

**PROTECTION OF THE FINANCIAL INTERESTS
OF THE EUROPEAN COMMUNITIES:
THE FIGHT AGAINST FRAUD AND CORRUPTION**

by

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ABSTRACT

The protection of the financial interests of the European Communities ('PIF'), as a political/legal endeavour presents unique features. Firstly it is central to the future of the Communities; increasingly it has been perceived as an essential ingredient to preserve the credibility of the 'European Project'. Secondly it has opened up a penal-administrative space at EC level, which many regard as a fore-runner to a European Criminal Legal Space - a vision fraught with difficulties. Notwithstanding the high profile of 'PIF', on the whole progress in fraud control has been uneven, due to the sectoral approach adopted. On the expenditure side of the budget, the most regulated area remains the part of the EAGGF-Guarantee Section Fund, whilst Structural Funds remain fairly un-policed. Of late it has been recognized that procurement fraud, involving the corruption of officials who work with Structural Funds, is rife in many Member States, and legislative solutions have been sought at EC level. On the income side of the budget, the control of VAT fraud rests mainly with the Member States. Other duties have become increasingly difficult to collect in view of the near-collapse of the transit system: solutions advocated include the computerisation of the transit system and various improvements in Customs' *modi operandi*. All Member States have experienced difficulties in recovering EC funds obtained through irregularities: a case study is offered, which compares the British and Danish approaches to the recovery of EC funds. In relation to VAT and excise regimes, the organisation of Customs, and recovery of funds, greater integration would be more effective than Commission supervision of the Member States.

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INTRODUCTION

'Fraus omnia corrumpit' (Julius Caesar)

There are three reasons why the protection of the financial interests of the European Communities should concern and interest all European citizens. Firstly, whether employed or not, they are tax payers and indirectly contribute to the budget. The protection of the financial interests of the European Communities is therefore a legitimate concern. Every year the Member States now pay the equivalent of between 4% to 5% of their GNPs into the Community budget.¹ Although this constitutes a relatively small contribution in percentage terms, the political significance of the EC budget² should not be underestimated. It exists to give expression to common policies, and to implement jointly agreed programmes, which both are an integral part of the European Project. Yet every year a proportion³ of the EC budget is misappropriated, through frauds and irregularities which increasingly involve more than one jurisdiction. Costly irregularities cast a shadow over the prospect for further integration (and enlargement), and raise political and legal issues for 'euro-sceptics' and 'euro-philes' alike.

¹ European Court of Auditors (1995) The European Court of Auditors, Auditing the finances of the European Union, June, page 13.

² Total estimated appropriations for 1997 show a grand total of 89 186 million ECU. In November 1996 one ECU was worth 57 pence.

³ Reported frauds entered into the Commission IRENE database point to a percentage of 1% to 3% of the budget being misappropriated, whilst much higher estimates have been ventured, to take into account unreported irregularities.

Secondly, the sharing of competencies between the Communities and the Member States is generally a delicate matter, due to the absence of clear principles in the Treaty for the allocation of regulatory powers.⁴ In no other area maybe is the balance more delicate than in matters relating to the protection of the financial interests of the European Communities, where the budget is the Communities', yet the enforcement the Member States'. Ambiguity starts with the budget itself. The Member states are responsible for the collecting and making available of resources to the Community. They are also responsible for spending over 80% of the same budget. Yet the Commission is responsible for the implementation of the budget in accordance with the principles of sound financial management.⁵ Furthermore the Community has no criminal jurisdiction, and relies entirely on the Member States for the protection of EC funds. Such an arrangement does not correspond to any of the models of public financing, and of protection of public funds we already know well.⁶ This means that there has been no blueprint for the protection of the financial interests of the European Communities. As a unique creative experiment in post-national rule making, it continues to be controversial.

Thirdly, in a political space that is neither wholly federal nor inter-governmental, there have been persisting concern about uneven and ineffective enforcement of EC law at national level. Fundamental

⁴ On this point, see Weatherill, S (1995) Implementation as a constitutional issue, in Implementing EC law in the United Kingdom: Structures for indirect rules, ed: T. Daintith, IALS London, Chancery Law Pubs, 325-360.

⁵ Articles 201 and 205 EC; Article 22(1), first subparagraph of the Financial Regulation.

⁶ Such arrangements include those evident in centralised states, federal governments or international organisations.

issues concerning Member States' attachment to common goals and trust continue to be raised. In the field of the protection of the financial interests of the European Communities, there has been specific concerns over the assimilation of EC funds with national funds, but also, more fundamentally, over the adequacy of national measures in a single market, in a world where formal, informal and criminal economies are increasingly seen as converging. The difficulty in preventing and sanctioning frauds affecting the EC budget, and in recovering funds, cannot be underestimated. The evolution of the informal economy, and its links with international organised crime make these tasks particularly challenging.⁷ Here both Naylor⁸ and Van Duyne⁹ help to understand the development, and extent of the 'organised crime'¹⁰ phenomenon in question. They find it useful to start with

⁷ See for example newspaper article: 'Criminal gangs exploit Union's single market', in European Voice 14 November 1996, page 4.

⁸ Naylor, R (1996) From underworld to underground enterprise crime, 'informal sector' business and the public policy response, Crime, Law and Social Change, volume 24, number 2, 79-150.

⁹ Van Duyne, P (1996) The phantom and threat of organised crime in Crime, Law and Social Change, volume 24, number 4, 341-377.

¹⁰ Most definitions of organised crime seem to be culturally specific, and range from the minimalist (a crime which involves more than one perpetrator), to the very detailed (involving particular mafias or syndicates making routine use of violence and intimidation). For this purpose, I am adopting Fijnaut's general definition of organised crime in Europe as involving 'professional criminals [who] distinguish themselves not only by the efficient and business-like way in which they commit certain crimes, but also by the close relations they have amongst themselves' (cf. Fijnaut, C (1991) Organized crime and anti-organized crime efforts in western Europe: An overview, in Organized crime and its containment, a transatlantic initiative, eds C. Fijnaut and J. Jacobs, Kluwer). For our purpose, the definition has the benefit of being sufficiently wide, and of not taking violence to be a major definitional determinant.

a distinction between two broad categories of economic crime: (i) the 'unambiguously criminal', which is dealt with by police measures and (ii) the (equally, if not more difficult to detect) 'otherwise legal', where enterprises deal with legal goods or services in illegal ways. The second sector is presumed to be much larger. Its existence is usually imputed to too much (and/or too complex) regulation, and it is seen as fundamentally a problem for the political authorities to solve. Looking at this separation between a crime market where goods are illegal, and a crime market where legal goods and services are handled in illegal ways, it seems at first that frauds and irregularities affecting the EC budget fall within the second category, in the 'price-wedge' market described by Van Duyne,¹¹ where the regulation of taxes, excises and EU subsidies are flouted. However neat this theoretical separation may seem at first sight, we shall see that in practice it flounders. The boundary between the two sectors has become blurred, making the task of both legislators and enforcers more difficult. For these reasons the author argues simply that an approach which focuses on *reducing opportunities* for fraud and corruption should be prioritised. This means, *inter alia*, completing the single market.

The focus of this work is on the institutional response, and the evolution of Community control, although it also contains a national study on the recovery of unwarranted payments. Although much of the literature on the protection of the financial interests of the European Communities has hitherto focused on the CAP,¹² little has

¹¹ Ibid, page 356.

¹² See for example Tiedemann, K (1975) La fraude dans le domaine des subventions: Crime et politique criminelle, *Revue de droit pénal et de criminologie*, 129-140; Dannecker, G (ed) (1993) *Combating subsidy fraud in the EC area*, Bundesanzeiger, Köln; Norton, D (1986) Smuggling under the CAP: Northern Ireland and the Republic of Ireland, *Journal of*

been written on, for example (i) large scale transit fraud, (ii) procurement fraud affecting the Structural Funds, (iii) the recovery of EC funds, (iv) corruption affecting the EC budget - nor has VAT fraud been much discussed in the context of the EC budget. The present work goes some way towards addressing these gaps, although it often raises more questions than it solves.

The protection of the financial interests of the European Communities has progressed in leaps and bounds since 1995, which means that by the time this work is examined, it may already be somewhat out of date. It should, however, reflect developments at least until the summer of 1996. This work does not claim to be comprehensive. For a start, it deals with the control of fraud affecting European Community finances, rather than European Union finances. This is because, notwithstanding new Treaty provisions,¹³ the position of expenditure incurred under the second and third pillars has not been clarified yet. Furthermore not all expenditure, or loans are audited by the European Court of Auditors (a situation they would like to see remedied, see chapter 2) and as a result are not open to scrutiny. A study of GNP national contributions has not been included, although the author is aware of the present controversy over the lack of uniformity in the Member States' calculations of their contributions, and this omission should not be interpreted as a belief that generally speaking, national treasuries are beyond reproach in their handling of EC funds. The control of frauds affecting Community Initiatives (which are part of the Structural Funds),

Common Market Studies, 32, 3, 319-342; Harding, C (1982) The European Communities and control of criminal business activities, International and Comparative Law Quarterly, April, 246-262.

¹³ Article 199 EC.

deserved more thorough treatment, but would have required a period of research at the Commission itself. It is unfortunate therefore that the author was age-barred from doing a 'stage' at DG XX or UCLAF. Because this work focuses on Community control, it does not address in detail issues of mutual assistance in criminal justice matters, which, in any case have been the subject of recent and extensive studies, to which the author would be able to add little.¹⁴ Lastly, because it dwells on control, the work is unashamedly 'top-down', although it deals with some of the issues relating to the rights of operators in chapters 2 and 4, and incorporates operators' views in chapter 3.

The structure is in four parts. Part I introduces the subject with a panoramic view of the evolution of control (chapter 1) and outlines the role of the European institutions, without going into the intricacies of budgetary control but taking into account proposed institutional reforms (chapter 2). Part II offers a more detailed account of Community control of income fraud (chapter 3) and expenditure fraud, focusing on intra-community expenditure (chapter 4). Part III (chapter 5) is a study of the recovery of EC funds in the United Kingdom, which ends with a comparison of the main features of its system with Denmark. Part IV is concerned with the widening of the debate. Chapter 6 deals with various aspects of corruption. Chapter 7 deals with the possible future contours of enforcement upon enlargement

¹⁴ See for example Van den Wyngaert, C (1996) Etude espace judiciaire européen, groupe thématique no 2 Règles de compétence et extra-territorialité, May; AERPE Luxembourg (1995) La protection du budget communautaire et l'assistance entre états, May; also Manacorda, S (1995) La criminalité économique internationale: Un premier bilan des instruments de politique criminelle, Le Trimestre du Monde, premier trimestre (Dossier Mafias et criminalité transnationale), pp 59-81.

to central and eastern Europe. Chapter 8 discusses the legal space and, in particular, the ambitious proposal for a *Corpus Juris*, which has been particularly motivated by considerations around the protection of the financial interests of the European Communities. However the work concludes by emphasizing the potential for fraud prevention through economic and fiscal integration, including measures to complete the single market.

Clearly this work would not have been possible without the support of my supervisor, Professor Leonard Leigh. I could not have wished for a better supervisor. Many British and EC officials kindly agreed to be interviewed, and their names are listed in appendix D. Contacts were made possible through the UK Association of Lawyers for the Protection of the Financial Interests of the European Communities (ALPFIEC), which, like sister organisations in each of the Member States, receives a (modest) grant from DG XX (European Commission Directorate General for Financial Control). DG XX also finances conferences which are ideal fora for students of EC fraud and related matters, so at no time did the author feel marginalised.

PART I.

EVOLUTION OF CONTROL AND INSTITUTIONS' ROLES

CHAPTER 1. EVOLUTION OF CONTROL: A PANORAMIC VIEW

1.1. Background: the Common Agricultural Policy

The setting up of a Common Market in the 1950s by the six founding Member States of the European Community meant the replacement of individual marketing structures with individual agricultural products by a Community marketing structure.¹⁵ This in turn meant the establishment of a Common Agricultural Policy (CAP henceforth) and a common price system for which the Community took financial responsibility. The objectives of the CAP were laid down in the Treaty of Rome and were to raise agricultural productivity, to ensure a fair standard of living to the agricultural community, to stabilize markets, to assure availability of supplies and to ensure that supplies reach consumers at reasonable prices.¹⁶

Although the CAP has made the Community self-sufficient in food supplies, the cost has been high. Every year most of the overall budget of the EC has been spent on maintaining the CAP, which has aptly been described by Lasok and Bridge as 'a hungry sacred cow ... leaving little for the development of other well-deserving policies'.¹⁷ Since 1978, the European Court of Auditors annual reports show that the Guarantee Section of the European Agricultural Guarantee and Guidance Fund (EAGGF henceforth), which is concerned with the support of prices for agricultural products, although declining in overall percentage, still forms the main part of EC

¹⁵ Lasok, D and Bridge, J (1991) Law and institutions of the European Communities, Butterworths, London, page 482.

¹⁶ Article 39 EEC; see also Harrop, J (1989) The political economy of integration in the European Community, Gower, page 69; Usher, J (1988) Legal aspects of Agriculture in the European Community, Clarendon Press, Oxford, pp 35-40.

¹⁷ Lasok and Bridge, op cit, page 489.

budget expenditure (see table 1.1.).

Table 1.1.

EC Budget and EAGGF Guarantee Section appropriations

Financial year	EC expenditure*	EAGGF Guarantee as % of total**
1977	9,584	74
1978	12,302	70
1979	14,447	72
1980	16,182	71
1981	19,986	58
1982	23,260	57
1983	26,533	60
1984	29,264	62
1985	30,616	65
1986	36,052	61
1987	37,452	61
1988	45,344	61
1989	46,426	60
1990	49,208	54
1991	59,369	55
1992	63,907	52
1993	70,408	52

Notes to table 1.1.

* EC expenditure is cited as million UA (Unit of Account) until 1977; million EUA (European Unit of Account) from 1978 to 1980; million ECU (European Currency Unit) from 1 January 1981.

** Sources: Court of Auditors' Annual Reports, 1977-1993. The figures under 'total EC budget' are the appropriations for commitment found in the seventeen Court of Auditors' reports for the financial years in question, but have been rounded up. The EAGGF Guarantee Section expenditure is from the same source, shown here as percentage of total budget. It has been rounded up to nearest million.

Frauds and irregularities affecting the Guarantee Section of the EAGGF have been widely reported and discussed, particularly in the context of exports of agricultural products and market intervention (see chapter 4 on expenditure fraud). Although the Commission is responsible for the integrity of the budget, the European Community has no criminal jurisdiction as such, so it is the responsibility of the Member States to investigate and to prosecute frauds and irregularities affecting the EC budget, to recover funds when necessary and to pay them back into the common purse. In December 1994, the Council stated in a resolution

[C]riminal provisions protecting the Communities' financial interests already exist in many areas in the Member States; there are wide variations, however, as to what constitutes an offence [...]; there are also gaps which may be affecting cooperation between Member States.

As a rule, Member States tend to think that their own national system of handling fraud affecting the Community budget is more effective than their neighbours.¹⁸ Since the 1960s the nature of enforcement has evolved. Much of the fraud control measures taken at EC level have taken place against a background of a rapid succession of enlargements (and a corresponding increase in the size and complexity of the CAP), and budgetary crises (hence the need to find ways to reduce the CAP). It is within this paradox that enforcement efforts, which until recently almost entirely focused on the CAP, must be located. The reality is, that although fraud has always existed, fraud enforcement has not always been high on the political agenda. Historically, four phases can be

¹⁸ Passas, N (1993) *Milking consumers and taxpayers: Farm frauds in the European Community*, Temple University, mimeoed text, page 19.

distinguished, which are briefly outlined below.

1.2. First (latent) phase: benign neglect

Although there are indications that the price equalisation and compensation schemes under Articles 55 and 62 ECSC gave rise to fraud as early as the late 1950s,¹⁹ and that the early CAP was also affected,²⁰ the 1960s and 1970s were characterized by weak enforcement or 'benign neglect'.

After 1962 the CAP gradually extended to cover all agricultural products. It was a time of expansion and growth, at least until 1973, when co-incidentally the first accessions took place. It was not until the late 1970s that the first steps were taken by the Community institutions to try and increase budgetary control, and in the process to protect the financial interests of the Community.

The first CAP regulations²¹ established a common price system for cereals and regulated trade with third

¹⁹ Case 23/59 FERAM v High Authority (1959) ECR 245 J.O (1958) 22 reported in Harding, C (1982) *The European Community and control of criminal business activities*, *International Comparative Law Quarterly*, page 250; also verbal testimony by Professor K. Tiedemann to the House of Lords in 1989, to the effect that the checks carried out on the steel industries in the 1960s 'revealed that one third in that type of subsidised group was fictitious' (House of Lords Select Committee on the European Communities fraud against the Community, Session 1988-89, 5th report, page 88).

²⁰ Tiedemann, K (1975) *La fraude dans le domaine des subventions: Criminologie et politique criminelle*, *Revue de Droit Pénal et de Criminologie*, 1975/76 edition, 137-139 in particular.

²¹ Council Regulations 25/62 JO 1962 p. 991 establishing the EAGGF; 19/62 JO 1962 p. 933 for the gradual organisation of the markets in cereals.

countries. In the 1960s and 1970s the CAP gradually extended to cover most agricultural products, including fish. Structural and guidance measures, however, were not implemented until the mid 1970s. The years 1960-73 have been described as an era of unprecedented growth and of GNP convergence within the Community.²² It may be that the post-war consensus and economic growth helped to buttress the phasing-in of the CAP without too many questions being asked about its eventual size. At this stage of expansion of the CAP, anti-fraud enforcement did not appear to be an urgent priority for the Member States, nor Community institutions. Political concern was limited and media interest scant.

After 1973 the rate of growth of GNP in the EC fell from 4.8% to 2.5% between 1973 and 1979²³ and a pattern of unequal development set in following the accession of Denmark, Ireland and the United Kingdom. This change of pattern coincided with the oil crisis. Indeed Tulkens²⁴ remarked that fraud became an issue around the time when economic disparities began to emerge between the Member States. In 1976 a draft convention for the protection of the financial interests of the Community was rejected by the Member States. As far as the Commission was concerned '[d]uring the sixties and the seventies [it] had its hands full with obtaining and delimiting its powers and with fleshing out and consolidating them.'²⁵ In fact,

²² Dunford, M (1994) *Winners and losers, the new map of economic inequality in the European Union*, *European Urban and Regional Studies* 1(2):95-114; Laffan, B (1992) *Integration and cooperation in Europe*, Routledge.

²³ Laffan op.cit. page 102.

²⁴ Tulkens, F (1994) *Les fraudes communautaires: Un observatoire pénal européen in Déviance et Société*, Vol XVIII number 2, page 219.

²⁵ Vervaele, J (1992) *Fraud against the Community: The need for European fraud legislation*, Deventer, Kluwer, page 15.

until the Court of Auditors was created in 1977 to work alongside Parliament in order to improve budgetary control, there was no institutional mechanism to advise on budgetary control or to review anti-fraud measures.

It also seems that the secondary legislation of the day had little impact. For example, Directive 77/435²⁶ left up to the Member States the scope and frequency of CAP inspections. There was no common definition of fraud and the Court of Auditors somewhat ambiguously opted for the word irregularity, 'which does not presuppose the establishment of an unlawful intention and does not, therefore as strongly as the word fraud, require irrefutable proof'.²⁷

1.3. Second (transitional) phase: control coordination

The 1980s were a time of constant quarrels over the budget,²⁸ when budgetary crises were increasingly blamed on the CAP and the costs of exports and surpluses in particular, were found to be 'largely responsible for the acute financial crisis of the Community'.²⁹ In 1980 the European Parliament refused to ratify the proposed budget until CAP expenditure, inter alia, was revised. From 1983 onwards the Community had difficulties balancing the books: the upwards trend in expenditure at Community level was occurring in a climate of fiscal restraint in

²⁶ Council Directive 77/435 OJ (1977) L 172/17 on scrutiny by the Member States of transactions forming part of the system of financing by the Guarantee Section of the EAGGF.

²⁷ Kok, C (1989) The Court of Auditors of the European Communities: The other European Court in Luxembourg, Common Market Law Review (26) page 360.

²⁸ Shackleton, M (1991) Budgetary policy in transition in L. Hurwitz and C Lequesne (eds) The State of the EC, Lynne Rienner Pubs, Colorado, page 65.

²⁹ Levy, R (1991) 1992: Towards better budgetary control in the EC? Corruption and Reform (6) page 289.

the Member States. These successive budgetary crises have to be put in the context of the accession of three new predominantly agricultural, poorer (in EC terms) countries: Greece in 1981 and Spain and Portugal in 1986. German re-unification in 1989 also contributed to budgetary de-stabilization.³⁰ Meanwhile the budget more than trebled. The period between 1985 and 1992 also corresponds to a peak in legislative activity in the lead up to the single market.³¹ It is also the time when crime prevention measures began to be incorporated into economic regulation, in order to compensate for the anticipated effects of the single market.³²

During this period, the Commission in particular started to take a much more active role in the supervision and the detection of fraud, particularly of Guarantee Section fraud (although the same funds' share of the budget starts to decrease, see table 1.1.). Directives were found wanting for the propose of enforcing an anti-fraud strategy which included increased scrutiny, so regulations began to be used more frequently. Unless they are absolutely unambiguous and precise, directives have to be transcribed into the laws of the Member States, which takes time, and requires political will. The repeal of Directive 77/435³³ in favour of Council Regulation

³⁰ Shackelton, M op. cit.

³¹ Burns, T (1996) Better lawmaking? An evaluation of the law reform in the European Community, W G Hart Legal Workshop, July 1996.

³² Dorn, N and White, S (1996) Beyond 'pillars and 'passerelle' debates: The European Union's emerging crime prevention space, Legal Issues of European Integration, forthcoming.

³³ OJ (1977) L 172/17.

4045/89³⁴ is a case in point. The Regulation explicitly requests Member States to submit their inspection programmes to the Commission for approval (Article 10) and requires scrutiny visits to be carried out on all targeted schemes.

In 1988 UCLAF³⁵ was created in order to coordinate efforts to tackle fraud. All fraud prevention operations extending beyond the responsibility of a single directorate were to be prepared and monitored by UCLAF.

So in this second phase, a 'secondary crime control space'³⁶ was established in the Community. That is to say the Community acquired limited powers and personnel to oversee the control efforts of individual Member States, which they did mostly in respect to CAP expenditure.

* 1.4. Third (active) phase: from administration to punishment?

Since the late 1980s enforcement has been stepped up. The principle of assimilation was established, as well as the right of the Commission to introduce administrative penalties of a punitive nature. In brief the administrative-control space of the 1980s has become the administrative-penal space of the 1990s. Fraud control generally acquired an 'actuarial' flavour and

³⁴ Council Regulation 4045/89 OJ (1989) L 388/18 on scrutiny by Member States of transactions forming part of the system of financing by the Guarantee Section of the EAGGF.

³⁵ See Decision of 20 November 1987 SEC(87) 572.

³⁶ Vervaele, J (1994) Fraude communautaire et sauvegarde du droit communautaire: Vers un droit pénal européen, *Déviante et Société*, Vol XVIII number 2, 201-210.

institutional powers were reinforced. The emphasis of control began to shift from CAP expenditure to procurement fraud affecting the Structural Funds, and the collecting of revenue, in particular import duties. However this shift has yet to be significantly reflected in the allocation of anti-fraud appropriations at Commission level, as illustrated in table 1.2.

Table 1.2.

Anti-fraud appropriations - comparative table for 1994, 1995 and 1996 financial year (in thousand ECU)

Budget areas	Budget Reference	1994	1995	1996
EAGGF Guarantee Section	B1360	86,000 (62%)	85,000 (66%)	44,000 (51%)
CAP	B2	31,000 (22%)	32,500 (25%)	28,500 (33%)
Customs/ indirect taxation	B5	15,800 (11%)	3,000 (4%)	3,200 (4%)
Coordination	(not coded)	(zero)	5,000 (4%)	99,200 (11%)
Structural Funds (inc. Cohesion Funds)	B2-150 B2-301	1,050 (1%)	2,700 (0.5%)	1,050 (1%)
Training (various)	A	5,289 (4%)	4,418 (3%)	(zero)
TOTAL		139,139 (100%)	132,618 (100%)	86,670 (100%)

Note to table 1.2.

Sources: European Commission reports on the fight against fraud for the years 1993, 1994 and 1995.

1.4.1. Assimilation

Given that the Member States deal with domestic fraud differently, shouldn't they at least treat fraud and irregularities affecting the common purse on par with those affecting domestic finance? The question was asked in the 'Greek maize' case³⁷ and the European Court of Justice ruled that

....Whilst the choice of penalties remains within their discretion, they [the Member States] must ensure in particular that infringements of Community law are penalized under conditions, both procedural and substantive, which are analogous to those applicable to infringements of national law of a similar nature and importance and which, in any event, make the penalty effective, proportionate and dissuasive. Moreover, the national authorities must proceed, with respect to infringements of Community law, with the same diligence as that which they bring to bear in implementing corresponding national laws.

Thus the principle whereby crimes affecting the Community budget had to evoke as serious a response as those affecting the national budget was articulated for the first time. The principle was later enshrined in Article 209a of the Treaty on European Union signed at Maastricht. The first paragraph of Article 209a states that the Member States must take 'the same measures to counter fraud affecting the financial interests of the Community as they take to counter fraud affecting their own financial interests'.

The case has two serious implications. Firstly, as

³⁷ Case 68/88 Commission v Greece ECR [1989] 2965.

Delmas-Marty pointed out in 1994, there are no reliable means of finding out whether the principle has been respected or not in the Member States.³⁸ That is to say it is difficult to gauge the extent to which Member States have dealt with frauds and irregularities affecting the EC budget on an equal footing with frauds and irregularities affecting the national purse, least a test be devised for that purpose.

Secondly De Moor³⁹ noted in 1992, that even if the stipulations of the Court in the 'Greek maize' case were strictly followed, very significant discrepancies would remain as between Member States in the protection afforded to the Community interests. This is because the definition of what constitutes an offence against the Community interests is determined according to the provisions of national laws, which vary greatly in their approach to Community fraud. Furthermore sanctions provided in the Member States may not be effective, proportional or dissuasive.

It became clear that to get an adequate system for preventing and sanctioning fraud against the Community a twin-track strategy would have to be pursued. Firstly the control and sanctioning power of the EC had to be increased to ensure minimum sanctions, without prejudice to any other criminal sanctions the Member states may wish to impose in addition. Secondly national provision,

³⁸ Delmas-Marty, M (1994) Rapport Final - Etude comparative des dispositions législatives, réglementaires des états membres relatives aux agissements frauduleux commis au préjudice du budget communautaire in rapport de synthèse, étude sur les systèmes de sanctions communautaires, SEC 1994(93), OOPEC page 1172.

³⁹ De Moor, L (1992) The legal protection of the financial interests of the European Community, in EC fraud ed J. Van der Hulst, Kluwer.

sanctions and practices had to be approximated.⁴⁰ In relation to the former, the question thus began to be asked about the Communities', and in particular the Commission's power to impose sanctions.

* 1.4.2. *The Commission's power to punish*

In the field of competition, the Commission already has a power to impose fines under Articles 65 and 66 ECSC⁴¹ and of Article 87 EEC.⁴² These provisions, however, make no reference to the Community budget. In 1991 the Theato Report⁴³ argued, inter alia, that Article 172 EC implied that the Council had a general power to include penalties in its regulations. This power was to be later confirmed by the case law of the European Court of Justice.

The Commission started to introduce sanctions in sectoral regulations, as part of its implementing powers. It did so with increasing frequency: 'ten times in 1988, seventeen in 1989, more than 30 in 1990 and as a standard practice thereafter'.⁴⁴ In 1992 The European Court of

⁴⁰ See Vervaele, J (1992) Subsidy fraud, in EC fraud ed J. Van der Hulst, Kluwer.

⁴¹ Article 65(5) authorizes the High Authority to impose fines or periodic penalty payments for a breach of the rules. Article 66(6) lays down a scale of fines from 3% to 15% of the value of the assets acquired.

⁴² Regulations and Directives can be adopted in order to ensure compliance with the prohibitions laid down in Articles 85(1) and 86 EEC by making provision for fines and periodic penalty payments.

⁴³ European Parliament (1991) Report of the Committee on budgetary control on the legal protection of the European Community's financial interests, rapporteur Diemut Theato, MEP.

⁴⁴ Heine, J (1994) Community penalties in agriculture and fisheries: legislative activity in the Commission, in The legal protection of the financial interests of the Community: Progress and prospects since the Brussels seminar of 1989, OOEPC, page 18.

Justice gave a ruling in *Germany v Commission*⁴⁵ which clarified the power of the Community in general, and the Commission in particular to introduce sanctions with a punitive, rather than a purely remedial or compensatory character, in the exercise of its powers to enact regulations for the common organisation of agricultural markets. In this context the Court recalled its ruling in *Köster*⁴⁶ to the effect that the imposition of penalties came within the Commission's powers if the Council had not reserved such powers to itself. The penalties laid down by Community law are meant to be enforced by the national authorities and not (as it the case in area of competition) by the Community institutions themselves.

This, in turn raised the question as to the nature of the sanctions to be applied in the Member States. In the early 1990s, one of the burning issues raised was whether the Commission had any power to impose particular criminal sanctions to be applied in the Member States in order to protect the financial interests of the European Communities.

Community law as it stands does not give the Community the power to lay down criminal penalties, although Articles 100 and 100A enable the Council to adopt measures for the approximation of the measures laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market. Article 100A has been used, for example, as the legal basis for the Money Laundering Directive,⁴⁷ which resulted in Member States

⁴⁵ Case C-240/90 *Germany v Commission* [1992] ECR I-5383.

⁴⁶ Case 25/70 *Einfuhr-und Voratsstelle für Getreide und Futtermittel v Köster, Berodt & Co*, preliminary ruling ECR [1970] 1161.

⁴⁷ Council Directive 91/308 OJ (1991) L 166/77.

setting up rules aimed at their financial and credit institutions, and creating specific offences. The more contentious Article 235 EC also allows the Council to take appropriate measures when the Treaty has not provided the necessary powers for doing so.

Generally the regulation of financial crime falls into the penal-administrative sphere, which means that the distinction between criminal and administrative penalties is blurred. The European Court of Justice has hitherto not been drawn into ruling on the exact nature of Community sanctions. However it ruled in Könecke, that what mattered was that the penalty, whatever its label, ensured the effective implementation of the regulation in question, and that it be imposed on a 'clear and unambiguous legal basis.'⁴⁸

The third phase of anti-fraud enforcement is also the time when surveillance is organised, and modern techniques are used to control fraud.

1.4.3. Actuarial measures

Increasingly in the third phase measures with a strong actuarial flavour were incorporated into regulations and surveillance became an important feature of enforcement, with the help of funds made available to the Member States specifically for the financing of remote sensing equipment and surveillance operations.⁴⁹ Detailed information has to be provided to the Commission on

⁴⁸ Case 117/83 Könecke GmbH and Co KG v Bundesanstalt für Landwirtschaftliche Marktordnung [1984] ECR 3291, para. 11.

⁴⁹ European Commission (1994) Protecting the financial interests of the European Community the fight against fraud 1993 Annual Report, OPEEC.

detected cases of irregularities.⁵⁰ Under Regulation 4045/89,⁵¹ for example, Member States must carry out an audit control programme on all traders in receipt of EAGGF funds. Risk analysis and targeting are methods increasingly used by the Member States' authorities responsible for enforcement, such as the Intervention Board for Agricultural Produce in the United Kingdom. Risk analysis involves the collecting and analysis of financial data, histories of irregularities and investigations and scrutiny visits.⁵² Application of the technique of risk analysis together with a systems audit, makes it possible to confine inspections to sensitive areas and to 'high risk' operations and/or recipients, identifying those control structures in the Member States which ought to be strengthened.⁵³ In 1994 the Commission issued a further Regulation (3122/94)⁵⁴ laying down the exact criteria (with regards to products receiving refunds) according to which high risk sectors could be targeted. Sectors vary from Member State to Member State. In the UK, for example in 1995 milk quotas, beef and cereals were targeted sectors for enforcement. Finance was made available to Member States implementing these measures, through Regulation 307/91,⁵⁵ which provided for

⁵⁰ Article 3(1) Council Regulation 595/91 OJ (1991) L 67/11.

⁵¹ OJ (1989) L 388/18, op.cit.

⁵² Intervention Board Anti-Fraud Unit (1994) 1993 Annual Report.

⁵³ EC (1994) op.cit.

⁵⁴ Commission Regulation 3122/94 OJ (1994) L 330/31 laying down criteria for risk analysis as regards agricultural products receiving refunds.

⁵⁵ Council Regulation 307/91 OJ (1991) L 37/5 on reinforcing the monitoring of certain expenditure chargeable to the Guarantee Section of the EAGGF. Article 2 specifies that the Community's financial contribution towards the remuneration of supplementary agents and equipment shall be 50% for the first three years and 25% for the fourth and fifth

additional funds to be made available for the control of a number of high risk areas for five years. Regulation 4045/89⁵⁶ provided for funds to be made available for the training of scrutiny officers and the setting up of computer systems to carry out the scrutiny programme.

In 1990 for the first time minima were set for the inspection of goods in the Member States: Council Regulation 386/90⁵⁷ imposed a duty on Member States to inspect 5% of all goods presented for export.

1.4.4. The uneven nature of control in the third phase

The stepping up of enforcement against EC fraud in the third phase fell mostly upon the EAGGF Guarantee Section Fund. Member States were still reluctant to establish control systems for Structural Funds identical to those in place to protect the Guarantee Section Fund. In July 1993 the Council adopted six Structural Funds regulations⁵⁸ to strengthen the principles of concentration, partnership, programming and additionality. This had the effect of bringing Structural Funds fraud enforcement into a phase corresponding to the second control-coordination phase described earlier with respect to the EAGGF Guarantee Section Fund. This is because reinforced partnership means closer collaboration between the Commission and all the relevant authorities

years.

⁵⁶ op.cit.

⁵⁷ OJ (1990) L 42.

⁵⁸ Council Regulations 2080/93 (FIFG Regulation) OJ (1993) L 130/1, 2081/93 (Framework Regulation) OJ (1993) L 193/5, 2082/93 (Coordination Regulation) OJ (1993) L 193/20, 2083/93 (ERDF Regulation) OJ (1993) L 193/24, 2084/94 (ESF Regulation) OJ (1993) L 193/39 and 2085/93 (EAGGF- Guidance Section Regulation) OJ (1993) L 193/44.

at national, regional or local level. Reinforced programming⁵⁹ means that Member States had to start submitting detailed programming documents, complete with specific objectives to be attained, and detailed financial tables showing national and Community finance. Finally, in view of prior difficulties in implementing the additionality⁶⁰ principle, the revised Coordination Regulation stipulated that each Member State had to maintain, in the whole of the territory concerned, its public structural or comparable expenditure at least at the same level as in the previous programming period, taking into account, however, 'the macro economic circumstances in which the funding takes place' - this last concept being rather difficult to unwrap. The Member States also acquired a duty to provide the financial information needed to verify additionality when submitting plans and regularly during the implementation of the Community Support Frameworks.

The principle of co-financing is considered to be an important tool in the control of fraud. It is felt that Member States have more incentive to prevent and prosecute fraud when a proportion of purely national finance is directly involved in the projects. However specific problems remain, which are explored in chapter 4.

⁵⁹ The last subparagraph in Article 5(2) of Regulation 4253/88 foresees that in order to simplify and to speed up programming procedures, Member States may submit in a Single Programming Document (SPD) the information required for the regional and social conversion plan referred to in Article 9(8) of Regulation 2052/88 and information required in Article 14(2) of Regulation 4253/88.

⁶⁰ The principle of additionality means that Community assistance should complement the contributions of the Member State rather than reducing them. For a discussion on the application of additionality in the Member States see White, S and Dorn, N (1996) EC fraud, subsidiarity and prospects for the IGC: A regional dimension? in European Urban and Regional Studies, 3(3) 262-266.

As far as the control of income fraud is concerned, this remained a neglected area (see chapter 3) until more ambitious plans were formulated for the protection of the financial interests of the Community.

1.5. Fourth (ambitious) phase

The approach to fraud control, until the mid 1990s has been described as 'atomistic'⁶¹ or 'fragmentary'⁶². In addition to possibly encouraging the possibility of displacement in criminal activities, the sector by sector approach has the drawback of adding to the complexity of the regulatory environment. This 'atomistic' response to fraud was felt to be inadequate. The main elements of the contemporaneous 'ambitious' phase are the stepping up of cooperation, the integration of control, the reinforcement of Commission powers of inspection and a recognition of the international and of the organised crime dimension of fraud and corruption, and of their money laundering implications.

1.5.1. The stepping up of cooperation

In 1994 the cooperation between Member States and Commission was stepped up. The Commission set up an advisory committee for the coordination of fraud prevention, consisting of two representatives working alongside anti-fraud services in each of the Member States. In November 1994 the Commission also set up a

⁶¹ See for example Marin, J-C (1994) Legal protection of the Community's financial interests: Experience and prospects since the Brussels seminar of 1989, in Legal protection of the Community's financial interests: Experience and prospects since the Brussels seminar of 1989, Oak Tree Press, Dublin, pp 204-207. [Both book and article have the same title]

⁶² Darras, M (1992) Le Parlement Européen et la protection juridique des intérêts financiers de la Communauté Européenne, in EC fraud, ed J. Van der Hulst, Kluwer.

freephone service, to encourage the reporting of fraud and set aside 200,000 ECU to reward informants. According to the Commission, payments to informants are relatively modest and correspond to the value of the information, and each informant is checked against an independent source before being paid. Unlike the situation which now prevails in the competition field, participating informants who are guilty of fraud enjoy no privileges, and cannot expect a lighter fine. The freephone service has proved successful. In addition, the 'Black List' Regulation places duties on Member States to notify the Commission (who in turn notifies other Member States) and under certain circumstances, to exclude traders from funding for periods of up to five years. The political significance of the Regulation is very considerable since it establishes a Community system requiring Member States to circulate information on certain operators and to adopt preventive measures. The potential of blacklisting to damage traders' interests should not be underestimated, although it must be remembered that it is confined, in the 'Black List' Regulation, to cases of irregularities exceeding 100 000 ECU over a one-year period (see chapter 4).

1.5.2. Integration of control

Several instruments have been put forward, but not all are in force at the time of writing. Taken together, they represent a giant step forward, in that they seek to reduce control disparities between sectors (through 'horizontal' first pillar instruments, which cut across most sectors of the budget), and disparities between the Member States' criminalisation of EC fraud (through third pillar instruments).

Council Regulation 2988/95: harmonisation of administrative sanctions

In 1995 a significant step forward was taken. A 'horizontal' Regulation on the protection of the European Communities' financial interests⁶³ (or 'PIF'⁶⁴ Regulation) was adopted under Article 235, which framed the whole range of Community sanctions and established rules for the interface of national criminal laws and Community administrative sanctions.

The 'PIF' Regulation (see appendix B) sets out a legal framework for Community administrative sanctions. It starts by giving the Member States a common definition of 'irregularity'. Irregularity in this context means any infringement of Community law resulting from an act or omission by an economic operator, which has, or would have, the effect of prejudicing the general budget of the Communities or budgets managed by them, either by reducing or losing revenues accruing from own resources collected directly on behalf of the Communities, or by an unjustified item of expenditure.⁶⁵ 'Resources collected directly on behalf of the Communities' excludes VAT, a small proportion of which only comes indirectly into the budget of the Communities. For the purpose of applying the Regulation, criminal proceedings may be regarded as having been completed where the competent national authority and the person concerned have come to an arrangement.⁶⁶

⁶³ Council Regulation 2988/95 OJ (1995) L 312/1.

⁶⁴ From the French 'Protection des Intérêts Financiers'.

⁶⁵ Article 1(2) of Council Regulation 2988/95 OJ (1995) L 312/1.

⁶⁶ Eleventh Preamble of the 'PIF' Regulation, OJ (1995) L 312/1.

The Regulation also lists Community sanctions available to national authorities for intentional irregularities.⁶⁷ These vary from the payment of an administrative fine to a loss of security or deposit.⁶⁸ Such sanctions may be suspended if criminal proceedings have been initiated against the person concerned in connection with the same facts.⁶⁹ A limitation period of four years is set for proceedings.⁷⁰ In its third title, the Regulation adopts general rules for checks, whether they be performed by the Member States, or the Communities' institutions. In its third title, concerned with checks, it refers to more detailed provisions concerning on-the-spot checks and inspections to be adopted discreetly.⁷¹

'PIF' Convention: harmonisation of criminal sanctions

The 1976 project⁷² for a Convention on the Protection of Community Financial Interests of the European Communities was resurrected in the early 1990s. The final text was agreed in July 1995 under the French Presidency of the Council, and published in the Official Journal in

⁶⁷ Article 5 of 'PIF' Regulation OJ (1995) L 312/1.

⁶⁸ Article 5(1)(a) and (f) of 'PIF' Regulation OJ (1995) L 312/1.

⁶⁹ Article 6(1) of 'PIF' Regulation OJ (1995) L 312/1.

⁷⁰ Article 3(1) of 'PIF' Regulation OJ (1995) L 312/1.

⁷¹ See Article 10 of 'PIF' Regulation OJ (1995) L 312/1.

⁷² See Draft for a Treaty amending the Treaties establishing the European Communities so as to permit the adoption of common rules on the protection under criminal law of the financial interests of the Communities and the prosecution of infringements of the provisions of those Treaties and amending the Treaty establishing a Single Council and a Single Commission of the European Communities so as to permit the adoption of common rules on the liability and protection under Criminal Law of Officials and other Servants of the European Communities, OJ C (1976) 222.

November 1995.⁷³ It has yet to be ratified. The Convention defines the concept of fraud affecting the EC budget, lays an obligation on the Member States to provide criminal penalties in cases of serious fraud, including custody for cases involving over 50,000 ECU. The signatories will also have to make provisions in their national laws for heads of businesses to be declared criminally liable in case of fraud. It lays a duty on the Member States to cooperate in deciding which State will prosecute. This requirement has in view the 'centralisation' of prosecution in a single Member State where possible. Furthermore, Member States will have a duty to transmit to the Commission the text of the provisions transposing into their domestic law the obligations imposed on them under the provisions of this Convention. The European Court of Justice has jurisdiction to decide on disputes between Member States if no solution is found within six months.

On the spot checks Regulation: Commission powers reinforced

A Regulation concerning on-the-Spot Checks and Inspections, was adopted but is not yet in force.⁷⁴

The proposed Regulation⁷⁵ concerning on-the-Spot Checks

⁷³ Convention on the Protection of the European Communities' Financial Interests OJ (1995) C 316/48.

⁷⁴ See European Commission Secretariat General UCLAF (1995) Proposal for Council Regulation concerning on-the-spot checks and inspections by the Commission for the detection of frauds and irregularities detrimental to the financial interests of the European Communities SEC(95)915Final.

⁷⁵ See UCLAF (1995) Proposal for Council Regulation concerning on-the-spot checks and inspections by the Commission for the detection of frauds and irregularities detrimental to the financial interests of the European Communities, SEC(95)09151; also General Secretariat of the Council DG FII (1996) amended draft for the subgroup on

and Inspections by the Commission for the detection of frauds and irregularities detrimental to the financial interests of the European Communities authorizes the Commission to send Commission officials to carry out on-the-spot checks at central, regional or local level on any economic operator directly or indirectly receiving a financial benefit from the European Communities. The Regulation also defines the powers and duties of the Commission controllers. Officials of the Member State may take part in the inspections. The Commission may ask officials of Member States other than that on whose territory inspections and checks are being performed to take part in them. The Commission may also resort to outside bodies to provide technical help.⁷⁶ All information collected is covered by the rule of confidentiality and the Community's provisions on data protection.⁷⁷ It is envisaged that this regulation should help to speed up the investigation of complex transnational cases.

[The] entry into force of the Regulation should make the beginning of a new phase of Community legislation designed to define more clearly the Community's powers of inquiry at sectoral level, through new regulations or the refinement of existing regulations.⁷⁸

protection of financial interests, 30 April. The vote which was meant to take place on 3 June 1996 was delayed because of the British non-cooperation stance over the British beef crisis, but in July 1996 the Commission hoped that the Regulation could still be agreed before the end of 1996.

⁷⁶ Article 4(3) of proposed on-the-spot checks Regulation.

⁷⁷ Article 6(1) of proposed on-the-spot checks Regulation.

⁷⁸ European Parliament (1996) Report (Consultation Procedure) on the proposal concerning on-the-spot checks and inspections by the Commission for the detection of frauds and irregularities detrimental to the financial interests of the

The Regulation reinforces the Commission's existing powers of inspection, and some Member States believe that this places the Commission at the limit, or beyond its powers of direct intervention in the Member States. Notwithstanding the extension of inspection powers proposed in the Regulation, checks will continue to rest and depend on the principle of cooperation with national agencies and officials.

Protocols to the 'PIF' Convention

Two protocols have been added to the 'PIF' Convention. They deal respectively with money laundering and judicial cooperation and with the corruption of EC and national officials, in cases involving EC funds.

A proposition for a protocol to the 'PIF' Convention was adopted by the Commission in December 1995. It deals with money laundering and judicial cooperation. It lays out the responsibility of legal persons, criminalised the laundering of fraud profits. It gives detailed rules for direct judicial cooperation and for determining which Member state takes the lead role for prosecution of transnational frauds. It lays out the competence of the European Court of Justice.

As the emphasis of control shifted to trade rather than farming, corrupt practices were increasingly highlighted in cases. For example, procurement frauds affecting the Structural Funds, and the evasion of duties were often carried with the connivance of officials. An anti-corruption protocol was added to the 'PIF' Convention. A more ambitious instrument, an anti-corruption convention still under discussion in 1997, proposes to extend the measures contained in the Protocol, whether the financial

interests of the European Communities are involved or not. These measures are examined in detail in chapter 6, which deals specifically with the fight against corruption.

* 1.5.3. Conclusion

In the 1980s it became apparent that the fast-enlarging Community budget attracted commensurate fraud, so measures to counter fraud affecting the EC budget were increasingly incorporated into sectoral regulations. These sectoral regulations place duties on the Member States to take appropriate measures to prevent irregularities, such as surveillance or checks based on risk analysis, but also to report certain irregularities and recover funds.⁷⁹ For instance a 1995 sectoral regulation agreed on the basis of Article 43, the 'Black List'⁸⁰ Regulation, targets traders claiming from the EAGGF Guarantee Section.

One effect of this sectoral approach has been that more attention has been paid to policing certain sectors of the EC budget than to others. On the income side of the budget, Member States are likely to carry on resisting any Commission interference with their sovereign right to raise taxes.

The unevenness of the control space was finally addressed

⁷⁹ Council Regulations 729/70 OJ (1970) L 94; 283/72 OJ (1972) 36; 595/91 OJ (1991) L 67; 4253/88 OJ (1988) L 374; Commission Regulation 1681/94 OJ (1994) L 178; Council Regulation 1164/94 OJ (1994) L 130; Commission Regulation 1831/94 OJ (1994) L 191.

⁸⁰ Council Regulation 1469/95 OJ (1995) L 145/1 implemented by Commission Regulation 745/96 OJ (1996) L 102/15.

through the 'PIF' Regulation,⁸¹ which confirmed the effectiveness of this system of penalties already in place for the Common Agricultural Policy and drew on the impetus provided by the Council's call for the introduction of Community administrative penalties in areas other than agriculture.⁸² Due to the near-collapse of the transit system, attention began to shift more noticeably to traders unlawfully claiming refunds or evading duties and the computerisation of the transit system was planned. However it is noticeable that anti-fraud appropriations dropped significantly in 1996. The financing for the central development of the computerization of the transit system, for example (under B5) was greatly reduced during the course of the 1996 budgetary procedure, casting doubts as to whether the system will be operational in 1998 as originally planned.⁸³ Thus budgetary considerations continue to play a key role in the fight against fraud.

⁸¹ Council Regulation 2988/95 OJ (1995) L 312/1 on the protection of the European Communities' financial interests.

⁸² European Commission (1996) Protecting the Community's financial interests The fight against fraud Annual Report for 1995, COM(96) 173, page 11.

⁸³ European Commission (1996) Rapport Intermédiaire sur le transit, SEC(96) 1739, Annex V.

