and investigative procedures aiming mainly to reinforce the investigative function and strengthen OLAF’s contribution to combating fraud and tax evasion in the European Union. In all the years that followed this reform, the number of investigations opened exceeded the threshold of 200, while until then their number was around 150.

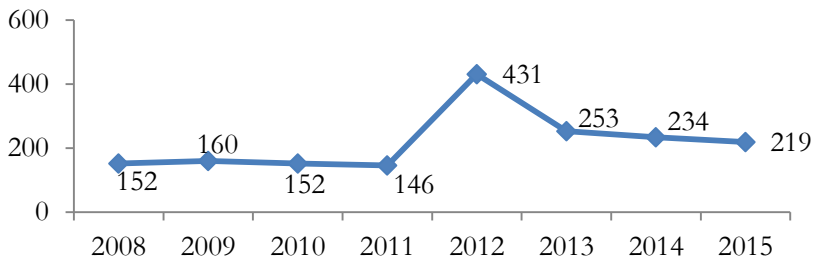


Figure 1. Investigations opened by OLAF during 2008-2015 [6]

The same trend can be noticed as regards the evolution of the number of investigations closed in the years following the 2012 reform (see Figure 2), reaching their peak in 2015 with 304 investigations concluded.

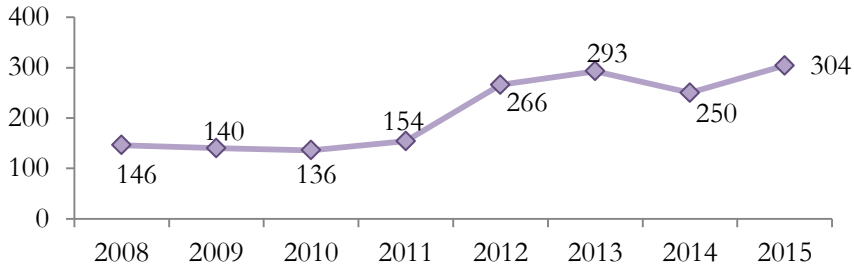


Figure 2. Investigations concluded by OLAF during 2008-2015 [6]

The closed investigations are followed by recommendations issued by the Director General of OLAF and forwarded to the competent authorities in Member States or in EU institutions and bodies, which are responsible for subsequent actions. According to OLAF annual reports (see Figure 3), the indictment rate in Romania is relatively low compared to other EU countries. Otherwise, Romania is the member state with the largest number of decisions taken by national authorities following OLAF’s recommendations between 2008 and 2015.

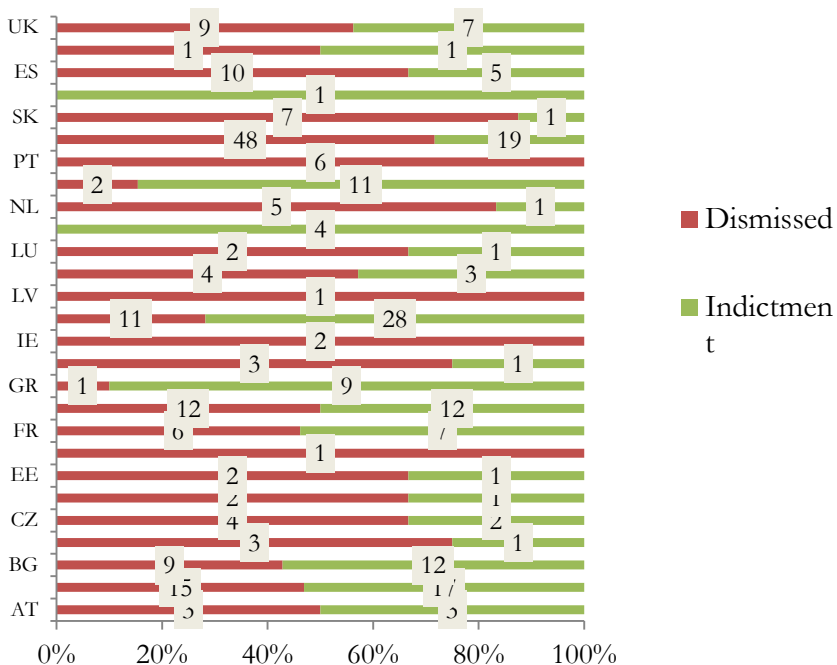


Figure 3. Indictment rate of the decisions taken by national authorities following OLAF’s recommendations between 2008 and 2015 [6]