CHAPTER 2. THE INSTITUTIONS AND THE FIGHT AGAINST FRAUD

2.1. Powers and responsibilities, agenda for change

As part of the consultation process leading to the IGC, the institutions have taken the opportunity, *inter alia*, to highlight some of the conundra, and difficulties they experience in relation to the protection of EC finance. They have, at times been able to make very specific proposals for change (see for example the European Court of Auditors). This chapter considers the existing powers and responsibilities of the institutions with respect to fraud control, (without going into the intricacies of the budgetary process itself) and discusses the agenda for change arising from the work carried out in preparation for the IGC.⁸⁴

2.2. The Commission

The Commission is the executive organ of the Communities,⁸⁵ and also its budgetary authority.⁸⁶ Its duties go beyond mere implementation of legislation, since it can make legislative proposals on its own initiative. Its power is however circumscribed,⁸⁷ since it may not make any proposals with appreciable budgetary implications unless it can guarantee that the proposal could be financed within the limits of the revenue available.

⁸⁴ See also White, S (1995) Reflections on the IGC and the protection of the financial interests of the EC in AGON, number 10, 10-13.

⁸⁵ Article 155 EC.

⁸⁶ Articles 203(3) EC and 205 EC.

⁸⁷ Article 201A EC.

Unlike a national, or a federal executive, the Commission has no tax-raising powers. The Member States are responsible for the collecting and making available of their GNP and VAT contributions, as well as Customs and other duties to the Community budget. Furthermore the Commission only spends a small proportion of the budget directly. The Member States are responsible for the collecting and making available of revenue, and also for most of the budget expenditure. The Commission also depends on the Member States for the protection of the financial interests of the European Communities, and has endeavoured to find out how such protection works in practice.⁸⁸ In this the work of the national associations of lawyers for the protection of the financial interests of the European Communities,⁸⁹ with their journal AGON acting as a conduit for discussion and information, must be noted.

The Commission works closely with its budgetary control 'partners' (Council and European Parliament) through the budgetary control committee. The relationship of the

⁸⁸ A series of reports have been commissioned by D-G XX (Financial Control) in each Member State, followed by synthesis reports: for example, in 1993, report of the study on the systems of administrative and criminal penalties of the Member States and general principles applicable to Community penalties SEC(93) 1172 (Known as the 'Delmas-Marty Report'); in 1995 Comparative analysis of the reports supplied by the Member States on national measures taken to combat wastefulness and the misuse of Community resources, November; also in 1995, report on Whistle blowing, fraud and the European Union (synthesis carried out by Public Concern at Work); in 1996, La transaction dans l'Union Européenne, rapport de synthèse (Known as 'Labayle Report').

⁸⁹ The first association was constituted in Italy in October 1990, and by 1993 all Member States had an association. See also De Moor, L (1993) The Associations of Lawyers for the Protection of the Financial Interests of the European Community (Speech to the founding symposium of the European Criminal Law), in Europäische Einigung und Europäisches Strafrecht, ed U. Sieber, Carl Heymanns Verlag, Bonn, 29-33.

Commission with the European Court of Auditors, often in the past strained by long drawn-out contradictory procedures,⁹⁰ has now improved.

2.2.1. IGC agenda

The position of the Commission in relation to the protection of the financial interests of the European Communities, it suggests in its IGC report, remains paradoxical on two grounds.⁹¹ Firstly, at the moment Council measures to control expenditure and combat fraud require an unanimous vote,⁹² whereas a qualified majority is enough to act as the budgetary authority and determine expenditure and revenue levels.⁹³ This means that potentially one Member State can veto a measure aiming to protect the financial interests of the European Communities, whilst no such possibility exists in the determination of revenue or expenditure. Secondly, the Commission alone is responsible for budget execution,⁹⁴ whereas the management of expenditure is mostly decentralised.

Notwithstanding the paradoxical position the Commission finds itself in, it has been able to improve the

⁹⁰ This procedure involves audit letters and reports being sent to the auditee with a request for a written reply within a given time-limit. The reply may be preceded by bilateral discussions in order to clarify any matters in dispute. In keeping with this practice, the Annual Report of the ECA includes responses from the institutions.

⁹¹ See European Commission (1995) *Préparation CIG 1996 contribution du Conseil, information aux délégations extérieures de la Commission*, info-note number 20/95, May; also European Commission (1995) SEC (95) 731 Final, Report on the operation of the Treaty of the European Union, May.

⁹² For example under Article 235 EC and 209 EC.

⁹³ Article 203 EC.

⁹⁴ Articles 205 EC and 201a EC.

coordination of its anti-fraud work through the work of UCLAF and COCOLAF.

2.2.2. *The work of UCLAF*

Since 1988 the Commission has been assisted in its fight against fraud by UCLAF (the coordinating unit for the fight against fraud), set up in order to replace the inter-service group responsible for on-the-spot checks which was attached to DG XX (Financial Control). The unit's main aim when it came into existence was to coordinate anti-fraud policy and effort within the Commission. To emphasize the general broad-based nature of its duties, it was decided to place UCLAF within the Secretariat General of the Commission rather than within an existing Directorate-General.⁹⁵ The majority of the 130 UCLAF personnel have been employed, in their respective Member States, in Customs, Police services with responsibility for financial crime, national audit offices, agricultural ministries' verification departments, etc.⁹⁶

UCLAF is responsible in the Commission for all aspects of the fight against fraud affecting the budget. It is split into six divisions, dealing respectively with legislation, intelligence gathering, Structural Funds, Own Resources, and two separate divisions handling agriculture. Its operational mission is primarily to support the Member States where they need co-ordination with other Member States and the relevant services of the Commission. UCLAF fulfils its mission mainly by

⁹⁵ See Knudsen, B (1994) Global programme of the European Community's fight against fraud, in *The legal protection of the financial interests of the Community: Progress and prospects since the Brussels seminar of 1989*, Oak Tree Press, Dublin, pp 247-251.

⁹⁶ See European Commission, UCLAF (1996) 17 questions on fraud, February.

investigation into suspected fraud cases with the aim of both establishing the sums at risk to be recovered and preparing a case suitable for submission to public prosecutors in the Member States. Such cases are entered into UCLAF's IRENE database and now number over 20,000.⁹⁷ Whilst UCLAF has the power to request that investigations be carried out by the competent services of the Member States involved, it may also take the lead in an investigation, while maintaining co-operation with the Member States concerned. This course of action is taken when the investigation cannot be carried out effectively without coordination with other Member States; for example, where elements of an important fraudulent operation appear to exist in various Member States simultaneously, or where evidence has to be obtained outside the Community. UCLAF also takes part in bringing forward legislative proposals which tighten legislative loopholes, seek equivalent treatment of EU fraud at both the administrative and criminal level, and give the Commission the power to undertake on-the-spot controls.

2.2.3. COCOLAF

In 1994 an advisory Committee for the coordination of fraud prevention was set up under Article 209a.⁹⁸ The Commission consults the Committee, made up of two representatives from each Member states, on matters relating to the prevention and the prosecution of fraud affecting the EC budget. This can be seen as an addition to the 'sectoral' Committee approach adopted hitherto, and thus an attempt to deal with the protection of the financial interests of the European Communities cross-sectorially.

⁹⁷ See newspaper article: 'Commission fraudbusters hot on the scent of misused Union funds' (feature) in *European Voice*, 10-16 October 1996, page 19.

⁹⁸ Commission decision 94/140 OJ L 61/27.

2.3. The European Court of Auditors

In view of the key role played by the European Court of Auditors in highlighting financial mismanagement and fraud, a slightly longer section is dedicated to its role and agenda for change.

2.3.1. Duties and powers

The creation in 1977 of a Court of Auditors, with specific responsibility for the external audit⁹⁹ of Community revenue and expenditure, followed from the creation of an autonomous budget of the European Communities, separate from those of the Member States, and managed by the European Institutions.¹⁰⁰ Since the implementation of the Treaty on European Union, the now re-named European Court of Auditors (ECA henceforth) occupies the rank of European Institution together with the Commission, Council, the Court of Justice and the European Parliament.¹⁰¹ This means, *inter alia*, that the ECA now has the power to defend its own opinions against other Community institutions in law. It acts as an external, independent auditor of European public

⁹⁹ An external audit is carried out by a body which is external to and independent of the auditee, the purpose being to give an opinion on and report on the accounts and the financial statements, the regularity and legality of operations, and/or the financial management (Everard, P and Wolter, D (1989) Glossary Selection of terms and expressions used in the external audit of the public sector, OOPEC).

¹⁰⁰ The Court of Auditors of the European Communities (now European Court of Auditors) was created by the Treaty of 22 July 1975, signed in Brussels, but did not become operational until 25 October 1977 when it took over from the EEC and Euratom Audit Board and from the ECSC Auditor.

¹⁰¹ Article 4 EC.

finances. The ECA is a collegiate body¹⁰² without judicial, or decision-making powers.¹⁰³ Notwithstanding these institutional constraints, it has been coined as 'the financial conscience' of the Union¹⁰⁴ and more colourfully by the media as 'the watchdog snapping at the heels of the institutions'.¹⁰⁵ As such it acts as a catalyst in the fight against waste and fraud. The ECA's institutional presence, however, is felt mostly through its reports and opinions,¹⁰⁶ and as such its power is one of persuasion in relation to the Commission in particular.

Generally speaking, the ECA has a duty to assist the European Parliament and the Council in exercising their powers of control over the implementation of the budget,¹⁰⁷ a task carried out mainly within the procedure for the discharge in respect of the implementation of the budget.¹⁰⁸ This includes submitting observations, particularly in the form of Special Reports, on specific questions and delivering opinions at the request of one of the other institutions of the Community.¹⁰⁹ The ECA

¹⁰² Article 188c(4) EC, third indent replacing Article 206b (3) EEC states that ' It [The Court] shall adopt its annual reports, special reports or opinions by a majority of its members.'

¹⁰³ See Bugnot, P (1982) La cour des comptes des communautés européennes Premier bilan, in *Revue du Marché Commun*, 609-623.

¹⁰⁴ Court of Auditors (1995), *po. cit.* pp 8-12.

¹⁰⁵ See newspaper article: 'Watchdog snapping at the heels of the institutions' in *European Voice*, 10-16 October 1996, page 19.

¹⁰⁶ The most important of these is the Annual Report, published in the Official Journal in November each year.

¹⁰⁷ Article 188c (4) EC, fourth subparagraph.

¹⁰⁸ Article 206(1) EC.

¹⁰⁹ Article 188c(4) EC, second subparagraph.

draws up an Annual Report after the close of each financial year, which is forwarded to the other institutions of the Community and is published, together with the replies of these institutions, in the Official Journal of the European Communities.¹¹⁰ The nature of the ECA's role and responsibilities point to a natural alliance with the European Parliament, and a constant dialogue with the Commission, whose responsibility it is to maintain budgetary discipline in accordance with the principle of sound financial management and to implement the budget.¹¹¹

It has been suggested that the powers of the ECA, which have already helped to improve Community financial procedures, have only marginally changed since 1977.¹¹² Be that as it may, the bulk of the work undertaken by the ECA has increased in line with the budget. At present it employs some 250 staff to audit revenue and expenditure representing approximately 4-5% of the total budgets of all the Member States.¹¹³ The European budget alone has been multiplied by a factor of 2.7 in ten years, rising from 28 800 million ECU in 1985 to 79 800 million ECU in

¹¹⁰ Article 188c (4) EC, first subparagraph.

¹¹¹ Articles 201 and 205 EC; Article 22(1), first subparagraph of the Financial Regulation.

¹¹² Church, J and Phinnemore, P (1994) European Union and European Community A handbook and Commentary on the post-Maastricht Treaties, Harvester Wheatsheaf, 292-294.

¹¹³ European Court of Auditors (1995) The European Court of Auditors Auditing the finances of the European Union, June, p 13.

1995.¹¹⁴ The ECA carries out the audit¹¹⁵ which is based on records, and if necessary, performed on the spot at the institutions of the Communities and in the Member States.¹¹⁶ It examines the accounts of all revenue and expenditure of all bodies set up by the Community for legality and correctness in so far as the relevant constituent instrument does not preclude such examination.¹¹⁷ It also examines whether financial management has been sound.¹¹⁸

The Treaty on European Union has added one new element to the ECA's tasks. It is now required to provide the European Parliament and the Council with a Statement of Assurance (SOA or DAS) as to the reliability of the accounts and the legality and regularity of the underlying transactions.¹¹⁹ The specific role of the ECA in testing the integrity of financial systems takes even more importance in the light of this new duty. The first

¹¹⁴ English version of the Report by the Court of Auditors to the 'Reflection Group' on the operation of the Treaty on European Union, May 1995, page 2.

¹¹⁵ Article 188a EC.

¹¹⁶ Article 188c (3) EC, first subparagraph.

¹¹⁷ Article 188c (1) EC, first subparagraph. The principle bodies audited on this basis are: the general budget of the Union and of the EEA, Community loans and borrowings, the Euratom Supply Agency, the European Centre for the Development of Vocational Training in Berlin, the European Foundation for the Improvement of Living and Working Conditions in Dublin, the European Schools, JET (Joint European Torus - research project on thermonuclear fusion), the EAC (European Association for Cooperation).

¹¹⁸ Article 188c(2) EC, first subparagraph; Article 2 of the Financial Regulation states that the budget appropriations must be used in accordance with the principles of sound financial management, and in particular those of economy and cost-effectiveness. Quantified objectives must be identified and the progress of their realization monitored.

¹¹⁹ Article 188c(1) EC, second subparagraph.

SOA¹²⁰ was delivered in November 1995 and found that the accounts for 1994 accurately reflected the revenue and expenditure, as well as the financial situation, of the Union, although their informative value should be improved. However it was not possible to give an assurance that all chargeable imports had actually been declared and had yielded the corresponding revenue. With regards to the expenditure part of the budget, there were too many errors in the transactions underlying the payments entered in the accounts for the court to be able to be able to give a positive global assurance of their legality/regularity. This, one would assume, sets the tone for future SOAs.

In the introduction to its 1993 Annual Report, the ECA points out that many of the problems it identified in accounting and financial management in 1983 had not yet been overcome. The ECA deplored that the development of Community activities had not been accompanied, either in the Commission or in the Member States, by a commensurate development of the necessary financial management. Furthermore, control systems and insufficient resources, both in quantity and in quality, had been allocated to ensuring the best use of public money.¹²¹ As a rule, it seems that the follow up of reports has been largely unsatisfactory,¹²² and that the ECA's influence has left something to be desired.

¹²⁰ European Court of Auditors (1995) Statement of Assurance concerning activities financed from the general budget for the financial year 1994.

¹²¹ Court of Auditors Annual Report for the 1993 financial year, see *supra*, page 5.

¹²² See O'Keefe, D (1994) The Court of Auditors, in Institutional dynamics of European integration Essays in honour of Henry G. Schermers, Volume II, eds. D. Curtin and T. Heukels, Martinus Nijhoff Pubs, page 183.

2.3.2. The ECA's consultative role

The present system distinguishes between compulsory and optional consultation. Under Article 209 EC, the ECA must be consulted during the legislative process, with respect to financial regulations - when they specify a procedure to be adopted for establishing the budget and for presenting and auditing accounts¹²³ when the methods and procedures with regards to cash payments are being determined,¹²⁴ and finally when rules concerning the responsibility of financial controllers, authorizing officers, and concerning appropriate arrangements for inspection are concerned.¹²⁵ These are, in fact, quite limited circumstances obliging the other institutions of the Union to consult the ECA.

The ECA may be consulted on matters not covered under Article 209. Under Article 188c(4) EC the ECA may, at any time, submit observations, particularly in the form of special reports, on specific questions and deliver opinions at the request of one of the institutions of the Community.¹²⁶ These special reports usually record the audit results obtained in specific management areas. In fact it looks as if only moderate use is made of the option to seek an opinion from the ECA. Out of 66 opinions produced between 1977 and 1990, 48 were produced under Article 209 (the compulsory procedure) and only 18

¹²³ Article 209(a) EC.

¹²⁴ Article 209 (b) EC.

¹²⁵ Article 209(c) EC.

¹²⁶ Article 206a (4) EEC, second subparagraph was replaced by Article 188c (4) EC, second subparagraph. The phrase 'particularly in the form of special reports' was added to the latter for clarification.

under Article 206a EEC (the optional procedure).¹²⁷ The ECA also produces reports *sui generis*.

Sitting rather uncertainly between those circumstances when other Community bodies must consult the ECA and those when they may, there has arisen an intermediate category of uncertain obligation, which perhaps we may call *good intentions*. For example, an agreement had been concluded between the Commission and the ECA, whereby the European Commission undertook, firstly, to propose that the Council should consult the ECA regarding any proposals which have a significant effect on the financial and budgetary mechanisms of the Communities and, secondly, to consult the ECA with regard to any similar measures within the scope of its own powers. But, according to Strasser, it seems that this agreement has had hardly any effect.¹²⁸ As a result the ECA was not asked for an opinion on the draft Regulation on the protection of the Community's financial interests.¹²⁹ Undeterred, the ECA produced an opinion in February 1995.¹³⁰ This opinion was not, however, published in the Official Journal. It is not surprising that, in its submissions to the IGC Reflection Group, the ECA asked for the compulsory procedure to be extended to any draft legislation which affects the Community's budgetary and financial mechanisms, particularly if they involve financial control.

¹²⁷ See Strasser, D (1991) *The finances of Europe*, p 277.

¹²⁸ Strasser, D (1991) *The finances of Europe*, p 277.

¹²⁹ Council Regulation 2988/95 OJ L 312/1 on the protection of the European Communities' financial interests.

¹³⁰ Observations de la Cour des Comptes sur la proposition de règlement (CE, EURATOM) relatif à la protection des intérêts financiers des Communautés ainsi que sur une proposition d'acte portant établissement de la convention relative à la protection des intérêts financiers des Communautés (document COM (94) 214 final du 15 Juin 1994), February 1995.

2.3.3. Budgetary control

The ECA objects to basic principles of financial control being flouted. The principles of separation of roles in financial control, and the principle of budgetary unity in particular have an important role to play in fraud (and corruption) prevention. The separation of roles means that the different roles of the various financial officers managing the funds be clearly defined and mutually exclusive. The principle of budgetary unity requires that all financial transactions concerning a public body be brought into a single document known as its budget, which is then voted on by its budgetary authority.¹³¹ Some attention is now paid to these principles and to their importance for the development of a Union whose activities, rather than being criminogenic, must be transparent, democratic, and cost-effective.

(i) Principle of separation of roles in internal control¹³²

One basic principle of financial control is that the management of funds be kept separate from the monitoring of their utilization. This basic principle of financial control is flouted when this function of independent surveillance is carried out by the same department whose expenditure is to be scrutinized.

¹³¹ Article 199 EC; Article 4 of the Financial Regulation; also Schmitt, V (1988) Dix ans de travaux de la cour des comptes européenne Essai de typologie pp 282-283; Strasser, 1991, The finances of Europe p 42.

¹³² Internal control is defined as 'all the procedures and means making it possible to comply with the budget and the rules in force, to safeguard assets, ensure the accuracy and reliability of accounting data and facilitate management decisions, in particular by making financial information available at the appropriate time.' (Everard, P and Wolter, D (1989) Glossary Selection of terms and expressions used in the external audit of the public sector, OOPEC).

In relation to the European budget this means that the duties of the authorizing officer, financial controller and accounting officer are mutually incompatible.¹³³ The authorizing officer alone is empowered to enter into commitments regarding expenditure, to establish entitlements to be collected and issue recovery orders and payment orders.¹³⁴ Each institution has an accounting officer, who is responsible for the collection of revenue and the payment of expenditure¹³⁵ The accounting officer alone is empowered to manage moneys and other assets and is responsible for their safekeeping. The financial controller is responsible for monitoring the commitment and authorization of all expenditure and the establishment and collection of all revenue. The financial controller acts as 'internal auditor' and is thus responsible for monitoring the commitment and authorization of all expenditure and the establishment and collection of all revenue.¹³⁶

Title V of the Financial Regulation only offers vague definitions of the roles of financial officers. However Article 126 of the Regulation requires that '[I]n consultation with the European Parliament and the Council and after the other institutions have delivered their opinions, the Commission shall adopt implementing measures for this Financial Regulation.' This requirement is reiterated in Article 209(c) EC: '[T]he Council [...] shall [.....] lay down rules concerning the responsibility of financial controllers, authorizing officers and accounting officers, and concerning appropriate arrangements for inspection.'

¹³³ Article 21, fourth subparagraph of the Financial Regulation.

¹³⁴ Article 21 of the Financial Regulation.

¹³⁵ Article 25 of the Financial Regulation.

¹³⁶ Article 24 of the Financial Regulation.

Although they have been hailed as a priority by the ECA for several years,¹³⁷ such implementing rules have yet to be agreed. As a result there sometimes occurs a 'slippage' in the separation of functions within the system of internal financial control. The financial controller gives an ex-ante approval to the authorizing officer. This prior approval all too often has the effect of encouraging the authorizing officer to offer his subsequent approval. Although the financial controller has the power¹³⁸ to submit an expert report to his institution (in particular with relation to the principle of sound management), he may be, as the ECA observes, naturally reluctant to do this in respect of expenditure for which he has already granted ex-ante approval. As a rule, the ECA has been very critical of internal financial control. In some cases, it reports a lack of rigour. It notes that in 1993 advance payments were made by the Commission on a quasi-automatic basis and on the basis of very superficial checks,¹³⁹ without proper examination of the underlying transactions.¹⁴⁰ Furthermore in 1992 the Commission granted financial assistance for the organization of 20 scientific conferences concerned with the coordination of projects in the Member States. In two cases, it even made 'advance payments' even though the conferences in question has ended several weeks earlier. Despite the fact that in five cases those who received the advance payments failed to submit their final accounts, this failure did not

¹³⁷ See for example Lelong, P (1989) *La cour des comptes des communautés européennes: Sa mission, son bilan, l'Europe en formation*, number 274, pp 35-44.

¹³⁸ Article 40 of Regulation 3418/93 laying down implementing procedures for the Financial Regulation.

¹³⁹ Court of Auditors Annual Report for the 1993 financial year, OJ (1994) C 327, p 164, 9.6.

¹⁴⁰ *ibid*, 9.6.

elicit any reaction from the Commission.¹⁴¹ They may also be carried out without the necessary, complementary, external audit. In 1993 the Commission adopted a plan of action in order to improve the quality of the European Development Fund's financial management, which hitherto did not come under the ambit of the ECA. The reasons advanced by the Commission for excluding Development Fund from the external audit of the ECA was that the Directorate-General for Development Aid had built up a satisfactory financial control system of its own. The ECA opposed this view, because it found it to be contradictory to the principle of separation of functions (found in Article 21 of the Financial Regulation). The Directorate-General for Development Aid had not only assumed sole responsibility for financial control, but also for accounting. On examination of the EDF's financial management, the ECA found that there were many operations whose eligibility was questionable. The Commission was not able, for example, to identify the various transactions accounting for a sum of at least 2,5 million ECU.¹⁴² The ECA concluded that a body appointed by the institution should make an investigation to determine how far individuals were liable in the Commission's departments.¹⁴³ But in the absence of a disciplinary framework defining liability, this may be difficult.

(ii) Principle of budgetary unity

If the separation of functions has an important role to play in preventing corruption, the principle of budgetary unity helps to ensure the equally important democratic accountability and transparency in Community finance.

¹⁴¹ *ibid*, 11.38(e).

¹⁴² *ibid*, p 271.

¹⁴³ *Ibid*, pp 284-285, 15.117-15.126.

In 1967 the budgets of the three communities were merged.¹⁴⁴ This helped to bring about the observance of the principle of budgetary unity, which requires that all financial transactions concerning a public body should be brought into a single document known as its budget, which is then voted on by its budgetary authority.¹⁴⁵ The ECA examines the accounts of all bodies set up by the Community only in so far as the relevant constituent instrument does not preclude such examination,¹⁴⁶ so it is not the case at the moment that all the Community's revenues and expenditure appears in the budget. Thus, there remain important exceptions to the principle of budgetary unity.¹⁴⁷ For example, in its Annual Report for the financial year 1993,¹⁴⁸ the ECA points out that in the context of several contracts signed with the Council of Europe in Strasbourg (about 1,5 Million ECU), the Commission agreed to subordinate the ECA's audit rights to the provisions of the Financial Regulation of the Council of Europe and only to authorize them to be exercised via the Council of Europe's Audit Committee. Situations of this sort undermine the audit powers of the ECA as laid down in the Treaty and given concrete

¹⁴⁴ See Article 20 of the Treaty signed in Brussels on April 1965, and which came into force on 1 July 1967 (known as the Merger Treaty) as amended by Article 10 of the Treaty of Luxembourg. The EEC budget, the operational budget of the EAEC and the administrative budget of the ECSC were merged into a single budget.

¹⁴⁵ Article 199 EC; Article 4 of the Financial Regulation; also Schmitt, V (1988) Dix ans de travaux de la cour des comptes européenne, pp 282-283; Strasser, 1991, The finances of Europe p 42.

¹⁴⁶ Article 188c (1) EC.

¹⁴⁷ See for example Strasser, D (1991) The finances of Europe, pp 44-47.

¹⁴⁸ Court of Auditors Annual Report for the 1993 financial year, OJ (1994) C 327, page 254, 14.90 on cooperation with the countries of Central and Eastern Europe.

expression, in the case in point, in Article 87, fifth subparagraph of the Financial Regulation, which states that 'the grant of Community funds to beneficiaries outside the institutions shall be subject to an audit being carried out by the ECA on the utilization of the amounts granted'. This has lead the ECA to argue that it should be entitled to audit all revenue and expenditure managed on behalf of the Community.¹⁴⁹ At present Article 188c(3) EC does not cover the inspection of records in institutions which are independent from the Member States and were not set up by the Communities (for example, the European Investment Bank)¹⁵⁰ or bodies set up by and managing funds for the Communities, but whose constituent instrument does not provide for control by the ECA (for example, the International Olive Oil Council). Within the context of the 1996 IGC, the ECA has proposed that the same Article be amended so as to include them (see part iv).¹⁵¹ In addition the field of application of the ECA's

¹⁴⁹ Court of Auditors report for the IGC, op.cit., p 4.

¹⁵⁰ Articles 198d and 198e EC; also Protocol annexed to the Treaty on European Union, 1992. The EIB's task is to contribute to the balanced and steady development of the common market in the interests of the Community. It does this by granting loans and giving guarantees which facilitate the financing of projects. This includes projects in less-developed regions, modernisation or development projects and projects of common interest in several Member States. It also facilitates the financing of investment programmes in conjunction with assistance from the structural funds and other Community financial instruments.

¹⁵¹ The proposed amended text reads (emphasis added): 'The audit shall be based on records and, if necessary, performed on the spot in the other institutions of the Community, **on the premises of any body which manages revenue and/or expenditure on behalf of the Community and in the Member States.**' The rest of the subparagraph remains unchanged, whilst the next subparagraph reads: 'The other institutions of the Community, **any body that manages revenue and/or expenditure on behalf of the Community** and the national audit bodies or, if these do not have the necessary powers, the competent national departments, shall forward to the Court of Auditors, at its request, any document or information necessary to carry out

audit powers should be clarified in areas which are not, or are only partly, covered by the 1992 Treaty on European Union. The ECA is now required to audit expenditure incurred under the second and the third pillars and which is chargeable to the budget of the European Communities.¹⁵² It has also been asked to audit expenditure chargeable to the Member States on a sliding scale basis (for example the EUROPOL budget) so it argues that these new duties should be acknowledged. It therefore suggests that it should be included under Article E EC, together with the other institutions.¹⁵³ In order to consolidate its auditing powers, the ECA argues that it should have access to the European Court of Justice for rulings on disputes arising from its lack of access to records. Although access to records must be a *sine qua non* of auditing, such access has occasionally been refused to the ECA (by the Commission, the Member States or private concerns) which is then unable to appeal against the decision.¹⁵⁴ Although other European institutions and their financial personnel have access to the Court of Justice, the ECA has no such access if disputes arise in the performance of its auditing duties. To guarantee the ECA access to the Court of Justice would

its task'. Article 188c(3) EC does not explicitly cover access to the records of private beneficiaries.

¹⁵² Article J.11, paragraph 2, first sub-paragraph and Article K 8, paragraph 2, second sub-paragraph, first indent.

¹⁵³ The proposed amended Article E EC reads (emphasis added): 'The European Parliament, the Council, the Commission (...) the Court of Justice and the Court of Auditors shall exercise their powers under the conditions and for the purposes provided for, on the one hand, by the provisions of the Treaties establishing the European Communities and of the subsequent Treaties and Acts modifying and supplementing them and, on the other hand, by the other provisions of this Treaty.'

¹⁵⁴ Article 188c (3) EC.

entail two additions to the Treaty.¹⁵⁵

This state of affairs has led the ECA to prioritise budgetary unity within the framework of the 1996 IGC: 'The Court should be automatically entitled to audit all revenue and expenditure managed on behalf of the Community'¹⁵⁶ - so that no Community income or expenditure be outside the reach of democratic control.

2.4. The European Court of Justice

The European Court of Justice (ECJ henceforth) ensures that the law is observed in the interpretation and application of the EC Treaty. The Treaty on European Union broke new ground by giving the ECJ the power to fine Member States that fail to comply with its judgements [Article 171(2)], but it excluded the new fields of Common Foreign and Security Policy (CFSP henceforth) and Justice and Internal Affairs (JHA henceforth), save when conventions adopted by the Member States make provision for it. Within the consultation process of the IGC, the Court has made a few suggestions which are relevant to the protection of the financial interests of the European Communities.

¹⁵⁵ The proposed additions to the Treaty read as follows. Article 280(a) EC: 'The Court of Justice shall have jurisdiction in disputes concerning such rights and prerogatives as have been conferred on the Court of Auditors by this Treaty'. Article 188c (5): 'Any infringement of the rights and prerogatives of the Court of Auditors may be placed by the latter before the Court of Justice. If the Court of Justice finds that an infringement has occurred, the persons responsible shall take such steps as may be necessary to comply with the Court of Justice's ruling'.

¹⁵⁶ See supra, Court of Auditors report for the IGC, 1995, p 4.

The ECJ contribution¹⁵⁷ to the Reflection process prior to the IGC stresses the need for a uniform application of the law throughout the Union but notes that, under Article L, it has no competence to decide cases in the field of Justice and Internal Affairs. A recent case confirms that it has no competence to interpret Article B.¹⁵⁸ According to the findings of the ECJ, there is at present no way of obtaining a ruling on certain constitutional matters.

The ECJ contribution was written in early June 1995, that is to say, before the Regulation and the convention for the protection of the financial interests were agreed. It therefore looked back to an earlier convention, concerning the Simplified Extradition Procedure. This, the first Convention to be signed under the third pillar, did not grant the Court any competency in dispute resolution. But things have moved on since then, with four new conventions on third pillar matters being signed in June 1995. The present author suggests that, of these, the Convention on the Protection of the Communities' financial interests may be seen as a breakthrough. It grants the Court the competence to interpret the provisions of the Convention by way of preliminary rulings, and to determine disputes arising out of the operation of the Convention, on application from a Member State or the Commission, when disputes have not been settled within six months.¹⁵⁹

Surprisingly, there are few key rulings in the area of the protection of the financial interests of the European

¹⁵⁷ European Court of Justice (1995) Rapport de la Cour de Justice sur certains aspects de l'application du Traité sur l'Union Européenne, May.

¹⁵⁸ Case C-167/94 Grau Gomis, judgement of 7 April 1995, nyr.

¹⁵⁹ Article 8 of 'PIF' Convention, OJ (1995) C 316/48.

Communities. *Commission v Greece*¹⁶⁰ has crystallised Member States' duties and competence with regards to the application of sanctions, and *Germany v Commission*¹⁶¹ has clarified the competence of EC institutions in imposing sanctions. The jurisprudence has also clarified the rights of operators when Community sanctions are involved.

2.4.1. Member States' duties and competence

According to Article 5 EC, Member States have a duty to take all appropriate measures to ensure fulfilment of the obligations arising out of the Treaty. This has been compared to the German doctrine of 'Bundestreuepflicht' or duty of loyalty.¹⁶² In particular, when governments of the Member States make decisions, they must be in accordance with the rule imposing on Member States and the Community institutions mutual duties of sincere cooperation.¹⁶³ Those requirements include the 'obligation of general diligence',¹⁶⁴ as specifically embodied in Article 8(1) and (2) of Council Regulation 729/70 with regard to the financing of the CAP, according to which Member States must (i) satisfy themselves that transactions financed by the Fund are actually carried out and are executed correctly, (ii) prevent and deal with irregularities and (iii) recover sums lost as a

¹⁶⁰ 68/88 *Commission v Greece* ECR [1989] 2965.

¹⁶¹ *Ibid.*

¹⁶² Contantinesco, V (1987) *L'article 5 CEE, de la bonne foi à la loyauté communautaire Du droit international au droit de l'intégration*, in *Liber Amicorum Pierre Pescatore*, eds: F. Capotorti, C-D Ehlermann, J. Frohwein, F. Jacobs, R. Joliet, T. Koopmans, R. Kovar, pp 97-115.

¹⁶³ See 230/81 *Luxembourg v European Parliament ('seat' case)* [1983] ECR 255, at 37.

¹⁶⁴ Case C-34/89 *Italy v Commission* ECR [1990] I 3603, at 12.

result of irregularities or negligence.

As part of this duty of diligence, the Member States must initiate any proceedings under administrative, fiscal or civil law for the collection or recovery of duties or levies which have been fraudulently evaded or for damages.¹⁶⁵ In the Amsterdam Bulb case¹⁶⁶ the European Court of Justice ruled that 'In the absence of any provisions in the Community rules providing for specific sanctions to be imposed on individuals for a failure to observe those rules, the Member States are competent to adopt such sanctions as appear to them to be appropriate'. In Hansen¹⁶⁷ the Court ruled that '...[W]hilst the choice of penalties remains within their discretion, [the Member States] must ensure in particular that infringements of Community law are penalized under conditions, both procedural and substantive, which are analogous to those applicable to infringements of national law of a similar nature and importance and which, in any event, make the penalty effective, proportionate and dissuasive.¹⁶⁸ And, to drive the point home the Court added: '... [I]t continues¹⁶⁹ to be the task of the Member States to undertake prosecutions and proceedings for the purpose of the system of levies and refunds and to continue¹⁷⁰ to take steps to this end vis-

¹⁶⁵ Case C-352/92 Milchwerke Köln/Wuppertal EG v Hauptzollamt Köln-Rheinau [1994] ECR I -3385, at 23.

¹⁶⁶ Case 50/76 Amsterdam Bulb BV v Produktschaap voor Siergerwassen [1977] ECR 137, [1977] 2 CMLR 218.

¹⁶⁷ Case 148/77 Hansen v Hauptzollamt Flensburg [1978] ECR 1787; [1979] 1 CMLR 604.

¹⁶⁸ Ibid, at 2, second paragraph.

¹⁶⁹ Author's emphasis.

¹⁷⁰ Ibid.

a-vis the parties involved.¹⁷¹

Assimilation remains a problem in some Member States, where the legal system has yet to be adapted.¹⁷² It just means that a Member State may extend its (sometimes fairly ineffective) ways of tackling economic crime EC funds. Predictably the question of the Commission's normative competence to impose sanctions appears in the jurisprudence of the Court, and it did in *Germany v Commission*.

2.4.2. Commission competence

The Community's power to create penalties to be imposed by national authorities and necessary for the effective application of the rules in the sphere of the CAP, based on Articles 40(3) and 43(2) EC, has repeatedly been recognised by the Court,¹⁷³ be it in the form of a requirement to refund a benefit unduly received,¹⁷⁴ the loss of security equivalent to that benefit,¹⁷⁵ or the forfeiture of a security.¹⁷⁶ In *Germany v Commission*,¹⁷⁷

¹⁷¹ Ibid, at 16.

¹⁷² See for example Courakis, N (1996) Greece: Coping with EU fraud, *Journal of Financial Crime*, Volume 4, number 1, pp 78-84.

¹⁷³ Cases 357/88 *Oberhausener v BALM* [1990] ECR 1669; 25/70 *EVGF v Köster*, ECR [1970] 1161.

¹⁷⁴ Case 288/85 *Hauptzollamt Hamburg-Jonas v Plange Kraftfutterwerke* [1987] ECR 611.

¹⁷⁵ Case C-199/90 *Italtrade v AIMA* [1990] ECR I- 5545.

¹⁷⁶ Cases 11/70 *Internationale Handelsgesellschaft v Einfuhr-und Vorratstelle für Getreide und Futtermittel* [1970] ECR 1125; 137/85 *Maizena v BALM* [1987] ECR 4587, at 12; C-155/89 *Philipp Brothers* [1990] ECR I-3265, at 40; C-199/90 *Italtrade v AIMA* [1991] ECR I-5545, at 10; 122/78 *Buitoni v FORMA* [1979] ECR 677; *Man (Sugar) v IBAP* [1985] ECR 2889.

¹⁷⁷ Case C-240/90 *Germany v Commission* [1992] I-5385.

the Court went one step further and held that exclusion from a scheme within the CAP came within the implementing powers which the Council may delegate to the Commission under Articles 145 and 155 EC. This is because penalties such as a surcharge on the reimbursement with interests of a subsidy paid, or exclusion for a certain period of a trader from a subsidies scheme are measures intended to *further* the CAP and the proper financial management of the Community funds designated for their attainment.

Following the ruling in *Germany v Commission*,¹⁷⁸ which established Community competence to impose penal-administrative sanctions, two questions arose in relation to the Community's powers to impose sanctions. The first concerns its competence to impose sanctions beyond the CAP (i.e to other parts of the EC budget), and the second relates to its competence to impose penal, rather than purely administrative, sanctions.

The 'PIF' Regulation¹⁷⁹ now extends the Community's competence to impose penalties beyond the sphere of the CAP.¹⁸⁰ This means that the Community now has competence to impose the types of penalties enumerated in Article 5 of the 'PIF' Regulation (ranging from fines to loss of deposit) to other parts of the budget. This now makes it possible, for example, to extend a specific regime of penalties to affect the collection of import duties, which as we shall see is badly affected by fraud.

With regards to the Community's competence to impose penal sanctions, the Court has consistently declined to be drawn into the distinction between penal sanctions

¹⁷⁸ C-240/90 *Germany v Commission* [1992] ECR I-5383.

¹⁷⁹ Council Regulation 2988/95 OJ (1995) L 312/1 on the protection of the European Communities' financial interests.

¹⁸⁰ *Ibid*, 12th preamble.

(the sole preserve of the Member States) and administrative sanctions (where the Community has a normative competence). Administrative sanctions apply without prejudice to criminal sanctions imposed in the Member States. The fact that fraud is due to the negligence of a producer, is not sufficient to invest the sanction with a penal character, given that fraud, and even more so negligence, is as much a concept of the civil as of the criminal law.¹⁸¹

2.4.3. *Rights of operators*

Penalties such as fines are imposed under both criminal and civil/administrative law in the Member States. In criminal law, the defendant's behaviour is the main issue in court, whilst in administrative decisions what is at stake is the legitimacy of the decision.

Administrative sanctions have increasingly been incorporated into regulations since a landmark case,¹⁸² which acknowledged the Commission's power to introduce penalties with a punitive, rather than merely remedial or compensatory character into regulations. Such penalties are not meant to replace criminal proceedings in the Member States, but rather they set minimal sanctions to be applied, irrespective of criminal proceedings.

The question has arisen as to whether or not increasing the share of administrative penalties against reprehensible behaviour does not tilt the balance of powers in favour of the executive.¹⁸³ At the national

¹⁸¹ Case C-240/90 Germany v Commission, at 16.

¹⁸² Case 240/90 Commission v Germany ECR (1992) I 5383.

¹⁸³ De Doelder, H (1994) The enforcement of economic legislation, in Administrative law application and enforcement of Community law in The Netherlands, ed J. Vervaele, Kluwer, pp 133-142.

level, although there have been studies concerned with the change of relationships between the judiciary and the legislature, little has been formulated on the consequences for the rule of law resulting from such a shift of judicial functions from the judiciary to the executive. Administrative sanctions do not automatically fall under the ambit of Article 6(1) ECHR.

In the Könecke¹⁸⁴ and Maizena¹⁸⁵ cases, the Court ruled that 'a penalty, even of a non-criminal nature, cannot be imposed unless it rests on a clear and unambiguous legal basis.' Furthermore, a penalty must not be retroactive.¹⁸⁶ It must be appropriate and necessary and proportionate to the objectives to be attained,¹⁸⁷ and must only be applied after the person concerned has had an opportunity to make known their views.¹⁸⁸ The requirement of judicial control also applies to administrative decisions.¹⁸⁹ According to

¹⁸⁴ Case 117/83 Könecke v Balm [1984] ECR 3291.

¹⁸⁵ Maizena v BALM [1987] ECR 4587.

¹⁸⁶ Case 63/83 R v Kirk ECR [1984] 2689, at 22: '[T]he principle that penal provisions may not have retroactive effect is one which is common to all the legal orders of the Member States and is enshrined in Article 7 of the European Convention for the Protection of Human Rights and Fundamental Freedoms as fundamental right; it takes its place among the general principles of law whose observance is ensured by the Court of Justice.'

¹⁸⁷ Cases C-319/90 Pressler v Germany [1992] ECR I-203, at 12; C-326/88 Anklagemyndigheden v Hansen [1990] ECR I-2911; 15/83 Denkavit [1984] ECR 2171; 122/78 Buitoni v Forma [1979] ECR 677; 66/82 Fromençais v Forma [1983] ECR 395.

¹⁸⁸ Case 85/76 Hoffman-La Roche v Commission (vitamins) [1979] ECR 461.

¹⁸⁹ Johnston v Chief Constable of the RUC [1986] ECR 1651 at 18.

Schockweiler,¹⁹⁰ the requirement of judicial control should apply, particularly when sanctions are involved.

But there has been more uncertainty whether the principle of equality of arms derived from Article 6(1) ECHR applies in administrative proceedings of a penal nature. The Court of First Instance has ruled that companies involved in antitrust proceedings, where the Community has the power to impose penalties directly, have a right to defend themselves,¹⁹¹ since the European Court of Justice has a duty to ensure that the procedural safeguards granted by ECHR are respected within the Community's legal order.¹⁹² This clarifies matters as far as competition hearings are concerned,¹⁹³ but what of administrative proceedings conducted in the Member States themselves, and which have for their objective the protection of the financial interests of the European Communities? There may be three (related) levels of difficulties in this area. Firstly, the case law of the Court of Human Rights is far from unequivocal as to whether penal-administrative sanctions should attract the same guarantees under 6(1) as criminal sanctions do. Secondly, learned commentators have argued that, because

¹⁹⁰ Schockweiler, F (1995) La répression des infractions au droit communautaire dans la jurisprudence de la Cour, La protection du budget communautaire et l'assistance entre états, in Proceeds of Luxembourg Conference, 12 May 1995, Luxembourg ARPE.

¹⁹¹ Case T-36/91, ICI, judgment of 29 June 1995, nyr.2

¹⁹² See cases C-260/89 ERT [1991] ECR 2925; also 46 and 227/87 Hoechst [1989] ECR 2859.

¹⁹³ See Van Der Woude (1996) Hearing officers and EC antitrust procedures The art of making subjective procedures more objective, Common Market Law Review, 33, 531-546.

the Community itself has not acceded to ECHR,¹⁹⁴ the Member States could conceivably 'find themselves in a situation in which they are required to take actions according to Community law which the ECHR forbids'.¹⁹⁵ This sounds rather far-fetched in view of the present incorporation of human rights into Community law, but it must be conceded that De Doelder may well have a point, since the implementation of the 'Black List' Regulation has come very close to creating such problems in the UK (see chapter 4). Thirdly, national administrative proceedings in general do not automatically ensure fulfilment of the same guarantees.¹⁹⁶ De Doelder has summarized the situation thus

The 'message' of both courts [ECJ and ECHR] is therefore not the same: the Court of Luxembourg gives Member States the task of imposing certain predetermined sanctions, while the Court in Strasbourg speaks in terms of 'reasonableness' and 'fairness'. The States are caught between two fires without a right-of-way rule.¹⁹⁷

2.4.4. Cooperation

The duty of 'sincere cooperation' must extend the

¹⁹⁴ In Opinion 2/94 CMLR [1996] 2 CMLR 265, the ECJ subsequently opined that as Community law stands, the Community had no competence to accede to the European Convention for the Protection of Human Rights and Fundamental Freedoms.

¹⁹⁵ Vermeulen, B (1994) The issue of fundamental rights in the administrative application and enforcement of Community law, in Administrative law application and enforcement of Community law in the Netherlands, Kluwer, page 47.

¹⁹⁶ De Doelder, H (1994) The enforcement of economic legislation, in Administrative law application and enforcement of Community law in the Netherlands, ed. J. Vervaele, Kluwer, page 141.

¹⁹⁷ Ibid, page 141.

Commission checks which are carried out in the Member States. This means that Commission officials have access to the same premises and to the same documents as national officials.¹⁹⁸ With respect to access to evidence, the Commission can be assimilated to the national authorities. National rules limiting access therefore also apply to the Commission. When the Commission has autonomous powers of inspection, national authorities have a duty to assist.¹⁹⁹ Member States also have a duty to cooperate with their national authorities by communicating information which is necessary for ensuring that Community law is applied.²⁰⁰ This duty is mutual, and the Commission also has a duty to cooperate with national authorities:

... [T]his duty of sincere cooperation is of particular importance vis-a-vis the judicial authorities of the Member States who are responsible for ensuring that Community law is applied and respected in the national legal system.²⁰¹

This requirement was added by the Treaty on European Union to the EEC Treaty:

¹⁹⁸ See case 267/78 Commission v Italy ECR [1980] 31; also Article 6(4) of Council Regulation 595/91 OJ (1991) L 67/11.

¹⁹⁹ Joined cases 46/87 and 227/88 Hoechst AG v Commission [1989] ECR 2859, at 4 second paragraph '....If the undertakings concerned oppose the Commission's investigation, its officials may, on the basis of Article 14(6) of Regulation 17 and without the cooperation of the undertakings, search for any information necessary for the investigation with the assistance of the authorities, which are required to afford them the assistance necessary for the performance of their duties. Although such assistance is required only if the undertaking expresses its opposition, it may also be requested as a precautionary measures, in order to overcome any opposition on the part of the undertaking.'

²⁰⁰ C-9/89 Spain v Council [1990] ECR 1383.

²⁰¹ Case C-2/8 Imm. J.J. Zwartveld and others [1990] ECR I-3365, at 1.

Without prejudice to other provisions of this Treaty, Member States shall coordinate their action aimed at protecting the financial interests of the Community against fraud. To this end they shall organize, with the help of the Commission close and regular cooperation between the competent departments of their administrations. (Article 209a, second paragraph).

2.5. The Council

The Council has a general duty to enact legislation, and indeed most laws are enacted by Council.

Under Article 209 EC, the Council acts unanimously on a proposal from the Commission and after consulting the European Parliament and obtaining the opinion of the Court of Auditors. Like the Commission and the European Parliament, it has budgetary duties. It makes financial regulations specifying the procedure to be adopted for establishment and implementation of the budget and for presenting and auditing accounts. It also determines the modalities for the payment of Own Resources into the budget. These tasks are carried out through the Budget Committee, which in turn reports to COREPER.²⁰² Importantly, it also lays down the rules concerning the responsibility of financial controllers, authorizing officers and accounting officers, and concerning appropriate arrangements for inspection.

2.6. The European Parliament

Generally, the European Parliament's power over the budget as a whole are limited. It does, however, have the right to reject the budget as a whole. But if it rejects

²⁰² Comité des Représentants Permanents; Committee of Permanent Representatives.

the budget, the Community can continue to spend at the same monthly rate as in the previous year.²⁰³ It is also responsible for granting discharge for the whole budget.²⁰⁴ The EP only refused discharge once in November 1984, when it refused discharge for the 1982 financial year. The Treaty on European Union strengthened the role of the EP by giving it power to demand information from the Commission about its execution of financial control, and by requiring the Commission to act on the EP's observations.²⁰⁵ The EP has the right to dismiss the Commission by a two-thirds majority,²⁰⁶ thus ensuring that the Commission pays a great deal of attention to its views. The EP generally wants to play a greater institutional role and this is reflected in its IGC proposals.

The European Parliament's IGC proposals²⁰⁷ can be divided between general concerns, those relating to budgetary control, those concerning other institutions and others.

2.5.1. General concerns

Generally the EP argues that it should have equal status with the Council in all fields of EU legislative and budgetary competence.

- Its role should be reinforced in those areas where there is currently inadequate scrutiny at European level,

²⁰³ Article 204 EC.

²⁰⁴ Article 206 EC.

²⁰⁵ Article 206 EC.

²⁰⁶ Article 144 EC.

²⁰⁷ European Commission (1995) Préparation CIG 1996 Contribution du Parlement Européen, information aux délégations extérieures de la Commission, info-note number 26/95, May.

for example in Justice and Internal Affairs. It stresses that the unanimity requirement has led to delays and to ineffective legislation in the past, and that consequently further extension of qualified majority voting is required if the EU is to function effectively. However for certain areas of particular sensitivity, unanimity will remain necessary, i.e Treaty amendment, 'constitutional decisions' (enlargement, own resources, uniform electoral system) and Article 235.

- Public access to EU documents should be greatly improved.

- The Union's powers in the agricultural sector largely evade the direct scrutiny of national parliaments and must be subject to greater democratic control by the European Parliament; in fact, responsibility for agricultural markets and prices policy, and thus for farm incomes policy, has long been outside the control of national parliaments.

- The democratic principle of the final adoption of the budget by the European Parliament must be maintained.

- Finally, the Treaty should be revised to permit tougher measures to be taken to combat fraud and other infringements of EU law, to permit wider-ranging investigations within the Member States (by means, for example, of a reinforced Article 138c) and to enable dissuasive penal and administrative sanctions to be imposed at EU level (with an article to permit harmonization directives in the area of relevant criminal law, and specifically obliging Member States to apply effective, proportionate, harmonised and deterrent penalties for breach of Community law).

2.5.2. Budgetary control

The EP finds Budgetary legislation confusing and asks that it be rationalised to distinguish between Own Resources decisions, financial regulation and budgetary discipline. Multi-annual financial programming should be incorporated into the Treaty. The income of the EIB should be treated as a Own Resource of the Community. The Union's budget should be the sole instrument for the realising the Union's objectives. The unity of the budget should be established, the Union budget incorporating the European Development Fund and CFSP and JHA expenditure and Community borrowing and lending.

The budgetary procedure should be simplified, more transparent and effective; the Commission's draft budget proposals should be the basis for the European Parliament's first reading.²⁰⁸

The distinction between compulsory and non compulsory expenditures should be abolished within a defined period; the European Parliament should be an equal partner for all expenditure.

2.5.3. Proposals concerning other institutions

The competence of the ECJ should be extended to areas relating to Justice and Internal Affairs and those covered by the Schengen agreement. The conditions for referring matters to the ECJ should be enlarged so that each institution of the Union should have the possibility (in addition to the means of redress in Article 173) of bringing an action in the Court where it considers that its rights have been infringed by the failure on the part of another institution or a Member State to fulfil a Treaty obligation.

²⁰⁸ European Commission (1995) Tableau comparatif des contributions du Conseil, de la Commission, du P.E, info-note number 32/95, May.

2.5.4. Other proposals

The EP proposes that when the Council is acting in its legislative capacity, its proceedings should be public and its agenda binding. The ECA should play its proper role in all the areas of EU activity.

2.5.5. The meaning of the EP agenda

The EP strongly supports the Commission in its efforts to control fraud affecting the budget. It even goes as far as recommending the constitutionalisation of the powers of the Commission checks in the Member States, and to harmonise criminal laws. On budgetary unity, it reflects the ECA's views (see above). Generally, the EP wishes to have equal access to all parts of the budget, in order to establish better accountability for the tax payer. This forward-looking agenda has its roots in the early concern the EP has shown in fraud control, and in its increasing involvement in matters relating to it.

2.5.6. The EP and fraud control

Historically, the European Parliament first showed concern over the protection of the Financial Interests of the European Communities in 1973, and subsequently through a number of reports.²⁰⁹ It also supported the 1976 proposal for a convention, which was subsequently shelved. At that time, the 1977 de Keersmaeker report²¹⁰ had already highlighted the need for sanctions, and in particular the need to ensure that Community fraud be given due consideration in the national laws of the Member States. In 1991 the Theato report reiterated the

²⁰⁹ De Keersmaeker Report (1977) EP document 531/76; Gabert Report (1984) EP document 1-1346/83; Guermeur Report 1987) EP document A2-251/86; Dankert Report (1989) EP Document A2-20/89; Theato Report (1991), EP document A3-0250/91.

²¹⁰ Ibid.

same concerns and deplored the fact that little progress had been made in that direction.

Of late, the EP's scrutiny of the Structural funds in particular, has increased. Whilst respecting the division of rule between the institutions as laid down by the Treaty, the revised Structural Funds legislation of 1993²¹¹ provides for a greater involvement of Parliament in the implementation of Community structural measures and as a result entails:

- forwarding to Parliament lists of the areas concerned in respect of Objectives 2 and 5b, the development plans submitted by the Member States, the Community Support Frameworks and the texts of the implementing regulations concerning monitoring and publicity.

- Notifying Parliament of the Community initiatives before their adoption, in order to enable the Commission to take note of Parliament's requests before each initiative

- providing regular and detailed information on the implementation of the funds.

(i) The budgetary control committee

Since 1973 the European Parliament (EP henceforth) has had a committee of sub-committee for budgetary control. The Committee's powers were determined by Parliament on 19 May 1983 and subsequently amended on 26 July 1989. The Committee is competent to examine, inter alia, the conditions of appropriations, the financing mechanisms and

²¹¹ See Articles 9(3), 11b(4), 16 of Council Regulation 2081/93 OJ (1993) L 193/5 (Framework Regulation) and Articles 10, 11, 23, 26(5), 32(2) of Council Regulation 2082/93 OJ (1993) L 193/30 (Coordination Regulation).

the administrative structures for putting them into effect, through a study of the cases of fraud and irregularity. Every quarter it reviews cases of fraud which are of interest. The Committee gives opinions on request or on its own initiative, to the parliamentary committees and other bodies of Parliament on matters within the field of budgetary control. Its busiest period is at the time of the discharge of the budget, at the beginning of every autumn. The committee, acting like the proverbial grit in the oyster, has been actively pressing the Commission to come up with credible strategies to fight fraud, the Council to pronounce on proposals for legislation, and has worked to improve communication strategies with the European Court of Auditors.²¹²

(ii) The temporary Committee of Inquiry²¹³

With fraud being high on the EP's agenda, it is not wholly surprising that the first Committee of Inquiry, set up under Article 138C EC, should be dedicated to it. The EP decided in 1995 that the subject of the inquiry should be to consider allegations of offences committed or of maladministration under the Community Transit System.²¹⁴ The TCI is due to report in January 1997 at

²¹² See European Parliament (1993) Rapport de la Commission du Contrôle Budgétaire sur les relations entre les organes de contrôle de budget communautaire, rapporteur John Tomlinson, A3-0320.

²¹³ On the setting up of the Committee and the necessary changes to the rules of procedure, see the following European Parliament reports: (1993) Les commissions parlementaires d'enquête des états membres de la CE, W3; (1994) Commission de règlement, de la vérification des pouvoirs et des immunités, PE 210.750; (1995), PE 212.084; (1995) Document de travail PE 211.818; (1995) Rapport PE 210.700; also Boyron, S (1995) Un pouvoir de contrôle confirmé: Les commissions temporaires d'enquête, report to the Commission Institutionnelle; Boyron, S (1995) Les commissions temporaires et les adaptations réglementaires nécessaires, ditto.

²¹⁴ Decision 96/C 7/01 OJ (1996) C 7.

the earliest,²¹⁵ and its work programme has included gathering evidence from all quarters (national Customs authorities, freight forwarders, national permanent representatives, commissioners, the International Chamber of Commerce, etc.). It will be interesting to see whether as a result of the inquiry, the Commission's anti-fraud programme is amended.

2.7. Discussion

the main function of the Commission, and in particular DG XX (Financial Control) has been to raise awareness, to make proposals, and to put forward implementing measures for existing secondary legislation. However, because the Commission's legislative proposals have to be adopted by an ^{unanimous} anonymous vote, they have often been shelved for long periods (e.g the 'PIF' Convention). Occasionally, the Commission's implementing efforts have seemed over-zealous to the Member States, as in the of the Code of Conduct attached to Council Regulation 4253/88,²¹⁶ which was subsequently annulled by the European Court of Justice (see chapter 4). Whether the handicap provided by the unanimity requirement is remedied through constitutional reform remains an open question at the moment. In this the EP's suggestion that certain powers of the Commission (in the field of inspection and harmonisation of criminal laws) be constitutionalised, and that qualified majority be extended to more areas pays lip service to the Commission.

But what are we to think of the ECA's quite detailed proposals, which are technical in as much as they deal with budgetary control, but nevertheless go to the heart

²¹⁵ According to the Rules of Procedure two three months extension are possible.

²¹⁶ OJ (1988) L 374/1.

of the problem? The ECA is playing an increasingly important role in the protection of the financial interests of the European Communities. Cynics might see in the ECA proposals merely an instance of a more general tendency for Community institutions to extend their powers. Be that as it may, specific proposals seem hard to fault - for example the need for all bodies handling EU funds to be subjected to an external audit must be heeded. A role for the Court of Auditors in investigations, an acknowledgement of its role under second and third pillars, and the possibility of appeal to the ECJ should also be given serious consideration. The request that the ECA be consulted in the legislative process when anti-fraud legislation is considered is difficult to rebut, yet may fail to gain a hearing, amongst the cacophony of other, more politically-visible issues projected for debate at the Inter-Governmental Conference.

If anything, pre-IGC reports should help to open up the discussion on fraud prevention through sound financial management, epitomised by the SEM 2000²¹⁷ initiative. The initiative²¹⁸ has already examined the possibility of extending the clearance of accounts procedure to the non-compulsory part of the budget, and has come to the conclusion that a new clearance procedure should be created for own resources.

²¹⁷ SEM 2000 is the acronym for the programme to improve financial management launched by the Commission in January 1995. Its full name is Sound and Efficient Financial Management, SEM 2000.

²¹⁸ See for example European Parliament, Budgetary Control Committee (1996) SEM 2000 Working document Rationalising controls Preventing fraud, PE 219.146; European Parliament, Budgetary Control Committee (1996) SEM 2000 Working document evaluation, PE 218.773; European Parliament, Budgetary Control Committee (1996) SEM 2000 Working document, Defining a methodological approach.

This signals the beginning of an era in which financial management promises to play a more dominant role in the fight against fraud.

PART II.

THE CONTROL OF INCOME AND EXPENDITURE FRAUD

CHAPTER 3. THE CONTROL OF FRAUD AFFECTING EC REVENUE

This chapter focuses on the control of fraud affecting traditional own resources (3.2.) and VAT-based own resources (3.3.), which are collected and controlled by the Member States themselves. First their respective history is examined briefly, and examples of fraud are given. This is followed by an expose of the Community control framework and Member States' responses. Proposed solutions are examined thereafter. The last part of the chapter (3.4.) deals with recent developments and prospects for improvement of the protection of the financial interests of the European Communities. Readers should note that the question of recovery of EC revenue has not been dealt with in any depth in this chapter, since a detailed case study has been included separately in part III.

3.1. Introduction: own resources

Community revenues are referred to as 'own resources'. This technically is a misnomer since the Community resources are collected by the Member States, and subsequently made available to the European Communities, as we shall see. The Council Decision of 21 April 1970 gave the Community for the first time 'financial autonomy through fiscal power',²¹⁹ by establishing a system of 'own resources' under Articles 201 and ~~173~~ EEC. At first own resources consisted of VAT, Customs duties and agricultural and sugar levies. In 1989 the own resources system was changed in order to accommodate a proportion of national GNPs, thus creating a regime of EC revenue raising which was felt to be more equitable. Decision

²¹⁹ See Strasser, D (1991) The finances of Europe, OOEPC, page 85.

88/376²²⁰ was closely followed by Council Regulations 1552/89²²¹ and 1553/89²²² laying down rules for the implementation of the amended regime. The regime was finally enshrined in the EEC Treaty when 201 EEC was amended by the Treaty on European Union to read:

Without prejudice to other revenue, the budget shall be financed wholly from own resources. The Council, acting unanimously on a proposal from the Commission and after consulting the European Parliament, shall lay down provisions relating to the system of own resources of the Community, which it shall recommend to the Member States for adoption in accordance with their respective constitutional requirements.

(Article 201 EC)

In the absence of a Community tax-collecting authority²²³ the system of 'own resources' means that Member States must make available to the Community budget a small proportion of their VAT and GNP, as well as various levies and duties. Levies, premiums, supplementary or compensatory amounts, additional amounts of items and other duties established at present or in the future by the institutions of the Communities in respect of trade with non-member countries, within the framework of the CAP and any other contributions and other duties established within the common organisation of the markets in sugar have been described by the Commission as 'traditional own

²²⁰ Council Decision 88/376 OJ (1988) L 185/24 on the Communities' own resources.

²²¹ Council Regulation 1552/89 OJ (1989) L 155/1 implementing Decision 88/376 on the system of the Communities' own resources.

²²² Council Regulation 1553/89 OJ (1989) L 155/9 on the definitive uniform arrangements for the collection of own resources accruing from value added tax.

²²³ Article 8(1) of Council Decision 88/376, supra.

resources' in order to distinguish them from (VAT-based) own resources. The payment of traditional own resources into the EC budget derives from the application of the Common Customs Tariff²²⁴ (CCT) to the Customs value of goods imported from third countries. It is to traditional own resources that we turn first.

3.2. Fraud and traditional own resources

Revenue frauds are prevalent in particular in the area of agricultural and Customs levies. The administration of sugar levies, however, is held to be relatively straightforward and leaves little scope for exploitation.²²⁵ Agricultural levies and Customs duties are collected by the Member States' Customs authorities from traders importing goods into the Community. Fraud occurs when a trader evades paying duty to the Customs authorities by, for example, misleading the authorities about the source of the goods, or the nature of the product he is transporting. The Common Customs Tariff alone contains over 4,000 product codes,²²⁶ so the scope for fraud (and error!) due to misdescription alone is vast. It is generally acknowledged that inward transits (i.e imports to the Community) are more susceptible to

²²⁴ Council Regulation 950/68 [1968] I OJ Spec. Ed. 275. The CCT was established even before the date provided for in the Treaty (1 January 1970), namely on 1 July 1968. The combined nomenclature of the system, which is based on the Harmonised Commodity Description and Coding System (Council Regulation 2658/87 OJ (1987) L 256), is reviewed annually.

²²⁵ Sherlock, A and Harding, C (1991) Controlling fraud within the European Community, *European Law Review* 16:20-36, page 22.

²²⁶ 'For processed goods, a further 932 product codes exist, 1,416 recipes and 14,000 non-standard recipes'. See Leigh, L and Smith, A (1991) Some observations on European fraud laws and their reform with reference to the EEC, *Corruption and reform* 6: 267-284, page 268.

fraud than outward transits (exports).²²⁷

Levies and duties are designed to bring the prices of imported goods to the level of Community prices. The product's country of origin does not generally affect the size of the levy. However, the system is complicated by preferential arrangements such as the Generalised Scheme of Tariff Preferences,²²⁸ which allows goods from certain developing countries discounts on levies and duties. Imports from third countries are regulated by Council Regulations 3285/94²²⁹ and 519/94.²³⁰ The Regulation includes a simplification and standardisation of the import formalities to be fulfilled by importers when surveillance or safeguard measures are applied.

3.2.1. *Fraud cases*

In external transit frauds goods are sometimes released onto the Community market *qua* Community goods, in order to evade duties (see cases 3 and 4). In all cases the correct determination of origin, following Article 24 of the Community Customs Code²³¹ and the jurisprudence of the Court²³² is of crucial importance to the integrity of

²²⁷ European Parliament (1996) Committee of Inquiry into the Community Transit System Response from the Irish Permanent Representation to the European Union, April, page 2.

²²⁸ The GSP was first adopted by the Community in 1971.

²²⁹ Council Regulation 3285/94 OJ (1994) L 349/53.

²³⁰ Council Regulation 519/94 OJ (1994) L 67/89. The countries listed in the Regulation includes countries whose economies are in transition towards a market economy, except where the Community has entered into an Association Agreement [] or a free trade agreement with the country concerned.

²³¹ Council Regulation 2913/92 OJ L 302/1.

²³² Disputes over the origin of goods have often arisen in relation to fish and shell fish, for example in case 100/84 *Commission v United Kingdom* [1985] ECR 170 and more recently in joined cases C-153/94 and C-204/94 *Faroe Seafood* ruling of

Community revenue, as illustrated by the four cases below.

Case 1: False Community origin: dairy products

In 1994 Spanish Customs found that certain companies had been purchasing dairy products from the Czech and Slovak Republics and releasing them onto the Community market with a false Spanish Customs' declaration. As a result some 15.7 million ECU of duties were evaded.²³³

Case 2: False preferential origin: bicycles from Vietnam²³⁴

In 1995 the Commission²³⁵ found that all the components used to make over 520 000 bicycles which were subsequently released onto the Community market (in particular the UK, Belgium, Germany and Denmark), did not actually originate from Vietnam, but from China and Hong Kong. The certificates of preferential origin from the Vietnamese authorities were therefore incorrect and the Customs duties evaded ran to 6.85 million ECU. In view of the circumstances in which the products were assembled,

14 May 1996, nyr; or in relation to products acquiring added value through processes of manufacture, for example cases 49/76 *Überseehandel v Handelskammer Hamburg* [1977] ECR 41, 34/78 and 114/78 *Yoshida* [1979] ECR 115 and 151; 162/83 *Cousin* [1983] ECR 1101, C-26/88 *Brother International v HZA Giessen* [1989] ECR 4253.

²³³ European Commission (1996) *Protecting the Community's financial interests the fight against fraud Annual Report for 1995* COM(96) 173, page 51.

²³⁴ See also newspaper article '"Mafia gangs involved" in 1 billion pounds EU frauds', in *Guardian* 9 May 1996, page 10.

²³⁵ Under Article 15b of Council Regulation 945/87 amending Regulation 1468/81 OJ (1987) L 90/3, the Commission may carry out administrative and investigative missions in third countries in coordination and close cooperation with the competent authorities if the Member States.

anti-dumping duties totalling 9.78 million may also be payable.²³⁶

Case 3: External transit fraud: sugar

In 1994 the German authorities informed the Commission about a case of fraud involving the dispatch of sugar originating in the Czech Republic and Poland to Morocco and Angola in transit through the Community. The goods, transported under the TIR system, were in fact released in Spain and Portugal, after Customs documents with forged stamps were presented. Evaded duties amount to 9 million ECU.²³⁷

Case 4: External transit fraud: beef

Beef from Argentina was unloaded in Rotterdam and placed under the external Community transit arrangements for carriage to Croatia. Forged Italian Customs documents were presented in Nice, and the beef was subsequently released onto the Italian market. Some 700 tonnes of beef were involved and the duty evaded totalled around 3 million ECU.²³⁸

Fraud in the EU transit forms an important part of the fraud with Customs duties. In contravention of transit arrangements, goods are not presented at the Customs office of expected destination. Instead, they are released onto the Community market without payment of the duties and other taxes which are due. Alternatively, Customs documents certifying the presentation of goods at the office of destination, or guarantees are forged,

²³⁶ European Commission (1996) Protecting the Community's financial interests, the fight against fraud Annual Report for 1995 COM (96) 173, page 62.

²³⁷ Ibid, page 54.

²³⁸ Ibid, page 55.

using stolen or counterfeit stamps. Up to now there has been no way of cross-checking the authenticity of Customs stamps. At the moment itineraries are not binding,²³⁹ so it is possible for cargoes to get 'lost' in this way. In the 'Greek Maize' case²⁴⁰ for example, maize originating from (the then) Yugoslavia was presented to the Belgian authorities, complete with false declaration of origin from Greece. The fraud had been carried out with the complicity of some Greek senior civil servants - hence the relevance of the fight against corruption in order to protect EC revenue (see chapter 6 on corruption).

The practices mentioned above (non-reporting, forgery of certificates) are particularly lucrative to the fraudster when the goods are, as the Commission describes them, 'sensitive'.²⁴¹ Sensitive goods fall into two categories. Firstly, some goods are sensitive because they attract a high level of indirect taxation, for example tobacco or alcohol. A single container load of cigarettes, for example, can attract duties and taxes of approximately 1 million ECU. This situation has prompted some commentators to suggest that cigarette smuggling was now more lucrative, and certainly less risky than illegal drug smuggling. Other sensitive, or high-risk goods attract high levels of subsidy or refund under the CAP (see chapter 3). Since the opening up of the borders to central and Eastern Europe in particular, the transit of sensitive products seems to have been targeted by

²³⁹ See for example European Parliament Committee of Inquiry into the Community Transit System (1996) Contribution submitted by the Danish Freight Forwarders Association in Copenhagen, March, at point 12.

²⁴⁰ Case 68/88 Commission v Greece ECR (1989) 2965.

²⁴¹ White, S (1996) The transit system in crisis: Argument for European Customs? Irish Journal of European Law, vol 2, pp 225-237.

criminal networks.²⁴²

3.2.2. Transit in the EU and beyond

Since the completion of the single market in 1993, under the Community Transit System, all goods transported within the Customs territory of the Community have been treated as Community goods unless demonstrated otherwise.²⁴³ This has had the effect of eliminating Customs formalities on such goods whilst on the territory of the Community. The Common Transit System, an extension of the Community Transit System to EFTA countries²⁴⁴ (Iceland, Norway and Switzerland), will include 22 participants after the Visegrad²⁴⁵ countries (Poland, Hungary, the Czech Republic and the Slovak republic) join in July 1996,²⁴⁶ in the first stage of an extension to

²⁴² European Commission (1995) *Fraud in the transit procedure, solutions foreseen and perspectives for the future*, COM(95) 108 page 5; also Rump, J (1993) *The legal protection of the Community's financial interests as seen by Customs investigators in Germany, in The legal protection of the financial interests of the Community: Progress and prospects since the Brussels seminar of 1989*, OOPEC pp 133-138.

²⁴³ Commission Regulation 1214/92 OJ L (1992) 132/1 on provisions for the implementation of the Community transit procedure and for certain simplifications of that procedure.

²⁴⁴ Convention on a common transit procedure, OJ (1987) L 226/1.

²⁴⁵ In February 1991 at Visegrad, in Hungary, the leaders of Hungary, Poland and what was then Czechoslovakia met to discuss their approach to European integration. They confirmed their wish for 'total integration into the European political, economic, security and legislative order' and agreed to cooperate in their progressive achievement of such integration.

²⁴⁶ Commission Decision 1/95 OJ (1996) L 117/13 of the EC-EFTA joint Committee on Common Transit concerning invitations to the Republic of Poland, the Czech Republic and the Slovak Republic to accede to the Convention of 20 May 1987 on a common transit procedure.

central and eastern Europe.²⁴⁷ Another transit regime also exists for countries outside the Common Transit System and which are signatories of the TIR Convention.²⁴⁸ Fifty eight countries world-wide are currently signatories of this convention, including all EU Member States taken both individually, and as the European Union.²⁴⁹

Main features of transit

The Common Transit System works according to a relatively simple principle. It allows for the suspension of duties and other charges during transit within the Common Transit territory, for goods coming from or going to third countries. The goods must be produced intact at the Customs office of destination within a prescribed time limit. This means that Customs controls are concentrated at the office of destination. The office of destination is therefore where most of the information on the consignment is, or should be, available. In practice, the procedure starts with the presentation of goods and the validation of a transit document at the Customs office of departure. One copy of the document²⁵⁰ is kept there. When the goods arrive at destination, the Customs authorities carry out the necessary controls, note the outcome on the document and return a copy to the office of departure. According to Article 96 of the Community

²⁴⁷ See Council Resolution OJ C (1995) 327/2 on the computerisation of customs transit systems, 11th preamble.

²⁴⁸ Customs Convention on the International Transport of Goods under Cover of TIR Carnets signed in Geneva, 1975.

²⁴⁹ Council Regulation 2112/78 OJ (1978) L 252. Implementing provisions for the TIR Convention and the Community Transit System are now both included in the Community Customs Code OJ (1992) L 302 and OJ (1993) L 253.

²⁵⁰ Commission Regulation 2453/92 OJ (1992) L 249/1 implementing Council Regulation 717/91 concerning the Single Administrative Document.

Customs Code,²⁵¹ the 'principal' (usually the forwarding agent) is responsible for ensuring that the goods are presented at the office of destination. If he fails to do so, a Customs debt is incurred. Guarantees may be lodged in order to ensure the collection of duties and other charges in the event of irregularities. The most common type of guarantee is the comprehensive guarantee,²⁵² which allows its holder to carry out an unlimited number of transit operations, involving any Community Customs office.²⁵³

The TIR system works on similar lines. It enables road hauliers to seal their vehicles in the country of origin, travel across national frontiers without interference, and have all Customs clearance and documentation processed at the final delivery point. It does this through a system of 'carnets'. A system of guarantees is also in place, with a flat-rate guarantee of \$50,000 applying to each journey.²⁵⁴ The TIR system is administered centrally in Geneva by the IRU (International Road Transport Union) and operates through a chain of Guaranteeing Associations, which are normally national trade associations representing freight movers and/or the industry generally. Most associations have a dual function in that they guarantee to meet claims by their own national Customs authorities where these arise from irregularities in the use of carnets, irrespective

²⁵¹ Community Customs Code, op. cit.

²⁵² European Parliament Committee of Inquiry into the Community Transit System (1996) Progress Report number one, rapporteur: Mr Edward Kellett-Bowman, March, mimeoed text, page 7.

²⁵³ Article 360 of Commission Regulation 2454/93 OJ (1993) L 253 implementing the Community Customs Code.

²⁵⁴ European Parliament Committee of Inquiry into the Community Transit System (1996) Revised note on the TIR carnets and the 'Community' and 'Common' Transit procedures, March.

of the nationality of the carrier or the origin of the carnet. At the same time the majority of Associations also issue carnets to their own national members. According to the IRU, some three million TIR carnets are now issued per year, 70% of which are issued in Eastern Europe.²⁵⁵ Table 3.1. compares the main features of TIR and Common/Community transit.

Table 3.1.

TIR/Common Transit procedures: main differences

TIR	COMMON/COMMUNITY TRANSIT
58 member countries	15 EU Member States + EFTA + Visegrad countries
Single numerically identified document issued and administered centrally	T1/T2 forms
Managed by IRU and national affiliated authorities	Managed by Customs
2.3 million carnets issued annually	18 million documents issued annually
Guarantee arranged through IRU - Carnet holder responsible (usually transporter)	Principal responsible for guarantee (but usually indemnity arranged by national association)
Obligatory approval of vehicles	No approval of vehicles
Obligatory sealing of vehicles	No obligatory sealing of vehicles
TIR plate identifies vehicle	No specific identification
Period of transit fixed by transporter	Period of transit fixed by office of departure: normally 8 days

Note to table 3.1.

Source: reproduced with adaptations from European Parliament Committee of Inquiry into the Community

²⁵⁵ European Parliament Committee of Inquiry into the Community Transit System (1996) Hearing with Commissioners Mario Monti and Anita Gradin, 26 March.

Transit System (1996) Revised note on the TIR carnets and the Community and Common Transit procedures, 18 March, PE 216.559, page 4.

The Community Transit System was originally put in place in a Community of six members, three of which (the Benelux countries) already had a Customs union. Since then the Community has grown and the number of trade transactions has increased enormously, to the point where Customs have been unable to cope with the sheer volume of administrative formalities. One important aspect affecting Customs' ability to respond is that the abolition of internal frontiers has tended to lead to a reduction in the number of Customs personnel, and in funding for equipment. This has had a 'disarming' effect on Customs, with morale running particularly low in some regions.

Not unlike the Common Transit System, the TIR system too has acquired new contracting parties, and in particular countries from the ex-Soviet block, with weak and disorganised Customs administrations.²⁵⁶ In such an environment, Customs services often fail to investigate suspected cases of frauds and irregularities and do little more than submit claims under the (flawed) guarantee system when irregularities (see below). The TIR system guarantee chain is at present receiving 500 Customs claims per day.

3.2.3. *Community Control framework*

Council Regulation 1552/89²⁵⁷ lays down the rules for implementing Decision 88/376²⁵⁸ on the system of the Communities' own resources. This Regulation supersedes Council Regulation 2891/77. It lays down rules for the

²⁵⁶ See European Parliament Committee of Inquiry into the Community Transit System (1996) Contribution by Jean Duquesne, president of ODASCE, Paris.

²⁵⁷ OJ (1989) L 155/1.

²⁵⁸ OJ (1988) L 185/24.

making available of traditional own resources, but also for the reporting of irregularities and the recovery of sums due. It empowers the Commission to carry out joint checks with the national competent authorities, or to carry their own on-the-spot checks. Council Regulation 1552/89²⁵⁹ was amended in 1993²⁶⁰ and 1994,²⁶¹ mainly in order to tighten up the arrangements whereby the Member States make available to the Commission the own resources assigned to the Community.

(i) Notification, keeping of records, crediting to Communities' account

Regulation 1552/89²⁶² first establishes a framework for the establishment of amounts payable to the EC budget. According to Article 6(2) of Council Regulation 1552/89,²⁶³ the own resources that are to be made available to the Community are established entitlements which have been collected or for which securities have been provided. These entitlements are entered by the Member States into 'A' accounts kept in the Treasury of each Member State.²⁶⁴ Entitlements not entered in the accounts because they have not yet been recovered and no security has been provided must be shown in separate 'B' accounts. However some Member States have been slow in establishing this system.

²⁵⁹ OJ (1989) L 155/1.

²⁶⁰ Council Regulation 3464/93 OJ (1993) L 317.

²⁶¹ Council Regulation 2729/94 OJ (1994) L 293.

²⁶² OJ (1989) L 155/1.

²⁶³ Ibid.

²⁶⁴ Article 2(1) of Council Regulation 1552/89.

(ii) Reporting fraud

The situation prior to the adoption of Council Regulation 1552/89²⁶⁵ was one where Member States could communicate to the Commission 'information of particular interest' under Council Regulation 1468/81, which deals with mutual assistance. This had resulted in scant reporting and difficulties in accounting for own resources.²⁶⁶ From first January 1990 each Member State has had to submit to the Commission a brief half-yearly report on any fraud or irregularity involving an amount exceeding 10 000 ECU stating the measures adopted in order to prevent the recurrence of cases of fraud and irregularities.²⁶⁷ Yet the Commission wishes more detailed reporting. It has submitted proposals to improve the present quality of reports by amending Regulation 1552/89.²⁶⁸ The amendment would have the effect of strengthening the present system of documentary checks and thus provide additional information.²⁶⁹

(iii) Checks

Joint inspections were the first form of Community inspection to be introduced by the Commission, and to be

²⁶⁵ OJ (1989) L 155/1.

²⁶⁶ House of Lords (1989) Select Committee on the European Communities fraud against the Community session 1988-89 fifth report, HMSO, page 12.

²⁶⁷ Article 6 (3) second subparagraph of Council Regulation 1552/89.

²⁶⁸ OJ (1989) L 155/1.

²⁶⁹ European Commission (1993) Report of the Committee of Budgets on the Commission Proposal to the Council for amending Council Regulation 1552/89, November; European Commission (1994) Report from the Commission on the functioning of the inspection arrangements for traditional own resources, January, COM(93) 691.

carried out in accordance with Council Regulation 165/74.²⁷⁰ The distinguishing feature of joint inspections is that the prime responsibility for carrying out the inspection (i.e. fixing the dates, and purpose) rests with the Member States. The choice of site of inspection rests with the Member State concerned. Article 18 of Council Regulation 1552/89²⁷¹ provides that the Member States must carry out checks and enquiries concerning the establishment and the making available of own resources, and any additional checks requested by the Commission.

The Commission can also conduct its own on-the-spot checks.²⁷² But the conditions under which the Commission may carry out those checks are severely restricted: the Commission must notify the Member State in advance, specifying the reasons, so that, for the sake of efficiency, the Member State in question can appoint its own officials to participate in the checks. As for the nature of such checks, the Commission found in 1992 that 'in 1991 most man-days of inspectors were spent in monitoring the introduction of the B accounts [separate accounts for uncollected debts] in the Member States'.²⁷³ A later Commission report²⁷⁴ (1994) shows that the areas

²⁷⁰ Council Regulation 165/74 OJ (1974) L 20/1 determining the powers and obligations of officials appointed by the authorities of the Member States.

²⁷¹ OJ (1989) L 155/1.

²⁷² Article 12 of Council Regulation 1552/89.

²⁷³ European Commission (1992) Report on the application of Council Regulation 1552/89 implementing Decision 88/376 on the system of the Communities' own resources, December, COM (92) 530, OPEEC.

²⁷⁴ European Commission (1994) Report on the functioning of the inspection arrangements for traditional own resources, January, COM(93) 691.

covered in its on-the-spot inspections carried out between 1990 and 1992 were as follows.

Table 3.2.

On the spot inspections carried out by the Commission in 1990, 1991 and 1992.

1990	
Inward processing	29%
Presentation at Customs - release into free circulation of fishery products	29%
Separate accounts	14%
Imports of cattle from Eastern Europe - Community transit	14%
Postal traffic	14%
Total	100%

1991	
Separate accounts	92%
Special destination	8%
Total	100%

1992	
Imports under preferential agreements	56%
Sugar and isoglucose levies	33%
Imports of cattle from Eastern Europe	14%
Total	100%

Note to table 3.2

Source: European Commission (1994) Report on the application of the inspection arrangements for Traditional Own Resources, COM(93) 691.

It has been an on-going concern of the Commission that the national authorities responsible for the collection of own resources should be able to produce to authorized Commission officials the documents substantiating the own resources collected.²⁷⁵ Access to documents has occasionally proved problematic to the Commission. In case 267/78,²⁷⁶ the Court found that a Member State may not contest the Commission's power to exercise its supervision as soon as the Communities' Own Resources have been established by the competent national authorities. However rules which in the national systems of criminal law prevent the communication to certain persons of documents in criminal proceedings may be relied upon against the Commission.

Article 20 of Council Regulation 1552/89²⁷⁷ sets up the Advisory Committee consisting of representatives from the Member States and the Commission. One of the aims of the Committee is to examine and discuss the problems raised in inspection reports. The procedure is designed to ensure equal treatment for the Member States, at least for those affected by the issues concerned. Following discussion in the Committee, the Commission adopts its final position and informs the Member State concerned accordingly.

(iv) Mutual assistance in administrative matters

Council Regulation 1468/81²⁷⁸ lays down rules for mutual

²⁷⁵ Amended proposal for a Council Regulation amending Council Regulation 1552/89, COM(94) 458, OJ (1994) C 382/6.

²⁷⁶ Case 267/78 Commission v Italy [1980] ECR 31.

²⁷⁷ OJ (1989) L 155/1.

²⁷⁸ Council Regulation 1468/81 OJ (1981) L 144/1 on mutual assistance between the administrative authorities of the Member States and cooperation between the latter and the Commission to ensure the correct application of the law on

assistance and cooperation with the Commission in agricultural and Customs matters. Council Regulation 945/87 amending Regulation 1468/81 allows the Commission to carry out 'Community administrative and investigative missions in third countries in coordination and close cooperation with the competent authorities of the Member States'.²⁷⁹ In practice these regulations and the Naples Convention of 1967²⁸⁰ are sometimes used simultaneously when third countries are involved. According to Article 209 EC, which was added to the EEC Treaty by the Treaty on European Union, Member States should take the same measures to combat fraud prejudicial to the financial interests of the Community (see Chapter 1). Also

Without prejudice to other provisions in this Treaty, Member States should co-ordinate action aimed at protecting the Community's financial interests against fraud. To this end, they should organise, with the assistance of the Commission, close and regular collaboration between the competent services in their administrations.

In the synthesis report regarding measures to combat wastefulness and the misuse of Community resources in the Member States,²⁸¹ the author concluded that cooperation

customs or agricultural matters.

²⁷⁹ Article 15b of Council Regulation 945/87 amending Regulation 1468/81.

²⁸⁰ The Naples Convention of 1967 was concluded between the six original EC Member States and later extended to the other Member States, still with the exception of Portugal. The Convention also covers judicial assistance to a certain extent.

²⁸¹ European Commission (1995) Protection of the Community's financial interests, Synthesis Document of the comparative analysis of the reports supplied by the Member States on national measures taken to combat wastefulness and the misuse of Community resources, COM(95) 556.

instruments were not ignored by the Member States, who found this type of cooperation satisfactory. This assertion is supported by the European Court of Auditors. The number of cases involving Customs fraud and irregularities that have been the subject of exchange of information under Regulation 1468/81 between the Commission and the Member States has risen from 33 in 1988 to 534 in 1994 (114 cases were new in 1994). The Commission estimated that the total amount of traditional own resources at stake in these cases was more than 600 million ECU as of 31 December 1994 - the equivalent of 2% of net traditional own resources collected that year.²⁸² However response times remain slow. Differences of all kinds (administrative, legal, technical) hamper the movement of information between Member States. A number of suggestions were made by the Member States in order to improve this state of affairs. In particular the need for a basic requirement for rapid information on transnational fraud emerged from the 'wastefulness' report mentioned earlier,²⁸³ since fraud rarely developed in isolation in one country.

There are several instruments on Customs co-operation included in various treaties between the Community and its Member States and third countries: the Treaty on the European Economic Area, association Treaties with central and eastern European countries²⁸⁴ and treaties on co-

²⁸² European Court of Auditors Annual Report for the financial year 1994 OJ (1995) C 303, page 25.

²⁸³ European Commission (1995) Comparative analysis of the reports supplied by the Member States on national measures taken to combat wastefulness and the misuse of Community resources, November.

²⁸⁴ The European Agreements with the Czech Republic, Slovakia, Romania and Bulgaria entered into force on 1 February 1995, thus extending mutual assistance in the customs field beyond the confines of the Community.

operation with other third states.²⁸⁵ These instruments are relevant for the prevention and detection of EC fraud, and it is expected that they will lead to more information being exchanged. Now is the time to think of a monitoring system that measures the effectiveness of such cooperation agreements.²⁸⁶

3.2.4. An 'immature' regulatory framework?

Clearly, until recently the regulatory framework has focused mainly on the making available of the correct amount of resources, rather than the fight against fraud. Council Regulation 1552/89²⁸⁷ introduced Commission on-the-spot checks, and has upgraded mutual assistance requirements. However on-the-spot checks remain limited in scope, and mutual assistance slow.

It is only in 1994 that a new GSP system was conceived, which allowed for the temporary withdrawal of preferences in cases of fraud or lack of administrative cooperation from the beneficiary country in checking certificates of origin. In December 1995 Council Regulation 2988/95²⁸⁸ on the protection of the Community's financial interests was adopted. The Regulation has the effect, inter alia, of

²⁸⁵ In 1995 instruments containing protocols on mutual assistance in the customs field were initialled or signed with Tunisia, Morocco, Israel, Slovenia, and the trans-caucasian republics. Interim agreements were also signed with Belarus, Kyrgystan, Moldova, Russia and Ukraine. Negotiations are continuing with the Faroes, Jordan, Egypt, Lebanon, South Africa, the United States, Canada and South Korea. Lastly, the Customs Union with Turkey, which entered into force on 1 January 1996, also includes a protocol on mutual assistance in Customs matters.

²⁸⁶ Schutte, J (1995) Administrative and judicial co-operation in the fight EC fraud, in *The Dutch approach in tackling EC fraud*, eds M.S. Groenhuijsen and M.I.Veldt, pp 127-134.

²⁸⁷ OJ (1989) L 155/1.

²⁸⁸ OJ (1995) L 312.

extending to traditional own resources the Commission's approach to administrative penalties already in place for the Common Agricultural Policy (see chapters 1 and 3), and which the Court of Justice has consistently upheld.²⁸⁹ One of the Regulation's main features is the list of penalties, which can already be found in earlier CAP (sectoral) regulations. It also gives a much-awaited definition of irregularity in the context of EC fraud. The main strength of the Regulation is to set a basic legal framework for the formulation of uniform administrative penalties with the same force throughout the Union. The penalties can be set for fraud relating to any area of Community policy where they are required and for which there is a legal basis (except VAT-based own resources). The need to set up a system of sanctions has been highlighted by the Commission.²⁹⁰ Another horizontal regulation under consideration is a Council Regulation concerning on the spot checks and inspections by the Commission for the detection of frauds and irregularities detrimental to the financial interests of the European Communities.²⁹¹ This Regulation would empower the Commission to ask officials of Member States other than that on whose territory inspections and checks are being performed to take part in them. The Commission would also be able to call on outside bodies to provide technical help to perform inspections. These officials or nominated bodies would work closely with the national authorities. This proposal has met with considerable resistance from

²⁸⁹ Cases 240/90 Germany v Commission [1992] ECR I-5383 and 104/94 Cereal Italia Srl, judgement of 12 October 1995, nyr.

²⁹⁰ European Parliament Committee of Inquiry into the Community Transit System (1996) Hearing with commissioners Mario Monti and Anita Gradin, March, page 20.

²⁹¹ European Commission (1995) Proposal for a Council Regulation concerning on-the-spot checks and inspections by the Commission for the detection of frauds and irregularities detrimental to the financial interests of the European Communities, SEC (95) 9151 Final.

certain Member States' governments, who have complained about the 'multiplicity of controls' and have invoked subsidiarity against its adoption.²⁹²

Nevertheless both horizontal instruments are particularly important in the field of fraud control for traditional own resources. This is because Community control has tended to lag behind other areas, particularly those concerned with the CAP. However the widening of the Commission's inspection powers is delicate, since it involves a degree of interference with national tax-raising authorities.

Guarantees: scope for reform

At the moment, about 18 million transit declarations (in quadruplicate) per year are processed manually by Customs under the Common Transit System²⁹³ and 2.3 million TIR carnets are issued every year, also manually. As a result Customs authorities have found it increasingly difficult to cope with the sheer volume of work, and, not surprisingly, have accumulated a backlog. With the extension of Common Transit to the Visegrad countries, the pressure on the system can only increase. Criticisms of the administration of the present system have already

²⁹² Myard, J (1996) *Combattre la fraude: Un défi pour les quinze* Rapport d'information déposé par la délégation de l'Assemblée Nationale pour l'Union Européenne sur la proposition de règlement du conseil relatif aux contrôles et vérifications sur place de la Commission aux fins de la constatation des fraudes et irrégularités portant atteinte aux intérêts financiers des communautés Européennes, French National Assembly Publications Kiosk.

²⁹³ European Parliament Committee of Inquiry into the Community Transit System (1996) Contribution from FENEX, Nederlandse Organisatie voor Expeditie en Logostiek insake communautair douanevervoer, Rotterdam, May, page 4.

been voiced by the European Court of Auditors²⁹⁴ and by the Commission.²⁹⁵ These criticisms seem to fall broadly under two categories. Firstly they highlight poor administration of the system generally. Secondly they note failure by the Member States to notify and to recover sums due. The two categories are briefly examined below.

Generally speaking, the Commission²⁹⁶ finds that Customs authorities in the Member States do not appear to give sufficient priority to transit controls. This means that investigations are not always carried out with the urgency required. Operators must present goods and documents to the Customs office of destination within certain time limits.²⁹⁷ However, in practice, these time limits do not appear to be respected. In addition, there is failure to impose penalties where the time limits are also not respected.

The late presentation to the Customs office of departure of the copy to be returned results in an accumulation of uncleared documents. In some cases, delays in transferring documentation between Customs offices seem so great that it would be impossible to respect the time limits laid down by Community legislation without a major effort to clear the backlog, bearing in mind the accumulated delays.

The two main criticisms in this area are that the amounts

²⁹⁴ Court of Auditors Annual Report for 1994, OJ (1995) C 303, 1.45 - 1.89; also previously Court of Auditors for 1987, OJ (1988) C 316, 3-17 et seq.

²⁹⁵ European Commission (1995) op.cit.

²⁹⁶ European Commission (1995) op.cit.

²⁹⁷ Twenty days in the case of air transport and 45 days in the case of sea transport.

recovered on the basis of Regulation 1552/89²⁹⁸ are very small and that only a few cases notified on the basis of the Regulation are subject to legal proceedings.

Three comments can be made in relation to the dearth of court proceedings, which according to the Commission, only number 22 out of 1000 cases. Firstly, the difficulties involved in getting different jurisdictions, and/or administrations to cooperate, in what is still basically a collection of national-territorial judicial spaces, should not be underestimated. Initiatives to improve cooperation have already been launched by the Commission. Secondly, the impact of insolvencies should not be overlooked, nor the relative ease with which economic operators -- in some jurisdictions -- can be discharged of their financial obligations, or alternatively just 'disappear' and 'resurrect'. In understanding this, a comparative analysis of the Member States' insolvency regimes might help to assess the situation better. Thirdly, a recent study commissioned by the Commission's Directorate of Financial Control and carried out in each of the Member States has shown that extra-judicial settlements were commonplace, particularly in Northern Member States.²⁹⁹ It follows that the number of court cases may not be even an approximate indicator of the effort exerted in order to recover funds, so in future the Commission may need to refine this particular indicator.

In some circumstances, recovery may be hindered by

²⁹⁸ Council Regulation 1552/89 OJ L (1989) 155/1 implementing Decision 88/376 on the system of the Communities' Own Resources.

²⁹⁹ See Labayle, H (1996) La transaction dans l'Union Européenne (Synthesis report for the studies carried out in the fifteen Members States concerning the settlement of fraud in cases affecting the EC budget), OOEPC.

specific aspects of the regulatory framework.³⁰⁰ In particular, there are shortcomings in the rules concerning guarantees and connected with the time limit of three years imposed by the Customs Code.³⁰¹

The rules concerning guarantees

One way in which the authorities can recover duties and charges, in the event of an irregularity, is through guarantees (securities),³⁰² which can be provided either by a cash deposit, or through a guarantor. Guarantees can apply on a fixed-rate basis, for a single operation, or be comprehensive. In some cases, securities are optional, that is to say required at the discretion of the Customs authorities in so far as they consider that a Customs debt which has been or may be incurred is not certain to be paid within the prescribed period. But in practice, Customs sometimes fail to demand guarantees when sensitive or high-risk goods are involved, or guarantees are sometimes insufficient to cover any debt which might be incurred.³⁰³ '[T]oo often, Customs administrations have been too slow to take action and have allowed guarantees to be unduly liberated or have failed to act against the Principal or against the other parties involved.'³⁰⁴

³⁰⁰ See European Commission (1995) Report on the recovery of Traditional Own Resources in cases of fraud and irregularities, September, COM(95) 398 Final, pp 10-11.

³⁰¹ Article 218(3) and 221(3) of the Customs Code, 2913/92 OJ L (1992) 302.

³⁰² Articles 189-200 of the Community Customs Code; also Council Regulation 3712/92 OJ L 378/15.

³⁰³ European Commission (1994) Report on the functioning of the inspection arrangements for traditional own resources, COM(93) 691.

³⁰⁴ European Parliament TCI (1996), written statement of Commissioner Liikanen, op.cit.

Particular problems arise in connection with the 'comprehensive' guarantee. A comprehensive guarantee document allows the holder to carry out an unlimited number of transit operations by road simultaneously. It is therefore the most flexible arrangement for traders, since it allows a series of operations by the same principal over a period of time. The amount of the guarantee is calculated according to a percentage of the import duties and other charges payable on the goods carried under the transit system on average during a week of the preceding year. The percentage varies according to the degree of risk involved. One criticism of this procedure is that there is no monitoring of the balance not yet committed or available. As a result, a comprehensive guarantee is often used to cover fresh transit operations although part or even all of the amount concerned has already been committed to cover non-discharged operations or operations under inquiry.³⁰⁵ Member States may request an authorization from the Commission to ban comprehensive guarantees for certain exceptional risk products,³⁰⁶ but in 1996 this possibility had only been used on two occasions. In 1995 the Commission adopted a Decision³⁰⁷ authorizing the Customs administration in Spain to take specific measures to forbid temporarily the use of the comprehensive guarantee for external community transit operations involving cigarettes. In 1996 another Decision³⁰⁸ was

³⁰⁵ European parliament Committee of Inquiry into the Community Transit System (1996) Reply from the Court of Auditors, March, page 5.

³⁰⁶ Article 360 Commission Regulation 2454/93, see supra.