It should be underlined that OLAF does not carry out any recovery of funds itself, this being done exclusively by Member States and by EU institutions and bodies. The large fluctuations recorded from year to year regarding the amounts recovered as the result of the investigations closed between 2008 and 2015 (see Figure 4) are due to the fact that a few high-profile, high value cases account for the bulk of recoveries in certain years. For example, in 2011 was reported a financial recovery of EUR 691.4 million, an exceptional amount due to particular circumstances that year, because until 2011 the total amount recovered in a case was recorded in the OLAF report in the year in which the case was closed regardless of when it was actually recovered. In order to better reflect the activity of the Office during the reporting year, future reports issued since then take into account the amounts recovered in the year of their recovery.

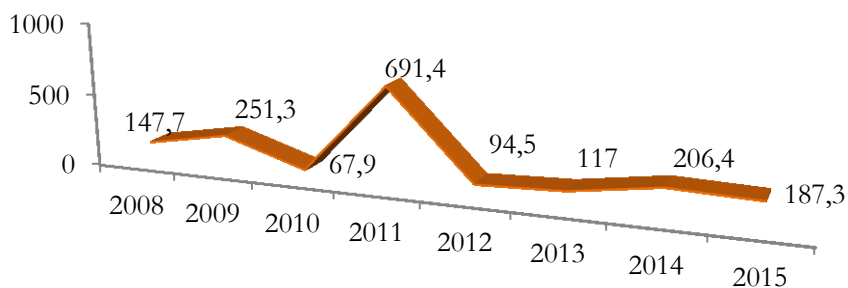


Figure 4. Financial recoveries from investigations closed by OLAF during 2008-2015 (EUR million) [6]

The contact institution of OLAF in Romania - Anti-Fraud Department (also known as “DLAF”, from the acronym of its title in Romanian: “Departamentul pentru Lupta Antifraudă”) is the national coordinator of the fight against fraud and tax evasion from the European Union budget. DLAF coordinates the adoption, at the national level, of legislative, administrative and operational measures designed to combat fraud and any other illegal activities affecting European Union’ financial interests.

Following the control actions carried out by DLAF, in case of indictment, it monitors all the measures undertaken by the Management Authorities to recover amounts due to the EU budget.

DLAF performs control actions following notifications received from OLAF, other national partner authorities or ex officio, regarding

possible irregularities, fraud and any other activities affecting European Union' financial interests.

According to its annual reports for the period 2008-2015 [1], the peak of DLAF's activity on open investigations was registered in 2015 (see Figure 5), with 40% more than those registered in 2012, the year of the last record.

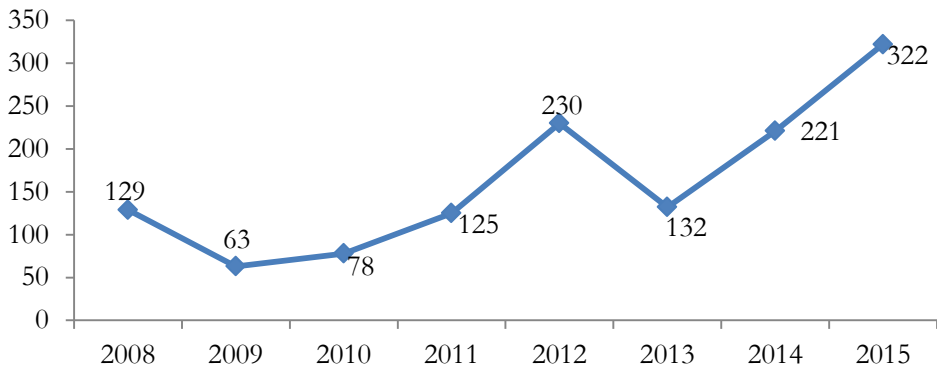


Figure 5. Investigations opened by DLAF during 2008-2015 [1]