³⁰⁷ Commission Decision 95/521 OJ (1995) L 299/24 adopting specific measures to temporarily prohibit use of the comprehensive guarantee for certain transit procedures.

³⁰⁸ Commission Decision 96/37 OJ (1996) L 10/44 adopting specific measures to temporarily prohibit use of the comprehensive guarantee for certain transit procedures.

adopted authorizing Germany to forbid temporarily the use of comprehensive guarantees for external Community transit for a list of goods such as bovine animals, frozen bovine meat, dairy products and oils, bananas and plantains, cereals and meslin, rye, sugar, undenaturated ethyl alcohol of 80% vol or higher and spirits, liqueurs and other spirituous beverages.

Principals, (who are usually the freight forwarders themselves) according to some representations made to the European Parliament, often lose both cargo and security.³⁰⁹ That is because in the absence of fixed itineraries, it is impossible for the Customs authorities to establish where the irregularity took place. The guarantee is often the only realistic chance of recovering lost revenue. As a result guarantors can find themselves responsible for a Customs debt, when in fact a third party is responsible for the fraud committed. In a communication of February 1996, the Commission noted the general reluctance of Customs to take action against debtors other than the principal.

The predicament of principals can be worse when high-risk goods are involved. Securities, in the case of 'high-risk goods such as cigarettes, were thought at one stage to be too low. In 1994, a 'special carnet' was established in the TIR system, requiring higher guarantees for alcohol and tobacco products. This measure backfired because, as a result of this increase, insurance companies are now refusing to insure such cargoes. Consequently the national associations and International Road Transport Union have now stopped the supply of carnets.

Notwithstanding this near-collapse of the system, the Commission still insists that higher guarantees are part

³⁰⁹ European parliament Committee of Inquiry into the Community Transit System (1996) Contribution submitted by the Bundesverband Spedition und Lagerei e.V., Bonn, March, mimeoed text; also from the Freight Transport Association, United Kingdom, March, mimeoed text.

of the answer to the transit crisis. But if one lesson has to be learned from the position of insurance companies, it is that commercial enterprise will not buttress an ailing system.

Another feature of the guarantee system is that if all goes well, the guarantor is released from his obligations twelve months after the date of registration of transit declaration. After three years the guarantor is automatically discharged if he has not been informed of the amount for which he is liable.³¹⁰

In practice Customs authorities often wait for 9 months or more to have elapsed before issuing the principal with a notification of non-discharge. The Court of Auditors found that some Customs authorities even waited until the end of the three year period after which, under Article 221(3) of the Customs Code, Customs debts cease to be enforceable, before they attempted to recover the guarantee.³¹¹ As a consequence a percentage of claims are time-barred.

Delays of several months are frequent in all the Member States, at the different stages of both the mutual assistance and the recovery procedures. The lack of procedures for coordination of recovery between the Member States contributes to this state of affairs. In complicated cases, there are signs that the three year time limit may be too short. Furthermore, Member States do not interpret this deadline in a consistent manner. In several Member States, national laws make provision for an extension of that period. This is not however the case in Denmark and the United Kingdom.

³¹⁰ Commission Regulation 2454/93 OJ (1993) L 253, Articles 359-379.

³¹¹ European Court of Auditors Annual Report for 1994, op.cit., page 28 and page 34.

3.2.5. Solutions foreseen

The solutions foreseen by the Commission can be divided into medium-term and long-term measures. Short term solutions include measures aimed at improving and strengthening transit legislation, and improving the detection of fraud. Long term solutions include the computerisation of the transit system, and a timetable has been established for the central development of this project (see table 3.3.).

Table 3.3.

Computerization of transit system: implementation, timetable and cost for central development

PHASES	PERIOD	TASKS	PROJECTED COST (ECU)
phase 0	1993-94	feasibility study	1 153 774
phase 1	1994-97	development of system specification	4 133 774
phase 2	1998-99	implementation and extension	10 526 000
phase 3	from 99	operation and maintenance	n/k

Note to table 3.3.

Source: European Commission (1996) Rapport Intermédiaire sur le transit, SEC(96)1739 annex V, page 5.

Medium term measures advocated are:-

(a) the introduction of the necessary flexibility to forbid throughout the Union the use of the comprehensive guarantee for those sensitive goods which present high risks of fraud;

(b) the introduction of an expedited procedure for returning and discharging transit documents concerning sensitive products, possibly including special identification of these documents;

(c) prohibiting a change of office of destination for sensitive goods (or at least allowing a change only on fulfilment of conditions which would enable the transport operation to be monitored);

(d) the drawing up of binding itineraries;

(e) the reduction of the time-limits and stages provided for under the inquiry procedure;

(f) the strengthening of the special Task Group set up by the Commission's Anti-Fraud Unit, UCLAF, charged in cooperation with Member States with taking all appropriate measures in the operational frameworks necessary to combat fraud in this sector.

(g) fuller involvement of economic operators in action to defeat fraud, (including clear legal provisions to create a shared financial responsibility for transporters); and

(h) strengthening administrative and operational cooperation with countries neighbouring the European Union.

Longer-term measures

As far as longer term measures are concerned, computerisation of the transit system has been put forward. This would mean that consignment details would be entered at departure. Those details would be transmitted electronically over an international network, to an office of destination in another country. The system would provide inquiry procedures for consignments which had not been discharged within the time allowed for their movement. Additionally, the system would be used for a better management of the system of guarantees, and risk analysis techniques would be applied to particular consignments. It is understood that such a system would have to be backed up by a number of physical controls at offices of destination. The system is not expected to be finalised before 1998 at the earliest.

3.2.6. Responses from the Council and the European Parliament

In its Resolution³¹² of November 1995 the Council agreed that computerisation of transit systems was the most important measure in the medium term to alleviate the serious problems currently affecting the system and that achieving it must be accorded absolute priority. It also called upon the Commission to proceed with work within its competence related to the same computerisation and called upon the Member States to allocate resources to the project in order to make it operational by 1998. Finally it called upon the Member States and the Commission to cooperate closely and coordinate their efforts with a view to attaining common objectives, and to make use of modern Customs techniques, such as risk-

³¹² Council Resolution OJ C (1995) 327/2 on the computerisation of customs transit systems.

analysis and audit-based controls.

In December of the same year, the European Parliament exercised its right, under Article 138c EC, to set up a Committee of Inquiry to investigate alleged contraventions or maladministration in the implementation of Community law.³¹³ According to the Parliament's Rules of Procedure,³¹⁴ the temporary³¹⁵ committee submits to Parliament a report on the results of its work, including minority opinions if appropriate. The report is due to be published in January 1997. It will recommend improvements with regard to the detection and prevention of fraud, the safeguarding of the Community's economic and financial interests and the recovery of sums due.³¹⁶

3.2.7. A question of integration?

The transit system offers a considerable challenge to the integrity of EC revenue. The Commission has put forward proposals to deal with the present crisis, which include reforms to the regulatory framework in the near future, and computerisation of the system in the longer term. The Council and the Commission have both pointed out that pending the computerisation of transit systems, it is essential for up-to-date Customs techniques to be applied, in order to improve the operation of current

³¹³ See European Parliament (1995) Request for the setting up of a temporary committee of inquiry to consider allegations of offences committed or of maladministration under the Community Transit System, PE 195.288/9.

³¹⁴ Under Article 4(3) of the Decision of the European Parliament, the Council and the Commission of 19 April 1995 on the detailed provisions governing the exercise of the European Parliament's right of inquiry, and Rule 136(10) of Parliament's Rules of Procedure.

³¹⁵ Article 136(4) of the Parliament's Rules of Procedure.

³¹⁶ European Parliament Decision OJ (1996) C 7/1 setting up a Temporary Committee of Inquiry, at 3.

procedures. It is to be hoped that meanwhile, these measures will go some way towards addressing some of the shortcomings in the regulatory framework and thus towards stopping the haemorrhage of EC funds, and reassuring the tax payer.

Computerisation has been the standard response to problems of international control in the past ten years, so it is not surprising that it has been advocated in this case. The author suggests that this, at best, can only be a partial solution.

The present manual system is slow, partly because of the sheer volume of work involved, but also because of the complexity of the present EC regulatory framework. This point has been made repeatedly by the European Parliament.³¹⁷ Complex legislation, unavoidably borne out of political compromise, often leads to hesitancy in the Member States with regards to implementation.

Unfortunately the level of complexity is not set to lessen with computerisation. Furthermore computerisation will not ease the need for more physical checks, for it will not, for instance, resolve the problem of fraud by means of substitution of goods en route. Nor will it improve mutual assistance *per se*.

In 1990 Delmas-Marty³¹⁸ found that most EC frauds were discovered by Customs authorities and prosecuted as absence of declarations or false declarations to the authorities. We have seen that these authorities have now often been depleted and reorganised after the abolition of fiscal frontiers, and in some regions suffer from low

³¹⁷ European Parliament Committee on Institutional Affairs (1996) Working document on measures to combat fraud, 24 January.

³¹⁸ Delmas-Marty, M (1990) Droit Pénal des affaires, PUF, Paris, page 144ff, second volume.

morale. Another problem is that, entrusted as they ^{are} far with the sovereign duty of collecting indirect taxation, their outlook has remained 'national-territorial'. But how long can it remain so?

The Member States have been accused of not giving enough priority to checks. When a consignment does not arrive at the office of destination within the agreed limits, the onus is placed on the office of destination to investigate. Two ingredients seem vital for success: 'ownership' of the task (i.e. feeling concerned about the outcome), and good cooperation networks. These attributes are evident in cases where attachments, and cooperative efforts between national Customs authorities are already taking place (for example France and the UK, The Netherlands and France, within the Benelux, as part of the Matthaëus Programme,³¹⁹ and as proposed under Customs 2000). In view of the success of these recent developments, and bearing in mind the duty of Member States to cooperate in order to combat fraudulent practices and the forgery of certificates in respect of the carriage of goods between Member States,³²⁰ the time seems ripe to take existing cooperation networks one step further.

One way of fostering task ownership amongst Customs, would be by creating a European Customs, who would properly own the task of protecting the financial interests of the European Communities.

In its first progress report, the above mentioned European Parliament's Committee of Inquiry asked whether

³¹⁹ The Matthaëus Programme is a Community Action Programme for the training of Customs officials, organised by DG XXI.

³²⁰ See Article 3(1) second subparagraph of Council Directive 83/643 OJ L (1983) 359/8; Article 16 of Commission Regulation 1214/92 OJ L (1992) 132/1; also Council Regulation 1468/81 OJ L(1981) 144/1.

the existence of fifteen different Customs authorities militated against the effective control of the transit system. This concern is reflected in the attempts which are currently being made to give national Customs authorities a more 'European' outlook. It has been suggested that, as part of the proposed Customs 2000 Programme, Customs officers should wear an emblem bearing the twelve stars. It is hoped that from this humble beginning, a change of orientation may occur. It is a moot point whether more cohesiveness would resolve the problem of administrative overburden and low morale. It is improbable that it would resolve the problem of third country civil servants on low pay scales who have to supplement their earnings through routine, small scale corruption.³²¹ (See chapter on corruption)

More controversial is the proposal for a 'joint European Customs academy' which has been proposed in order to supplement the training of Customs officers of the Member States, as part of the same 'Customs 2000' Action programme. This programme is at the time of writing (July 1996), under discussion.³²² This could be the first step towards a European Customs Authority - an authority who would 'own' the task of recovering EC funds fully.

This type of 'consolidation' exercise is already planned in other areas. The 'free movement of judges' is something we can now look forward to. This will involve a small number (at first) of liaison judges working in

³²¹ See Spinellis, D (1995) The phenomenon of corruption and the challenge of good governance, in Proceeds of OECD Symposium on corruption and good governance, 13-14 March, page 12.

³²² European parliament (1996) Session document, recommendation for second reading on the Common Position established by the Council with a view to the adoption of a European Parliament and Council Decision adopting a Community action programme on Customs (Customs 2000), Committee on Economic and Monetary Affairs and Industrial Policy, March.

Member States other than their own, as required.³²³

3.3. Fraud and VAT-based own resources

3.3.1. Background: harmonisation

The proportion of VAT revenues Member States make available is small: 1,4% , destined to fall gradually to 1% by 1999.³²⁴ It is not until the budget for 1979 that VAT became an 'own resource'³²⁵ and it is now the main source of EC revenue. VAT fraud affects national revenues foremost. Much of the Community control framework deals with the correct establishment of own resources per se rather than the fight against VAT fraud. Since first January 1993 fiscal frontiers have been abolished,³²⁶ VAT rates have been (somewhat) harmonised and transitional arrangements have been in operation, pending a move to the definitive system. It has been argued that, by pressing ahead with the abolition of frontier controls without VAT or excise harmonisation, the Commission did in fact relegate the common interest in effective collection.³²⁷

The original provisions on tax harmonisation in the Treaty of Rome (Article 99 EEC) left to the Council to

³²³ Article 9(2) of Draft Protocol, on the basis of Article K.3 supplementary to the Convention on the protection of the European Communities' financial interests, SEC (95) 9296 PEN.

³²⁴ Article 3 of Council Decision 94/728 OJ (1994) L 293/9 on the system of the European Communities' own resources.

³²⁵ Decision of 21 April 1970 OJ L 94/19; Council Regulation 2891/77 OJ (1977) L 336/1; Council Regulation 2892/77 OJ (1977) 336/8.

³²⁶ See written question number 190/93, OJ (1993) C 264/19 (93/C 264/34) by Sotiris Kostopoulos concerning VAT payments after 1 January 1993.

³²⁷ Levy, P (1991) 1992: Towards better budgetary control in the EC? Corruption and Reform 6: 285-302, page 292.

consider how taxes could be harmonised in the interest of the Common Market. The Single European Act required the Council to adopt proposals for the harmonisation of legislation regarding turnover taxes and indirect taxation, for the purpose of the process of harmonisation and functioning of the internal market. The first and second VAT directives³²⁸ required Member States to 'replace their present system of turnover taxes by a common system of value added tax'. This goal was postponed to 1972 by the third VAT Directive.

The primary purpose of the sixth VAT Directive in 1977 was to provide a uniform basis of taxation.³²⁹ However the Directive contained many derogations and left the Member States with complete freedom to set their own rates of VAT.

The removal of the insulating effect of the fiscal frontiers required some harmonisation of rates in order to avoid significant diversions of trade due to tax-induced price variations.³³⁰ Rules were agreed for the approximation of VAT rates.³³¹ This meant that from first January 1993, rates no lower than 15% were applicable in the Member States, although two reduced rates remained applicable, neither of which may be lower than 5%, on specified categories of goods and services. Higher rates were abolished, although zero rates and special reduced rates could be retained during the transition period. There is, as yet, no uniform rate of VAT in the European Union, nor for that matter of excise duties. Standard VAT

³²⁸ First VAT Directive 67/227 OJ (1967) L 71 and second VAT Directive 67/228 OJ (1967) L 71.

³²⁹ Sixth VAT Directive 77/388 OJ (1977) L 145.

³³⁰ Farmer, P and Lyal, (1994) EC tax law, Clarendon Press, Oxford.

³³¹ Directive 92/77 OJ (1992) 316/1.

rates still vary between 15% in Luxembourg to 25% in Sweden. In addition, the Member States apply increased, reduced, super-reduced rates (less than 5%) and exemptions according to national policies. This has resulted in a number of asymmetrical characterisations³³² (i.e similar economic transactions which are treated in different ways by the Member States as far as the application of the place of supply is concerned), which in turn have lead to distortions in competition, as predicted.

3.3.2. The removal of fiscal frontiers: impact on intra-Community collection of VAT

As a result of the abolition of fiscal frontiers on 1 January 1993, the concept of import and export within the Community has been replaced by the concept of intra-community acquisition and supply of goods. The Commission proposed a switch to a system under which goods and services would be taxed in their country of origin but the tax would be redistributed between Member States, through a clearing house system. Without such a clearing house system exporting Member States (The Netherlands in particular) would gain revenue. This has been described as the 'origin' system since the tax is collected by (but does not accrue to) the Member State of origin. The Neumark Report³³³ noted in 1962, the origin principle usually applies in the fields of company tax and personal income tax for reasons both of administrative efficiency and equity. This contrasts with a system based on the 'destination' principle where the vendor invoices his intra-community supplies to purchasers who are identified

³³² Amand, C (1995) The future VAT regime in the European Union the opinion of the tax consultants, European Taxation, July, 219-222.

³³³ European Commission (1962) Rapport de Comité Fiscal et Financier, OOEPC.

for VAT in another Member State at a zero rate. It is then the purchaser's responsibility to declare the VAT on their intra-community acquisitions. The principal case for applying the destination principle to VAT rests on the need to avoid distortions of competition. That is to say, a consumer in country A should always pay a price containing the same element of tax, no matter in which country the goods have been produced.

Following a lengthy legislative process, the Commission decided to retain a modified version of the destination system following the abolition of fiscal frontiers. This hybrid solution can be found in Directives 91/680³³⁴ and 92/111.³³⁵ These arrangements were still in existence at the time of writing (July 1996). Although the transition arrangements are applicable until 31 December 1996, their period of application will automatically be extended pending the entry into force of definitive arrangements based on collection of tax in the country of origin. So far, the move to the 'origin' principle has proved highly contentious.

3.3.3. Transitional arrangements: problems

As mentioned earlier, the transitional VAT system which came into effect at the beginning of 1993 has been described as a hybrid.³³⁶ Its main features can be summarised as follows:

³³⁴ Article 28 of Directive 91/680 on the abolition of fiscal frontiers OJ (1991) L 376/1.

³³⁵ Council Directive 92/111 OJ (1992) OJ L 384/47 amending Directive 77/388 and introducing simplification measures with regard to value added tax.

³³⁶ European Parliament (1995) Options for a definitive VAT system, Economic Affairs Series, September, executive summary.

- As far as most final consumers are concerned, the origin principle applies. Once VAT has been paid in one Member State, the goods are in free circulation throughout the Community.

- In the case of commercial transactions, and also of certain sales to final consumers under three 'special regimes' (distance sales; cars, boats, planes and sales to exempt bodies) the destination principle applies. Traders must keep records of all sales to another Member State and all acquisitions from other Member States. Every trader must have a VAT number, so that sellers are able to check the tax status of the customers through VIES (the computerised VAT Information Exchange System).³³⁷

In practice, this means that the delivery of goods to another member State is exempt from VAT, and that the purchase of goods in the Member State of destination is subject to VAT, with the tax payable by the purchaser.

The three likeliest types of fraud under such a system are (i) the diversion of goods, allegedly sold to a trader in another Member State, for illegal sale on the domestic market, (ii) the suppression of untaxed purchases from traders in other Member States for illicit sales in the country of destination and (iii) collusion between purchasers and suppliers to suppress intra-Community transactions.³³⁸ It is the problem of collusion between traders in different Member States which seems to put the greatest amounts of VAT at risk. Indeed all the purchaser has to do to release goods untaxed is to suppress the final stage of the transaction

³³⁷ Article 6 of Council Regulation 218/92.

³³⁸ Levy, R (1991) 1992: Towards better budgetary control in the EC? Corruption and Reform 6:285-302, page 293.

documentation.

3.3.4. Community Control framework

Although Regulation 2891/77³³⁹ was repealed and replaced by Council Regulation 1552/89,³⁴⁰ Council Regulation 2892/77 was merely amended by Council Regulation 1553/89, which lays down the definitive arrangements for the collection of own resources accruing to value added tax. As a rule, Member States pay VAT-based own resources Member States VAT-based own resources to the Commission monthly.³⁴¹

Under Article 11 of 1553/89 the Commission's checks are carried out at the offices of the relevant authorities in the Member States. The Commission uses these checks to verify that the correct methods are used to centralise the basis of assessment and to determine the weighted average rate and the total amount of the net VAT revenue collected. Council Regulation 165/74³⁴² which determine the powers and obligations of officials appointed by the Commission also apply to checks relating to VAT resources.³⁴³

Article 8(2) of Decision 88/376³⁴⁴ stipulates that the checks, which are also provided for under Article 18 of

³³⁹ Regulation 2891/77 OJ (1977) L 336/1.

³⁴⁰ OJ (1989) L 155/1.

³⁴¹ Article 10(3) of Council Regulation 1552/89.

³⁴² Regulation 165/74 (1974) L 20/1-3.

³⁴³ Article 12(2) of Council Regulation 2982/77 OJ (1977) L 336; Article 11(2) of Council Regulation 1553/89 OJ L (1989) L 155/9.

³⁴⁴ OJ (1988) L 185/24.

Council Regulation 1552/89³⁴⁵ are mainly concerned with the reliability and effectiveness of national systems and procedures for determining the base for own resources accruing from VAT and GNP.

Compared to the control framework of the EAGGF Guarantee Section Fund, for example, Community control of VAT seems slight. Vervaele³⁴⁶ has argued that Member States reticence can be explained by the fact that unlike agricultural expenditure, failure to collect own resources is in principle the responsibility of the Member State, which then owes money to the Community. The only exception to this case is force majeure.³⁴⁷ Although traditional own resources are 100% Community resources, only a small proportion of VAT accrues to the Community. It follows that it is in the area of VAT that the most resistance is likely to be encountered with regards to Commission 'interference' in fighting fraud by way of extending the penal-administrative sphere that is already established in all other sectors, and in the recovery of funds.

As mentioned earlier, the transitional VAT system involves goods leaving one Member State without payment of VAT. It therefore relies on the full cooperation of all operators involved and in cases of suspected irregularities, on good communication channels between the Member States' competent authorities. Council Regulation 218/92 replaces Directive 79/1070³⁴⁸ extending the application of Directive 77/799 on administrative co-operation in the field of taxation. Council Regulation

³⁴⁵ OJ (1989) L 155/1.

³⁴⁶ Vervaele, J (1994) *La fraude communautaire et le droit pénal européen des affaires*, PUF, Paris.

³⁴⁷ Article 17(2) of Regulation 2892/77 OJ (1977) L 336/8.

³⁴⁸ Directive 79/1070 OJ (1979) L 331/8.

218/92 introduced the VIES (VAT Information Exchange System).³⁴⁹ The Regulation lays down rules for computer-based information exchange between Member States concerning the intra-Community movement of goods. This is to ensure that intra-Community supplies and movements of goods are properly registered for VAT in the Member States of destination.

One criticism of the Regulation is that it only makes provision for the very minimum of requirements with regards to exchange of information. It makes no provision for automatic exchange of information for certain categories of transactions where there may be loss of revenue. Information has to be requested and 'the requested authority shall provide the information as quickly as possible and in any event no more than three months after receipt of the request'.³⁵⁰

3.3.5. Collection and tax debt policies in the Member States

The administrative procedures, material resources and human resources dedicated to the collection and control of VAT vary greatly in the individual Member States, as do procedures for remitting, or writing off the tax. In addition the Member States vary in their individual approach to debt settlement. For example, some Member States have a 'bargaining' system of tax settlement, whilst others do not. Remission involves the decision to waive, either wholly or partially an amount of payable tax. Under Article 22(9) of Directive 77/388, the Member States may exempt taxable persons from payment of VAT where the amount in question is insignificant. National

³⁴⁹ Council Regulation 218/92 on administrative cooperation in the field of indirect taxation (VAT) OJ (1992) L 24/1.

³⁵⁰ Article 5(1) of Council Regulation 218/92.

legislation applies in determining in which cases remission may occur. For example Denmark, The Netherlands and the United Kingdom have legislation which authorizes the remission of tax debts. Greece and Italy only have measures having equivalent effect, whilst Belgium Spain and France have no such provision. As for writing off (the cancelling of part or whole of the tax payable in the accounts by the relevant administration), it occurs in all the Member States when a debtor has disappeared or when a forced recovery procedure has not succeeded, but in varying proportions. The European Court of Auditors found that the variability of such an accounting procedure did have an impact on net revenue collected - from very little in Belgium to 4% in the new German Länder. Taking data obtained in eight of the Member States, it estimated the amount concerned to be around 3 400 million ECU (which had not been included in the calculation of the Community own resource base).³⁵¹

Prosecution

The Member States have important responsibilities in the area of fraud affecting the EC budget. They must take 'the same measures to counter fraud affecting the financial interests of the Community as they take to counter fraud affecting their own financial interests'.³⁵² Clearly the principle of assimilation so described, is not an issue when it comes to collecting national income, a small proportion of which becomes 'own resources'. The problem is that although fiscal frontiers have been abolished, the Member States retain very different approaches to tax evasion/fraud.

³⁵¹ Court of Auditors Annual Report (1993) OJ C 327, 1.61 et seq.

³⁵² Article 209a EC.

Consequences for fraud control

The cumulation of the system's main features, such as the non-harmonisation of VAT regimes, the nature of the transitional system itself, the minimalist character of the present mutual assistance requirements, and the different prosecution policies produce an environment where revenue can easily be lost to the Member States and the Community. Indeed it has been recognised that the present shortfall in revenues in some of the Member States could partly be the result of opportunities for fraud offered by the present tax regime.³⁵³

The impact of the non-harmonisation of VAT regimes (rates, collection, remission and write-offs practices) should not be underestimated. At the very least it has a distorting effect:

The Commission agrees with the Court that the current diversity of national approaches could result in inequality of treatment of taxpayers and distortions of competition and could also impair the proper collection of the VAT own resource. It therefore undertakes to look closely at the matter in conjunction with the Member States, with a view to arriving at a uniform approach [...]³⁵⁴

The nature of the transitional system itself means that the possibility exists for operators to acquire goods without paying VAT in order not to account for subsequent transactions. With minimalist mutual assistance requirements, the investigating authorities in the Member States are often left with a cold paper trail, if any at

³⁵³ See newspaper article 'Value Added Tax EU may offer fraud opportunities' in Financial Times 14/15 September 1996, page 4.

³⁵⁴ Court of Auditors (1993) Annual Report for 1992, page 296 at 1.45. (second paragraph).

all.

The differing approaches to the prosecution of VAT evasion or fraud within the Union also creates 'zones of leniency', which have been likened, more dramatically, to 'internal fiscal havens' by Caraccioli.³⁵⁵ Cumulatively, this diversity helps to create an uneven control space, which a skilled operator can take advantage of.

[Knowledgeable] economic operators would be led to choose fictitious domiciles for their businesses with an aim to setting up evasive or avoidance-type operations in those [Member States] that best suit them.³⁵⁶

Over fifty percent of the EC budget comes from a proportion of the Member States' VAT. Each Member State has a unique constellation of VAT rate, collection and remission procedures and prosecution policies. Some of these constellations create potential 'internal tax havens' within the single market. The author argues that an effective strategy to protect the finances of the Community requires (i) the harmonisation of some of the collection procedures, (ii) improved mutual assistance and (iii) the setting of some minimum standards of

³⁵⁵ Caraccioli, I (1995) Vers un droit fiscal européen, paper given at a Conference on the protection of the financial interests of the European Community, Dublin 1-2 June; also Caraccioli, I (1995) Verso un diritto penal tributario europeo, *Il Fisco*, 26/95, 6660-6663 and Caraccioli (1995) L'importanza del diritto penale tributario in ambito europeo, *Il Fisco*, 30/95, 7525-7526.

³⁵⁶ Caraccioli, I (1995) Vers un droit fiscal européen, paper given at a Conference on the protection of the financial interests of the European Community, Dublin 1-2 June, page 6, author's translation.

prosecution throughout the Community.³⁵⁷

3.3.6. Perspectives: indefinite postponement of the definitive system?

It had been envisaged that at the end of 1996 the transitional system would give way to a system where VAT is paid at source, i.e in the Member States in which goods originate. In a 'State of origin' system VAT is deductible in the Member State of destination. This, according to the German Ministry of Finance, would take us closer to 'a single market [where it is] just as easy to deliver from Cologne to Paris as from Cologne to Munich'.³⁵⁸ Powerful arguments for a swift move to the definitive system have been made anew in 1996. Firstly, the present 'destination' VAT has been found to be unsatisfactory as an equitable 'own resource'. This is because despite the provisions in the sixth Directive, VAT has always been challenged as a foundation for equitable national contributions to Community expenditure. Since imports are included, but not exports, it penalises countries with trade deficits. More seriously, it does not take account of variations in the proportion of national economies that are VAT-registered. This was clearly recognised by the Community itself when, in 1992, it brought into being the GNP-related 'fourth resource' and reduced the maximum VAT rate from 1.4% to 1%. Since total contributions are now governed by a GNP ceiling, the case for a separate VAT element is not now obvious.

³⁵⁷ See note 125.

³⁵⁸ Bundesministerium der Finanzen (1994) Formulation of the definitive scheme for imposing turnover tax on the intra-Community trade in goods and services and for a functional clearing procedure, Federal Ministry of Finance, Bonn, page 110.

Secondly, it has been argued in a report from DGXXI that one of the drawbacks of the destination system presently in operation, with its tangle of complex administration procedures, is that it opens the door to tax fraud and so reduces the overall tax take of governments³⁵⁹ and hence their fiscal power.³⁶⁰ It has also been argued elsewhere that to omit accounting for intra-Community transactions would be potentially less attractive in the definitive system, since this would result in the non-deductibility of the input tax.³⁶¹ Furthermore the effect on the revenue departments of Member States, if transactions are not reported, would be less severe under the final system as compared to the transition period, since at least the non-deducted input tax is collected.³⁶²

However the differences in VAT rates between Member States would continue to create problems under the origin principle. There are currently 27 different VAT rates in the Community (plus exempt supplies), which would greatly complicate the deduction of input tax by purchasers. The multiplicity of reduced rates and derogations, and the selection and definitions of categories to which a reduced rates can apply, are the main problems.

³⁵⁹ See Bridges, M (1996) Tax evasion A crime in itself: The relationship with money laundering, *Journal of Financial Crime*, Volume 4, number 2, pp 161-168; also newspaper article: 'Labour voices fears over VAT', *Financial Times*, November 11 1996, page 11. According to the article: "In 1995-96 VAT receipts were about £5 bn lower than projected [...] a related reason for this fall has been the a cut in staffing levels at Customs".

³⁶⁰ See newspaper article: 'Monti sets out radical plan for VAT shake-up' in *European Voice*, 20-26 June 1996, page 1.

³⁶¹ Raponi, D (1996) L'I.V.A comunitaria: Le tappe per il passaggio al regime definitivo, paper given at a conference held in Venice and entitled L'I.V.A e l'Unione Europea, Frodi, controlli, sanzioni, 24 February.

³⁶² See Terra, J and Wattel, P (1992) *European Tax Law*, Kluwer, chapter on mutual assistance.

The new system requires a 'clearing house' to avoid the swelling of tax revenues in exporting Member States. However the setting up of a clearing system has proved a major stumbling block in moving on to the 'State of Origin' system and the implementation of the definitive system had been postponed for what seemed to be an indefinite period.³⁶³ The Commission has now presented a proposal³⁶⁴ for a Directive amending the sixth Directive, which would have the effect of fixing the minimum and maximum rates at 15% and 25% respectively, for the period from 1 January 1997 to 31 December 1998. At present Member States must apply a standard VAT rate of not less than 15%, with no upper limit. This harmonisation is part of a programme to culminate in a common clearing system by mid 1998, closely followed by the definitive system. Goals to be achieved by the end of 1996 include, inter alia, measures to improve the collection of taxes and the cooperation between Member State administrations.

3.4. Protecting EC revenue against fraud: the future

According to UCLAF,³⁶⁵ from cases reported the Commission, it is known that up to two per cent of the EU budget (of over 70 billion ECU in 1995) is subject to fraud and irregularities. There is, as far as the irregularities affecting the EC budget are concerned, a belief that they occur mostly on the expenditure side, for example with regards to subsidies to farmers and exporters. But the reality is that irregularities involving larger amounts also exist on the 'income' side of the budget. In fact in 1994 the cost of reported

³⁶³ See newspaper article: 'Senior EU tax official faces sack in VAT row' in Financial Times, 27 October 1995, page 22.

³⁶⁴ VAT - proposed change to standard-rate system, European Commission Press Release IP/95/1437, 20 December 1995.

³⁶⁵ Unité de Coordination pour la Lutte Anti Fraude, the Commission's anti-fraud coordination unit, Directorate F.

irregularities amounted to 3,4% of the traditional own resources budget (import duties).³⁶⁶ One of the main areas under attack is that of Community transit, where the guarantee system is faltering. Of the 12 000 cases reported by the Member States between 1991 and 1995, 120 (1% of the total) by themselves accounted for 50% of the total budgetary impact. Fraud cases involving organized crime are few and far between, but their effect on the budget is considerable: out the 273 cases under investigation coordinated by the Commission, 20% involved sums of more than 100 000 ECU, and in half of them the amounts involved were more than 1 million ECU.³⁶⁷ It is no wonder therefore that the transit system has been repeatedly described as 'in deep crisis' and 'near collapse'. The scale of fraud demonstrates that illegal transactions are no longer isolated cases. They illustrate the establishment of a 'grey market' involving also the laundering of profits from drug trafficking, the provision of funds for the drugs market and the progressive contamination of all commercial sectors. Generally there is a considerable political impetus to deal with this problem at the level of the European institutions, since the credibility of the European project seems to be implicated (see Chapter 1). But the legal, administrative, organisational and technical difficulties involved in keeping one step ahead of fraudsters should not be underestimated, as I hope the present chapter has made clear.

There are hopeful signs that the problem of loss of

³⁶⁶ See Goybert, C (1995) *La fraude communautaire: Mythes et réalités*, *Revue du Marché Commun*, number 388, May, 281-283; UCLAF (1996) *Seventeen questions on fraud*, February, mimeoed text, page 1.

³⁶⁷ European Commission (1996) *Protecting the Community's financial interest The fight against fraud Annual Report for 1995*, COM(96) 173, pp 48-49.

revenue and fraud are being tackled. Transit fraud has been put very firmly on the agenda, with a myriad of medium-term measures envisaged, and a vast computerisation project on the horizon, which is expected to be operative by 1998. The Community control framework to protect Community revenue is 'immature', compared to the framework in place to protect EAGGF Guarantee Section expenditure, as the next chapter will demonstrate. Until recently the emphasis of Community regulation with regards to own resources has been on the making available of the correct sums to the Community. It is not until 1990 that Member States acquired a duty to report frauds and irregularities exceeding 10 000 ECU to the Commission. In this area of tax raising and levies collecting, which is the sole prerogative of the Member States, it is difficult for the Commission to make proposals which are likely to meet with the approval of the Council in particular, least they be confined to the improvement of technical matters. That is why an embryonic European Customs Authority would be a major breakthrough.

It is hoped that the new horizontal instruments will help to 'streamline' fraud control at Community level. But it is the short term, which, perhaps, should give cause for concern. Some parliamentarians have expressed grave concerns about the extension of the Common Transit System to the Visegrad countries.³⁶⁸ Concerns centre around the adequacy of Customs infrastructure and the ability to police eastern borders of countries where, historically, there has been a fair degree of tolerance of the growth of the 'second economy'.³⁶⁹ One question that must be

³⁶⁸ See for example written question E-0275/96, OJ (1996)C 185/47.

³⁶⁹ Naylor, R (1996) From underworld to underground enterprise crime 'Informal sector' business and the public policy response, Crime, Law and Social Change, volume 24,

raised in this respect is whether EU citizens will ultimately have to bear the cost of fraud through their GNPs (at the moment any loss of income incurred through traditional own resources or VAT is made up through the GNP contribution of the Member States). This extra burden put on GNPs would mean that the burden would rest, ultimately, on the wealthier Member States: a purely unplanned form of re-distribution!

In the field of VAT, it is hoped that further harmonisation and the change to the definitive system will eventually erase some of the opportunities for fraud built into the present system. The Commission is also looking at the possibility of harmonising some of the VAT collection procedures in the Member States - a move which some commentators argue is at the very limit, or beyond its competence. VAT is excluded from the competence of Council Regulation 2988/95, and from the 'PIF' Convention. VAT seems set to remain an area where the Commission has difficulties in asserting any competence in terms of fraud control. However the challenge remains one of trying to make tax havens created by the different VAT constellations less attractive, by means of a directive. Much work remains to be done in order to protect the financial interests of the European Community in this difficult area. Community efforts are likely to be resisted in some of the Member States on the grounds of interference with sovereign tax-raising powers. Finally, it must also be recognised that, within the Union, some of the opportunities for fraud are created by the uneven nature of integration. Economic integration has raced ahead for over forty years, whilst fiscal, monetary, political and judicial integration and other forms of cooperation, have lagged behind. As long as VAT rates are not fully harmonised, and the definitive system

number 2, 79-150, page 85.

in place, the present danger of collusion between seller and buyer in order to avoid VAT will remain.³⁷⁰ The extreme variation in excise duty rates also invites fraud, particularly in the UK and the Republic of Ireland where excise duties represent a higher proportion of national revenues.³⁷¹ The complexity of the EC regulatory framework, and the uneven nature of integration, seem set to continue posing difficulties for the collection of both EC and national revenues.

At community-level there is no doubt that efforts are being made to protect the EC budget from loss of revenue, although the main responsibility will continue to rest with the individual Member States.

³⁷⁰ See White, S (1996) EC fraud- What is VAT? Journal of Financial Crime, January, pp 255-259.

³⁷¹ See Easson, A (1989) The elimination of tax frontiers in 1992: One European Market, EUI Florence.

CHAPTER 4. THE CONTROL OF FRAUD AFFECTING EC EXPENDITURE

This chapter focuses on the control of expenditure fraud, that is to say fraud affecting the EAGGF Guidance Section Fund (4.1.) and the Structural Funds (4.2.). The structure is similar to that of chapter 3, although the chapter is, of necessity, longer. In each section the origins of the funds are examined briefly and examples of fraud are given. The Community's control framework follows, together with the latest developments. The last part of the chapter (4.3.) offers a summary and deals with recent developments and prospects for improvement of the protection of the financial interest of the European Communities.

4.1. The EAGGF Guarantee Section

Article 40(4) of the EC Treaty expressly provides that, in order to enable the common organisations to attain their objectives, one or more Agricultural Guidance and Guarantee Funds may be set up. As a result the EAGGF Guidance and Guarantee Section was established in 1962³⁷² in order to cover agricultural market support and to assist farm modernisation schemes. Under Regulation 17/64³⁷³ the fund was later split up into a Guarantee Section³⁷⁴ which includes (i) expenditure relating to refunds on exports to third countries and (ii) intervention intended to stabilize the agricultural markets. and a Guidance Section (see 3.2.) which includes expenditure relating to measures undertaken in order to attain the objectives of the CAP set out in Article 39,

³⁷² Council Regulation 25/62, OJ (1962) L 991 (special edition 1959-62, page 126.

³⁷³ OJ (1964) L 586.

³⁷⁴ Articles 1, 2 and 3 of Council Regulation 729/70 JO (1970) L 94/13.

in particular matters of structural policy.³⁷⁵

4.1.1. EAGGF Guarantee Section fraud

There is a well-established typology of fraud. Reported frauds under the Guarantee Section include the famous carrousels, re-export and classification frauds. A *carrousel* occurs when a good quality product is exported from the EU, attracting a high rate of subsidy. The same product is then re-imported as a low-quality product, thus attracting low duties. Traders may repeatedly carousel in and out of the Union until the product is unfit for human consumption. In a *destination fraud* a consignment is described, for example as going to a third country destination attracting a high subsidy. In fact it goes to a destination which should attract a small subsidy, or no subsidy at all. *Re-export fraud* relies on goods being brought back within EC borders without Customs being aware of it.³⁷⁶ Additionally frauds often involve the *substitution or alteration of foods*, when for example goods held in intervention storage are of lower quality than declared to the authorities, or disguised. *Ghosting* is also common. In Italy, for example, durum wheat stocks were found in 1994 to be 25% smaller than those declared. Products exported may also be hazardous to health. Another 1994 case involved a consignment of 3 000 tonnes of beef destined to the former Soviet Republics which was found not to have been adequately sterilised. The sum involved was estimated at 11.5

³⁷⁵ See Usher, J (1988) *Legal aspects of agriculture in the European Community*, Clarendon Press, Oxford, page 104.

³⁷⁶ See for example Ruimschottel, D (1994) *The EC budget: Ten per cent fraud?* EUI Florence; Tutt, N (1989) *Europe on a fiddle*, Helm, London.

million ECU.³⁷⁷ Examples of imaginative schemes abound which nearly always involve the forgery of documents, the misclassification or mis-representation of goods,³⁷⁸ and the connivance of officials. For example in 1995, an Italian olive oil company was investigated for unlawfully claiming export refunds through a parent company since 1990. The olive oil thus exported was 'sweetened', and thus did not qualify for aid. The estimated total cost to the Community was 4 million ECU.³⁷⁹

4.1.2. EAGGF Guarantee Section Control framework

It is in this area that the most advanced control framework can be found. The legislation places requirements on the Member States to notify, check and recover sums due. These requirements are found in other areas of the EC budget and are therefore un-surprising. The difference here is that requirements have been refined over a longer period, and have become quite exacting. The framework also goes well beyond what has been attempted in other areas of the budget, with for example the 'Black List' Regulation, which is examined below in some detail.

(i) Budgetary control

The EAGGF Guarantee Section is subject to the clearance of accounts procedure. Under Articles 98 to 104 of the Financial Regulation, the EAGGF Guarantee Section budget

³⁷⁷ European Commission (1994) Protecting the financial interests of the European Community The fight against fraud, OOPEC, pp 28-30.

³⁷⁸ Doig, A and Graham, M (1993) Fraud and the Intervention Board, Journal of Asset Protection and Financial Crime, Volume 1, number 3, 225-233.

³⁷⁹ European Commission (1996) Protecting the Community's financial interests The fight against fraud Annual Report 1995, COM(96) 173, OOPEC, page 71.

is implemented in three stages. The first stage is the payment of advances to the Member States. The second stage is when the payments are charged to each budget heading, on the basis of the returns submitted by the Member States showing the expenditure incurred. The third stage is the clearance of accounts. Article (2)(b) of Council Regulation 729/70 makes provision for the clearance of accounts. This means that, once a year, the Member States send their annual accounts of expenditure, as well as all relevant certificates and reports to the Commission.³⁸⁰ The clearance account decision then determines the amount of expenditure effected in each Member State, during the financial year in question, which is chargeable to the EAGGF. This decision is reached with the help of a committee. This system ensures that the Directorate-General for agriculture verifies the manner in which the appointed national authorities have used the appropriations for the CAP.

(ii) Notification, checks and inspections

The Member States have to provide detailed information on cases of irregularities.³⁸¹ Under Council Regulations 729/70³⁸² and 595/91,³⁸³ the Commission may take part in relevant inspections and inquiries by the Member States.³⁸⁴ It may also carry out autonomous

³⁸⁰ Article 4 of Commission Regulation 1663/95 OJ (1995) L 158/6.

³⁸¹ Articles 3 and 5 of Council Regulation 595/91.

³⁸² OJ (1970) L 94/13.

³⁸³ Council Regulation 595/91 OJ (1991) L 67/11 concerning irregularities and the recovery of sums wrongly paid in connection with the financing of the CAP and the organisation of an information system in this field and repealing Regulation 283/72.

³⁸⁴ Article 9(2) of Council Regulation 727/70; also Article 6(1) of Council Regulation 595/91.

inspections.³⁸⁵ Member States have a duty to carry out systematic scrutiny of documents, in order to give the best possible assurance of the effectiveness of the measures for preventing and detecting irregularities.³⁸⁶ This applies without prejudice to inspections undertaken under Article 9 of Council Regulation 729/70.³⁸⁷ Regulation 3122/94³⁸⁸ lays down the exact criteria for risk analysis as regards products receiving refunds, and Council Regulation 307/91³⁸⁹ makes additional funds available for the control of a number of high risk areas. Council Regulation 386/90³⁹⁰ places a duty on Member States to inspect 5% of all goods presented for exports.

With respect to aids to the crop and livestock sectors, Council Regulation 3508/92³⁹¹ establishing an Integrated Administration and Control System (IACS) in the Member States to replace the hitherto sectoral approach to control. This means that the system comprises, in each Member State, a computerised data base, an alphanumeric identification system for agricultural parcels, a harmonised control system and in the livestock sector, a system for the identification and recording of animals. Commission Regulation 3887/92³⁹² lays down rules for the implementation of IACS. In particular, on-the-spot checks

³⁸⁵ Article 9(1) of Council Regulation 727/70.

³⁸⁶ Article 2 of Council Regulation 4045/89 OJ (1989) L 388/18.

³⁸⁷ OJ (1970) L 94/13.

³⁸⁸ OJ (1994) L 330/31.

³⁸⁹ OJ (1991) L 37/5.

³⁹⁰ OJ (1990) L 42.

³⁹¹ Council Regulation 3508/92 OJ (1992) L 355/1.

³⁹² Commission Regulation 3887/92 OJ (1992) L 391/36 laying down detailed rules for applying the integrated administration and control system for certain community aid schemes (IACS).

must cover 10% of livestock aid applications and 5% of area aid applications.³⁹³ Applications subjected to on-the-spot checking are selected by the competent authority in the Member State on the basis of risk analysis.

(iii) Penalties

Farmers and fishermen

Under IACS, there are time limits for the presentation of aid applications and late presentation triggers a cut of one percent per working day of delay, and eligibility is lost altogether after 20 days.³⁹⁴ If the area determined by the authorities is found to be less than that declared in the 'area' aid application, the aid is reduced. If the difference is more than 20% of the determined area, no aid is granted. In the case of a false declaration made intentionally or as a result of serious negligence, the farmer is excluded from the aid scheme for the calendar year in question, or from any aid scheme for the following calendar year.³⁹⁵ Notwithstanding the ruling of the Court in case 240/90,³⁹⁶ in the context of fisheries, penalties were at first rejected. Articles 35 and 36 (relating to penalties) of Council Regulation 2847/93³⁹⁷ were deleted following difficult Council discussions.

Traders

An exporter who requests a refund in excess of that applicable, sees his refund reduced by (a) half the

³⁹³ Article 6(3) of Commission Regulation 3887/92, *op.cit.*

³⁹⁴ Article 8 of Commission Regulation 3887/92.

³⁹⁵ Article 9(2) of Commission Regulation 3887/92.

³⁹⁶ Case C-240/90 Germany v Commission [1992] ECR I-5383.

³⁹⁷ Council Regulation 2847/93 OJ (1993) L 261/1.

difference between the refund requested and the refund applicable to the actual exportation or (b) twice the difference between the refund requested and the refund applicable, if the exporter has intentionally supplied false information.³⁹⁸ Where the reduction results in a negative amount, the exporter shall pay that negative amount. Where reimbursement is covered by a security not yet released, seizure of that security shall constitute recovery of the amounts due. Where the security has been released, the beneficiary has to pay the amount of the security which would have been forfeit plus interest calculated from the date of the release to the day preceding the date of payment.³⁹⁹

These penalties apply without prejudice to supplementary national penalty arrangements.

(iv) Recovery and Member States' liability

Member States have a duty to recover sums lost as a result of irregularities or negligence, and to inform the Commission of the measures taken for those purposes and in particular of the state of the administrative and judicial procedures.⁴⁰⁰

When the amounts recovered are placed at the Fund's disposal, the Member State may retain 20%.⁴⁰¹ Article 8(2) of Council Regulation 729/70⁴⁰² states that in the

³⁹⁸ Article 11 of Commission Regulation 2945/94 amending Regulation 3665/87, OJ (1994) L 310/57.

³⁹⁹ Article 3 of Commission Regulation 2954/94.

⁴⁰⁰ Article 8(12) of Council Regulation 729/70 OJ (1970) L 94.

⁴⁰¹ Article 7(1) of Council Regulation 595/91 OJ (1991) L 67.

⁴⁰² OJ (1970) L 94/13.

absence of total recovery, the financial consequences of irregularities or negligence must be borne by the Community, with the exception of irregularities or negligence attributable to administrative authorities or other bodies of the Member States. On the question of Member States' liability, the European Court of Justice has ruled, in this context, that where the incorrect application of Community law is attributable to a Community institution, the Community should bear the financial consequences. In the majority of cases, however, the Court has found that the EAGGF was not liable for the expenditure, that is to say that the Member State had to accept financial responsibility for over-spent or missing funds.⁴⁰³

4.1.3. The 'Black List' Regulation

In 1995 the 'Black List' Regulation introduced a system for the identification and the communication, between the relevant authorities of the Member States, of commercial operators who have committed irregularities or against whom there are well-founded suspicions, with a view to excluding them from the Guarantee Section of the EAGGF. The commercial operators targeted are those who, for example, claim export refunds or sell intervention products. Due respect to the principle of subsidiarity means that Member States retain considerable discretion with regards to the detailed implementation of this Regulation in this sensitive arena, which touches closely on the rights of operators. The author examines the scope of the Regulation, raises questions concerning the rights of operators, discusses selected implementation problems and finally examines the two diametrically-opposed perceptions of the Regulation.

⁴⁰³ See for example case 18/76 Germany v Commission (EAGGF) [1979] ECR 343.

The 'Black List' Regulation,⁴⁰⁴ and its implementing Regulation,⁴⁰⁵ which took effect in the Member States on 1 July 1996 must be put in the wider context of the protection of the financial interests of the European Communities, which has intensified since the late 1980s.⁴⁰⁶ In 1995 a Regulation for the Protection of the European Communities⁴⁰⁷ or 'PIF' Regulation came into effect. A Convention of the same name⁴⁰⁸ has yet to be ratified. Other measures enhancing scrutiny, or developing cooperation, are under discussion.⁴⁰⁹ The level of fraud in the transit system, which allows the elimination of Customs formalities within the transit areas,⁴¹⁰ has reached alarming proportions, with a reported figure of over 1 billion ECU of revenue lost

⁴⁰⁴ Council Regulation 1469/95 OJ (1995) L 145/1 on measures to be taken with regard to certain beneficiaries of operations financed by the Guarantee Section of the EAGGF.

⁴⁰⁵ Commission Regulation 745/96 OJ L (1996) 102/15.

⁴⁰⁶ White, S (1995) A variable geometry of enforcement? Aspects of European Community budget fraud, Crime, Law and Social change 23:235-255, page 240.

⁴⁰⁷ Council Regulation 2988/95 OJ (1995) L 312/1, on the Protection of the European Communities' Financial Interests.

⁴⁰⁸ Council Act of 26 July 1995 drawing up the Convention on the Protection of the European Communities' Financial Interests, OJ (1995) C 316/48.

⁴⁰⁹ In June 1996 the ECOFIN Council agreed in principle a Regulation concerning on-the-spot checks and inspections by the Commission for the detection of frauds and irregularities detrimental to the financial interests of the European Communities; two protocols to the 'PIF' Convention and an 'Anti-Corruption' Convention have yet to be agreed.

⁴¹⁰ Commission Regulation 1214/92 OJ (1992) L 132/1 on provisions for the implementation of the Community Transit procedure and for certain simplifications of that procedure; Convention on a Common Transit Procedure OJ (1987) L 226/1; Customs Convention on the International Transport of Goods under Cover of TIR Carnets, 1975.

through fraud between 1990 and 1995,⁴¹¹ whilst a small percentage of operators are responsible for over 80% of amounts defrauded. It has been recognised that organised criminal networks are now involved.⁴¹² The present crisis in the transit system has made it more difficult for the Member States to discharge some of the specific duties connecting with the running of the EAGGF Guarantee Section. Member States have a duty to take all the measures necessary to ensure that transactions financed by the EAGGF Guarantee Section are actually carried out and properly executed, and to prevent and follow up irregularities.⁴¹³ A further duty concerns the need to check the reliability and probity of operators, as highlighted in case 240/90.⁴¹⁴

In the circumstances, the prospect of the Member States being able to black list certain operators has proved an attractive legislative goal, and one the European Parliament in particular has pursued vociferously. The technique of black listing has been used successfully in other areas, in order to deny access to the market to economic operators who either failed to conform to minimum standards of safety or who made regular use of dubious practices.⁴¹⁵

⁴¹¹ European Parliament (1996) Temporary Committee of Inquiry into the Transit System (1996) Written statement by Commissioner Liikanen, March.

⁴¹² See newspaper articles: 'EU cheated off by tax scam', Guardian, 23 May 1996, page 3; 'Traffic de cigarettes: l'Etat roulé' in l'Express, 9 May 1996 page 39; 'Mafia gangs involved in £1 billion EU frauds', in Guardian, May 9 1996, page 10.

⁴¹³ Article 8 of Council Regulation 729/70 OJ (1970) L 94/13.

⁴¹⁴ Case 240/90 Germany v Commission ECR (1992) I-5383, at 26, page 5431.

⁴¹⁵ See newspaper article: 'A hidden hand of corruption', Financial Times, 6 June 1996, page 27.

The 'Black List' Regulation, which concerns us here, has two aims. The first is to make known throughout the Community certain fraudulent, or suspected traders who are drawing funds from the Guarantee Section of the EAGGF. This is achieved through the inclusion of the same operators into an EU-wide information system. The second aim is to specify measures to be taken to prevent the same fraudulent or suspected operators from committing further irregularities.⁴¹⁶ The measures, which can be cumulative, include reinforced checking, suspension of payments relating to current operations and exclusion from future operations for a period of up to five years. The Commission has excluded itself from the field of application of the Regulation: only the 'competent national authorities of the Member States' are provided with information available under the new system. The political significance of the Regulation is, however, very considerable since it establishes a Community system requiring Member States to distribute information on certain operators and to adopt preventive measures.

Here the legal basis and scope of the 'Black List' Regulation are examined first. The protection of the rights of operators is followed by a discussion on the potential impact of the Regulation.

(i) Scope of 'Black List' Regulation

The only provision in the Treaty with regards to the protection of the financial interests of the European Communities (Article 209a) was added by the Treaty on European Union. It requires the Member States to take the same measures to counter fraud affecting the financial

⁴¹⁶ The definition of 'irregularity' can be found in Article 1(2) of Council Regulation 2988/95 OJ (1995) L 312/1, on the Protection of the European Communities' Financial Interests, or 'PIF' Regulation.

interests of the Community as they take to counter fraud affecting their own financial interests and has yet to be used as a legal basis. Most anti-fraud measures nevertheless are found within the first pillar. The legal basis for the 'Black List' Regulation, for example, is Article 43 EC, which enables the Commission to submit proposals for working out and implementing the Common Agricultural Policy. Notwithstanding its place in the architecture of the Union Treaty, the Regulation 'polices' since its scope extends to measures which can have serious economic consequences for traders, as we shall see.

Two distinct groups of operators

For practical purposes, operators are divided into two distinct groups in the 'Black List' Regulation. Operators 'A' are those who have committed an irregularity or irregularities either deliberately or through serious negligence and have unjustly benefited from a financial advantage, or attempted to benefit therefrom. Operators 'B' are those who have been the subject, on the basis of established facts, of a preliminary or judicial report by the competent authorities of the Member States.⁴¹⁷ A 'preliminary or judicial report' is defined in the implementing Regulation as 'the first written assessment, even if only internal, by a competent administrative or judicial authority based on concrete facts that an irregularity has been committed, deliberately or through gross negligence, without prejudice to the possibility of this being revived or withdrawn subsequently on the basis of developments in the administrative or judicial procedure'.⁴¹⁸ Operators who have participated in

⁴¹⁷ See Article 2(3) of Commission Regulation 745/96 and Article 1(2) of Council Regulation 1469/95.

⁴¹⁸ Article 1(2) of Commission Regulation 745/96 OJ (1996) L 102/15.

committing an irregularity, or who are under a duty to take responsibility, or to ensure that it is not committed may fall under either category 'A' or 'B'.⁴¹⁹ Member States apply their relevant national legislation in order to determine whether an irregularity has been committed or attempted, deliberately or through gross negligence.⁴²⁰

Notification

The 'Black List' Regulation targets operators who have committed, or are suspected of having committed irregularities which involve amounts in excess of 100 000 ECU, over a period of one year⁴²¹ starting to run on the date on which the first irregularity was committed.⁴²² The Member States are responsible for implementing procedures relating to notification.⁴²³ Each Member State designates a single competent authority to make and receive notifications. The said authority, using a standard form, transmits its notifications to the Commission, which transmits them to the competent authorities of the other Member States.⁴²⁴ As part of the notification, the following must be transmitted to the

⁴¹⁹ Article 1(4) of Commission Regulation 745/96 OJ (1996) L 102/15.

⁴²⁰ Article 1(5) of Commission Regulation 745/96 OJ (1996) L 102/15.

⁴²¹ Article 2(1) of Commission Regulation 745/96 OJ (1996) L 102/15.

⁴²² Article 2 of Commission Regulation 745/96 OJ (1996) L 102/15.

⁴²³ Article 2(1) of Council regulation 1469/95 OJ (1995) L 145/1.

⁴²⁴ Article 5(1) of Commission Regulation 745/96 OJ (1996) L 102/15.

Commission:⁴²⁵ (ii) their category ('A' or 'B'), (iii) details of the inquiry (iv) facts leading to measures being taken under the 'Black List' Regulation and (v) cross-references to notifications already made under previous legislation.⁴²⁶

Previously, Member States have interpreted the requirement to notify, which can already be found in Article 4 of Council Regulation 595/91⁴²⁷ and Article 14 of Council Regulation 1468/81⁴²⁸ in a 'minimalist' manner.⁴²⁹ It is anticipated that the more detailed implementation measures contained in the 'Black List' Regulation will induce the Member States to identify traders. But should a Member State fail to implement rules relating to notification, the implementing Regulation⁴³⁰ now empowers the Commission to ensure that the identification and notification system is implemented

⁴²⁵ Article 5(2) of Commission Regulation 745/96 OJ (1996) L 102/15.

⁴²⁶ Council Regulation 1468/81 OJ (1981) L 144/1; Council Regulation 595/91 OJ (1991) L 67/11; also Council Regulation 1469/95 (1995) OJ L 145/1.

⁴²⁷ Council Regulation 595/91 OJ (1994) L 67/11 concerning irregularities and the recovery of sums wrongly paid in connection with the financing of the Common Agricultural Policy and the organization of an information system in this field and repealing Regulation 283/72.

⁴²⁸ Council Regulation 1461/81 OJ L (1981) L 144/1 on mutual assistance between the administrative authorities of the Member States and Cooperation between the latter and the Commission to ensure the correct application of the law on customs or agricultural matters.

⁴²⁹ See articles: 'Parliament wants to increase sanctions against fraud in the framework of the CAP', in Europe, 17 February, 1995, p 10; 'The Council adopts the "Black list" of companies that defraud, allocation of preventive community means to combat fraud in the EAGGF', in Europe, 26 June 1995, p 10.

⁴³⁰ Article 2(2) of Commission Regulation 1469/95 OJ (1995) L 145/1.

by the Member State concerned. This provision was entered as a request of the European Parliament,⁴³¹ concerned that the Regulation should not be 'vague and toothless'.

Reinforced checking

According to the 'Black List' Regulation, and its implementing Regulation, any operator ('A' or 'B') presenting a risk of non-reliability may be subjected to reinforced checking, with respect to any EAGGF Guarantee Section transactions.⁴³² This gives the competent authorities 'carte blanche' to increase the level of checks when in doubt.

Suspension

The Regulation provides for payments for current operations to be suspended, or guarantees to be held back.⁴³³ This sanction can apply to both categories of traders ('A' or 'B').⁴³⁴ The scope of sanction(s) is determined on a case by case basis by the competent authority, taking due account of the real risks of possible further irregularities, as well as the following:

- (a) the stage of the inquiry being held, depending on whether an operator 'A' or operator 'B' is involved;

⁴³¹ See COM (95) 194 Final including the amended proposal.

⁴³² Article 3(1) of Commission Regulation 745/96 OJ (1996) L 102/15.

⁴³³ Article 3(b) of Council regulation 1469/95 which echoes Article 5(d-f) of the 'PIF' Regulation OJ (1995) L 312/1.

⁴³⁴ Article 3(2) of Council Regulation 1469/95 OJ (1995) L 145/1.

(b) the volume of his operations within the EAGGF field;

(c) the amount of Community funds involved in the suspected or established irregularity;

(d) the seriousness of the irregularity according to whether it has been committed or attempted, deliberately or through gross negligence.⁴³⁵

Exclusion

Exclusions only apply to operators 'A', and to the product sector of the EAGGF Guarantee Section in which the irregularity has been committed or attempted. Exclusions can vary between 6 months to five years and are to be determined in the Member States, using the four criteria (a-d) above.⁴³⁶

(ii) Rights of operators

The rights of operators have been considered in the Regulation with respect to retroactivity, confidentiality, data protection, the right to be heard, the right to be removed from the black list and proportionality.

Exclusion measures may not be applied to irregularities before the entry into force of the 'Black List' Regulation. Article 5(2) of the implementing Regulation

⁴³⁵ Article 3(3) of Commission Regulation 745/96 OJ (1996) L 102/15.

⁴³⁶ Article 3(4) second subparagraph of Commission Regulation 745/96 OJ (1996) L 102/15; also Article 5 (d) of 'PIF' Regulation 2988/95 OJ (1995) L 312/1.

states that notifications exchanged must be confidential. Member States must take all necessary precautions to ensure that the information they exchange remains confidential and is not sent to persons other than the Member States or institutions whose duties require that they have access to it, unless the Member State has agreed to such disclosure. The relevant provisions laid down in the rules on mutual assistance in Customs and agricultural matters⁴³⁷ and in Directive 95/46 apply *mutatis mutandis*.⁴³⁸

Article 4(1)(a) of the 'Black List' Regulation stipulates that operators have the right to a prior hearing and a right of appeal in respect of exclusion and suspension where appropriate. A 'prior hearing' in this context means an opportunity to offer explanations to the authority administering the EAGGF Guarantee Section, not access to an independent court. The question of what right of appeal traders would have against direct Commission measures is also left open.⁴³⁹ This may, in time, raise challenges under Article 6(1) and 6(2) of the European Convention of Human Rights.

In the case of a Member State finding that an operator had been wrongfully blacklisted, the Commission must be informed, and must in turn relay this fact to the other Member States, which must in turn immediately inform those to whom they had notified these personal data under Regulation 1469/95. Clearly transmission involves several steps, and re-instatement may be protracted. Furthermore

⁴³⁷ Article 4(2) of Council Regulation 1469/95 OJ (1995) L 145/1.

⁴³⁸ Directive 95/46 OJ (1995) L 281/31 on the protection of individuals with regard to the processing of personal data and the free movement of such data.

⁴³⁹ See European Parliament (1995) Opinion of the Committee on Agriculture and Rural Development for the Committee on Budgetary Control, point 1.15, 24 January.

the Regulation does not say whether, in case of loss of profits due to wrongful black listing or delays involved in removing names from the black list, damages would be available, and from where. There remains the question of whether, in the event of loss of profit or injury to a trader, a Member State would have to make damages available under *Brasserie du Pêcheur/ Factortame III*.⁴⁴⁰ The first of several pre-conditions for the award of reparation under the above-mentioned case is that the breach of Community law must be attributable to the national legislature acting in a field in which it has a *wide discretion to make legislative choices*.⁴⁴¹ It is a moot point whether put together, the 'Black List' Regulation and its implementing Regulation leave the Member States a wide discretion to make legislative choices, although an element of choice is involved.

Although the 'Black List' Regulation places a duty on the Member States to comply with the principle of proportionality with respect to the measures it makes available and the irregularity, whether it is committed or suspected, it may be more difficult to apply the principle if traders are already subject to, for example, financial penalties under other specific provisions under the CAP.⁴⁴² It must also be remembered that the measures contained in the 'Black List' Regulation can be cumulative.

In addition to this, authorities who recover extra-

⁴⁴⁰ C-46/93 and C-48/93 *Brasserie du Pêcheur v Germany and R V Secretary of State for Transport, ex parte Factortame*, judgement of 5 March 1996, nyr.

⁴⁴¹ Author's emphasis.

⁴⁴² Article 6 of Council regulation 1469/95 OJ (1995) L 145/1.

judicially⁴⁴³ (as is more common in most of the northern Member States)⁴⁴⁴ may have to juggle existing requirements in order to make black listing possible. For example, in the UK it seems that black listing could become part of the compounding contract possible under Article 152 of the Customs and Excise Management Act 1979. This means an addition to the 'already astonishing' powers of Customs,⁴⁴⁵ which may give rise to problems of proportionality.

Discussion

Although the Regulation is precise in what it seeks to achieve, most of the implementation details are left to the competent authorities in the Member States. This means that competent authorities are not subjected to a 'legislative straight jacket', but on the other hand, they have to deal with the absence of detailed implementing guidelines. This creates a tension at implementing level.

For example, when operators 'B' are involved, notification is triggered by the first written assessment (even if just internal) based on concrete facts that an irregularity has been committed either deliberately or through gross negligence. Clearly the Member States will have various 'trigger points'. It must be noted that although the notification of an operator who has been convicted of fraud does not raise any particular legal

⁴⁴³ See White, S (1996) Black listing: Three questions, AGON number 12, 8-9.

⁴⁴⁴ Labayle, H (1996) La transaction dans l'Union Européenne Rapport de synthèse ('Labayle Report').

⁴⁴⁵ 'The powers entrusted to Her Majesty's Customs and Excise are in themselves astonishing' Forbes, J in R v HM Customs and Excise, ex parte Haworth, 17 July 1985.

problem, the notification of a suspect does raise problems, particularly since the level of proof is not specified.

The Economic and Social Committee was not slow in underlining the seriousness of the injury to an operator unjustly identified by a Member State as presenting a risk of 'non-reliability'.⁴⁴⁶ It is likely, therefore, that the competent authorities will exercise extreme caution before notifying. The length of exclusion, too, is at the discretion of the sole competent authority. There is no detailed criteria or 'yardstick' to be used throughout the Community. Put together, these factors alone may lead to an uneven 'black list' enforcement area. However in view of the high threshold (100,000 ECU) and the small relatively number of notifications expected, this may not cause a significant problem within the single market.

(iii) Conclusion: black listing, an important step in the fight against fraud?

There are two differing perceptions of the 'Black List' Regulation. One view is that it is only a superficially attractive measure, with limited potential impact on the protection of the financial interests of the European Communities. This is so, it has been argued, because the Regulation duplicates existing provisions, particularly those now contained in the 'PIF' Regulation, which now frames Community sanctions. Secondly, a combination of factors may ensure that notifications remain as 'minimalist' as they were under Regulations 1468/81 and 595/91: (i) the high pecuniary threshold (100 000 ECU),

⁴⁴⁶ See Opinion on the Proposal for a Council Regulation on measures to be taken in dealing with certain beneficiaries of operations financed by the Guarantee Section of the EAGGF, OJ (1994) C 393/81, page 82.

(ii) the need for competent authorities to pay the fullest attention to the rights of operators and (iii) the (linked) need of competent authorities to exercise due caution in order to avoid any possible claims for damages. This diminishes the potential impact of the Regulation.

Another view is that the Regulation is in fact 'filling an important legislative lacuna'. This is because in the single market, it has been too easy for unscrupulous traders, when they are known or suspected of being involved in irregularities by a Customs authority, to claim export refunds from other EU Customs authority, where they are not suspected. The present prescribed level of checks (not less than 5% according to Article 3(6) of Council Regulation 386/90⁴⁴⁷ and Commission Regulation 2221/95),⁴⁴⁸ and the absence hitherto of a EU-wide computerised system to monitor transit have meant that the same 'mobile' operators could remain undetected by Customs authorities. The Regulation 'sends the right message' to traders who, if detected, have much to lose.

The author feels that there is no need at this stage to take an unnecessarily pessimistic view of the Regulation. As John Tomlinson, MEP, recently pointed out in an address to the UK Association of Lawyers for the Protection of the Financial Interests of the European Communities, the 'freephone' line, established in 1994 in all the Member States to encourage informants to report fraud affecting the EC budget was also greeted with much

⁴⁴⁷ Council Regulation 386/90 OJ (1990) L 42 on the monitoring carried out at the time of export of agricultural products receiving refunds or other amounts.

⁴⁴⁸ Commission Regulation 2221/95 OJ (1995) L 224 laying down detailed rules for the application of Council Regulation 396/90 as regards physical checks carried out at the time of export of agricultural products qualifying for refunds.

scepticism at first.⁴⁴⁹ It is now well established and proving an invaluable tool in the fight against fraud affecting the EC budget. The same fate may await black listing.

The 'Black List' Regulation will be subjected to a review no later than July 1997.⁴⁵⁰ It may be that this revision process will help to 'iron out' uncertainties and ambiguities. If this is the case, black listing may be successfully extended to cover Structural Funds, and thus help to deal with the equally serious problem of procurement fraud⁴⁵¹ which is presently affecting them.

4.2. Structural Funds

The tasks of the Structural Funds are defined in Council Regulation 2081/93 (Framework Regulation). The European Development Fund (ERDF henceforth) finances measures aimed at the modernisation of infrastructure, in accordance with Article 130c of the EC Treaty.⁴⁵² Within the framework of Article 123 of the EC Treaty, The European Social Fund (ESF henceforth) finances various measures to combat unemployment.⁴⁵³ The EAGGF Guidance-Section promotes rural development in line with the

⁴⁴⁹ ALPFIEC Conference 16 May 1996, London School of Economics.

⁴⁵⁰ Article 7 of Council Regulation 1469/95 OJ (1995) L 145/1.

⁴⁵¹ White, S and Dorn, N (1996) EC fraud, subsidiarity and prospects for the IGC; A regional dimension? European Urban and Regional Studies, 1996 3(3) 262-266; also Battistotti, I (1995) Protection des Intérêts financiers et Fonds Structurels, seminar paper, Cabinet Bonino Brussels, European Commission, March.

⁴⁵² Article 3(1) of Council Regulation 2081/93 OJ (1993) L 193/5.

⁴⁵³ Article 3(2) of Council Regulation 2081/93.

principles set out in Article 39 of the EC Treaty.⁴⁵⁴ The tasks of the Financial Instrument of Fisheries Guidance⁴⁵⁵ (FIFG henceforth) are set out in Articles 1-3 of Council Regulation 2080/93 in accordance with Article 43 of the EC Treaty.⁴⁵⁶ The most recent of the Structural Funds is the Cohesion Fund, set up in 1993 under Article 235 EC to finance key environmental and transport infrastructure projects in the four poorest Member States - Spain, Portugal Greece and Ireland - whose per capita GDP is less than 90% of the EU average. The tasks of the Cohesion Fund are set out in Council Regulation 1164/94.⁴⁵⁷

The total expenditure on Structural Funds will add up to approximately 170 billion ECU between 1994 and 1999 - around a third of the overall budget - compared with 64 billion between 1989 and 1993. Around 90% of the funds are paid out to Member States initiatives (national or regional initiatives), whilst 9% is spent directly by the Community, with a 1% reserve for innovative measures (Community initiatives)⁴⁵⁸.

⁴⁵⁴ Article 3(3) of Council Regulation 2081/93.

⁴⁵⁵ Article 3(3a) of Council Regulation 2081/93.

⁴⁵⁶ Council Regulation 2080/93 OJ (1993) L 193/1 laying down provisions for implementing Regulation 2058/88 as regards the financial instrument of fisheries guidance.

⁴⁵⁷ Council Regulation 1164/94 OJ (1994) L 130, establishing a Cohesion Fund and repealing Council Regulation 792/93 establishing a cohesion financial instrument.

⁴⁵⁸ Article 11 of Council Regulation 4253/88, as amended by Council Regulation 2082/93.

Table 4.1.

Breakdown of Structural Funds by Objective and by Member State (in million ECU)

	OBJECTIVES:						C.I.	TOTAL
	1	2	3+4	5A	5B	6		
	----- 1994-1999 -----					1995 -1999	1994 -1999	
B	730	341	465	191.6	77	N/A	346.8	2,151.4
DK	zero	119	301	262.5	54	N/A	117.4	853.9
D	13,640	1,566	1,942	1,133.8	1,227	2,557	N/A	22,065.8
GR	13,980	zero	zero	zero	zero	zero	1,241.9	15,221.9
E	26,300	2,415	1,843	431.6	664	N/A	3,129.3	34,782.9
F	2,190	3,773	3,203	1,912.7	2,238	N/A	1,813.1	15,129.8
IRL	5,620	zero	zero	zero	zero	N/A	591.4	6,211.4
I	14,860	1,462	1,715	798.6	901	N/A	2,121.4	21,858
L	zero	15	23	40	6	N/A	21.2	105.2
NL	150	650	1,079	159.2	150	N/A	603	2,791.2
P	13,980	zero	zero	zero	zero	N/A	1,127	15,107
UK	2,360	4,580	3,377	439.3	817	N/A	1,782.2	13,355.5
A	185.5	101	395	388	411	N/A	163.5	1,644.1
FIN	zero	183	343	354	194	526.81	171.4	1,772.2
S	zero	160	520	198	138	280	142.4	1,438.4

Note to table 4.1.

Source: European Voice newspaper, 18-14 July 1996, page 19.
National and Community initiatives.

For national initiatives, the Member States, acting in conjunction with the regional authorities, submits to the Commission a development plan setting out its priorities for action. A Community Support framework (CSF) is then negotiated between the Commission and the authorities of the Member State which reflects Community priority objectives. The Commission then adopts the programmes proposed by the Member State. An alternative route is for the Member State to submit a Single Programming Document (SPD) which brings together priorities and programmes. A single decision is then taken by the Commission on the SPD. As far as Community initiatives are concerned, the Commission relies on its Green Paper and the subsequent guidelines to adopt programmes proposed by the Member States. For the period 1994 to 1999, these programmes concentrate on seven themes: (i) cross-border cooperation (INTERREG); (ii) local development in rural areas (LEADER); (iii) support for the most remote regions (REGIS); (iv) the integration into working life of women, young people and the disadvantaged (EMPLOYMENT); (v) adaptation to industrial change (ADAPT, SME, RECHAR, KONVER, RESIDER, RETEX); (vi) urban policy (URBAN) and (vii) restructuring the fisheries sector (PESCA).

4.2.1. Background: Two major reforms

The first reform of the Structural Funds was effected as part of a larger political and economic plan to reduce economic disparities in anticipation of a single market. The Single European Act introduced Title V into the EEC Treaty, which deals with economic and social cohesion. Article 130d in particular requires the Commission to submit a proposal to amend the structure and operational rules of the Structural Funds. In the 1988 revised regulations, the emphasis was put on (i) concentration of Structural Funds on priority objectives, (ii) participation or partnership with the Member States, (iii) coherence with the Member States' economic policies, (iv) sound financial management (v) monitoring involving simplification, surveillance and flexibility.

The Structural Funds were reformed a second time in 1993. In July of that year the Council adopted six revised regulations governing the Structural Funds. With a budget of 141 billion ECU for a six year period, the Structural Funds became the favoured instrument to improve economic and social cohesion in the Community. First guiding principles were clarified and reinforced⁴⁵⁹ to include:

* The concentration⁴⁶⁰ of measures on six priority objectives (see below) for development.

* Programming,⁴⁶¹ which results in multi-annual development programmes.

* Partnership,⁴⁶² which implies the closest cooperation possible between the Commission and the appropriate authorities at national, regional or local level in each Member State for the preparatory stage to implementation of the measures.

* Additionality,⁴⁶³ which means that Community assistance

⁴⁵⁹ See European Commission (1993) Community Structural Funds 1994-99, ODOPEC, pp 10-25.

⁴⁶⁰ Reinforced concentration: Articles 1(1,2,3,4,5) [priority objectives]; 8(1,2,3) [eligibility of objective 1 regions]; 9(1,2,3,4,5,6) [eligibility objective 2 regions]; 11(1,2,3,4) [eligibility of objective 5b areas]; 12(1,2,3) [available resources] and 12(4) [allocation and appropriations] of Council regulation 2081/93 (Framework Regulation) OJ (1993) L 193/44.

⁴⁶¹ Programming: Article 6 of Council Regulation 2081/93 [period covered and timetable]; Articles 8,9,10, 11b of Council Regulation 2081/93 and Articles 5,6 and 10 of Council Regulation 2081/93 [adjusted procedures]; Article 1 of ERDF Regulation 2083/93, Article 1 of ESF Regulation 2084/93, Articles 2 and 5 of EAGGF-Guidance Fund 2085/93, Article 3 of FIFG Regulation 2080/93 [scope of funds].

⁴⁶² Partnership: Article 4 of Council Regulation 2081/93.

⁴⁶³ Additionality: Article 9 of Council Regulation 2082/93. Each Member State now has to maintain, in the whole of the territory concerned, its public structural or comparable expenditure at least at the same level as in the previous programming period, taking into account the macro-economic

complements the contributions of the Member State rather than reducing them. This requires that the Member States maintain public spending on each objective at no less than the level reached in the preceding period.

Another key principle which is reiterated in the 1993 revised Framework Regulation is co-financing.⁴⁶⁴ The Community contribution as a general rule is still not more than 50% of the total costs for Objectives 2, 4 and 5b and not more than 75% of the total cost for assistance under Objective 1. However Article 13(3) of the Framework Regulation specifies that, in exceptional and duly justified cases, the contribution from the Structural Funds in Objective 1 regional in the four Member States concerned by the Cohesion Fund may rise to a maximum of 80% of the total cost, and to a maximum of 85% of the total cost for the outermost regions as well as for the outlying Greek islands which are under a handicap as far as distance is concerned.

Objective 1 provides ERD, ESF and EAGGF Guidance Section financial assistance⁴⁶⁵ for regions with a per capita GDP of less than 75% of the Union average (almost 70% of total Structural Funds allocation goes to designated objective 1 regions). Objective 2 covers areas suffering from industrial decline where unemployment rates are higher than the EU average through the ERDF and ESF. Objectives 3 and 4 cover the long-term and young unemployed, and workers whose employment prospects are threatened by industrial change through the ESF. Objectives 5(a) and 5(b) apply to fragile rural areas and farmers and fishermen facing structural changes. Objective 5(a) operations are financed through the EAGGF Guidance

circumstances in which the funding take place, as well as a number of specific economic circumstances, namely privatisations, an unusual level of public structural expenditure undertaken in the previous programming period and business cycles in the national economy'.

⁴⁶⁴ Article 13 of Council Regulation 2081/93 OJ (1993) L 193/5.

⁴⁶⁵ For correspondence between funds and objectives, see Article 2 of Council Regulation 2081/93 OJ (1993) L 193/5.

Section and FIFG, and 5(b) though the EAGGF Guidance Section, the ESF and ERDF. Finally objective 6 was set up to cater for the special needs of the Nordic countries when they joined the European Union in 1995, and aims to promote employment and structural adjustment in areas with an extremely low population density, through all the funds.⁴⁶⁶

Where a form of assistance involves participation under more than one Structural Fund and/or more than one other financial instrument, it may be implemented in the form of an integrated approach.⁴⁶⁷

The revised regulations thus not only made possible the financing of operations in new regions and the co-financing of new operations, but also introduced new procedural rules, as we shall see.

4.2.1. Fraud and the Structural Funds

Although much has been written about fraud affecting the CAP, and in particular the EAGGF Guarantee Section fraud, there is a dearth of literature on Structural Funds, in spite of the growing number of reported irregularities, which must be at least partly related to the new requirements placed on Member States by the 1993 reform.

In 1995, 58% of cases of irregularities notified concerned the European Social Fund, 20% the European Regional Fund, 20% the EAGGF-Guidance, 2% FIFG and 1% the Cohesion Fund.⁴⁶⁸ The total

⁴⁶⁶ Article 52 of Council Decision 95/1 OJ (1995) L 1 adjusting the instruments concerning the accession of new Member States to the European Union amending Protocol number 6 annexed to the Act of Accession (OJ (1994) C 241, page 354.

⁴⁶⁷ Article 5(5) second subparagraph of Council Regulation 2081/93 ('Framework Regulation').

⁴⁶⁸ European Commission (1996) Protecting the Community's financial interests The fight against fraud Annual Report for 1995 COM(96) 173, OOPEC, table 7 page 90.

financial impact was estimated at 44 million ECU,⁴⁶⁹ although it is not always possible to quantify the exact financial impact. Broadly frauds affecting the Structural Funds, whether they affect national or Community initiatives, seem to fall into three categories: (i) cases where 'phantom' activities are involved (ii) cases where funds are used for a different purpose and (iii) procurement frauds, when the EC competition rules are breached. Frauds usually involve over-invoicing, falsifying documents and/or bribery of officials (see chapter 6 on corruption).

(i) National initiatives

ESF fraud

Community fraud involving vocational training programmes tends to be of two types: (i) when the project appears to meet all the criteria but its cost has been deliberately inflated, and (ii) when false accounts are submitted in order to get approval for a non-existent or ineligible project or to obtain more than the project actually costs.⁴⁷⁰

Case 1

Between 1989 and 1993 a Belgian institute received the equivalent of 760 000 ECU by way of co-financing for training schemes. The Schemes never took place: the instructors mentioned in the files were in fact research workers who had never done any teaching.⁴⁷¹

Case 2

⁴⁶⁹ European Commission (1996) Protecting the Community's financial interests The fight against fraud Annual Report for 1995 COM(96) 173, OPEEC, table 5 page 88.

⁴⁷⁰ Bassi, A (1994) Community frauds upon the ESF: The Italian experience, in The legal protection of the financial interests of the Community: Progress and prospects since the Brussels seminar of 1989, pp 225-238.

⁴⁷¹ European Commission (1995) Protecting the Community's financial interests The fight against fraud Annual report for 1994, OPEEC, page 51.

An Italian firm received 5 million ECU of ESF between 1985 and 1992 to train pilots. The students listed were in fact fictitious. Following an investigation by the Naples Court seven airline officials were prosecuted.⁴⁷²

Case 3

The Commission found a number of anomalies in the contract management procedure operated by a recipient company in Sardinia. Apart from anything else, there was no way of distinguishing training costs (if indeed there were any) and salary costs.⁴⁷³

Case 4

In Lisbon, a trade union federation and some of its leaders and subcontractors have been prosecuted for diverting ESF and national subsidies worth 1.5 million ECU. The organisers had presented artificially inflated expenditure and had failed to organize training courses.⁴⁷⁴

Case 5

More recently (July 1996) a British university has come under scrutiny over 600,000 pounds of ESF, which allegedly had not been used to retrain unemployed people, but rather to finance existing students.⁴⁷⁵

ERF fraud

The granting of large regional development contracts can involve

⁴⁷² European Commission (1995) Protecting the Community's financial interest The fight against fraud Annual Report for 1994, page 52.

⁴⁷³ Ibid, page 51.

⁴⁷⁴ European Commission (1996) Protecting the Community's financial interests The fight against fraud Annual Report for 1995, page 74.

⁴⁷⁵ Newspaper article: 'EU fraud squad calls on campus', in Guardian, 23 July 1996, pp 2 and 3, Education Section.

breaches of the EC procurement rules,⁴⁷⁶ when for example public works contracts are granted in exchange for favours.⁴⁷⁷

Case 6

On scrutinizing the administration of the French Departement of Var in 1994-95, the Provence-Alpes Cote d'Azur regional audit body discovered over-invoicing involving more than 5 million ECU in connection with the supply of equipment to encourage technical innovation (ERDF co-financing 38 million ECU under the Renaval programme for the conversion of shipbuilding areas from 1990 to 1993). The judicial inquiries suggest that local councillors received under-the-counter payments totalling at least 0.5 to 1 million ECU in exchange for falsifying public contracts.⁴⁷⁸

Guidance Section fraud

Case 7

As a result of an investigation by the magistrates at Reggio Calabria (Italy) carried out in conjunction with a Commission on-the-spot investigation in January 1994, it was established that serious irregularities extended to olive oil storage and bottling facilities at the Calabria regional centre at San Lorenz, as well as to the storage centres at Castri and Eboli. The three centres had visibly never actually operated, for at both Castri and Eboli buildings were dilapidated, access roads were impassable and bottling machinery was neither bolted to the floor nor connected to vats. The Commission commenced the procedure for halting assistance and recovering sums already paid - approximately 3 million ECU. It joined *partie civile* proceedings to the

⁴⁷⁶ See Article 7(1) of Council Regulation 2081/93 and second subparagraph of Article 25(6) of Council Regulation 2082/93.

⁴⁷⁷ D'Aubert, F (1994) *Main basse sur l'Europe*, pp 181-186 on the Abruzzo scandal.

⁴⁷⁸ European Commission (1996) *Protecting the Community's financial interests The fight against fraud Annual report for 1995*, COM(96) 173, page 75.

prosecution at San Lorenzo.⁴⁷⁹

(ii) Community initiative fraud

Set up in 1990,⁴⁸⁰ INTERREG is the largest Community Initiative. It is intended to prepare frontier regions for the completion of the single market and aims to solve the specific economic development programmes of the Community's internal and external border regions. The total Structural Funds contribution to INTERREG during the 1989-1993 period was initially estimated at 800 million ECU. Typical frauds affecting INTERREG⁴⁸¹ involve the use of INTERREG funds for projects which involve little or no inter-regional cooperation.

Case 8

When the Court of Auditors carried out its audit of the INTERREG Community initiative between Ireland and the UK, it found that only 39 out of the 270 projects of which the OP consisted were of a trans-frontier nature and were receiving joint financing from two Member States on the basis of this.⁴⁸²

Case 9

In Sardinia, six persons were committed for trial on charges of diverting aid granted by the Commission for the construction of an innovative wind-power plant costing an estimated 1.25 million.

Case 10

In 1994, for the first time, the Commission sent a request to

⁴⁷⁹ European Commission (1995) Protecting the Community's financial interests The fight against fraud Annual report for 1994, OOPEC, page 53.

⁴⁸⁰ Communication C(90) 1562/3 OJ C (1990) 215, Annex 1.

⁴⁸¹ See Court of Auditors OJ (1995) C 303 for the 1994 financial year, 4.61 - 4.72.

⁴⁸² Court of Auditors OJ (1995) C 303 concerning the financial year 1994, at 4.68.

twelve Member States under Article 209a EC⁴⁸³ in order investigate a network of contractors in the tourism field. The use of fictitious subcontractors and over-invoicing were two of the means used by the networks.⁴⁸⁴

4.2.3. Structural Funds control framework

According to Article 23 of Council Regulation 4253/88⁴⁸⁵ Member States had to inform the Commission of the measures taken to verify that operations had been properly carried out, to prevent and to take action against irregularities and to recover any amounts lost. This vague requirement was supplemented by a Code of Conduct⁴⁸⁶ requiring Member States, inter alia, to report irregularities above 4 000 ECU every four months. This code of conduct was subsequently annulled by the European Court of Justice in 1991,⁴⁸⁷ on the grounds that it went beyond the measures intended in Article 23(1) of Council Regulation 4253/88.⁴⁸⁸ This, predictably, had a negative impact on Member States' reporting activities. At the end of 1992, for example, only two Member

⁴⁸³ The second paragraph of Article 209a reads: 'Without prejudice to the provisions of this Treaty, Member States shall coordinate their action aimed at protecting the financial interests of the Community against fraud. To this end they shall organize, with the help of the Commission close and regular cooperation between the competent departments of their administrations.' The implementation of more comprehensive cooperation on enforcement to tackle cross-border fraud committed by organized crime rings is thus a particular aim of Article 209a of the EC Treaty.

⁴⁸⁴ European Commission (1995) Protecting the Community's financial interests The fight against fraud Annual Report for 1994, page 54.

⁴⁸⁵ OJ (1988) L 374/1.

⁴⁸⁶ Code of Conduct OJ (1990) C 200/3 on the implementing provisions for Article 23(1) of Council Regulation 4253/88 relating to irregularities, and the organization of an information system for irregularities.

⁴⁸⁷ Case C-303/90 France v Commission judgment of the Court of 13 November 1991.

⁴⁸⁸ OJ (1988) L 374/1.

States had reported cases with total financial implications of approximately 1 million ECU.⁴⁸⁹ In its Annual Report for the year 1991, the Court of Auditors denounced this state of affairs.⁴⁹⁰

The same Regulation empowered the Commission to carry out autonomous⁴⁹¹ or associated checks, which involve Commission officials taking part in on-the-spot checks carried out by the Member States' authorities.⁴⁹² However it seems that, with scarce reporting from the Member States, the Structural Funds remained a low inspection priority for the Commission, since no associated checks were carried out until 1994.⁴⁹³ But the regulatory landscape was to change dramatically after 1993.

After the second reform, the Structural Funds including the Cohesion Fund still share the same regulatory framework, which can be found in Council Regulation 2082/93⁴⁹⁴ (the Coordination

⁴⁸⁹ European Commission (1992) Report and Action Programme for 1993 COM(93) 141, OOPEC, page 10; also European Commission (1995) Protecting the Community's financial interests The fight against fraud Annual report 1995, COM(96) 173, OOPEC, table 23 page 96.

⁴⁹⁰ Court of Auditors Annual Report for the financial year 1991 OJ (1992) C 330, 7.43-7.44.

⁴⁹¹ Article 23(2) first and second subparagraphs of Council Regulation 4253/88 OJ (1988) L 374/1 laying down provisions for implementing Regulation 2052/88 as regards coordination of the activities of the different Structural Funds between themselves and with the operations of the EIB and the other existing financial instruments.

⁴⁹² Article 23(2) third and fourth subparagraphs of Council Regulation 4253/88 OJ (1988) L 374/1.

⁴⁹³ European Commission (1996) Protecting the Community's financial interests The fight against fraud Annual Report for 1995, OOPEC, table 5 page 88.

⁴⁹⁴ Council Regulation 2082/93 OJ (1993) L 193/20 laying down provisions for implementing Regulation 2052/88 as regards coordination of the activities of the different Structural Funds between themselves and with the operations of the European Investment Bank and the other existing financial instruments.

Regulation) which amends Council Regulation 4253/88⁴⁹⁵ and extends its provisions to the Cohesion Fund and FIG. The former Regulation 2082/93 lays down rules for financial control (Article 23), the reduction suspension and cancellation of assistance (Article 24) and monitoring, appraisal and evaluation (Articles 25 and 26) within the framework of partnership, as defined above. Articles 23 and 24 in particular herald two significant changes. Firstly, there is a move from the 1989 system of control of individual projects, towards a regime of control based on 'systems audit', which places greater emphasis on controls carried out in the Member States. Secondly, there is also more emphasis on the role of Member States in managing and controlling funds, in line with the recognition that Member States administrations are responsible for 80% of expenditure, and also with the principle of subsidiarity enshrined in the EEC Treaty by the Treaty on European Union signed at Maastricht. As a result of this new approach, Commission Regulations 1681/94⁴⁹⁶ and 1831/94⁴⁹⁷ (inspired from Council Regulation 595/91⁴⁹⁸ already in force in the EAGGF Guarantee Section) were adopted in order to define the duties of Member States with respect to irregularities and recovery in more detail.

⁴⁹⁵ OJ (1988) L 374/1.

⁴⁹⁶ OJ (1994) L 178/47.

⁴⁹⁷ OJ (1994) 191/9.

⁴⁹⁸ OJ (1991) L 67/11.

(i) Financial Control

According to Article 24 of Council Regulation 2082/93⁴⁹⁹ (the Coordination Regulation), the Commission may now reduce or suspend assistance if an irregularity or significant change affecting the nature and conditions for the implementation of the operation or measure are revealed. Sums received unduly or to be recovered must be repaid to the Commission.⁵⁰⁰

(ii) Reporting fraud

Every quarter, Member States have a duty to make a detailed report to the Commission concerning any irregularities involving sums of over 4 000 ECU⁵⁰¹ (unless expressly required by the Commission) which have been the subject of an initial administrative or judicial investigations.⁵⁰² In this context Member States must also report, on a quarterly basis, the measures taken to recover sums wrongly paid. This includes the reasons for any abandonment of recovery procedure or any abandonment of criminal prosecutions.⁵⁰³ By the end of 1993, nine out of 12 Member States had reported a small number of cases, with a financial impact of million ECU.⁵⁰⁴ But by the end of 1995 194 cases of irregularities had been reported in total, with a total financial impact of 44

⁴⁹⁹ OJ (1993) L 193/20.

⁵⁰⁰ Article 24(3) of Coordination Regulation.

⁵⁰¹ Article 12 of Commission Regulation 1681/94 OJ (1994) L 178/43, concerning irregularities and the recovery of sums wrongly paid in connection with the financing of the structural policies and the organisation of an information system in this field.

⁵⁰² Article 3 of Commission Regulation 1681/94 OJ (1994) L 178/43.

⁵⁰³ Article 5 of Commission Regulation 1681/94 OJ (1994) L 178/43.

⁵⁰⁴ European Commission (1995) Protecting the Community's financial interest The fight against fraud Annual Report for 1994, OPEEC, table 3 page 73 and table 4 page 74.

million ECU.⁵⁰⁵

(iii) Recovery

Unlike Council Regulation 591/91,⁵⁰⁶ Council Regulations 1681/94⁵⁰⁷ and 1831/94⁵⁰⁸ make no provisions for a 'reward' for national government departments amounting to 20% of sums recovered, but they do allow the possibility of amounts recovered being entirely reassigned for the benefit of operations or final beneficiaries other than those involved in the irregularity, subject to the constraints of transparency and budgetary discipline.⁵⁰⁹

(iv) Mutual assistance

When irregularities may have repercussions outside their territories or they show a new malpractice, Member States have a duty to report to the Commission to the other Member States concerned.⁵¹⁰

(v) Monitoring

Member States are responsible for the monitoring of the assistance. Such monitoring must be carried out by way of jointly agreed reporting procedures, sample checks and the establishment

⁵⁰⁵ European Commission (1996) Protecting the Community's financial interests The fight against fraud Annual Report for 1995, COM(96) 173, OPEEC, table 5 page 88.

⁵⁰⁶ Article 7 of Council regulation 595/91 OJ (1991) L 67.

⁵⁰⁷ OJ (1994) L 178/47.

⁵⁰⁸ OJ (1994) L 191/9.

⁵⁰⁹ Article 11 of Commission Regulation 1681/94 OJ (1994) L 178/43.

⁵¹⁰ Article 4 of Commission Regulation 1681/94 OJ (1994) L 178/43.

of monitoring committees.⁵¹¹ Furthermore monitoring must be done with the help of indicators showing

- the stage reached in the operation and the goals to be attained within a given time span,

- the progress achieved on the management side and any related problems.⁵¹²

The Commission and EIB may delegate representatives to the monitoring committees, with the agreement of the Member State concerned.⁵¹³

For multi-annual operations, progress reports must be submitted every six months, and a final report must be submitted to the Commission within six months of completion of the operation.⁵¹⁴ The monitoring committee may adjust the procedure for granting assistance. These amendments have to be notified immediately to the Commission and to the Member States concerned. They become effective as soon as confirmation is received from the Commission within a period of 20 working days. Other amendments are decided by the Commission, in collaboration with the Member State concerned, after the monitoring committee has delivered its opinion.⁵¹⁵

The Commission is concerned about transparency, and for this purpose, and within the context of the application of Community rules on the award of public contracts, notices sent to the Official Journal for publication must specify those projects for

⁵¹¹ Article 25(1) of Coordinating Regulation.

⁵¹² Article 25(2) of Coordinating Regulation.

⁵¹³ Article 35(3) of Coordinating Regulation.

⁵¹⁴ Article 25(4) of Coordinating Regulation.

⁵¹⁵ Article 25(5) of Coordinating Regulation.

which Community assistance has been applied for or granted.⁵¹⁶ The Commission publishes implementation details in the Official Journal.⁵¹⁷

(vi) Evaluation

In order to ensure the effectiveness of Community assistance, measures taken for structural purposes must be subjected to appraisal monitoring and, after their implementation, evaluation.⁵¹⁸

4.2.4. *Evaluation of control framework*

Three main criticisms have been levelled at the present system by the Commission:

(i) the system is complex and the division of responsibilities between the Commission and the Member States on financial management and control is not clear.

(ii) The number of initiatives causes confusion.

(iii) The number of committees also causes confusion.

The Commission has suggested that one way of avoiding confusion would be to cut down the number of committees involved in the process, and to tighten control systems.⁵¹⁹ One way of tightening controls would be to make the continuing financing of a programme

⁵¹⁶ Article 25(6) of Coordinating Regulation.

⁵¹⁷ Article 25(7) of Coordinating Regulation.

⁵¹⁸ Council Regulation 2052/88 OJ (1988) 185/9 on the tasks of the Structural Funds and their effectiveness and on coordination of their activities between themselves and with the operations of the European Investment Bank and the other existing financial instruments.

⁵¹⁹ See Newspaper article 'Venice to duck regional funding issue', in European Voice 2-8 May 1996, page 5.

more strictly conditional upon agreed terms.

The Commission should be stronger and stop paying out money if it is not satisfied with the programmes. Under the Structural Funds we can say that if something is not changed after the first set of payments, we will not hand over the remaining funds.⁵²⁰

More fundamental criticism has also been put forward.