Regarding the evolution of the number of investigations closed in the same period, the peak was reached in 2013 (see Figure 6), followed by two consecutive years of fewer finalizations.



Figure 6. Investigations concluded by DLAF during 2008-2015 [1]

In relation to the total value of the cases investigated and finalized by DLAF during the period 2008-2015 (see Figure 7), the estimated financial impact of irregularities and possible frauds discovered increased considerably in the last years (its value even doubled in 2015 compared to 2013).

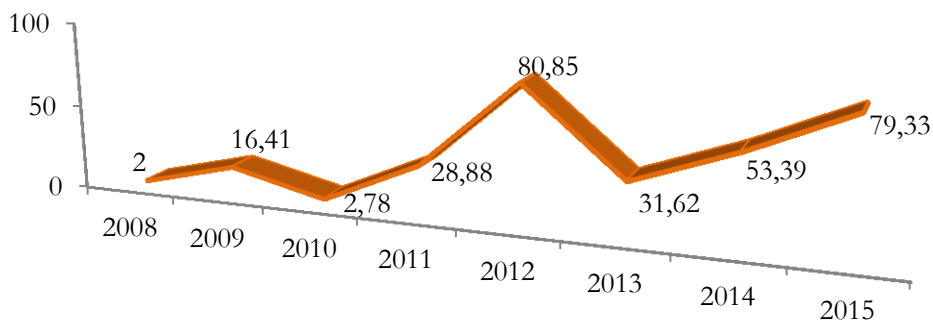


Figure 7. Financial impact of the investigations concluded by DLAF during 2008-2015 (EUR million) [1]

6. Discussions

The information presented above and related to the number of investigations opened and concluded by OLAF and DLAF during the given period are comparable, showing even a similar evolution for the most part, as can be seen from the graphs.

In appreciating the financial impact of the closed investigations, if the data available at European Union level and extracted from OLAF's annual reports refers to amounts effectively recovered when implementing decisions taken following closed investigations, DLAF reports for Romania present just an estimation of financial impact of possible frauds found following closed investigations. That is why the two sets of information cannot actually be compared.

However, the analysis can be extended to the object of investigations opened and finalized by the two institutions, and this will be the subject of a new research by the authors.

7. Conclusions

The European Union's annual budget amounts to € 145 billion (according to 2015 figures). Although it is an important amount, it accounts for only 1% of the revenue generated annually by the European Union's economies.

The European Union's budget is particularly geared towards areas where European funding can bring real change. It finances what would not

finance national budgets or what would be more costly for them. Many of the achievements of the European Union would not have been possible without a common budget. The existence of an European budget, in fact, addresses the common challenges in an effective way, which would not be possible if the 28 Member States acted on their own. Moreover, each of the 508 million European citizens benefits in one way or another from the European Union budget.

However, regardless of how public money is spent, there is always the risk of fraud, which is often used by some EU Member States to protect or favor their own businesses or their own nationals. Consequently, even as a result of an European Parliament' survey conducted in 2016 [8], 75% of European citizens want more EU action especially on the fight against tax fraud.

However, growing, but even modest results on combating fraud of the European Anti-Fraud Office's activity and its corresponding institutional partners from the Member States, respectively Anti-Fraud Department in Romania, on combating fraud, confirm that, in the recent years, a better protection of EU taxpayers' money is ensured and that European funds are increasingly reaching projects that stimulate development and ensure the well-being of the Union's population.

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