(a) The highest proportion of reported fraud concerns the ESF. The services subsidised by the ESF tend to be intangible, and it can be difficult to monitor progress or evaluate the impact of a measure. Generally with respect to the ESF and other Structural Funds goals need to be more clearly defined.

(b) The task of assessing genuine additionality can be complicated - particularly in the case of multiple funding.⁵²¹ Occasionally infra-state issues of subsidiarity arise and disputes about the level at which additionality should operate (local, regional or national).⁵²² This means that the principle of co-financing may not offer the desired safeguard against fraud.

(c) ERDF payments are mainly paid in advance and have had the temporary effect of an advance to national budgets, at least

⁵²⁰ Cf. extract from European Voice newspaper of 9-11 May 1996 'Gradin demands tougher measures to combat fraud' in AGON number 12, June 1996, page 16.

⁵²¹ See for example European Commission (1994) Report on the audit and management and control systems for Structural Fund measures in the Member States, SE(94) 1654, page 20.

⁵²² See Fothergill, S(1995) The struggle over European funding, Local Government Information Unit, London; also White, S (1996) EC fraud, subsidiarity and prospects for the IGC: A regional dimension? European Urban and Regional Studies, 3(3), 262-266.

where these advances are not paid out immediately to the final recipient. This situation, the Court of Auditors has suggested 'does not constitute a guarantee for the best possible use of the resources mobilized'.⁵²³

The reforms needed in order to fraud-proof Structural Funds therefore go beyond the proposed reinforcement of ex ante and ex post assessments.

4.2.5. *New developments*

Member States have been holding back matching funds, which means that unclaimed funds have risen from 15 billion ECU in 1993 to 16 billion ECU by July 1996.⁵²⁴

A series of cooperation protocols have been signed to cooperate on the control of the use of Structural Funds.

Concern has been expressed over the future of the Structural Funds in an enlarged union, although decisions on support for regions under the Structural Funds after 1999, including the designation of eligible areas, will not be made before the beginning of 1998.

⁵²³ Court of Auditors OJ C (1995) 303 Annual Report for the 1994 financial year, at 4.93.

⁵²⁴ Newspaper article 'EU states fail to spend £16 billion in regional aid', in Financial Times, 29 July 1996, page 1.

PART III.

RECOVERING UNWARRANTED PAYMENTS

CHAPTER 5. THE RECOVERY OF UNWARRANTED PAYMENTS

5.1. Introduction

This chapter deals with the recovery of unwarranted payments in the UK. Firstly it outlines the responsibilities of the Member States in the present budget structure (5.1.). It then goes on to examine the modes of recovery available in English law in some detail (5.2.). A brief comparison of British and Danish systems (5.3.) leads to a concluding discussion on possible improvements (5.4.). It is hoped that this chapter, including its brief, but necessary comparative element, will have the potential to stimulate discussion on ways of improving recovery rates.

At a time when a consensus no longer seems to prevail on the 'European Project', waste and fraud in the budget of the European Communities, more than ever, have the potential to undermine the credibility of the Union.⁵²⁵ The United Kingdom has been particularly vociferous in demanding improvements in this area, at times even urging the Commission to take more steps to combat waste and fraud. Since the late 1980s the Commission has been highly active in assisting the Member States in the fight against fraud affecting the Community budget, as evidenced by a series of policies and measures.

The recovery of unwarranted payments, however, is the sole responsibility of the Member States. In the words of the Commission '[T]he recovery of all income due to the Community budget and all Community funds which have been acquired fraudulently is a[nother] high priority. Virtually all own

⁵²⁵ See Report by the European Court of Auditors to the Reflection Group, May 1995, 3.1 p 8; also speech by Anita Gradin, Commissioner with a responsibility for fraud prevention, reported in Reuter textline of 30 March 1995; speech by Diemut Theato, MEP, Chairman of the Committee on Budgetary Control of the European Parliament at the University of Urbino, 9 June 1995 reported in AGON, no 10, October 1995.

resources are collected by the Member States and about 80% of Community funds are paid out to the final beneficiary by the member States. This is why recovery in the first instance is a task for the Member States.⁵²⁶ Such recoveries are effected with varying degrees of speed and success throughout the European Union. In its Annual report for the 1993 financial year, the European Court of Auditors deplored the general 'lack of success so far' in that area and stressed the need for urgent attention. This view was also shared by the Commission's Directorate for financial Control (DG XX), and led to the commissioning of a study in 1995, which focused on each of the Member States' rules governing settlements and similar arrangements and their application to Community expenditure (the 'settlement' study). For the purpose of the study, on which this chapter draws, 'settlement' was broadly defined by the Commission as 'any act whereby the authorities of a Member state exercise a power to negotiate and terminate a dispute or state of uncertainty as to rights and obligations in the context of procedures for the recovery of sums of money or for the imposition of penalties'.⁵²⁷ The aim of the United Kingdom national study, carried out by the present author, was to throw some light on the way the relevant United Kingdom authorities recover sums which have been wrongly paid by national authorities from EC funds. It paid particular attention to extra-judicial settlements since the Commission was concerned that extra-judicial settlements in particular lead to sub-optimal recoveries.

The first, and probably the most striking feature of the British way of settling such matters, is that the three jurisdictions of

⁵²⁶ European Commission (1995) Protecting the Community's financial interests The fight against fraud Annual Report 1994, COM (95) 98, March.

⁵²⁷ European Commission, DG XX (Financial Control), 1995, Methodological note to researchers.

the United Kingdom⁵²⁸ do not display the same type of 'two phase' system commonly found in most other European Union Member States.⁵²⁹ Settlements occur either judicially (mostly through the civil courts) or extra-judicially through long established procedures such as compounding, or setting-off. This 'either-or' system is addressed in more detail in 5.2.1.- 5.2.3. Secondly, although some of the European Union Member States have centralised systems of fraud enforcement and recovery,⁵³⁰ the United Kingdom operates through a number of agencies. Their roles and recovery policies (when they have been made public) are addressed in 5.2.4., as well as the particularities of various extra-judicial settlement procedures, such as setting-off, compounding and writing-off. The effectiveness of such procedures is discussed in 5.2.5. Issues arising from administrative discretion, and of redress against administrative decisions are dealt with in 5.2.6. A brief comparison between the Danish and British systems is offered in 5.3, followed by concluding remarks in 5.4.

But first, a brief outline of the EC budget, and of the duties of the Member States with regards to the recovery of EC funds may prove useful background.

5.1.1. Budget structure

The European budget has been multiplied by a factor of 2.7 in ten

⁵²⁸ This chapter refers to England and Wales, unless otherwise stated. The law of Northern Ireland is closely modelled on English law, which applies in England and Wales. Scots law is markedly different: its legal principles, rules and concepts are modelled on both Romanistic and English laws.

⁵²⁹ 'The judicial procedure is usually in two stages, the first corresponding to the ordinary first instance hearing by a judge sitting alone, and the second being an appeal procedure of one kind or another'. (Page 16 of the Delmas-Marty Report).

⁵³⁰ For example the Guardia di Finanza in Italy, the Office Général de Lutte contre la Délinquance Economique et Financière Organisée in Belgium, and the Office Central pour la Répression de la Grande Délinquance Financière and the Office Central de Prévention de la Corruption in France.

years, rising from 28 800 million ECU in 1985 to 79 800 million ECU in 1995.⁵³¹ To give an idea of the magnitude of the EC budget, it suffices to add that the European Court of Auditors at present audits revenue and expenditure representing approximately 4-5% of the total budgets of all the Member States.⁵³² The structure of the budget, however, is relatively simple.

The Union itself has no power to raise taxes, so it is dependent on the Member States' contributions for its budget. In 1977 Council Regulation 2991/77⁵³³ established a system of 'Communities' own resources', which established a basis for the Member States' contributions. Contributions from the Member States now fall into three broad categories. Firstly over 50% of EC revenue comes from a weighted percentage (usually around 1 - 1,4%) of the Member States' VAT revenues. This amounted to 38 million ECU in 1993 and 36 million ECU in 1994.⁵³⁴ Since 1988 the Member States have also made a contribution based on their national GNP,⁵³⁵ which constitutes the second largest contribution from the Member States. Lastly 'traditional own resources', made up of Customs duties, sugar and isoglucose levies and agricultural levies, altogether amounted to approximately 20% of total

⁵³¹ European Court of Auditors (1995) Report to the Reflection Group on the operation of the Treaty on European Union, May, p 2.

⁵³² European Court of Auditors (1995) The European Court of Auditors Auditing the finances of the European Union, June, p 13, mimeoed text.

⁵³³ Council Regulation 2891/77 implementing the Decision of 21 April 1970 on the replacement of financial contributions from Member States by the Communities' Own Resources, OJ (1977) L 336/1.

⁵³⁴ European Court of Auditors Annual Report for the 1993 financial year OJ C (1994) 327, diagram 1: general budget 1995: estimated revenue; also European Court of Auditors Statement of Assurance concerning activities financed from the general budget for the financial year 1994, 1995, diagram 1: general budget 1994: estimated revenue, November, mimeoed text.

⁵³⁵ Article 2 of Council Decision 88/376 OJ L (1988) 185/24.

estimated revenue in the 1994 financial year. On the expenditure side, in 1994, over 52% of the budget was spent on EAGGF Guarantee Section Fund, concerned with the support of prices for agricultural products, and over 30% on 'structural operations and fisheries' to help the more disadvantaged regions.

Although media reports have tended to focus on irregularities affecting subventions to the agricultural sector (i.e. on the expenditure side), frauds and irregularities affect all parts of the budget.

5.1.2. Frauds and irregularities

In March 1995 the Commission adopted the 1994 Annual report⁵³⁶ by its Coordinating Unit for combatting fraud in which it emerges that 4,264 cases of irregularities and fraud were detected by the Member States and the Commission in 1994, an increase of a third on 1993. The amounts involved in these irregularities doubled in relation to the previous year and reached 1.032.7 million ECU, which constitutes 1,2% of the total budget. It is the area of 'traditional own resources', i.e. the area concerned with the collection of import levies, which seems to present a more acute problem. Reported irregularities amounted to 3,4% of revenue in 1993.

Commentators have argued that these figures were only 'the tip of the iceberg'. The extent to which one can rely on official statistics to measure the extent of crime remains one of the classic disputes in criminology.⁵³⁷ The position taken by UCLAF is

⁵³⁶ See Goybert, C (1995) *La fraude communautaire: Mythes et réalités*, *Revue du Marché Commun et de l'Union Européenne*, no. 388, May, 281-283.

⁵³⁷ Jupp, D (1989) *Methods of criminological research*, Unwin Hyman, London, p 47-48; also Eglin, P (1987) *The dispute over the meaning and use of official statistics in the explanation of deviance*, in J. Hughes, J. Anderson and W. Sharrock, *Classic disputes in sociology*, Allen and Unwin, London, p 108-36.

typically institutionalist: 'There is no evidence that the level of frauds on the EU budget is increasing. However, there is a steadily increasing trend to discover fraud, [...] which can be attributed to initiatives taken by UCLAF to achieve effective enforcement and verification efforts on the part of the Member States.'⁵³⁸ In this figures and statistics from the Commission data bases are useful in as much as they draw our attention to the level of reporting and enforcement activity. However, there is no doubt that the more irregularities are reported, the more money the Member States have to recover in order to pay it back into the common purse. It is to the specific duties of the Member States that we turn now.

5.1.3. Duties of Member States

The Member States have a set of duties to fulfil with regards to the sanctioning of irregularities. For instance, sanctions must guarantee real and effective judicial protection⁵³⁹ and have a real deterrent effect.⁵⁴⁰ Furthermore redress must be available against administrative decisions. The remedies themselves must be effective. They must not be available under less favourable conditions than those applicable to the enforcement of a similar right of a domestic nature.⁵⁴¹ Remedies must be designed in such a way that it is not impossible to exercise the rights the national

⁵³⁸ UCLAF (1995) Anti-fraud coordination in the EU, European Journal on Criminal Policy and Research, Vol 3, 2:65-74.

⁵³⁹ Case 68/88 Commission v Greece [1989] ECR 2965, para 23.

⁵⁴⁰ Case 79/83 Dorit Hartz v Deutsche Tradax GmbH [1984] ECR 1921, 1941.

⁵⁴¹ See for example cases 33/76 Rewe v Landwirtschaftskammer für das Saarland [1976] ECR 1989, 1997-1998; 309/85 Barra v Belgium and the City of Liege [1988] 2 CMLR 409, 418.

courts have a duty to protect.⁵⁴² Finally remedies should not be less favourable than those governing the same⁵⁴³ or similar rights of action in an internal matter.⁵⁴⁴ Member States also have particular duties with respect to recovery, both on the revenue and expenditure sides.

On the revenue side, Council Regulation 2891/77⁵⁴⁵ requires the Member States to establish, enter in the accounts and recover any amounts due in cases where fraud or irregularity has been established. The Commission's role is to ensure that recovery procedures are indeed initiated and completed by national authorities so that Member States can be given a discharge when their management is satisfactory. If sums are not recoverable owing, for example, to bankruptcy or lapse of time, the onus is on the Member State to show that it has done everything possible to recover them if it is to be exempted from making them available to the Community.⁵⁴⁶ The Regulation also introduced the possibility of releasing Member States from the obligation to make amounts available for reasons of force majeure. Because of the very restrictive interpretation of force majeure by the Court of Justice, the Member States have only made use of this possibility in very rare occasions since the Regulation entered into force.

In accordance with Article 6(2)(b) of Regulation 1552/89,⁵⁴⁷ Member States must, in the quarterly statements which they send to the Commission, enter established entitlements that have not yet been recovered in a separate 'B' account. These are then

⁵⁴² Case 45/76 *Comet v Produktschaap voor Siegerwassen* [1976] ECR 2043.

⁵⁴³ *Ibid.*

⁵⁴⁴ Case 199/82 *Amministrazione delle Finanze dello Stato v San Giorgio* [1983] ECR 3595, 3612.

⁵⁴⁵ Regulation 2891/77, OJ (1977) L 336/1.

⁵⁴⁶ European Commission (1995) *The fight against fraud Annual Report for 1994*, pp 70-71.

⁵⁴⁷ OJ (1989) L 155/1.

incorporated annually into the Commission's balance sheet and revenue and expenditure account. However in its report on the application of Council Regulation 1552/89⁵⁴⁸ produced in 1992, the Commission remarked that few cases had been reported where amounts of more than 10 000 ECU had not been recovered, as required by Article 6(3)(2) of the Regulation. The cases involving more than 10 000 ECU reported by Germany, the Netherlands and the United Kingdom had been the result of bankruptcies where there were no assets, the disappearance of debtors or insufficient guarantees.⁵⁴⁹ In its special report accompanying the Statement of Assurance for the financial year 1994,⁵⁵⁰ the European Court of Auditors pointed out that 'the separate accounts held by the Member States, which serve as the basis for the Commission's data, contain numerous errors and omissions, the main one being that they are not exhaustive. [...] The checks carried out in various Member States revealed a variety of shortcomings in the way the separate accounts were kept, particularly in the United Kingdom, where, following the audits carried out, the national authorities called upon the services concerned to make the necessary improvements.' An assurance has now been given by the British government that 'B' accounts would be kept in future. This state of affairs has made it difficult to quantify amounts yet to be recovered in the UK.

The Commission has proposed changes to Regulation 1552/89,⁵⁵¹ in

⁵⁴⁸ OJ (1989) L 155/1.

⁵⁴⁹ See European Commission (1992) Report on the application of Council Regulation 1552/89 implementing Decision 88/376/EEC, Euratom on the systems of the Communities' own resources, COM (92) 530, December.

⁵⁵⁰ European Court of Auditors (1995) Special Report in support of the Statement of Assurance concerning activities financed from the general budget for the financial year 1994 accompanied by the Commission's reply, the Parliament's reply, the Court of Justice's reply, the Economic and Social Committee's reply and the Committee of the Regions' reply, November, OOPEC.

⁵⁵¹ See amended proposal for a Council Regulation amending Council regulation 1552/89, OJ (1994) C 382/6.

order to help secure an improvement in the follow up of recoveries. The proposed amendment, yet to be agreed by Council seeks to achieve the following:

- * more effective penalties for delays in making available amounts due
- * an analysis of the reasons for failure to recover own resources - so that criteria can be drawn up defining the financial liability of the authorities responsible for collection
- * more uniform and comprehensive information on fraud and irregularities involving more than 10 000 ECU
- * an improvement in the Community's ability to assess the quality and results of the recovery and inspection activities of the national authorities through comprehensive annual reports presented according to a standard model.

On the expenditure side, Council Regulation 729/70⁵⁵², amended by Council Regulation 2048/88⁵⁵³ requires the Member States to recover EAGGF sums paid as a result of irregularities or negligence, and inform the Commission of the measures taken for those purposes and in particular of the state of the administrative and judicial procedures. Read literally, this is sometimes interpreted by officials to mean that full recovery must be pursued in the courts, which would leave little room for administrative discretion.

Similar obligations to recover funds exist with respect to Structural Funds, in accordance with Council Regulations 4253/88⁵⁵⁴ and 2082/93.⁵⁵⁵ Member States are free, in the absence of a remedy expressly provided by the Community measure in question, to choose between sanctions available under national

⁵⁵² OJ 1970 L 94/13.

⁵⁵³ OJ 1988 L 185/1.

⁵⁵⁴ OJ (1988) L 374/1.

⁵⁵⁵ OJ (1993) L 193/20.

law.⁵⁵⁶ Where the question of sanctions is not dealt with in Community measures, then

[P]eriods of limitation, rights of set off, the extent of rights or reimbursement of improper charges, payment of interest and so on are matters to be regulated by the domestic law of the Member States in whose courts the individual right-holder seeks to proceed.⁵⁵⁷

5.1.4. Recoveries

It is also in the area of traditional own resources that Member States seem to have the most difficulties in effecting recoveries. For the period 1991-1994, a total of 94% of the money obtained through irregularities in the traditional own resources sector was still to be recovered, as opposed to 83% on the expenditure side (see tables 5.1 to 5.4).

In the area of traditional own resources, in the period 1991-1994, the Member States recovered between 0% and 53% of amounts outstanding. The United Kingdom notified 22% of cases, but only recovered 2% of sums due (see tables 5.3. and 5.4.).

On the expenditure side, and for the same period, the Member States recovered between 3% and 66% of unwarranted payments. The United Kingdom notified 15% of cases and recovered 41% of sums due (see tables 5.1.- 5.2.).

⁵⁵⁶ Cases 50/76 Amsterdam Bulb BV v Produktshaap voor Siegerwassen [1977] ECR 137; 265/78 H Ferweda BV v Produkt voor Vee en Vlees [1980] ECR 617.

⁵⁵⁷ Bourgoïn S A and others v Ministry of Agriculture and Food [1986] QB 716, 755, per Oliver LJ (dissenting).

Table 5.1. Communications of Member States on Irregularities, EAGGF Guarantee Section 1991-94*

	----- Cases -----			----- Amounts in ECU -----		
	Notif-ied	Closed	Open	Notified	Recovered	To be recovered
B	119	58	61	11 450	737 154	10 715 940
DK	221	175	46	10 503 868	4 908 684	5 595 184
G	546	265	281	66 217 645	12 301 686	53 915 959
EL	327	65	262	86 353 034	58 267 596	28 085 438
P	519	218	301	82 746 803	2 263 922	80 482 881
F	389	254	135	54 252 457	17 282 240	36 970 217
IR	65	48	17	5 507 529	2 137 890	3 369 639
I	955	108	847	560 685 454	35 748 902	524 936 552
NL	428	331	97	22 621 210	11 093 595	11 527 615
P	270	38	232	14 961 534	1 037 472	13 924 062
UK	670	466	204	26 774 056	11 006 035	14 825 247
ALL	4 509	2 026	2 483	942 073 684	156 82 176	784 348 734

Note to tables 5.1-5.4. Source: European Commission (1995) Protecting the Community's financial interests, The fight against fraud, Annual Report 1994, pp 82-83. Note to table 5.1. Luxembourg had no irregularities to report. Belgium and Greece are represented only for the first three quarters of 1994.

Table 5.2. Recovery of Traditional EAGGF Guarantee Section, 1991-94 (first two quarters of 1994)

	Cases notified	Amount notified	% of amount notified recovered to be recovered	
B	3%	1%	6%	94%
DK	5%	1%	47%	53%
D	12%	7%	19%	81%
EL	7%	9%	66%	33%
ES	12%	9%	3%	97%
F	9%	6%	32%	68%
IR	1%	1%	39%	61%
I	21%	60%	6%	94%
NL	9%	2%	49%	51%
P	6%	2%	7%	93%
UK	15%	3%	41%	55%
ALL	100%	100%	17%	83%

Table 5.3. Communications of Member States on Irregularities, Traditional Own Resources, 1991-94 (first two quarters of 1994)

	----- Cases -----			----- Amounts in ECU -----		
	Notif-ied	Closed	Open	Notified	Recovered	To be recovered
B	328	203	125	49 205 846	7 267 239	41 938 607
DK	86	41	45	6 848 827	2 799 554	4 049 273
D	1 548	115	1 433	171 442 258	7 715 408	163 726 850
EL	66	0	66	3 223 998	0	3 223 998
SP	192	15	177	14 051 855	1 025 938	13 025 917
F	544	9	535	53 500 248	5 093 467	48 406 781
IR	32	13	19	8 001 875	1 183 211	6 818 664
I	408	41	367	92 474 916	654 257	91 820 659
L	2	1	1	85 220	45 417	39 803
NL	44	1	43	9 513 448	122 232	9 391 216
P	84	39	45	2 969 940	579 444	2 390 496
UK	961	224	737	92 167 252	1 844 104	90 323 148
ALL	4 295	702	3 593	503 485 683	28 330 271	475 155 412

Table 5.4. Recovery of Traditional Own Resources, 1991-94 (first two quarters of 1994)

	Cases notified	Amount notified	% of amount notified	
			recovered	to be recovered
B	8%	10%	15%	85%
DK	2%	1%	41%	59%
D	36%	34%	5%	95%
EL	2%	1%	0%	100%
ES	4%	3%	7%	93%
F	13%	11%	10%	90%
IR	1%	2%	15%	85%
I	9%	18%	1%	99%
L	0%	0%	53%	47%
NL	1%	2%	1%	99%
P	2%	1%	20%	80%
UK	22%	18%	2%	98%
ALL	100%	100%	6%	94%

The jurisprudence of the Court of Justice offers little guidance on what may be an acceptable delay for the recovery of a sum owed to the EC budget. A recent case (1992) states that Member States have a duty to take steps to rectify irregularities promptly, whether time-limits are expressly laid down by relevant Community rules or not.⁵⁵⁸ Although it is not clear what the Court meant by 'promptly', it found that delays of ten and four years before commencing proceedings constituted negligence under Article 8 of Council Regulation 729/70.⁵⁵⁹ At the moment delays of several years in recovering unwarranted payments seem to be the norm rather than the exception throughout the Union.

5.2. Recovering EC funds in the UK: background

In the United Kingdom, for some time, there has been concern over the perceived inadequacies of serious fraud trials.⁵⁶⁰ This has added momentum to the 'creeping decriminalization' of fraud, including revenue fraud. The result has been that 'many against whom there is a strong prima facie case of fraud negotiate their way out of the criminal justice process'.⁵⁶¹ Civil proceedings, on the other hand tend to be long, complex and costly, so amounts are often settled before the hearing. In contrast, extra-judicial (administrative) recovery has consistently been praised as fast, efficient and inexpensive.⁵⁶² This type of recovery is in tune with the present government's pragmatic approach to revenue collecting,

⁵⁵⁸ Case 34/89 Italy v Commission re: olive oil production aid [1992] 2 CMLR 797, judgment 7-14, page 274-275.

⁵⁵⁹ Ibid.

⁵⁶⁰ See for example Fraud Trials Committee Report chaired by Lord Roskill (1986) HMSO, London.

⁵⁶¹ Levi, M (1987) Regulating fraud, white-collar crime and the criminal process, Tavistock Publications, London, page 183.

⁵⁶² See for example Patel v Spence [1976] 1 WLR 1268, 1270 and A-G v Johnstone (1926) 10 T.C 758.

and its general concern for cost-effectiveness. This preference in turn raises the issue of the availability, and effectiveness of remedies against administrative decisions. The general features of criminal, civil and extra-judicial routes are explored below.

5.2.1. *The civil route*

Unlike most of its European Union neighbours, the United Kingdom has no administrative finance courts. All courts have full jurisdiction to decide cases in administrative matters and to exercise control over administrative bodies and tribunals. As a rule, only courts can impose fines. Another feature of the British systems is that civil and criminal jurisdictions are separate and distinct.

With some exceptions, the County Court (Sheriff Court in Scotland) usually deals with cases involving a debt up to a certain amount⁵⁶³ and the High Court (Court of Session in Scotland) with debts above that limit.⁵⁶⁴ It is open to the defendant to pay to the court the amount claimed before the hearing. If this is done at any time up to the time of the hearing, the action is stayed. The court and its administration take no part in preparing a case for trial other than to make orders and to grant relief but only upon the application of a party to the proceedings. Another important feature of civil judgments is that they are usually awarded irrespective of the debtor's ability to pay.

If the action is for a sum not exceeding £1,000 and when both parties agree⁵⁶⁵ the matter can go to a Small Claims Tribunal in the County Court (or Sheriff Court in Scotland). The usual

⁵⁶³ £50,000 in England and Wales.

⁵⁶⁴ S3 of the Courts and Legal Services Act 1990.

⁵⁶⁵ This limit can be raised to £5,000 when both parties are agreeable.

rules of procedure do not apply and the waiting time for a hearing is shorter (usually six to eight weeks). The Intervention Board (see below), for example, has made increasing use of this procedure since the increase in upper limit. The parties do not have to be represented, and it is possible for the State to send a non-legal member of staff to the hearing as a representative.⁵⁶⁶ The award is final although an arbitrator can set it aside if, for example, it was made in the absence of one of the parties, and a reasonable excuse for the absence is provided.

Insolvencies have increased at a vertiginous rate these last few years, and must be mentioned as they increasingly affect the authorities' ability to recover debts.⁵⁶⁷ In its first Statement of Assurance (for the financial year 1994) the European Court of Auditors points out that in one case a British company receiving a subsidy in the regional sector had gone out of business; neither a manager nor the company's accounts were available.⁵⁶⁸ Generally, in cases of insolvency,⁵⁶⁹ the official receiver (attached to the court)

⁵⁶⁶ Intervention Board for Agricultural Produce (IBAP): authority responsible for the administration of the CAP in the United Kingdom.

⁵⁶⁷ See newspaper article: '4,000 directors thought to be serial failures' in Financial Times, 28 October 1996, which reads: "Out of 952,432 UK company directors, 37% have been associated with one or more [business] failures in the past seven years. The number of directors with 10 or more failures to their names has climbed four-fold in two year [1994-1996] to 4,000. [This is due to] a general increase in criminal and fraudulent behaviour in the corporate world. Many of the 4,000 directors deliberately closed down companies to avoid paying debts and then set up new ones, often in a bid to defraud customers, suppliers or business partners."

⁵⁶⁸ European Court of Auditors (1995) Statement of Assurance concerning activities financed from the general budget for the financial year 1994, page 71.

⁵⁶⁹ This is far from being an uncommon problem in the UK where the number of personal and corporate bankruptcies now number around 60,000 a year. This is due to a system where, broadly speaking, the advantages of bankruptcy or winding-up

appoints a trustee or liquidator when there are assets to be distributed amongst creditors.⁵⁷⁰ The trustee is then responsible for the distribution of assets amongst creditors *pari passu*, but in strict order of priority. First, the expenses of bankruptcy must be paid.⁵⁷¹ The costs can consume 40% of assets, about twice as much as an individual voluntary arrangement. The government takes the biggest bite, followed by the insolvency practitioner, with lesser amounts by selling agents and solicitors.⁵⁷²

Second, preferential debts to a few Crown bodies take precedence. They are debts due to the Inland Revenue or Customs and Excise, social security contributions, contributions to occupational pension schemes, remuneration of employees, etc.⁵⁷³

Third, ordinary debts can be settled and, in this, all unsecured creditors rank equally. This usually means that each of the ordinary creditors receives a dividend expressed as so many pence in the pound upon the debt in question. As a rule the insolvency process produces minimal returns for ordinary unsecured creditors.

Clearly all bodies engaged in the recovery of EC funds are not granted the same status with respect to debt recovery, with

(getting rid of creditors) far outweigh the disadvantages (temporary disqualification for directorship of a company, for example). The leniency of this system has led to the 'Phoenix Syndrome' where bankrupts repeatedly 'resurrect' 'new' companies under different names without paying old creditors. Some legal commentators talk about 'the bankruptcy of bankruptcy' and argue for reforms which allow more differentiation between the small domestic debtor and the corporate debtor.

⁵⁷⁰ S324 (1) of the 1986 Insolvency Act.

⁵⁷¹ Ibid, S324(1) of the 1986 Insolvency Act.

⁵⁷² Graham Report (1994) Report chaired by David Graham, QC Insolvency law: An agenda for reform, JUSTICE.

⁵⁷³ Preferential debts are listed in Schedule 6 of the Insolvency Act 1986.

Customs and Excise enjoying an advantage with respect to the recovery of VAT. All others are unsecured creditors. One criticism of the system is that creditors are not kept informed of developments.⁵⁷⁴

In its 1985 Report, the Civil Justice Review identified the main deficiencies of civil justice as being 'delays, cost and complexity'. The Heilbron-Hodge Report painted a similar picture in 1993 and called for reforms.⁵⁷⁵ Indeed, it is not unusual for recoveries to take over two years, and for costs to exceed monies recovered. A recent study estimated that when the costs of both sides were combined, they amounted to 125% of recoveries in the County Court and between 50 and 75% in the High Court.⁵⁷⁶ This has lead Lord Woolf to comment that 'the present system provides higher benefits to lawyers than to their clients'.⁵⁷⁷ The 'cost-effectiveness threshold' is quite high, whatever the nature of the claim. More recently (June 1995) the Woolf Interim Report on the civil justice system in England and Wales⁵⁷⁸ put forward a series of recommendations, which in brief include:

- litigation to be divided into fast-track cases (£3,000 to £10,000) and multi-track cases (more than £10,000);
- fast-track cases to be subject to a streamlined procedure including an abbreviated trial, normally restricted to three hours, within 20 to 30 weeks;

⁵⁷⁴ Ibid.

⁵⁷⁵ Civil Justice on trial: The case for change.

⁵⁷⁶ See Slapper, G and Kelly, D (1993) English Legal System, Cavendish Publishing, 123-145.

⁵⁷⁷ Newspaper article 'The Mackay solution' editorial in the Financial Times, 29 July 1996, page 15.

⁵⁷⁸ Woolf Enquiry Team / The Right Honourable the Lord Woolf, 1995, Access to Justice: interim report to the Lord Chancellor on the civil justice system in England and Wales, published by on behalf of the Woolf Enquiry Team, London, 266 pages, June.

- sanctions to be imposed by judges in cases where lawyers fail to meet strict deadlines;
- lawyers to take a precise pleading in a statement of case;
- judges to be given discretionary powers to allocate the burden of costs at the end of the case by reference to the conduct of the parties.⁵⁷⁹

Some of the proposals relate specifically to 'offers to settle' and aim to encourage reasonable and early settlement of proceedings:

- (1) The present practice of making payment into court should be replaced by a system which permits the parties to make an offer of settlement.
- (2) Offers to settle can be made by a plaintiff as well as a defendant.
- (3) Offers to settle can relate to individual issues.
- (4) Offers to settle can be made before the commencement of proceedings.
- (5) Offers to settle can result in substantially enhanced costs and interest being payable.
- (6) The extent of entitlement to costs and interest in respect of an offer should be in the court's discretion and should depend on the extent of disclosure by the parties.

Criticisms of the proposals have been, *inter alia*, that it fails to break the 140 year cycle of making no real inroads on cost and delay, and that it augments judges' undirected

⁵⁷⁹ See Newspaper article 'Woolf report in sheep's clothing', in Times of 6 August 1996, page 35.

discretion.⁵⁸⁰

The situation at present is that most civil disputes are settled out of court: fewer than 10% of cases where a writ is issued actually go to court. Notwithstanding this preference for out of court settlements, by far the largest number of cases dealt with by the County Court still relates to debt recovery. Currently the civil courts in England and Wales deal with over three million such claims each year. Should the Woolf recommendations with respect to settlements be implemented, one can expect that in the future, overall, an even larger proportion of cases will be settled out of court.

The Civil Fraud Regime

There has been a steady move away from criminal prosecution in the fiscal sphere. The 1985 Finance Act decriminalised VAT regulatory offences. As a whole VAT offences remain the most decriminalised, as the great majority are dealt with under the civil fraud regime. This regime, which was brought into being by Section 13 of the 1985 Finance Act on VAT, was extended to excise duties by the 1994 Finance Act, and will also apply to Customs duties shortly. The 'civil fraud' regime is therefore of particular significance in this context.

Under this regime, anyone who evades duty (whether or not his behaviour gives rise to any criminal liability) is liable to a penalty. The degree of proof required is based on the balance of probabilities rather than the criminal standard of beyond reasonable doubt.

In the civil fraud regime the standard of proof of dishonesty is not stated. Evasion is defined as the act of claiming any

⁵⁸⁰ Watson, G (1996) From an adversarial to a managed system of litigation: a comparative critique of Lord Woolf's interim report, Achieving civil justice Appropriate dispute resolution for the 1990s, ed: R. Smith, Legal Action Group, London.

repayment, rebate or drawback of duty, any relief exemption from or any allowance against duty, or any deferral or other postponement of liability to pay any duty or of the discharge by payment of any such liability, without being entitled to it.⁵⁸¹ Although these acts do not necessarily attract the full range of financial penalties (fixed or proportionate penalty, daily penalty), failure to pay any amount appears to be a decisively aggravating factor, and attracts the full range of financial penalties from the court in all cases.⁵⁸²

A person convicted of the fraudulent evasion, or the attempted evasion of duty chargeable on goods (this usually involves forgery), or any provision of CEMA applicable to goods is liable to a penalty of the prescribed sum or three times the value of the goods, whichever is the greater, or to imprisonment for a term not exceeding six months.⁵⁸³

In VAT cases, Customs and Excise will usually prosecute if a sworn statement (as to true earnings and profits) turns out to be incorrect.

Early cooperation with officials is taken into account when assessing the fine.⁵⁸⁴

Fines in the civil fraud regime

Under the civil fraud regime (soon to be extended to Customs duties, as mentioned earlier), the system of assessing the fine is mixed. It is proportional to the loss sustained, but also has a fixed-sum element (i) and (ii).

⁵⁸¹ Article 8 (2) of the 1994 Finance Act.

⁵⁸² Article 9(4) of the 1994 Finance Act.

⁵⁸³ Article 170 of the Customs and Excise Management Act 1979.

⁵⁸⁴ Article 8(7)(b) and (d) of the 1994 Finance Act 1994.

(i) for a failure to pay any amount of duty in contravention of subordinate legislation, 5% or £250, whichever is the greater amount

(ii) for the continuation of the above or failure to send a return, above the initial penalty in (i) to a penalty of £20 for every day, after the first, on which the conduct continues.⁵⁸⁵

There is also a right to mitigation on grounds which exclude insufficiency of funds.⁵⁸⁶

Criminal and civil liability

When irregularities entail both criminal and civil liability, parallel civil proceedings are usually delayed until the criminal prosecution is concluded. A fine or compensation order can be imposed by the criminal court at that stage. It is usually a matter of judicial discretion as to whether concurrent civil proceedings about the same subject-matter as a prosecution are stayed. The court must decide whether justice between the parties requires this. It will have regard, inter alia, to the following circumstances:

- the possibility of prejudicial publicity from the civil proceedings
- whether the criminal trial is imminent and
- whether there is a real danger that the defendant would be prejudiced by being forced to disclose his defence to the criminal charge prematurely.⁵⁸⁷

⁵⁸⁵ Article 9 of the 1994 Finance Act.

⁵⁸⁶ See Lagerberg, F (1994) It's no longer criminal, Taxation, 17 March, page 530-531.

⁵⁸⁷ Jefferson Ltd v Bhetcha [1979] 1 WLR 898. cf. Supreme Court Practice, Vol.2, para 3355 (1982 ed).

5.2.2. *The Criminal route*

With regards to Crown prosecutions, the principle of expediency (*opportunit *) prevails.⁵⁸⁸ This means that the Crown Prosecution Service (CPS)⁵⁸⁹, the Lord Advocate in Scotland or those responsible for prosecution decisions in departments such as HM Customs and Excise decide whether to prosecute or whether to pursue some other course of action (including dropping the case). In this context, Harding has pointed out that

[I]t would be misleading [...] to divorce negotiated settlements from the analogy of criminal proceedings when it is clear that at a national level of criminal procedure issues in relation to prosecution, trial and sentence may be decided in an administrative fashion.⁵⁹⁰

The CPS, for example, processes cases put up for prosecution through a two-stage evidential test. The first test consists in deciding whether there is enough evidence to provide a 'realistic prospect of conviction' against each defendant on each charge. 'Weak evidence' remains the most often quoted

⁵⁸⁸ Professor Ashworth identified three groups of countries: (i) Member States where the principle of legality was maintained without significant exceptions like Austria, Greece and Spain (ii) Member States where the principle of expediency played a limited role like Portugal, Germany and France and (iii) Member States where prosecutors were allowed to make a wide use of the principle of expediency like Luxembourg, Sweden and the systems within the United Kingdom. (Ashworth, J (1989) *Techniques for reducing subjective disparity in sentencing in Disparities in sentencing causes and solutions*, Council of Europe, Strasbourg).

⁵⁸⁹ The Crown Prosecution Service was set up in 1986 and the prosecution of most criminal offences is now in its hands.

⁵⁹⁰ Harding, C (1993) *European Community investigations and sanctions*, Leicester University Press, page 68.

reason for not going ahead with prosecution.⁵⁹¹ The second test relates to the public interest. This means that even if the evidential sufficiency test is satisfied it must still be in the public interest to prosecute. In cases of any seriousness, a prosecution will usually take place unless there are public interest factors tending against prosecution.⁵⁹² Two of the public interest factors against prosecution listed in the Code for Crown Prosecutors appear to be particularly relevant:

- The defendant has put right the loss or harm that was caused (but defendants must not avoid prosecution simply because they can pay compensation); or
- Details may be made public that could harm sources of information, international relations or national security.

But Crown prosecutors must decide how important each factor is in the circumstances of each case and go on to make an overall assessment.

There is no constitutional interpretation of the public interest. The executive is free to interpret public interest as they wish. In this context, Levi recently (1995) pointed out that

'[W]hat is or is not "in the public interest" is essentially subjective and can be political (with a small or a large p). British examples in which it has been alleged that pressure has been exerted not to prosecute in fraud cases include the House of Fraser case

⁵⁹¹ See Home Office (1994) Case screening by the Crown Prosecution Service: how and why cases are terminated, Research Study 137, HMSO.

⁵⁹² See Crown Prosecution Service (1994) The Code for Crown Prosecutors.

(involving the take-over of Harrods department store by the Fayed brothers, allegedly supported by the Sultan of Brunei); the Peter Cameron-Webb case (involving alleged "baby syndicates" given preferential treatment at Lloyd's of London); and the decision by the Department of Public Prosecution (DPP) in 1978 not to prosecute companies that broke sanctions imposed at the time of Rhodesia's Unilateral Declaration of Independence on the grounds that 'no good would be served by raking over these almost dead coals'. (The last is the only example in which policy rather than that usually unfalsifiable category "insufficient evidence" was given as the reason for non-prosecution.)⁵⁹³

In the more recent 'Supergun' affair,⁵⁹⁴ Customs and Excise were advised that there were no realistic prospects of a conviction. But in view of the nature of the case, Customs and Excise sought advice from the Attorney-General as to whether there might be exceptional circumstances justifying prosecution in the public interest. The Attorney General concluded that a prosecution should not be brought without a reasonable prospect of conviction and that public interest considerations should not be introduced as a way to justify prosecutions [without a prospect of conviction]. Sir Richard Scott later endorsed this advice in his report, concluding

⁵⁹³ Levi, M (1995) Serious fraud in Britain, Corporate crime: Contemporary debates, eds F. Pearce and L. Snider, University of Toronto Press, 181-198, page 188.

⁵⁹⁴ The 'Supergun' affair involved the seizing in 1990 by Customs and Excise at Tees Dock, Middlesbrough, UK of large tubes which were discovered to be sections of barrel for a huge long-range artillery gun. No export licence had been applied for as they were exported as petrochemical pipes. Customs and Excise prosecuted managers in the British firms who had forged the tubes. Two lines of defence emerged. The first was that the defendants did not know that the tubes were intended to be used as weapons. Secondly, the defendants had expressed concerns to the Ministry of Defence and the DTI in 1988 about a possible military use of the tubes. The government departments had failed to investigate the concerns.

that while there may be wholly exceptional circumstances in which such a prosecution could properly be brought, he could not formulate any practical examples.⁵⁹⁵ The CPS has been openly criticised for reducing or even dropping charges to save money.⁵⁹⁶

In his report, Sir Richard Scott took the view that although the CPS and the SFO were independent prosecuting agencies, government departments were not. Government departments' prosecutions could be regarded as a means of enforcing departmental policies in the area in question.⁵⁹⁷ This can lead (as in the 'Supergun' affair) to two different prosecuting bodies taking contrary decisions in the same circumstances. At present there are no signs that the various agencies which, in one way or another, represent the public interest actually converge in their approach to EC fraud.⁵⁹⁸

Government departments with powers of prosecution have their own guidelines for prosecution, which also adhere to the principle of opportunity. However policies on prosecutions are rarely set out publicly.⁵⁹⁹

⁵⁹⁵ 'Scott Report' or Report of the Inquiry into the Export of Defence Equipment and Dual-Use Goods to Iraq and Related Prosecutions (1996) HMSO, by Sir Richard Scott, Vice-Chancellor of the Supreme Court, J1 33, J1 39.

⁵⁹⁶ See Rose, D (1996) In the name of the law: The collapse of criminal justice; also newspaper article 'When justice takes a walk', in Guardian, November 19 1996, pp 2-3.

⁵⁹⁷ Scott Report, op.cit, K.4.7.

⁵⁹⁸ White, S (1995) The public interest as represented in English law: Relevance for EC fraud, proceeds on a conference held at Urbino, Italy, July.

⁵⁹⁹ Harwood, R (1996) Corruption and public sector fraud Prosecution by government agencies, Journal of Financial Crime, Volume 4, number 1, pp 51-54.

Fines

Financial penalties are, by far, the most frequent penalties imposed by the criminal courts. A financial penalty can be imposed on its own, or in combination with a term of imprisonment, or any other sentence. In England, the magistrate's courts, which exercise jurisdiction over less serious crime, can impose a fine for any offence tried before them, up to a fixed upper limit.⁶⁰⁰

The Crown Court is empowered to impose a fine in lieu of, or in addition to imprisonment (provided that the offence does not carry a mandatory sentence such as life imprisonment). It enjoys an unlimited fining jurisdiction, although the prohibition of excessive fines found in the Magna Carta (1215)⁶⁰¹ and the Bill of Rights (1689)⁶⁰² still apply. In criminal courts generally, the level of the fine is determined by the gravity of the offence and the offender's financial circumstances.⁶⁰³ (A 'unit fine' experiment of 1991-1994 has been abandoned by the government). A fine can be paid in instalments. This is usually granted at the hearing without having to make a special application to the court. Both amount and period of repayment are subject to judicial discretion.

A Criminal court can request a financial circumstances report before imposing a fine. A fine can be imposed in addition to a

⁶⁰⁰ Where for example an offender has been summarily convicted of an offence triable either way the maximum fine is £5,000 under s.17(2)(c) of the 1991 Criminal Justice Act.

⁶⁰¹ Grebing, G (1982) The fine in comparative law a survey of 21 countries, Cambridge Institute of Criminology, Occasional Papers number 9, page 86 and note 479.

⁶⁰² It forbids 'excessive baile... excessive fines and cruell and unusuall punishments'.

⁶⁰³ S.19(2) of the 1991 Criminal Justice Act explains that this may have the effect of either reducing or increasing the amount of the fine.

term of imprisonment, or in addition to a probation order. Alternatively, it can be imposed on its own (see compensation order, 2). A request to pay a fine by instalments is usually granted to the offender by the court without special application. Again, the amount and period of repayment are the subject of judicial discretion. In case of default to the terms agreed, a 'means inquiry' is ordered by the court. A means warrant has the effect of producing payment in most cases but, when it fails, the court is empowered to change the sum of the fine imposed or to remit. But generally speaking the Keith Committee (1983) found that, in revenue cases

'compared with the scale of culpable arrears, the fines imposed in the larger cases are modest...The recovery of fines imposed in the larger cases ...is slow and difficult...given the circumstances and scale of the larger tax frauds, it is questionable whether such sentences have significant deterrent value.'⁶⁰⁴

Compensation orders, which seek to compensate the victim for any damage caused, have been described as a method of short-circuiting civil proceedings. It is difficult to gauge, within the remit of this research, what role they have in the protection of the financial interests of the European Community, if any. Although in the past a compensation order could only be made in addition to another sentence for crime, a criminal court can now make one in its own right. A compensation order can also be made even though the precise amount of the loss or damage has not been proved.⁶⁰⁵

In cases of criminal bankruptcies the CPS is invariably the petitioner. In deciding whether to apply for a criminal bankruptcy order⁶⁰⁶ (which has the effect of making available

⁶⁰⁴ Keith Committee (1983) see supra.

⁶⁰⁵ Ibid.

⁶⁰⁶ S39 of the Powers of Criminal Courts Act 1973.

the machinery of civil bankruptcy administration for the recovery of sums owed), the CPS applies two criteria:

First, whether the offender has sufficient means to make bankruptcy proceedings worthwhile,

Second, whether it is in the public interest to take proceedings in respect of those assets (because, for example, such action might cause severe hardship to the criminal bankrupt's family).⁶⁰⁷ But generally speaking, as Levi (1989) pointed out '... Civil redress against convicted persons is comparatively rare: it is more common as an alternative to prosecution.'⁶⁰⁸

Finally there is no 'constitution de partie civile' whereby the civil and criminal actions can be joined in one single proceeding.⁶⁰⁹ Nor can the victim apply to join the proceedings as a civil party (plainte de partie civile).

5.2.3. Extra-judicial settlements: UK agencies and their practices

It is also within the discretion of government bodies managing EC funds to recover unwarranted payments without going to court. Such settlements occur when the agencies decide to offset amounts, to compound or to withhold payments. In line with the 'either/or' system in operation, extra judicial proposals for settlement are not presented to an independent body for approval. In practice, it is up to the aggrieved person to challenge the administrative decision with the administration

⁶⁰⁷ See Hodgson Report (1984) Profits of crime and their recovery Report of a Committee chaired by Sir Derek Hodgson (1984) Heinemann, London.

⁶⁰⁸ Levi, M (1989) Fraudulent justice? Sentencing the business criminal, in Paying for crime, ed P.Carlen and D. Cook, Open University Press, Milton Keynes, UK.

⁶⁰⁹ See Cappelletti, M (1989) The judicial process in comparative perspective, Clarendon Press, Oxford.

itself. Most administrations have a formal internal review mechanism, and they will review on request, on the understanding that 'mistakes can occur on either side'. If the dispute persists a judicial remedy has to be sought. In some cases, the treasury can write off unrecoverable debts. These are addressed in more detail under part 5.

UK agencies

There is no central organizational framework in the United Kingdom for the prevention, detection, investigation and prosecution of EC fraud or irregularities.⁶¹⁰ Instead, a fragmented approach prevails, with each government body with a responsibility for the management of EC funds adopting a different policy with regards to the recovery of funds, as we shall see. MAFF, the Intervention Board for Agricultural Produce (IBAP), H.M Customs and Excise, the Department of Employment and the Treasury are the main government departments with responsibilities for EC funds which are examined below.

MAFF

MAFF (the Ministry of Agriculture, Fisheries and Food) administers, with the Agriculture Departments in Scotland, Northern Ireland and Wales, government policies on agriculture, horticulture and fisheries. These department deal with the recovery of sums relating to the funds they administer. These include funds from the guarantee and from the guidance section of the EAGGF, from FIFG⁶¹¹ and from some

⁶¹⁰ See Doig, A (1995) A fragmented organizational approach to fraud in a European context - The case of the United Kingdom public sector, in European Journal on Criminal Policy and Research, special edition on corruption and corporate crime, Vol 3, 2:48-64.

⁶¹¹ The Financial Instrument for Fisheries Guidance (FIFG) provides structural assistance in the fisheries and aquaculture sector and for the processing and marketing of its

of the Community initiatives.⁶¹²

The Intervention Board for Agricultural Produce (IBAP)

IBAP is a separate government department which is accountable to the four Agriculture Ministers and funds all the expenditure in the United Kingdom under the Guarantee Section of the EAGGF. It also administers the trader-based Guarantee Section schemes in the United Kingdom. It is responsible for accounting for the recovery of overpayments and the collection of levies in respect of the schemes which it administers.

From time to time the authorities (MAFF, the Intervention Board) find themselves due to make a payment to a beneficiary of the Common Agricultural Policy who has failed to pay a levy or repay an overpayment within the time limit that has been given. The legal position in the UK is that mutual debts may be set off against each other provided that there are established debts, that the two parties are acting in the same capacity in relation to both debts and they both agree. Set-off is the right to set up a compensating debt against a creditor in extinction or diminution of the claim, so that both obligations are to that extent simultaneously discharged and a net obligation is substituted.⁶¹³ Set-off postulates mutual but independent obligations between two parties.⁶¹⁴ It applies regardless of the degree of fault. Indeed 'in the case of an insolvent trader, such set-off may constitute the only practicable way open to the authorities to recover the wrongly paid sums'.⁶¹⁵ Unlike Customs and Excise, the authorities

products.

⁶¹² For example under LEADER II or PESCA , see supra.

⁶¹³ Hanak v Green [1958] ALL ER 141 at 153.

⁶¹⁴ Southern, D (1994) Set-off revisited, New Law Journal (1994) 6669, page 1412-1414.

⁶¹⁵ Case 250/78 Deka Getreideprodukte GmbH v EEC [1983] ECR 421.

dealing with agricultural subventions do not have any power to seize goods or assets, so when farmers are not agreeable to set-off, they become liable to civil proceedings. Set-off is used mostly when there are repeated payments, for example in the case of subventions to farmers within the context of the EAGGF Guarantee Section funds.

HM Customs and Excise

Customs and Excise is responsible for the collection and administration of Customs and Excise duties and value added tax, the compilation of overseas trade statistics, the collection of Customs and agricultural levies for the European Union and the enforcement of prohibitions of the importation of certain goods. Most of the work is now organised in executive units. The Department is responsible for control of the export of all goods subject to export refunds and gets involved in negotiating extra-judicial settlements with respect to VAT and trade levies. It can prosecute in its own right.

Customs and Excise have the power to compound. This power, to be exercised entirely within their discretion, means that they can drop a case altogether, or reach an agreement with an individual to drop a case, generally in consideration of a payment of money.⁶¹⁶ The Inland Revenue also have the power to compound.⁶¹⁷ The Keith Report found that this power was exercised with respect to 90% of VAT fraud cases.⁶¹⁸ Figures show that, in 1993 and 1994, this power has also been exercised with respect to CAP levies, as well as other duties (see table 5.5.) - but not to the degree reported in the Keith

⁶¹⁶ S152 (a) of the Customs and Excise Act 1979; see also H.M. Customs and Excise (1992) Customs, compounding, seizure and restoration, customers' booklet, HMSO.

⁶¹⁷ S102 of the Taxes Management Act 1970.

⁶¹⁸ Keith Report on Enforcement Powers of Revenue Departments, Cmnd 8822 (1983) para 16.4.3.

Report in respect of VAT.

Table 5.5.

Outcomes of court cases and compounded resolutions: CAP offences, 1992-94

	Court			Settlements under S152 CEMA
	Number of people involved	Number of people imprisoned	Fines (in thousands of pounds sterling)	Fines (in thousands of pounds sterling)
<u>From 1/4/92 to 31/3/93:</u>				
Import	5	2	200.9	39.5
Export	11	4	200	88.5
<u>From 1/4/93 to 31/3/94:</u>				
Import	3	No figures available	No figures available	No figures available
Export	8	2	158	41.75

Note to table 5.5.

Source: H.M Customs and Excise Annual Report for the year ended 31 March 1993, pp 88-89; H.M Customs and Excise Annual Report for the year ended 31 March 1994, pp 92-93.

Both compounding and civil fraud penalties are used in areas controlled by Customs and Excise, i.e VAT, excise, duties and levies. There is no difference in treatment between national funds and EC funds.

The Department of Trade and Industry (DTI)

The Department's responsibilities are wide-ranging and include government policy on regional development, inward investment, energy, export services, innovation, environment, deregulation, competition policy, small firms and consumer affairs. The Department's responsibilities cover the UK as a whole, with the exception of some of its duties relating to regional assistance, which are devolved. It is within the Department's discretion to negotiate extra-judicial settlements with respect to the European Regional Fund (ERF) and of Community initiatives such as the SMEs initiative⁶¹⁹ INTERREG II,⁶²⁰ LEADER II,⁶²¹ RECHAR II,⁶²² RESIDER II,⁶²³ RETEX,⁶²⁴ KONVER,⁶²⁵ URBAN,⁶²⁶ PESCA⁶²⁷ as well as pilot

⁶¹⁹ The SME initiative is intended to help small and medium-sized enterprises to participate in the economy.

⁶²⁰ INTERREG II supports the development of networks and cross-border, transnational and inter-regional cooperation in areas such as the transfer of skills and technology towards the less-favoured regions.

⁶²¹ LEADER II supports local initiatives for rural development.

⁶²² RECHAR II assists the economic and social conversion of coal mining areas hardest hit by mine closures.

⁶²³ RESIDER II assists the economic and social conversion of steel areas.

⁶²⁴ RETEX aims to promote the diversification of activities in regions which are overt-dependent on the textile and clothing industry.

⁶²⁵ KONVER aims to help to help areas affected by the run-down of defence-related industries and military installations.

⁶²⁶ The URBAN initiative is aimed at supporting schemes in depressed urban areas.

initiatives in inter-regional cooperation⁶²⁸ and most activities under the fourth R & D programme⁶²⁹ when it sees fit. It can also prosecute in its own right, in certain circumstances.

The Department of Employment

The responsibility for the administration of the European Social Fund (ESF) and of various Community initiatives⁶³⁰ rests with the Department of Employment. It discharges its responsibilities through the ESF Unit based in London. Its Verification and Audit Section (VAS) was established recently in order to meet the responsibilities under Article 23 of Council Regulation 2082/93.⁶³¹ In Scotland, the Secretary of State for Scotland now has responsibility for training policy and the administration of objectives 1, 2 and 5b under the ESF now rests with the Scottish Office Industry Department (SOID). The Northern Ireland Office too has similar devolved responsibilities with respect to Northern Ireland. These agencies can be involved in negotiating extra-judicial settlements with respect to the European Social Fund, but have

⁶²⁷ PESCA aims to help areas which are heavily dependent on fishing to adapt to economic changes and diversify their activities.

⁶²⁸ For example PACTE, which promotes cooperation at local and regional level in the area of development; OUVERTURE and ECOS, which promotes cooperation between the less favoured regions of the European Union and their counterparts in central and eastern Europe and RECITE, which supports 36 inter-regional projects and networks of regional and local authorities across the European Union in fields such as economic development.

⁶²⁹ The fourth framework programme for Community Research and Technological Development (1994-1998) supports research and development activities in key industrial technologies.

⁶³⁰ EMPLOYMENT-NOW, to reduce unemployment amongst women; EMPLOYMENT-HORIZON to improve employment prospects of disabled people; EMPLOYMENT-YOUTHSTART to prevent youth unemployment and several equal opportunities action programmes, etc.

⁶³¹ OJ (1993) L 193/20.

no power to prosecute in their own right. In the 1994 financial year, the United Kingdom reported no fraud in this area. According to the London office, minor mistakes and irregularities, when they occurred were dealt with, for example, by withholding payments until appropriate targets were met.

H.M. Treasury: Overseeing role and direct involvement

The Treasury is responsible for tax and monetary policy, the control and planning of public expenditure, international financial relations, supervision of the financial system, and a range of Civil Service management issues. The responsibility of the Treasury and its executive agencies⁶³² extends throughout the United Kingdom. Apart from its general executive role, the Treasury is directly involved in certain decisions, for example those relating to write-offs.

5.2.4. Particularities of extra-judicial recoveries in English law

(i) Setting-off: background

The right of set-off exists both under common law and under statute. The statutory right of set-off belongs to the administrative branch of the law and can be found in various forms in banking and consumer right legislation.⁶³³ It is based on the 1592 Compensation Act in Scotland, and the 1729 and 1735 Statutes of Set-off in the rest of the United Kingdom. In England the Statutes of Set-off were repealed but their effect were preserved in the procedural rules of

⁶³² See HMSO Publications (1995) *The Civil Service*, HMSO.

⁶³³ For example the Sale of Goods Act 1979 S53 (1) (a) provides for set-off.

1879.⁶³⁴ Because set-off is procedural in nature, it is *lex fori*⁶³⁵ - which means that it is classified according to (the many) circumstances in which it can arise. Furthermore set-off can only be invoked as a defence: it is 'a shield not a sword'. We shall see that in the discretionary British systems, this can create problems because set-off is being used more pro-actively than it was intended to be.

Mutuality and equity are two central pre-requirements to set-off. The doctrine of mutuality (also called reciprocity, privity or the requirement of *concursum debiti et crediti*) requires that one person's claim shall not be used to pay another person's debt.⁶³⁶ The requirement of equity (i.e. that the demands be held in the same right) would seem to mean no more than each of the parties who is liable to the other, should be the beneficial owner of a cross-demand.⁶³⁷

The literature confirms that set-off can be regarded as similar to payment. In setting off his cross-claim, the debtor 'pays' the creditor's primary claim *pro tanto* and obliges the creditor to 'pay' the cross-claim. There is therefore a *pro tanto* redemption, discharge, satisfaction, extinguishment or reduction of the reciprocal debts.⁶³⁸

Set-off is used when there has been an overclaim (deliberate or not) of a subsidy and when the amount over-claimed can be deducted from the next payment. The type of set-off we are mostly concerned with here is of the solvent variety which has

⁶³⁴ Section 2 of the Civil Procedure Act Repeal Act R.S.C ord.17, r.18 Paragraphs 2-6 et seq.

⁶³⁵ Meyer v Dresser (1864) 16 CB (NS) 646.

⁶³⁶ See Wood, P (1989) English and international set-off, Sweet and Maxwell, London, page 1221.

⁶³⁷ Derham, R (1987) Set-off, Clarendon Press, Oxford, page 155.

⁶³⁸ Wood, op.cit., page 16.

some similarities with a banker's right to set-off sums from customers' accounts.

The right to offset is not automatic, with some exceptions.⁶³⁹ In cases of insolvency, set-off is mandatory. The insolvency Act 1986, S323, provides that where before the commencement of a bankruptcy there have been mutual dealings, an account shall be taken to establish the net balance for which the creditor may prove in the bankruptcy. The substance of mandatory set-off in solvency remains the same for companies as for individuals.⁶⁴⁰

Some regulations specifically request that aids should be paid to the beneficiaries in their entirety.⁶⁴¹ In defence of set-off under these circumstances, the UK authorities have argued that

... [S]et-off does not actually decrease the entitlement of the beneficiary to be paid the amount in question ... [t]he setting-off of part or all of the subsidy payment does not affect the entitlement to aid which has been calculated without deduction.⁶⁴²

⁶³⁹ Wood (op.cit.) states that in France and many other jurisdictions basing themselves on the Napoleonic Code, set-off is automatic as soon as mutual independent claims are eligible for set-off, i.e when they are both liquid and have matured due and payable. The set-off occurs without the parties being aware of it. Jurisdictions following automaticity of independent set-off includes (besides France) Belgium, Luxembourg and Spain (...) although it may be that not all these jurisdictions are wholly faithful to the Code.

⁶⁴⁰ R 4.90 of the Insolvency Rules 1986, SI 1986 adopts identical wording, mutatis mutandis, to s323 of the Insolvency Act.

⁶⁴¹ For example Council Regulations 1765/92 (arable crops), 2066/92 (beef), 2082/93 (structural aids), 615/92 (oilseeds), 84/93 (tobacco).

⁶⁴² Extract from a letter from Robert Lowson, Minister for Agriculture to Guy Legras, Director General of DGVI dated 14 February 1995.

This has been the subject on an on-going debate between the UK authorities and the Commission, the case law of the European Court of Justice shedding little light on this subject.⁶⁴³

This state of uncertainty led the Intervention Board to produce a 'non-paper' in 1992 stating that

...[T]he United Kingdom authorities would welcome a provision of Community law enabling the competent authorities of the Member States to withhold payments under CAP schemes to the extent that they believe the beneficiary to be indebted to them under the CAP.

The main pre-conditions to set-off are that:

- (i) there is no obvious intent to defraud
- (ii) a payment becomes available to set-off
- (iii) the farmer/trader agrees
- (iv) the conditions for mutuality are present.

With respect to the third requirement, which says for example that an agreement should be sought before amounts are offset,

⁶⁴³ In case 118/76 *Balkan-Import-Export v Hauptzollamt Berlin-Packhof* [1977] ECR 1117 the Court of Justice gave a preliminary ruling to the effect that a national administration could not apply a domestic rule when 'its effect would be to modify the scope of the provisions of Community law'. In the case of *Pigs and Bacon Commission v McCarren and Co*, Supreme Court of Ireland [1981] 3 CMLR 408, the Court of Justice ruled that a question of set-off was one to be decided according to national law although the obligation to repay the levy and recover the bonus both derived from Community law. Similarly in joined cases 146, 192 and 193/81 *BayWa AG and others v Bundesanstalt für Landwirtschaftliche Marktordnung* [1982] ECR 1503, the Advocate General pointed out that the application of a national rule is forbidden when it would 'alter the effect of the Community rules'. In case 250/78 *Deka v EEC* [1983] ECR 421, Advocate General Mancini inferred from this that set-off in relation to sums payable under Community legislation was governed by EC law. This view appears to have been endorsed by the Court itself when it said that Community rules 'may give rise, as between authorities and traders, to reciprocal and even related claims which are an appropriate subject for set-off'.

practice varies. When an agreement has not been properly sought by the authorities, this may lead to judicial review.

There is no fixed upper limit of set-off in financial terms. For practical purposes, the maximum that can be off set is the total amount due to the beneficiary by the administration.

The main principle governing set-off is the principle of mutuality, which postulates mutual but independent obligations between two parties. In some circumstances, the mutuality requirement is difficult to satisfy, as we shall see.

Third agency involved in set-off

When a third agency is involved in the management of EC funds, for example of EAGGF Guidance Section Funds, two possibilities have to be envisaged:

(1) the third agency is a Crown body and the principle of mutuality applies (the Crown being indivisible) or

(2) the third agency is not a Crown body, because its agents do not act merely as agents of the Crown in exercising their functions. Without mutuality, there is no (self-help insolvent) set-off, *stricto sensu*.

Although the second possibility was only encountered in Northern Ireland, it cannot be dismissed as an oddity. This is because these last few years have seen a vast programme of privatisation, reaching areas hitherto the sole preserve of the Crown. As a result, agencies proliferate which act on behalf of the Crown, but are not necessarily Crown bodies themselves.⁶⁴⁴ If this trend is to continue, it may well have an increasing impact on the availability of set off as a

⁶⁴⁴ Davies, J and Willman, J (1991) What next? Agencies, departments, and the Civil Service, Institute for Public Policy Research, London.

defence.

Multiple registrations

Strictly speaking the principle of mutuality does not apply when, for example, claims originate

- from different members of the same family running the same farm or business
- from different individuals in the same partnership
- from the same individual(s) but under different or new company names (concurrently or successively).

One of my interviewees was sanguine about this difficulty, and suggested that it could be overcome by extending the system of securities/guarantees, perceived as successful, to more areas of the CAP. This system has the advantage that the security created can be used to settle relevant debts, and also remains valid in the event of the debtor's insolvency.

Setting-off across schemes

There does not appear to be any reason in English or Scots law why set-off should not occur across schemes, as long as the schemes are run by the same Crown body and this does not involve any unauthorized transfer of information.

Setting-off between national and EC funds

Can the authorities set off between national and EC funds? This has been the subject of an on-going debate. Recent Correspondence (1994) from the Commission to the British authorities shows that subsidy stops should not apply on Community premia provided for in certain regulations.

[...] Several Community Regulations [...] provide that the Community premia are to be paid over to the

beneficiaries 'in their entirety' (cf. Regulation 615/92, oilseeds, Regulation 1765/92, cereals, Regulation 2066/92, beef, Regulation 84/93, tobacco and Regulation 2082/93, structural aids). The Commission services take the view that these provisions exclude the possibility for national authorities to withhold the Community premia concerned in order to recover debts arising from national schemes or provisions.⁶⁴⁵

In other words

[...] The use of any such direct aid granted as part of the reform of the CAP to offset a State Claim against those entitled to this aid (for example, a national tax liability) is not permitted.⁶⁴⁶

But more recently (February 1995) the UK authorities have argued that

... [T]here may be cases where purely national debts are recovered from payments under wholly Community funded schemes and, conversely, cases where it will be possible to recover Community debts from payments under wholly UK funded schemes which would be of particular benefit to the Community. It is our understanding of the law handed down from the European Court that a debtor should not be treated more or less favourably in relation to Community schemes than he would be in relation to national schemes. The rules of set-off under the national law should therefore not be operated in a way which prejudices the operation of Community law. By parity of reasoning, the

⁶⁴⁵ Extract from letter originating from G. Legras, Director General of D-G VI to Mr Richard Grant, the Scottish Office, Agriculture and Fisheries Department, Edinburgh dated 1.7.1994.

⁶⁴⁶ Extract from letter originating from René Steichen to The Rt. Hon. William Waldegrave, Minister of Agriculture, dated 27.12.1994.

Community rules should, whenever possible, be interpreted in such a way that there is no discrimination against the operation of national law [...] We have a long experience of using 'subsidy stops' both in Scotland and elsewhere in the UK and we have found that this is a very useful method of debt recovery. There have rarely been objections from farmers or traders directly affected and their application avoids recourse to alternative protracted and expensive debt recovery procedures.⁶⁴⁷

There is no limit to the amount that can be recouped through a compounded settlement. Each settlement has a reparative element (sum to be recovered) and a punitive element (fine). The amount of the punitive element in the settlement is discretionary. Compounding is part of Customs Law. In order to compound, Customs must have enough evidence for a criminal prosecution. Compounding applies both to criminal offence proceedings and to condemnations which are civil proceedings. There is no set rule about when the negotiations for a compound should begin, and s152 of CEMA does not place any time limit on the matter.

Customs and Excise may also, after a court judgment, mitigate or remit any pecuniary penalty imposed under s152(c) of CEMA - although this does not apply to VAT and the so-called civil penalties which the Department can assess under the Finance Act 1985.

(ii) Compounding

According to Customs and Excise, the one unequivocal guideline in deciding the suitability of a case for compounding is that the evidence would support a criminal prosecution. Each case is considered on its merits after a careful evaluation of all

⁶⁴⁷ Extract from letter originating from Robert Lawson, Minister (Agriculture) to Guy Legras, Director General of DG VI, dated 14 February 1995.

known mitigating or aggravating factors including relative seriousness. Evidence of guilt (but not admission of guilt) is a prerequisite to compounding. An alleged offender is free to make an offer of settlement, but Customs and Excise can turn it down. A person who is offered a compounded settlement and turns it down is prosecuted in the criminal court. The general policy on compounding can mostly be found in answers to Parliamentary questions, and in the Keith Report.⁶⁴⁸ As a rule the Department is reluctant to compound, and will usually prosecute in the following cases:

- (a) where a person already has a departmental record
- (b) where he is known to be subject to a suspended prison sentence or on bail, nor when other related offences are being considered, either by Customs themselves, another Government department or the police
- (c) when he is an undischarged bankrupt or in the case of a limited company is in administration or receivership
- (d) where a person, in virtue of his occupation, is supposed to have been more aware than the general public of the gravity of his offence (judges, lawyers, accountants and civil servants fall into that category)
- (e) in obscenity cases involving children
- (f) when illicit distillation is involved, with a risk to public health
- (g) when Customs personnel have been assaulted by members of the public
- (h) when abuse of hydrocarbon oil road fuel is involved
- (i) when firearms are involved.

This list is not exhaustive, and may be added to by Customs. There is no threshold for compounding, and compounding settlements can reach millions of pounds. As far as civil fraud is concerned, there is a discretionary limit of £100,000

⁶⁴⁸ Report of the Committee on Enforcement Power of the Revenue Departments, chaired by Lord Keith of Kinkel, 1984, Cmnd 9440, HMSO.

beyond which Customs and Excise prefer to prosecute. According to Customs, compounded settlements are only available for first offences. Further offences are dealt with by the courts.

With regards to compounding, in 1983 the Keith Committee⁶⁴⁹ recommended that although the tax authorities should be able to compound or make settlements, the names of the persons concerned should be publicised, except where there had been full spontaneous voluntary disclosure⁶⁵⁰. This was not taken up.

There is no special provision for the notification of third parties (apart from the provisions to be found in EC law). In case of insolvency, creditors are not usually kept informed of developments

Fines in compounded settlements

According to Customs and Excise, the punitive element of a compounding settlement (or 'fine' part of the compounded settlement) rests (informally) on a sliding scale roughly 25% and 100% of the reparative element, but can occasionally exceed 100%. In deciding on the amount of the punitive element of the compound, Customs broadly follow the guidance issued to the courts in CEMA, although they are not bound by it in this respect and enjoy complete discretion. In the Act a sum of up to three times the value of the goods can be set,⁶⁵¹ although in compounded settlements involving EC funds, the amount of levy is usually taken into account, rather than the value of the goods.

⁶⁴⁹ See Keith Report, supra.

⁶⁵⁰ Ibid, paras 18.5.54 and 20.2.11-12.

⁶⁵¹ Article 170 (3)(a) of the Customs and Excise Management Act 1979.

The fine part of the compounded settlement can also be reduced when the alleged offender cooperates with the authorities at an early stage.

There is no hard and fast rule and authorities decide on a case by case basis.

(iii) Withdrawal/request for repayment

The 1995 Structural Funds Manual contains a draft offer letter which states that the Secretary of State reserves the right to withhold any or all of the payments and/or to require part or all of the grant to be repaid under certain circumstances. There is no provision for any contract of this type to be put up for approval to an independent tribunal.

(iv) Withholding payment

Authorities managing the Structural Funds make plain in their offer of contract to beneficiaries that they reserve the right to withhold any or all of the payments in the following circumstances:

- (i) there is a substantial, or material, change in the nature, scale, costs or timing of a project.
- (ii) The future of the project is in jeopardy.
- (iii) There is unsatisfactory progress towards completing the project, or the project is not completed by the agreed date.
- (iv) There is unsatisfactory progress towards meeting the forecast outputs specified.
- (v) Any of the information provided in the application for grant or in supporting or subsequent correspondence is found to be substantially incorrect or incomplete.
- (vi) The applicant is in receipt of a grant from other Community Institutions towards project costs, unless the grant has already been taken into account.
- (vii) The assistance exceeds European Community Aid

limits to the extent that any grant paid should not have been paid; or a decision of the European Commission or of the European Court of Justice requires payment to be withheld (or recovered).

(viii) This point applies to the public sector only:- any grant or other payment, which is payable towards the project, has been received or is likely to be received from any public authority. Of course, this does not apply to payments whose availability and amount have already been taken into account at the time the offer was made.

(ix) The project is used for purposes other than those specified in the offer letter during its economic life as specified in the offer letter.

The authorities can withhold payment of certain sums pending the outcome of court proceedings. In the recent case of *Jewers*, DG VI found that the Intervention Board had acted appropriately in doing so.

(v) Exchequer write-offs

Under Article 8(2) of Council Regulation 729/70, Member States must bear the financial consequences of irregularities and negligence attributable to their administrative authorities or other bodies.

In some cases, therefore, debts are written off and the loss borne by the Exchequer. For the 1993 financial year (March 1993 to April 1994), a comparatively small amount of just over £247,000 was put forward by the Intervention Board to be written off in that way. The Treasury is keen to ensure that write-offs should be kept to a minimum. One of the strategic objectives, stated in the Corporate Plan 1993-94 to 1997-98 of the Intervention Board, in relation to disallowance resulting from its actions and falling on the Exchequer following the clearance of the 1991 EAGGF accounts, is to limit such disallowance to within 0.40% of the total of the accounts

submitted for that year.

The position at the moment is that for EAGGF write-offs under £10, no prior recovery action is necessary. In the case of overpayment of subsidies and refunds or under collection of co-responsibility levies not exceeding £40, no prior recovery action is necessary except when overpayments to the same payee for the same cause total more than £40 a month. The same applies for Own Resources uncollected debits not exceeding £40. The Treasury may withhold their authority to write off, when they are not satisfied that proper steps have been taken to investigate a loss, to impose financial penalties or take adequate disciplinary procedures. A refusal by the Treasury to sanction write-off is reported to the Comptroller and Auditor General, and by the latter to the Public Accounts Committee, who may question the Accounting Officer about the action taken.⁶⁵²

Write-off can also occur, on a case by case basis, as a result of consultation with the Commission.⁶⁵³ In a case where the Intervention Board was owed in excess of £800,000 by a trader on the peas and beans scheme, it was approached by the debtor with the following dilemma. The debtor said he could pay £250,000 and carry on trading and retain his firm's employees - alternatively he could become bankrupt, with a result that very little would be recovered at all. In the circumstances, DG VI agreed that the Intervention Board should accept the £250,000 offered.

(vi) Other arrangements

Repayment of grant

⁶⁵² Finance Manual of the Intervention Board for Agricultural Produce, London.

⁶⁵³ Article 4(2) of Council Regulation 595/91 (1991) OJ L 67.

The authorities also reserve the right to require part or all of the grant to be repaid in the circumstances outlined above. When matching funders have acted as guarantors, they are approached for repayment before civil proceedings are instituted.

* Informal arrangement in case of insolvency

An 'informal moratorium' can sometimes be reached with creditors, such as a re-scheduling of debt payment. A break down of the arrangement leads to civil court proceedings.

5.2.5. Discussion: the effectiveness of extra-judicial settlements, from an English point of view

Three main claims have been made in relation to extra-judicial settlements, namely that they are fast, quick and cost effective. These claims are briefly examined below.

(i) Effectiveness

Non-court recoveries are perceived as highly effective, although a certain amount of institutionalised 'cherry picking' goes on: for example the person concerned must be solvent and/or in receipt of regular sums.

There are areas of uncertainty, particularly with regards to set-off. For example, it is not clear to what extent set-off can occur when a third party is involved, either between schemes, or between national and EC schemes. Nor are time-limits clear.

At the moment, furthermore, there is no specific appeal procedure which deals with disputes over amounts to be offset. Although agreement is meant to be a *sine qua non* of set-off, it is occasionally used more aggressively.

(ii) Quickness

Administrative recoveries have been speedier than those effected by the courts. But it is not known how long administrative procedures can retain their reputation for dispatch now that new appeal procedures are being set up. The policy of the Customs and Duties Tribunal is to hear an appeal within three months of it being ready for listing, and to issue the decision, which will usually have been reserved, within two months of the date of hearing. Currently the waiting time for a hearing is around ten weeks throughout the United Kingdom. It is obviously too early to speculate on how long Customs duty cases will take to go through the system once the new appeal procedures (see below) get in full swing. on the other hand, the review procedure may work well and not produce many tribunal cases. But it must be remembered that the inferior courts in the UK are not always fast.⁶⁵⁴

(iii) Cost-effectiveness

Unlike court recovery, administrative recoveries are regarded as cost-effective. The importance of cost-effectiveness leads some civil servants to argue that when the defendant is on income support, or when he is drawing legal aid (both are means-tested in the UK), then this is a fair indication that recovery through the courts will not be successful, and will cost the tax payer a disproportionate amount to pursue. This is particularly true, they argue, when the defendant is drawing on legal aid funds, in which case the cost to the tax

⁶⁵⁴ For example in the recent case of Darnell (Case of Darnell v the United Kingdom, judgment of 26 October 1993, series A, Vol 272) the European Court of Human Rights found unanimously that the United Kingdom had breached article 6(2) of the Convention by letting Mr Darnell wait nearly nine years for an Industrial Tribunal hearing.

payer will be even greater.⁶⁵⁵ The cost-effectiveness argument can thus be carried ad absurdum by the executive.

No doubt that when the debtor is solvent, administrative recovery is more cost-effective, and quicker than the courts can be, although it remains to be seen whether the introduction of new procedural safeguards will affect this performance. When the debtor has been declared bankrupt (a relatively easy process in the UK), it may be that little can be done to recover funds. The determination of whether funds are available for recovery or not - i.e., the thoroughness of the financial investigation - therefore remains of crucial importance.

5.2.6. The question of administrative discretion.

Government agencies with a responsibility for the managing of EC funds, and the recovery thereof may set-off, compound, withhold funds, or simply request repayment. Small amounts may also be written off. Special arrangements may also apply in cases of insolvency. These settlements modes are addressed in some detail below. On the whole, administrations prefer extra-judicial settlements, because of increasing staff and costs constraints. This state of affairs raises question about the powers of discretion these agencies have. For example, how is that same discretion circumscribed?

The issue of the extent and limitation of administrative power can partly be discussed within the framework of the polarity legality v expediency. The principle of legality usually refers to the doctrine of mandatory prosecution but also, more generally, to the strict subordination of all administrative or other actions to legal rules. The principle of expediency, by contrast, refers to the ability to act with discretion and

⁶⁵⁵ The case of Saunders show that, because of the way the legal aid fund is administered, even relatively wealthy defendants on fraud charges can draw on legal aid.

deal with matters on a case by case basis.

If one imagines a legalistic - expediency-prone continuum, the United Kingdom could perhaps be placed towards the 'expediency' end. We have seen that when cases are put up for Crown prosecution, they are carefully 'filtered' in a two-stage process (see 5.2.2. above), which involves an assessment of the likely outcome. In fact the likely outcome is a consideration very much at the forefront throughout the system.

In reality, however, approaches are never purely 'legalistic' or 'discretionary'. Discretion is always circumscribed: 'authorities vested with discretionary powers by an Act of Parliament can only exercise such powers within the limits of the particular statute'⁶⁵⁶. Sometimes discretion is embedded in the legislation itself with expressions such as 'they see fit' (see CEMA 1979 mentioned earlier) and therefore is statutory. So,

*Même au sein de l'univers de la règle et du règlement, le jeu avec la règle fait partie de la règle du jeu.*⁶⁵⁷

The opportunity versus expediency debate does not necessarily help to clarify matters in the British context. It is a moot point as to whether any discussion as to the limits of discretion in the UK could more usefully focus on the procedures available to resolve the disputes which unavoidably arise from its use.

Two types of discretion

⁶⁵⁶ LJ Kerr in R v London transport Executive ex parte GLC [1983] 2 WLR 702.

⁶⁵⁷ Bourdieu, P (1990) Droit et passe-droit, le champ des pouvoirs territoriaux et la mise en oeuvre des règlements, Actes de la Recherche en Sciences Sociales, 81/82, page 89.

What is the nature of this discretion? Theories of administrative discretion suggest that it arises in two main forms:

* discretionary non-performance or moderated performance of duties - as it seems when viewed from the perspective of strict legalism;⁶⁵⁸

* pro-active discretion - meaning a very active doing of things - possibly going well beyond what explicitly has been provided for in legislation. Yet it is not illegal, since it is not judged illegal by the judiciary, indeed commonly it is not even reviewed by the judiciary.

Discretion as non-action or moderated action

Traditionally, Customs and Excise has been entrusted with a great deal of discretion. S152(a) of the CEMA provides that the Customs Commissioners may, as they see fit,

'stay, sist⁶⁵⁹ [....] any proceedings for an offence or for the condemnation of any thing as being forfeited under the Customs and Excise Act'.

In other words, Commissioners are free to decide not to prosecute. This provision being statutory, it does not require the permission of any member of the judiciary. In this process, an alleged offender may make an offer of compound, but Customs and Excise are quite free to turn it down. Commissioners may also, after judgment, mitigate or remit any

⁶⁵⁸ Summarized in Makridimitris, A (1984) Reasoning and legality in administration PhD thesis, University College, London; also Pérez-Diaz, C (1994) L'indulgence, pratique discrétionnaire et arrangement administratif, Déviance et Société, Dec.1994 Vol XVIII no 4 page 397-430.

⁶⁵⁹ To 'sist' is the equivalent of staying proceedings in the terminology of the Scottish jurisdiction.

pecuniary penalty imposed under s152(c) of CEMA. But this is the exercise of discretion does not end there.

Pro-active discretion

It would be wrong to assume, as some legalist commentators have done, that discretion is exercised mostly by deciding not to do things: 'not to prosecute, not to initiate, not to investigate, not to deal or not to publicize'.⁶⁶⁰ Discretion can also mean being highly pro-active - in ways other than prosecution. Such actions cannot be understood as 'doing nothing' or 'indulgence'⁶⁶¹.

For example, although Customs may decide not to prosecute, they are highly active in achieving compounded settlements. Authorities managing the Structural Funds, for example, spell out very clearly, in their offer letter, conditions which can lead to the withdrawal or suspension of the benefit. In that way, the beneficiary is forewarned and bound by contract. Such pragmatic pro-active agenda takes into account not only the need to deter and prevent, but also the need to recover funds quickly at the lowest cost to the state, whilst enabling traders and farmers to carry on with their commercial activities.

Except in cases of complex and serious frauds, when cases are put up for criminal prosecution, agencies are usually at liberty to take social and other factors into consideration when deciding upon their course of action. In using their discretion, the authorities follow internal guidelines and/or have an internal procedure to decide how a case should be dealt with. These guidelines are not usually in the public

⁶⁶⁰ Davis, K (1979) Discretionary justice: A preliminary enquiry, University of Illinois Press.

⁶⁶¹ This is the French word used in some instances of extra-legal discretion, which clearly describes the practice of 'letting people off'.

domain. A notable exception is the customers' leaflet on compounding from Customs and Excise which makes clear in what circumstances compounding will not be considered.

The use of statutory discretion raises questions of due process, some of which have recently been addressed. But its use must be put in the wider context of the administration of justice. The justice system is overburdened and extra-judicial settlements are increasingly seen as helping to relieve the situation.

(ii) Redress against administrative decisions

One means of speeding up the recovery procedure would be the adoption of the Commission's proposal on amending the Regulation on Own Resources 15589/89. Another means is the more systematic use of the 'clearance of accounts' procedure, where agricultural expenditure is affected by irregularities and deficiencies of control. Here again, the Commission has proposed an amendment to the existing rules.

Redress can be sought through internal reviews and tribunals. New procedures include the Customs' duties tribunal, the customs' adjudicator and the Intervention Board adjudicator. It can also be sought through the ombudsman (iv), or through the process of judicial review in the courts (v).

* The Customs' duties tribunal

Article 253 of the Customs Code contained in Regulation 2913/92⁶⁶² states that Title VIII of the Code, relating to appeals, shall apply to the UK on 1 January 1995.⁶⁶³

⁶⁶² [1992] OJ L 302.

⁶⁶³ The United Kingdom obtained a delay of one year before implementing the requirement for an appeal system contained in the Customs Code.

As a result, in order to 'replace a very limited area of appeal to the High Court on duty matters, which inevitably was lengthy and expensive',⁶⁶⁴ the jurisdiction of the VAT Tribunal has now been extended to cover Customs duties. The appeal process provided for in the 1994 Finance Act has two stages: the review stage and the tribunal hearing per se, unlike the VAT appeal process which has no intermediary stage.

The review stage

An administrative (internal) review must be requested before a matter can be referred on appeal.⁶⁶⁵ Furthermore a request to review must be made

- by those who are liable to pay duty or penalties or upon whom conditions, restrictions or prohibitions are imposed
- within 45 days of the written notification of a decision by Customs and Excise.⁶⁶⁶

Under Section 14(1) a request can be made for an internal review of an assessment or a decision in respect of:

- whether Customs duty or an agricultural levy of the EU should be charged
- the rate and duty of levy, or the amount charged
- the identity of the person liable to pay the amount charged, or the amount for which he is liable
- whether and to that extent a person is entitled to relief or repayment, remission or drawback of an amount of duty or levy

⁶⁶⁴ See Mc Farlane, G (1994) Customs Tribunals, Importing Today, May/June 1994, pp 16-17.

⁶⁶⁵ S14 (2) of the 1994 Finance Act.

⁶⁶⁶ S14(2) and 15 of the 1994 Finance Act.

- an assessment for a penalty, as well as duty
- or any decision of a description specified in Schedule 5 of the Act.

A second request for a review is barred,⁶⁶⁷ unless there are new facts. There is no provision for extending the time limit (45 days), though it is expected that Customs will accept genuine requests up to 90 days after the decision.

It is only possible to offer comments made on the review stage with respect to VAT cases. Despite assurances that the review is undertaken by officers not involved in the case,⁶⁶⁸ the procedure itself has previously been described as lacking independence and not creating any opportunity for the evidence to be properly heard on both sides. In a report⁶⁶⁹ Lord Mishcon described the process as one

... of a colleague walking over to another colleague in the same room saying 'You have been asked to review this matter. I shall explain to you briefly why I made this decision. Do you mind initialling this paper to say you approve of what I did and said?

As a result some observers feel that an external reviewer should be involved. Other commentators also feel that the review

inserts an extra stage in the appeal process causing further delay and increased costs. It is particularly bad where a universally binding decision is required by an industry on Customs. Customs frequently regard tribunal decisions as not universally applicable, so it is necessary to go the High Court which takes at present 18

⁶⁶⁷ S14(2) of the 1994 Finance Act.

⁶⁶⁸ S15 of the 1994 Finance Act.

⁶⁶⁹ House of Lords Official Report April 29, 1991, col 548.

months to two years from the date of the tribunal decision.⁶⁷⁰

The review can confirm, vary or withdraw the original decision. If Customs do not respond within 45 days, they are deemed to have confirmed their original decision. On the other hand, the review procedure is a way of augmenting the level of non-court resolutions.

The tribunal stage

An appeal to the tribunal is only allowed once the internal review has been carried out. It must be lodged by the person who requested the internal review within thirty days of the decision in dispute. An appeal is struck out if all the duty has been paid or satisfactory security provided.⁶⁷¹

In all cases (VAT, excise, Customs duties) tribunals do not usually hear appeals unless the disputed amount has already been paid. A waiver can be applied for, either from Customs or from the tribunal. In cases of hardship, a 'hardship application' has to be made. If Customs and Excise oppose the hardship application, then the tribunal arranges a hearing to decide whether or not to grant the certificate. Generally speaking third parties do not get involved in this review procedure, unless their property is in danger of forfeiture, confiscation or restitution.

There are two types of appeal: full appeals; appeals on ancillary matters. Fully appealable matters are usually 'money matters'⁶⁷² and include liability to excise, Customs duties

⁶⁷⁰ Cockfield, R and Mulholland, M (1994) Tribunals, reviews and appeals: Sections 7 and 14-16, British Tax Review, page 283.

⁶⁷¹ S16 of the 1994 Finance Act.

⁶⁷² See Editorial: An appealing trader (1994) in Customs News, page 3.

and agricultural levies, rate of duty or levy or excise, liability of a particular person, any entitlement to repayment and amounts of the new penalties.

Appeals on ancillary matters (non-money matters, authorizations, etc)⁶⁷³ are in form of quasi-judicial review. Ancillary matters include decisions relating to the release of goods, unloading, transshipment, etc. With respect to ancillary matters, the tribunal has limited powers. That is to say that it can only overturn a decision by Customs if it is satisfied that Customs could not have reasonably arrived at it. The test of reasonableness was laid down by Lord Greene in the *Wednesbury* case mentioned earlier.

Export refunds remain outside the extended jurisdiction of the VAT and Duties Tribunal. The exporter who is aggrieved by the application of this new penalty regime is obliged either to seek judicial review of a decision adverse to him, or to commence an action for recovery of sums statutorily due to him⁶⁷⁴ and to argue the penalty issues in that context. However, 'administrative penalties recently introduced into the export refund regime may be appealed by reference to a higher authority within the Intervention Board. A full appeal mechanism including an independent assessment is currently being set up.'⁶⁷⁵

The Tribunal route: remaining problems

Although the extension of the jurisdiction of the VAT tribunal to Customs duties must be applauded, some issues still need to be addressed.

⁶⁷³ Ibid.

⁶⁷⁴ *Roy v Kensington and Chelsea Family Practitioner Committee* [1992] 1 AC 624.

⁶⁷⁵ Communication from Intervention Board, 26.7.95.

(a) A single importation could involve VAT, Customs, excise and/or agricultural levies. Thus, there could be friction between the various jurisdictions.

(b) The 45 day rule may cause hardship to some importers.

(c) There is no provision for compensation after a successful appeal following judicial review by tribunal.⁶⁷⁶

(d) There is some concern that the restriction on right of direct access to the tribunal, and the cutting back on full appellate powers for some matters, may actually breach the Customs Code (Article 243 of the Customs Code suggests that there should be the option either of an administrative appeal or of an appeal to an independent tribunal, or both against [all] decisions taken by the Customs authorities which relate to the application of Customs legislation).

(e) The seizure of goods as liable to forfeiture has not been included in the list of appealable matters under CEMA.

(f) Tribunals decisions are not binding, and can be appealed against in the High Court (which adds on average another two years' delay to the proceedings). At present, in London, approximately 10% of cases heard in the tribunal are appealed against in that way.

(g) Finally, as mentioned earlier, export refunds remain outside the extended jurisdiction of the VAT and Duties Tribunal. Commission Regulations 2945/94⁶⁷⁷ and

⁶⁷⁶ S7 (5) of the 1994 Finance Act.

⁶⁷⁷ OJ 1994 L 130/57.

1829/94⁶⁷⁸ amend the base legislation on export refund machinery⁶⁷⁹ by inserting a scheme of administrative penalties for overclaims. In practice this may mean less compounding in the future, but it does not resolve the problem of lack of redress to an independent tribunal.

The Customs Adjudicator

The role of the Revenue Adjudicator has just been extended to deal with complaints related to Customs. The office had been investigating complaints against the Inland Revenue for two years, and since 1 April 1995 it can now also investigate complaints regarding Customs and Excise. The adjudicator does not deal with appeals on matters where independent tribunals - such as VAT and duties tribunals - already exist for settling disagreements. She deals with cases when people complain, for example, that they have been harassed during an investigation, or when they have been improperly refused information under the Open Government provisions.⁶⁸⁰ Her decisions are binding on the Inland Revenue and Customs and Excise. Redress can take the form of an apology, putting matters right, or 'consolatory payments', but usually only from the private sector.⁶⁸¹ A person's right to ask their Member of Parliament (MP) to refer complaints to the Parliamentary Commissioner for Administration⁶⁸² (also called Parliamentary Ombudsman) is unaffected by the adjudicator's office. The obverse is not true.

⁶⁷⁸ OJ 1994 L 191/5.

⁶⁷⁹ OJ 1987 L 351/1.

⁶⁸⁰ See HMSO Publications (1994) Open Government: Code of practice on access to government information, HMSO.

⁶⁸¹ Filkin, E (1994) Complaint and redress mechanisms in the public sector, paper given at the OECD Paris Symposium, mimeoed text, restricted.

⁶⁸² The office was set up by the Parliamentary Commissioner Act 1967.

The Intervention Board's Adjudicator

Another new development is the appointment of an adjudicator by the Intervention Board, whose role it is to examine cases of complaint against maladministration by Intervention Board officials.

The Parliamentary Commissioner for Administration (Ombudsman)

The ombudsman only deals with certain matters⁶⁸³ where a member of the public has sustained injustice in consequence of maladministration and where no right of appeal or review exists. The Parliamentary Commissioner Act⁶⁸⁴ lays down the rules for access to the ombudsman. A written request must be made to a Member of Parliament⁶⁸⁵ who may decide to pass on the complaint to the ombudsman. The investigation is conducted in private⁶⁸⁶ and usually within twelve months from the day on which the person aggrieved first had notice of the matters alleged in the complaint.⁶⁸⁷

The main criticism of the Parliamentary Ombudsman's system relates to the lack of direct access.⁶⁸⁸ A complainant may find it difficult, in some cases, to convince his MP to take

⁶⁸³ Parliamentary Commissioner Act 1967 amended in 1967, 1987 and 1994. S5 of the Act lists matters subject to investigation.

⁶⁸⁴ Ibid.

⁶⁸⁵ As per Article 5(2)(a) of the Act. The Member of Parliament, by convention, must usually be the constituent's MP, otherwise the request may be referred back to the said M.P.

⁶⁸⁶ Article 7(2) of the Parliamentary Commissioner Act 1994.

⁶⁸⁷ Article 6(3) of the Parliamentary Commissioner Act 1994.

⁶⁸⁸ Stacey, F (1978) Ombudsmen compared, Clarendon Press, Oxford.

his complaint to the ombudsman. Following the 1993 Select Committee's Review of the UK Ombudsman system, the MP 'filter' is to be retained, although in the interest of speed, once an MP has referred a complaint to the ombudsman, the latter will deal with the complainant directly, whilst keeping the referring MP in touch. A nine months target for investigations was also set.

Judicial Review

When there is no right of appeal against administrative action or where all rights of appeal have been exhausted, an application can be lodged for judicial review but only on the grounds of procedural impropriety, unreasonableness, irrationality or incompatibility with Community law. It is difficult to underestimate the procedural hurdles this involves. Notwithstanding this deterrent, there has been a spectacular increase in the use and scope of the public law remedy of judicial review of administrative action. In 1974 there were 160 applications for judicial review, in 1984 1,230 applications were lodged and in 1993, 3,335.⁶⁸⁹

The appeal involves a reconsideration of the application *de novo* (an application to set aside a judgment which has been given in default of appearance is not regarded as a form of appeal). The application has to be lodged by the person aggrieved, i.e a person with a specific legal interest in the issue. The nature of relief offered under judicial review generally is of a narrow and limited dimension.

There is no liability in English law for *ultra vires* activity *per se*, unless a public body or official acts negligently or maliciously or knowingly outside his powers or jurisdiction. Furthermore, when a challenge is made upon the legality of action or decision-making of public bodies, the presumption is

⁶⁸⁹ Lord Chancellor's Department (1994) *Judicial Statistics for the year 1993*, HMSO.

always *omnia praesumuntur rite esse acta*, which the plaintiff must displace on a balance of probabilities.⁶⁹⁰ Generally speaking, the courts are reluctant to enforce statutory obligations upon public bodies where to do so would cause significant public expenditure.

Damages, interim relief

Claims under *Francovich*⁶⁹¹ have usually been decided within the context of national law on liability, which means that reviews have not usually resulted in an award for damages. But

following the House of Lords decision in *Factortame II*⁶⁹² injunctive relief, including interim relief, became available against the Crown. The House of Lords has decided that, contrary to its original view in *Factortame II*, interim injunctions, interlocutory injunctions and proceedings for contempt of court were available against ministers as a matter of English law.⁶⁹³

The preceding may show that, although there is no explicit requirement of national law to preserve the homogeneity of national law failing within and outside the sphere of Community law, such homogeneity is perceived as desirable. As shown by the decision of the House of Lords in *M v Home Office* it can be achieved, in the field and for the sake of legal protection of the rights of individuals, through means of 'homogeneity

⁶⁹⁰ *Cannock Chase DC v Kelly* [1978] 1 WLR 1 CA n29.

⁶⁹¹ *Francovich v Italian State* (C 6 and 9/90) [1992] IRLR 84 2 CMLR 66.

⁶⁹² *Factortame v Secretary of State for Transport* [1990] 2 AC 85.

⁶⁹³ *M v Home Office* [1993] 3 All ER 537.

friendly' judicial interpretation.⁶⁹⁴

In *Factortame III*⁶⁹⁵ the ECJ confirmed that in the event of a breach of Community law attributable to a Member State, in a situation where the same state has a wide discretion to make legislative choices, individuals suffering loss or injury are entitled to reparation, where the rule of Community law breached is intended to confer rights upon them, and when the breach is sufficiently serious and there is a direct causal link between the breach and the damage sustained by the individuals. Such reparation cannot be conditional upon fault on the part of the organ of the State responsible for the breach. Furthermore national legislation which generally limits the damage done to certain, specifically protected individuals not including loss of profit by individuals is not compatible with EC law.

In the circumstances, one would expect administrations to exercise a great deal of caution, for example, before imposing any sanctions on economic operators. In this *Factortame III* may indirectly circumscribe administrative discretion. Only time will tell whether this, in turn, has a negative impact on the recovery rate in the UK. Meanwhile, it may be useful to turn to another Member State, in order to glean ideas on how recovery rates could be improved.

5.3. A comparative dimension: Denmark

We have seen that in the United Kingdom there is no centralised agency responsible for the management and recovery

⁶⁹⁴ Van Gerven, W (1995) Bridging the gap between Community and national laws: Towards a principle of homogeneity in the field of legal remedies? Text of the first Gildesgame lecture delivered in the University of Oxford on 2 February 1995, *Common Market Law Review* 32: 679-702.

⁶⁹⁵ Joined cases C-46/93 and C-48/93 *Brasserie du Pêcheur v Germany and R v Secretary of State for transport, ex parte Factortame*, judgement of 5 March 1996, nyr.

of EC funds. The overall picture is one of flexibility and fragmentation, with the various government agencies concerned evolving different approaches to the recovery of EC funds, as practical circumstances dictate. In the absence of obvious criminal intent, there is overall a preference for extra-judicial settlements, because they are thought to be cost-effective and speedier than court settlements. A possible exception to this rule can be made for small claims court settlements, which because of the informality of proceedings, can be less costly and speedier. Court proceedings usually mean that recoveries will be either protracted, or unsuccessful because of the level of insolvency generally.

At first glance, there are striking similarities between the British and Danish systems. For example, Denmark has no system of administrative courts. The decision whether to instigate criminal proceedings is subject to the principle of opportunity, as it is in the United Kingdom. Denmark has not incorporated the European Convention of Human rights into its national legislation, although it does have a written constitution. Furthermore the Danes also favour the practice of setting-off whenever possible.

However the Danish system is characterised by a high level of integration. Firstly, the Inland revenue and Customs and Excise have fused into one government department. One implication of this fusion is that it widens the possibilities for set-off, and therefore the chances of recovery. Secondly, Denmark has a centralised EU-directorate to manage EC funds. Thirdly, Denmark has a 'fast track' system of fines and recovery, as we shall see. It is difficult to compare recovery rates within the Union, as so many factors impinge. The Danes, for example, are fond of reminding us that they are a small country, and that this may somehow make recovery easier. The United Kingdom, in comparison, still imports a great deal from outside the European Union, hence the very high number of irregularities in the 'traditional own resources' area.

Nevertheless, there is no doubt that Denmark is comparatively successful in recovering funds. For the period 1991-1994, it managed to recover 41% of unwarranted payments in traditional own resources (see tables 5.3.-5.4.), having reported 86 irregularities during that period. It recovered 47% of unwarranted payments in the EAGGF Guarantee Section Fund, having reported 221 irregularities during that period. In view of this comparative success, which can be gauged by looking at the tables above, it may be interesting to examine the main features of the system for the recovery of EC funds in Denmark.

5.3.1. General features of Danish system

In Denmark the police usually prosecute cases where the statutory penalty for the violation does not exceed a fine (with some exceptions which need not concern us here). Cases under police prosecution are always tried without lay judges. In court a fine may be agreed upon with the consent of the accused and the police, provided the judge sees no reason to doubt the guilt of the accused and considers the fine an equitable one. The judge may also decide the case by issuing a warning to the accused.⁶⁹⁶

In practice the system works as follows. The EU Directorate in Denmark sends a letter with a brief description of the offence and a reference to the provisions which allegedly have been violated. A postal cheque form is enclosed. If the amount is paid the case is closed.⁶⁹⁷ The police or the administrations

⁶⁹⁶ Toft-Hansen, H-G (1982) The law of procedure in constitutional and administrative law Danish law A general survey, Bianco Lunos BogTrykkeri A/S, Copenhagen.

⁶⁹⁷ Greve, V and Gulmann, C (1994) Denmark: The system of administrative and penal sanctions, Report submitted to the EC Commission in accordance with a study contract of 19 September 1990, in The system of administrative and penal sanctions in the Member States of the European Communities, Volume 1, national reports, OOPEC.

managing EC funds can suggest a fine. The accused can, by not paying the fine, cause the case to be brought before the judge. The police only enter the scene as auxiliaries to the specialised agency, and, most importantly, to prosecute the case immediately before the judge.

Recoveries are expedited:

... [P]enalties are still comparatively rare, but settlements on recovery of funds unlawfully paid and received are common. When alleged offenders are solvent, recovery may be smooth and expedite, especially when such debtors receive amounts periodically as a set-off is then the solution. Set-off is not unknown in other fields; also in fiscal cases surplus payments in some respects may be set-off against other taxes due. But in no field is set-off such a spectacularly practical and efficient solution as in the EU cases.⁶⁹⁸

The last sentence is a strong echo of the British position on set-off.

5.3.2. Particularities of Danish extra-judicial recoveries

In Denmark, the police have a general competence to settle a case by an agreed fine, in accordance with Article 931 of the Administration of Justice Act which provides:

Where it is assumed that a violation will not result in a penalty of more than a fine the police chief may, instead of submitting an indictment to the court, indicate to the accused party that the case may be concluded without any legal action if he pleads guilty and is prepared to pay a fine of an amount stated to him within a stipulated term which, upon his request, may be extended.

⁶⁹⁸ Garde, P (1995) Settlement in Danish law, OOPEC, page 9.

A similar rule applies to confiscation.

Identical rules apply in relation to the Ministry of Agriculture's administration of the EC market organisation (Article 29 of the Act) and to the Customs/tax authorities, within their respective fields.

In Denmark, there exists a system of administratively imposed fines. This takes the shape of a letter in the form of an indictment. If the relevant official, typically a senior policeman, opines that the prosecution ought not to ask for a higher punishment than a fine, a postscript will be added to the text of the indictment as follows: 'if you admit your guilt and pay a fine of ...kroner, the case is closed; otherwise the case will be referred to the court' - much like the Dutch *transactie* system.⁶⁹⁹

Section 63 of the Danish Constitution endows the courts with a right to review the legality of administrative decisions. It refers to the right of the courts to 'decide any question relating to the scope of the administration's authority'. This review is placed in the hands of the ordinary courts. However it is a principle of Danish law that there shall normally be a possibility of having a case tried at two - and only two - levels.⁷⁰⁰ The ombudsman, whose powers go beyond that of his British counterparts, is also entitled to review the decisions of an administration.

5.4. Conclusion: improving recovery rates

⁶⁹⁹ Garde, P (1989) The suppression of fraud against the European Communities in Danish law and practice, in *The legal protection of the financial interests of the Community: progress and prospects since the Brussels seminar of 1989*, pp 212-217, Oak Tree Press, Dublin.

⁷⁰⁰ See Nielsen, G.T (1982) *Constitutional and administrative law in Danish law, a general survey*, Bianco Lunos BogTrykkeri A/S, Copenhagen, pp 49-60.

Focusing first of all on set-off, it is clear from the Danish and British examples that setting off is an efficient way of recovering EC funds. The situation in the UK is that set-off between tax and Customs claims is not possible,⁷⁰¹ and that there are uncertainties regarding the application of set-off in particular circumstances. Civil court proceedings in the UK remain slow and costly. The Woolf Report has suggested a number of reforms to speed up procedures in the civil courts, and increase the scope for extra-judicial settlements in England and Wales.

On the basis of a very brief comparison of recovery in the UK and Denmark, it is fair to say that three conditions maximise the recovery of funds: firstly the integration of tax and Customs authorities, secondly an ambitious and robust approach to set-off, with clear ground rules and finally a fast-track court system to back up extra-judicial recovery. These are reforms which would benefit the UK generally.

But the international aspects of recovery should not be overlooked. A recent report stressed the need for mutual assistance legislation to be updated to the realities of the single market. The Commission has also asked to be automatically associated to requests for assistance when Community interests are involved.⁷⁰²

For some time the Commission has been concerned that

⁷⁰¹ Martyn Bridges' cry that '[H]istorically, one of the problems in dealing with tax evasion [in the UK] is that different government departments have not cooperated with, or even spoken to each other' must be echoed. (Bridges, M, 1996, Tax evasion - A crime in itself: The relationship with money laundering in Journal of financial Crime, November 1996, volume 4, number 2, page 165).

⁷⁰² See White, S (1996) Recovering EC funds: The extra-judicial route in Fraud on the European budget, vol 4 number 3, Hume Papers on Public Policy, Edinburgh University Press, page 68.

settlements may not be effective as a mode of recovery. The conclusions of the Edinburgh Council of December 1992 stated that ' {O}n agriculture, with particular reference to the clearance of accounts, the Commission intends to give the national authorities more responsibility for applying Community legislation by allowing them, under certain conditions, to negotiate settlements with individuals'. As a result the Commission put forward a proposal for a directive authorising the Member State, on a case by case basis, to derogate from certain provisions contained in the CAP (i.e the duty of Member States to recover amounts due in full).⁷⁰³ It seems therefore that the Commission has used the word 'settlement' in two different ways. The first way, contained in the proposed directive denotes 'settling for less'; whereby the later Commission definition, used in the settlement (transaction) study of 1995 refers to the practice of settling extra-judicially. Indeed, in systems where recovery are effected only through the courts (e.g. Spain, Greece), extra-judicial settlements are often equated to settlements for less than the sum due. However this is not true of settlements in other systems (for example in the Netherlands, Denmark or the United Kingdom) where recovering full amounts extra-judicially is a normal, and legal expression of administrative discretion.

One wonders therefore what intervention (if any) can be taken in this area by a Commission respectful of subsidiarity. As the Labayle Report⁷⁰⁴ has confirmed, there is a bewildering diversity of practice in the Union concerning the recovery of EC funds. The proposal puts forward the idea that settlements constituting less than the amount owed should be approved by the Commission. This would not affect the UK, since its

⁷⁰³ Commission minute VI/ 025658 dated 26.07.93 From G. Legras, Director General of DG VI.

⁷⁰⁴ Labayle, H (1996) La transaction dans l'Union Européenne Rapport de synthèse ('Labayle Report').

agencies already consult with the Commission on such matters when they arise. Perhaps the instances when no recovery can be made at all should be of more concern to a Commission eager to protect EC finance. In this research on insolvency regimes in the Member States and the way they affect the recovery of EC funds could throw a great deal of light on the present state of affairs.

PART IV.

WIDENING THE ENFORCEMENT AGENDA

CHAPTER 6. PROCUREMENT, INTERNATIONAL TRADE AND CORRUPTION

6.1. Introduction

There is now a recognition that the CAP is not the only area in which fraud is taking place, and of the dangers posed by transit and procurement fraud. In the last area in particular, EC fraud cases continue to throw up a variety of corrupt or 'grey' practices engaged in by officials, economic operators and/or various intermediaries.

However there is no agreed definition throughout the Union of what constitutes a corrupt practice. This means that some Member States criminalise conduct which others do not. For example one Member State may define a certain conduct as 'trading in influence' (a criminal offence) whilst another accepts it as 'lobbying'. Furthermore, provisions in the criminal laws of the Member States relating to the corruption of officials are often restricted to nationals.⁷⁰⁵ Most national criminal laws punish the bribery of national public officials but at the same time do not make it a specific criminal offence for companies to bribe foreign officials. Bribes to foreign officials are tax-deductible in some of the Member States.⁷⁰⁶ This situation creates a 'legal vacuum' as far as certain officials are concerned, whether they be EC officials or officials from another Member State, but also in relation to some economic operators.

Because of the international dimensions of both transit and procurement, the concern over protection of the EC budget has been 'spilling over' - from the Member States and the Union,

⁷⁰⁵ It is not the case in the UK, where the Prevention of Corruption Act criminalises corrupt acts by 'any member, officer or servant of a public body'.

⁷⁰⁶ See for example: Transparency International (1995) The fight against corruption: What the European Union can do, November, unpublished paper; Newspaper article: "Anger over bribes ruling" in European, 18 April 1996, page 17.

to international trade and international relations. It is now more difficult to 'detach' EC fraud and corruption conceptually from other types of international and organised financial crime, as we shall see.

This chapter examines these issues. Firstly, the problem with respect to EC funds is discussed, in particular the award of public contracts financed by the Structural Funds, and the prospects for improvement are explored. Secondly, the Union's specific response in the shape of two third pillar proposals is examined in some detail (6.3.). Thirdly some of the difficulties in evolving a successful anti-corruption strategy are discussed with regards to EC officials (6.4.). Fourthly the impact of corruption on the terms of international trade - an issue fore-fronted by the United States - is discussed, together with the Union's response. Corruption undeniably has an international dimension, and calls for an international strategy, which is discussed in closing.

It is argued that the Union must define the problem in its own way, by articulating a strategy which is capable of both protecting the financial interests of the European Communities, but also of dealing with the international ramifications of corruption. Many of these issues recur within the context of enlargement of the Union which, for reasons of space, is dealt with in chapter 7.

6.2. Procurement and EC funds: the impact of corruption

In 1991, Woolcock found that 'total public procurement in the EC accounts for about 15% of GDP'.⁷⁰⁷ However government contracting has in certain countries been a byword for corruption in many forms: financial, political, social or

⁷⁰⁷ Woolcock, S (1991) Public procurement, in The state of the European Community Policies, institutions and debates in the transition years, eds: L. Hurwitz and C. Lequesne, Lynne Rienner Publishers, Longman.

legal.⁷⁰⁸ According to a European Parliament report, in most Member States, bribes would amount to between 2 and 10% of the value of transactions.⁷⁰⁹ The Council of Europe estimates that in some countries between 10 and 15% of the price the consumer pays for a product goes into corruption.⁷¹⁰ In Germany, for example, the amount involved would reach between 5 and 10 billion DM a year.⁷¹¹ Der Spiegel newspaper reported in July 1996 that 50 employees of private companies and 10 of the Frankfurt airport were being investigated for alleged corruption in the construction of their airport's Terminal 2. Millions of DM were used for bribing airport officials in bids amounting to a total value of 2.5 billion DM. The bribes resulted amongst other things in increased prices for the projects. The public prosecutor estimated an increase of prices by about 20 to 30%.⁷¹² Indeed the main area in which corrupt practices have been highlighted is that related to public work contracts and services.

Within the context of the EC budget, procurement financed out of the Structural Funds, which in the 1994 financial year accounted to approximately 40% of the 68 446 million ECU budget, is naturally also affected. Public works and supplies contracts were the first areas to be regulated at Community

⁷⁰⁸ Gormley, L (1994) Public Procurement, 1993, in The European market Myth or reality? eds D.Campbell and C. Flint, Kluwer, page 151.

⁷⁰⁹ European Parliament (1995) Report of the Committee on Civil Liberties and Internal Affairs on combatting corruption in Europe, rapporteur: Mrs Heinke Salish, December.

⁷¹⁰ Council of Europe (1995) Administrative, civil and penal aspects, including the role of the judiciary, of the fight against corruption, proceedings of 19th Conference of European Council of Ministers, Valletta, Malta, 14-15 June 1994.

⁷¹¹ Ibid, pp 39-41.

⁷¹² See Transparency International Newsletter, September 1996, page 13.

level in the 1970s,⁷¹³ with an initial emphasis on four specific aspects:

- (i) compulsory advertising any tender notices in the OJ for tenders above certain thresholds,
- (ii) the prohibition of discriminatory standards
- (iii) the harmonisation of technical requirements and
- (iv) transparency in selection and award procedure.

In anticipation of the single market and of the related opening up of public procurement, substantial problems were highlighted. A report from the Commission noted that in particular the transposition of the 1970s procurement directives was unsatisfactory and that there were numerous and varied breaches of every Community procurement rule by public purchasers. The report however acknowledged that public procurement was both a complex and politically sensitive area.⁷¹⁴ This led to a re-casting of the 1970s directives (see below) to tighten existing rules, and to a closer monitoring of transposition.

In the mid 1990s procurement cases involving EC funds, corrupt practices often come to light, predictably, in relation to the tendering process itself, but also in the use of intermediaries. There are also a number of 'grey' practices, which, more controversially perhaps, need to be examined for their ability to give good value for money and to foster fair practices generally. A few cases are outlined below, followed by discussion of the EC control framework, and the prospects for its improvement.

⁷¹³ Council Directives: 71/305 OJ (1971) 185/5 (coordinating of procedures for the award of public work contracts); 77/62 OJ (1977) 13/1 (coordinating procedures for the award of public supply contracts). The former was repealed by Council Directive 93/37 and the latter by 93/36.

⁷¹⁴ European Commission (1993) The opening up of public procurement, OOPEC; see also Arrowsmith, S (1996) An assessment of the legal techniques for implementing the procurement directives, W G Hart Legal Workshop, London, July.

6.2.1. Procurement fraud

(i) Procurement corruption cases and 'grey area' practices

(a) The tendering process

Case 1: No tendering procedure

A total absence of tendering procedures was found in the majority of projects administered by the regional government of Cantabria (Spain). The contracts, with an estimated worth of 20 million ECU were awarded to the enterprises directly and by word of mouth. The contracts were only formalised subsequently, sometimes not until after the work had been completed.⁷¹⁵

Case 2: Exclusion of low bids

Low bids were excluded with respect to the Gomeira airport project, worth 13 million ECU and the Almendralejo highway project (Spain) worth 5 million ECU.⁷¹⁶

(b) Intermediary bodies

Case 3: conflicts of interest

In Italy 8 million ECU of Community funds were transferred to a private company acting^{as} an intermediary body. The audit revealed an apparent conflict of interest concerning the management of this 8 million ECU operation by a high-ranking Commission official.

In Andalucia (Spain) the President of a vocational training centre which had received Community assistance was also on the staff of the intermediary body responsible for allocating the funds.⁷¹⁷

⁷¹⁵ Ibid, 4.29 (a).

⁷¹⁶ Ibid, at 4.29. (g) and (h).

⁷¹⁷ Ibid, at 4.54.

Case 4: Insolvency

In Spain the administration of a global subsidy amounting to 46 million ECU was entrusted to an intermediary body which, on the basis of the 1991-92 financial data, did not present the solvency guarantees required.⁷¹⁸

Case 5: Double charging

In Italy, two suppliers of services had supplied two enterprises with an identical service, which consisted of setting up a quality control manual and an automated management system, and had invoiced both for the same amount, namely 18.6 million ECU.⁷¹⁹

Case 6: Amendment to project

In the case of the Lucas Estate in Birmingham (UK), the project implemented and costing 5.5 million ECU was found to differ substantially from the project for which the contract was awarded.⁷²⁰

(c) Some grey areas

Structural Funds are also affected by practices which hardly offer value for money, even if, arguably, they are not illegal. For example The ERDF was used to co-finance a one-day seminar in Mecklenburg-West Pomerania organized by an association of local businessmen. The ERDF contributed three quarters of the total cost of 165 000 ECU. The main feature of this meeting was a one-hour speech by a Member of the European Commission, who was hired through a private agency at a cost of approximately 20 000 ECU (excluding VAT) for the service. The Court of Auditor's checks established that the cost of

⁷¹⁸ Ibid, at 4.52.

⁷¹⁹ Ibid, at 4.59.

⁷²⁰ Ibid, at 4.28(f).

this event was quite out of proportion to the result obtained.⁷²¹

The low rate of officials' remuneration in central and eastern Europe has been flagged in the evidence given to the Committee of Inquiry on transit fraud as one factor which encourages corrupt practices (see chapter on income fraud). The Committee's observation would be in line with a Mertonian reading of corruption, seeing disparities in wealth, or income (i.e extremes) as creating incentives to deviant behaviour. There is little or nothing the European Union can do about low remuneration of officials in central and eastern Europe, but PHARE consultancy fees, by contrast, are within its remit. In 1995, average fees paid to western consultants in the PHARE programme ranged from 300 ECU to 1,000 ECU per day (such fees totalled 20 million ECU in Hungary alone). But the range was only 50 to 200 ECU per day for local consultants working in PHARE beneficiary countries.⁷²² Although it is understandable that standards of living vary from one country to the next, the Commission could perhaps look into ways of not exacerbating already existing and serious disparities.

6.2.2. Procurement control framework

Article 7 of Council Regulation 2052/88⁷²³ stipulates that measures financed by the Structural Funds or receiving assistance from the EIB or from another existing financial instrument must be in keeping with the provisions of the Treaties and with Community policies, including those concerning the rules on competition and the award of public work contracts. Compliance with Article 7 therefore requires the full and correct transposition of Community directives on

⁷²¹ Ibid, at 4.82.

⁷²² Euro-East Information Service, PHARE consultants' fees, December 19 1995.

⁷²³ OJ (1988) L 185/9.

competition. Judging by the number of proceedings under way, the Member States are experiencing the same difficulties in transposing as they did in the 1970s, and/or are as ambivalent, depending on one's preferred reading of the situation.

The group of directives now regulating public work contracts and supplies (89/665, 92/13, 92/50, 93/36, 93/37 and 93/38)⁷²⁴ are particularly relevant to ERDF interventions, which relate mainly to infrastructure investments involving the award of public work contracts. The aim of the directives is to ensure transparency and competitive tendering for public contracts above 5 million ECU and supplies above 130,000 ECU, so as to avoid discrimination at the time they are awarded. However, all too often their transposition into national law has been either protracted, or inaccurate, as illustrated in table 6.1. overleaf.

⁷²⁴ Council Directives: 89/665 OJ (1989) L 395/33 (coordination of the laws, regulations and administrative provisions relating to the application of review procedures to the award of public supply and public work contracts); 92/50 OJ (1992) L 209/1 (coordination of procedures on the award of public service contracts; 92/13 OJ (1992) L 76 (review procedures for contracts in the water, energy, transport and telecommunications sectors); 93/36 OJ L 199/1 (coordinating procedures for the award of public supply contracts); 93/37 OJ (1993) L 199/54 (coordinating procedures for the award of public works contracts); 93/38 OJ (1993) L 199/84 (coordinating the procurement procedures of entities in the water, energy, transport and telecommunications sectors).

Table 6.1.

Transposition of procurement directives as of 30.6.96

Directives	BE	DK	DE	EL	ES	FR	IRL	IT	LU	NL	PT	UK	AUT	SE	SU
89/440 (Works)	!							!			!				
88/295* (Supplies)											!				
89/66 (Remedies)			!	!	!						!				
90/531 (Supplies)	!		!	D							D	!			
92/13 (Remedies)			!	D		!	!	!			D	!			
92/50 (Services)															
93/36 (Supplies)											!				
93/38 (Services)	!			D	D						D				

KEY:		Full transposition not yet communicated to the Commission
	!	Transposition communicated, infringement proceedings taken
		Transposition communicated to the Commission
	D	Derogation

Notes to table 6.1.

Source: Communication from DGXV dated 13 August 1996, translated from French by author.

* Now superseded by Directive 93/38

In order to check whether the rules concerning public works contracts were respected in the award of Structural Funds, in 1988 the Commission imposed a system of reporting on the Member States,⁷²⁵ which included a declaration that those contracts which had not been published (i.e. under the special procedures exempting from publication) had been awarded in accordance with the directives and a questionnaire on public works which has to be sent to the Commission at the latest when the request for payment of the balance of the Structural Funds subsidy is made. However in its report for the 1994 financial year, the European Court of Auditors found that this system had not been implemented.⁷²⁶ Usually, the regional and local authorities were poorly informed about the existence, content and purpose of the 'public procurement questionnaire' thus introduced.⁷²⁷

As a result, the Commission abandoned this instrument in favour of a new supervisory system, to take effect in 1994. For all operations exceeding 25 million ECU, decisions to grant Community finance automatically entail the transmission to the Commission of the main details concerning awards of the contracts concerned, including the record of the award of tenders, the aim being to ensure systematic and more thorough checks. As a result of those checks, the Commission can (i) agree without reservation the proposed contract awards, (ii) agree in principle subject to retrospective check, or (iii) suspend finance. Smaller projects are monitored on the

⁷²⁵ Communication C(88) 2510 OJ (1989) C 22/3, from the Commission to the Member States concerning checks that the rules relating to public works contracts are being respected in the projects and programmes financed by the Structural Funds and the financial instruments.

⁷²⁶ Court of Auditors Annual Report for the financial year 1994 OJ (1995) C 303/1, at 4.23.

⁷²⁷ See European Commission (1996) The Structural Funds in 1994, sixth Annual Report, OOPEC, page 117.

basis of on-the-spot checks. But in view of the growing number of public work contracts awarded in the Member States, and subject to the rules of subsidiarity, the Commission is now considering a system of certifying that the internal procedures for awarding contracts employed by each awarding authority comply with Community law.⁷²⁸ It would, however still be up to the Member States to ensure that the certification is meaningful on a day-to-day basis.

In its Annual Report for the 1994 financial year, the ECA commented '[T]he lack of transparency in awarding public work contracts is not without consequence as regards the risk of fraud and irregularity'.⁷²⁹ There are two aspects in particular where transparency seems to be lacking. Firstly, Member States seem to prefer to make maximum use of the exceptions⁷³⁰ provided for under the procurement rules, and secondly it is unclear how intermediaries are selected.

Exemptions to procurement rules

Under Article 7(2) of Council Directive 93/37 contracting authorities may, under certain circumstances, waive the requirements for prior publication of a contract notice, and select their own candidates. One criticism which is often levelled at the Member States is that too much use is made of such exceptions: negotiated procedures (with chosen suppliers), restricted procedures (with a list of qualified suppliers) and preference schemes⁷³¹ 'where an

⁷²⁸ Ibid.

⁷²⁹ Ibid, at 4.28.

⁷³⁰ European Commission (1987) An EC programme for public procurement in the Community, COM(86) 375.

⁷³¹ European Commission (1989) National regional preference schemes in the placing of public contracts, COM(89) 400.

appeal to local preference permits direct negotiations'.⁷³² There is still therefore ample opportunity to circumvent basic procurement rules such as advertising, competitive tendering and non-discrimination. This is not aided by the lack of clarity in defining exceptions. What might, for example, constitute an 'urgency brought about by events unforeseen'? Such an emergency has the effect of waiving basic procurement rules [Article 7(3)(c)]. Once transcribed into national law, this exemption could lead to wildly different approaches in the Member States. The abuse of any such exemptions leads to the possibility of contracts (for our purpose, involving EC funds) being awarded on the basis of personal preference and gain.

The selection of intermediaries

The use of intermediary bodies, agencies or other private bodies continues to raise problems, and the system need tightening up. Intermediaries can be designated by the Member States in order to manage global grants. The intermediary then allocates individual grants to final beneficiaries.⁷³³ Intermediaries must have the necessary administrative capability,⁷³⁴ must be present and represented in the regions concerned, operate in the public interest, and represent the socio-economic interests directly concerned by the implementation of the measures planned.⁷³⁵ Although intermediary bodies must provide adequate solvency guarantees and have the

⁷³² European Commission (1996) *The Structural Funds in 1994*, OOPEC, pp 116-117.

⁷³³ Article 5(1)(c) of Council Regulation 2052/88 OJ (1988) L 185/9.

⁷³⁴ Article 16(1) of Council Regulation 4253/88 OJ (1988) L 374/1.

⁷³⁵ Article 6(1) of Council Regulation 2083/93 (ERDF) OJ (1993) L 193/34.

administration capacity necessary for the administration of the subsidies,⁷³⁶ there are at present no formal procedures for selecting such bodies. At Commission level, an inter-departmental consultation is provided for, but the authorizing officer retains the option of ignoring opinions given.

6.2.3. *Prospects for improvement*

There is according to Draetta,⁷³⁷ Transparency International⁷³⁸ and a recent report from the European Parliament,⁷³⁹ more that the European Union can do to combat corruption within the confines of the first pillar. In particular procurement rules could be tightened up. Exemptions need to be narrowed further, and the selection of intermediaries, in particular needs regulating. But bearing in mind that some of the Member States have been slow in transposing the procurement directives, it is clear that such a move could only be a small part of a wider strategy to prevent and control corrupt practices (and recover monies laundered as a result). Such a strategy is at present emerging inter-governmentally.

⁷³⁶ Article 16 of Council Regulation 4253/88 OJ (1988) L 374.

⁷³⁷ Draetta, U (1995) The European Union and the fight against corruption in international trade, *Revue de Droit des Affaires Internationales*, number 6, pp 701-711.

⁷³⁸ Transparency International (1995) The fight against international corruption What the European Union can do, November; also paper by Dieter Frisch at T.I. Workshop in London on 4 July 1996, same title.

⁷³⁹ European Parliament (1995) Report of the Committee on Civil Liberties and Internal Affairs on combatting corruption in Europe, rapporteur Heinke Salish, December.

6.3. The emergence of a European strategy

The so-called third pillar of the Treaty on European Union is host to two relevant instruments which address this situation: a Protocol focused tightly upon the financial interests of the Community - dealt with at this point in the work - and a broader 'Anti-Corruption' Convention which will be discussed later.

6.3.1. The anti-corruption Protocol to the 'PIF' Convention

The purpose of the Protocol to the Convention on the Protection of the Financial Interests of the European Communities is to combat corruption that damages or is likely to damage the European Communities' financial interests and which involves European or national officials or members of the Commission, the European Parliament, the Court of Auditors and the Court of Justice and corruption of the type referred to in the Convention, committed by the same officials and members.⁷⁴⁰ It takes into account the immunities conferred by the Protocol on the Privileges and Immunities of the Communities.⁷⁴¹ The PIF Convention has been agreed and its adoption by Council is anticipated. It was drawn up on the basis of Article K.3(2c), which gives the Council of Ministers a framework within which to draw up conventions in areas of common interest, such as combatting fraud on an international scale.

⁷⁴⁰ Council of the European Union (1995) introduction, draft protocol to the Convention on the Protection of the European Communities' financial interests, document 11723/95, November, page 1.

⁷⁴¹ On this point see European Commission (1996) Protecting the Community's financial interests the fight against fraud annual report 1995 COM(96) 173, page 17; also White, S (1996) \Proposed measures against corruption of officials in the EU, in European Law Review, forthcoming.

As a necessary first step, the Protocol defines 'European Official' and 'National Official'.⁷⁴² A European Official means any employee within the meaning of the Staff Regulations of the European Communities or seconded person carrying out corresponding functions. National Official is to be understood, for the purposes of application of criminal law, by reference to the definition of 'official' and 'public officer' in the national law of the Member State in which the person in question performs that function.

The Protocol also gives a definition of 'passive' and 'active' corruption, where the former refers to the official who is corrupted and the latter to the person who induces corruption.⁷⁴³ More precisely, passive corruption is defined as the deliberate action of an official who requests, accepts or receives, directly or through a third party, for himself or for a third party, offers, promises or advantages of any kind whatsoever to act or refrain from acting in accordance with his functions or in the exercise thereof in breach of his official duties in a way which damages or is likely to damage the European Communities' financial interests. Active Corruption is defined as the deliberate action of whosoever promises or gives, directly or through an intermediary, an advantage of any kind whatsoever to an official for himself or for a third party for him to act or refrain from acting in accordance with his duty or in the exercise of his functions in breach of his official duties in a way which damages or is likely to damage the European Communities' financial interests.

The protocol also proposes that the two categories of

⁷⁴² Article 1 of proposed 'anti-corruption' Protocol.

⁷⁴³ Articles 2 and 3 of proposed 'anti-corruption' Protocol.

officials, European and national, are to be assimilated for the purpose of national anti-corruption legislation.⁷⁴⁴ This means that each Member State would ensure that measures in their respective criminal laws relating to the corruption of officials apply equally to all officials with responsibilities for EC funds. This is not the first time that the principle of assimilation has been used in the protection of the financial interests of the European Communities. The principle was first applied in this area in the Greek Maize case,⁷⁴⁵ when the Court of Justice ruled that infringements of Community law were to be penalised under the conditions analogous to those applicable to infringements of national law. The principle was then enshrined in Article 209a of the EC Treaty, which was added by the TEU, and which requires Member States to take the same measures to counter fraud affecting the financial interests of the Community as they take to counter fraud affecting their own financial interests. The requirement can thus be seen as an extension of already established practice in the Member States.

As well as assimilating Union officials to national officials under criminal law, the protocol requires Member States have established their jurisdiction in a number of circumstances. They must prosecute in any of the following conditions:

- (i) if the offence is committed in whole or part in their territory,
- (ii) if the offender is a national or an official of the state concerned,
- (iii) if the offence is committed by or against a European or National official, Government Minister, elected Member of Parliament, member of the Member

⁷⁴⁴ Article 4 of proposed 'anti-corruption' Protocol.

⁷⁴⁵ Case 68/88 Commission v Greece [1989] ECR 2965.

state's highest courts, member of its Court of Auditors, or a member of the Commission, European Parliament, European Court of Auditors or Court of Justice who is a national of the Member State concerned and,
(iv) if the offender is a European official working for the Community institution or a body set up under the Treaties establishing the Communities and with its headquarters in the Member State concerned.

A Member State which does not extradite its own nationals would have to establish its jurisdiction over corruption offences committed by officials outside the national territory. A Member State also has to prosecute whenever extradition is not appropriate. Files, information and exhibits would be transmitted in accordance with the procedures laid down in Article 6 of the European Convention on Extradition. Bilateral and multilateral agreements concluded between Member States and relevant declarations would remain unaffected.

The measure therefore provides for 'limited extra-territoriality' (in as much as it only applies within the territory of the EU), for EU and national officials and in the context of the protection of the financial interests of the European Communities.

Member States would have to ensure that active and passive corruption are punishable by effective, proportionate and dissuasive criminal penalties, including penalties involving deprivation of liberty which can give rise to extradition. Penalties would apply without prejudice to the exercise of disciplinary powers.⁷⁴⁶

Each Member State would have to take the necessary

⁷⁴⁶ Article 5 of proposed 'anti-corruption' Protocol.

measures for heads of businesses to be declared criminally liable in cases of corruption involving officials.

A sizeable obstacle to the prosecution of allegedly corrupt officials is the failure of cooperation mechanisms, which lag behind the realities of international criminality. As corruption takes the form of an international crime, its suppression is still regulated by national legal instruments inherently territorial in nature and, therefore, largely inadequate to confront it.⁷⁴⁷ When and if the proposed measures come into effect, Member States would acquire duties to cooperate effectively, when the corruption constitutes a criminal offence, in the investigation, the prosecution and in carrying out the punishment imposed, by means, for example, of mutual legal assistance, extradition, transfer of proceedings or enforcement of sentences passed in another Member State. They would also have to cooperate in deciding which Member State should prosecute, in order to 'centralise' prosecutions in a single Member State.

The provisions on ne bis in idem contained in the 'PIF' Convention would also be extended to cases of corruption by officials. This means that an official whose trial has been finally disposed of in a Member State may not be prosecuted in another Member State, save in exceptional circumstances. Member States would be able to launch a second prosecution if, for example, the facts which were the subject of the judgment rendered abroad constituted an offence directly against the security or other equally

⁷⁴⁷ Draetta, U (1995) The European Union and the fight against corruption in international trade, *Revue de Droit des Affaires Internationales*, number 6, page 703.

essential interests of that Member State.⁷⁴⁸ However, exceptions would not apply if the Member State in question had requested, in respect of the same facts, prosecution by the other Member State, or granted extradition of the person concerned.

No provision in the Protocol would prevent Member States from adopting internal legal provisions which go beyond the obligations deriving from the 'PIF' Convention. Lastly, Member States would acquire a duty to transmit to the Commission the text of their domestic law into which the provisions of the Protocol are transposed.

The European Court of Justice would have jurisdiction to rule on disputes between Member States on the interpretation or application of the Protocol if no solution is found within six months. This 'compromise' was also adopted in the 'PIF' Convention. In addition, certain disputes (for example, relating to the definitions of corruption, the principle of assimilation, ne bis in idem, internal provisions and transmission) between the Commission and the Member States which have not been resolved by negotiation would be submitted to the European Court of Justice. Excluded from this dispute-resolution mechanism are disputes regarding the interpretation of 'National Official' contained in Article 1, second indent of paragraph 1, where presumably the national view would prevail.

The Protocol would not enter into force until the Convention for the Protection of the Financial Interests of the European Communities has entered into force. In any new Member State, it would enter into force ninety

⁷⁴⁸ This would only be possible if the Member State in question had already made a declaration notifying adoption of the Convention.

days after accession.⁷⁴⁹

As far as the relationship with the 'PIF' Convention is concerned, Article 7 of the 'anti-corruption' Protocol would ensure that the provisions already contained in the 'PIF' Convention with regards to the criminal liability of heads of businesses,⁷⁵⁰ extradition,⁷⁵¹ cooperation,⁷⁵² ne bis in idem (save reservations),⁷⁵³ internal provisions and transmission⁷⁵⁴ would be extended to cases involving corrupt officials.⁷⁵⁵

6.3.2. Extension of third pillar strategy: the anti-corruption convention

More recently, a more ambitious project has been agreed by the Council of Ministers: a Convention on the fight against corruption of officials of the European Communities or officials of Member States of the European Union.⁷⁵⁶

The contents of this Convention duplicate that of the Protocol, except for one important consideration: its action is not restricted to the protection of the financial interests of the European communities. According to the Convention, the principle of 'limited

⁷⁴⁹ Articles 9 and 10 of the proposed 'anti-corruption' Protocol.

⁷⁵⁰ Article 3 of 'PIF' Convention.

⁷⁵¹ Article 5(1), (2) and (4) of 'PIF' Convention.

⁷⁵² Article 6 of 'PIF' Convention.

⁷⁵³ Article 7 of 'PIF' Convention.

⁷⁵⁴ Articles 9 and 10 of 'PIF' Convention.

⁷⁵⁵ Article 7 of 'anti-corruption' Protocol.

⁷⁵⁶ Document 4265/96 JUSTPEN of 12 January 1996, Council Act drawing up the Convention.

extra-territoriality' outlined above is extended to any act of passive or active corruption by an EU or national official. The question of the fight against political corruption, however, remains a sensitive issue.⁷⁵⁷

The Convention was drawn up on the same legal basis as the Protocol, with the aim of improving judicial cooperation. Its contents duplicate the provisions (examined above) extracted from a conjoint reading of the 'PIF' Convention and its first Protocol. In its first six articles, the Convention reiterates the Protocol's definitional provisions on National and European Officials, passive and active corruption, with one difference: in the definitions of passive and active corruption, the words 'or is likely to damage the European Communities' financial interests' have been omitted. This means that the 'Anti-Corruption' Convention seeks to establish common rules for dealing with corruption, leaving aside the question of the impact it may have on the EC budget.

The provisions on assimilation, penalties and jurisdiction are reproduced word for word. The provisions found in the 'Anti-Corruption' Convention concerning criminal liabilities of heads of businesses, extradition, cooperation, ne bis in idem rules and provisions of national laws can also be extracted from a joint reading of the 'PIF' Convention and its protocol.

Again, the European Court of Justice would have jurisdiction over disputes if no solution were found within six months. The present text suggests that its entry into force would not differ substantially from that of the 'PIF' Convention. The 'Anti-Corruption' Convention would have to be ratified by all the Member States and

⁷⁵⁷ See parliamentary question E-2106/94 OJ (1995) C 36/39.

apply ninety days thereafter. Until then, the Member States could choose to apply the Convention either bilaterally, or through the means of a declaration. This process has been referred to as one of 'rolling ratification'.⁷⁵⁸ It would be open to accession by any State that becomes a member of the European Union.

There is only one respect in which the 'Anti-Corruption' Convention differs from the earlier proposal for a Protocol, and it is in the area of cooperation. A conjoint reading of the Protocol and the 'PIF' Convention establishes that, when the corruption of officials concerns at least two Member States and constitutes a criminal offence, then those States would have a duty to cooperate effectively in relation to investigation, prosecution and punishment. This could be achieved by way of mutual legal assistance, extradition, transfer of proceedings, enforcement of sentences passed in another Member State, and/or other means of cooperation.⁷⁵⁹ This has the effect of limiting cooperation to criminal proceedings.

The 'Anti-Corruption' Convention, by contrast, states that if officials are involved in passive or active corrupt behaviour (defined above) which concerns at least two Member States then the States would have to cooperate effectively in the investigation, in judicial proceedings and in enforcing the penalty imposed, for instance by means of mutual legal assistance, extradition, transfer of proceedings or enforcement of judgments rendered abroad.⁷⁶⁰ This could be interpreted to mean that

⁷⁵⁸ See Statewatch bulletin, volume 6, number 4, July-August 1996, page 6.

⁷⁵⁹ See Article 7 of the protocol read in conjunction with Article 6 of the 'PIF' Convention.

⁷⁶⁰ See Article 8.

administrations have a duty to cooperate in cases of suspected corruption, even if the behaviour in question was not the object of criminal sanctions. This reflects the opinion, expressed by the Council of Europe Multidisciplinary Group on Corruption, that a comprehensive anti-corruption strategy should not be confined to the criminal sphere alone.⁷⁶¹

Thus, apparently, the proposed 'Anti-Corruption Convention' would go beyond the proposed Protocol in one important respect, by mandating for cooperation in control of conduct, regardless of whether the diverse legal and other traditions of Member States have led them to regulate such conduct within their administrative, civil and/or criminal law systems.⁷⁶² In this way, the proposed Convention builds up and extends existing forms of cooperation in the administrative and civil spheres.

For example, in the administrative sphere, instruments exist to promote cooperation in Customs and tax matters. It is now being recognised that cooperation is equally important in cases of corruption involving officials. Administrative authorities may be in a position to cooperate more speedily than judicial authorities.

Cooperation in the civil sphere is also of primary importance. The need for authorities to cooperate in attempting to recover advantages illegally obtained, of actions for damages, or for breach of contract which may involve more than one Member State, must not be

⁷⁶¹ Council of Europe (1995) Draft Programme of Action Against Corruption by the Multidisciplinary Group on Corruption, October, page 21.

⁷⁶² See Council of Europe (1995) Administrative, civil and penal aspects, including the role of the judiciary, of the fight against corruption, proceedings of the 19th Conference of European Ministers of Justice, Valetta, Malta, 14-15 June 1994, Council of Europe Publishing, Strasbourg.

overlooked.

6.3.3. Discussion on protocol and convention

It must be asked whether the proposed measures described above sufficiently address the weakness in the ways in which the European Communities presently respond to the challenge of corruption. For this author, the answer must be that they have potential, which can only be assessed once they come into force. It seems important that these instruments be in place before the next enlargement, which promises to be a difficult one. However the implementation of conventions in general,⁷⁶³ and third pillar instruments in particular tend to be protracted. Once implemented, the usual difficulties associated with judicial cooperation often apply.

At present inter-governmental acts, such as the Protocol and Convention outlined above, require unanimity, and escape the scrutiny of the European Parliament. Instruments do not become effective until they are ratified by the fifteen Member States. Disputes over the jurisdiction of the European Court of Justice can be protracted, as in the case of the Europol Convention. In the case of the 'Anti-Corruption' Convention it is hoped that a similar compromise can be reached concerning the role of the European Court of Justice. The Europol convention stipulates that whenever a dispute cannot be settled within six months, the matter may be referred to the Court of Justice by a party to the same dispute.

This conditionality has lead some commentators to argue that matters related to the protection of the financial interests of the Community, in particular, should be brought under Community competence (first pillar), where

⁷⁶³ For example the Dublin Convention, signed in June 1990, still awaits full ratification six years later.

these problems do not arise. A similar argument has been made in relation with the fight against corruption (see 5.).

The protocol to the 'PIF' Convention will not enter into force until the 'PIF' Convention itself has entered into force, that is to say after all the Member States have ratified it. Nevertheless, some aspects of this Convention and its protocols raise considerations that may be delicate for Member States, and interact with broader issues regarding the 'third pillar' and the IGC. One problem for cooperation in criminal investigation of cases of possible corruption is that many different administrations may have to cooperate, which in some cases may cause difficulty. Another is that transfers of criminal proceedings, even within the European Union, are slow.⁷⁶⁴ Diplomatic channels have often proved an unsatisfactory conduit for rogatory letters. In addition, the enthusiasm for the use of rogatory letters can vary greatly from one Member State to the next, with for example Italy making the most use of the medium in the European Union, and the United Kingdom seldom doing so.⁷⁶⁵ This has prompted some commentators to put forward the 'free movement of judges' as a remedy to this unsatisfactory state of affairs.⁷⁶⁶ Indeed the proposed second Protocol to the 'PIF' Convention provides for a network of 'liaison judges' in order to facilitate

⁷⁶⁴ See newspaper article 'Greeks in EU fraud case', *The European*, 15 February 1996, page 18.

⁷⁶⁵ Leguet, G (1996) *La confusion dans la répartition des compétences dans le domaine des poursuites*, paper given at the Conference on the protection of the financial interests of the European Communities, held in Lille, 25-26 January.

⁷⁶⁶ De Angelis, F (1996) *Les problèmes liés à la décentralisation*, paper given at the conference on the protection of the financial interests of the European Communities, held in Lille, 25-26 January.

judicial cooperation.⁷⁶⁷ This step in the direction of a common European legal space may however cause pause for thought in some justice ministries.

Meanwhile, should the 'Anti-Corruption' Convention be adopted, any ensuing improvement in cooperation in the administrative and civil spheres could bring considerable benefits. The potential value of the proposed extension of cooperation from the criminal to the civil and administrative spheres will be appreciated by those who acknowledge present difficulties facing cooperation in criminal matters. In some circumstances, evidence may be more readily available within an administrative context than a criminal one. Another potential limitation of relying too much upon criminal proceedings is that in some Member States, the discretion not to prosecute may be used by the prosecuting authorities, perhaps occasionally for political reasons, or sometimes the judiciary itself is 'penetrated by the world of corruption'.⁷⁶⁸ For all these reasons, it seems important that future improvements in cooperation not be confined to the criminal sphere alone, and both the Protocol and the proposed convention are to be welcomed on this score.

Taken together, the proposals go a considerable way towards enhancing cooperation in criminal law for the prosecution of corruption, leaving administrative and civil cooperation as useful back-ups. The problem of corruption is being addressed in an unprecedented climate of transparency and this can only bear witness to the renewed vigour of the European project.

⁷⁶⁷ Article 9(2) of the proposed second Protocol to the Convention on the Protection of the European Communities' Financial Interests sees proposal for a Council Act, COM(95) 693, December 1995.

⁷⁶⁸ See Council of Europe (1995) op.cit. report presented by the Italian Minister of Justice.

6.3.4. International agreements and American proposals

The global situation has been considerably altered by the opening-up of markets, culminating in the conclusion of the Uruguay Round and the establishment of the WTO. The impact of these developments has been heightened by the association agreements and the setting-up of the EEA, the accession of the new Member States and the Association Agreements with countries of central and Eastern Europe.⁷⁶⁹ Unfortunately, in our 'post-national'⁷⁷⁰ economies of increasingly freer trade, where commerce and procurement are international, relevant national rules all too easily fail to address the more negative consequences of the single market and of the broader internationalisation of trade.

Internationally, there are a number of recommendations and codes of practices which have been agreed to in various fora.⁷⁷¹ The 1994 OECD recommendation on bribery in international business transactions,⁷⁷² for example, spells out part of the control agenda, but it is not binding. The recommendation suggests, inter alia, that bribes should no longer be tax-deductible (as they presently are in some of the Member States), and that the

⁷⁶⁹ See OJ (1994) C 397.

⁷⁷⁰ See for example newspaper article: 'Let's make the global playing field level', in the Independent, 5 June 1996; also McShane, D (1996) Global business: global rights, Fabian Pamphlet 575.

⁷⁷¹ See for example International Chamber of Commerce (1996) Extortion and bribery in international business transactions, Revisions to the 1977 Report and rules of conduct to combat extortion and bribery, March. This report covers recommendations to governments and international organisations and rules of conduct to combat extortion and bribery.

⁷⁷² OECD (1994) Council Recommendation on bribery in international business transactions adopted by the Council at its 829th session on 27 May 1994, C(94)/75.

bribery of foreign officials should be sanctioned on par with the bribery of national officials. But the problem with non-binding instruments is basically, that no one state wants to be first at making them binding, lest they lose out economically. This perception means that some comprehensive non-binding instruments have remained non-binding to-date. Following an OECD pact signed in Paris in April 1996, however, there have been some moves in the direction of abolishing the tax deductibility of bribes in some of the Member States, with iatrogenic consequences, such as the resurgence of legal phone tapping in Germany for the first time since the end of the second world war.⁷⁷³ The non-deductibility of bribes may, in any case, have little impact if it turns out that most bribes are paid out of laundered money.⁷⁷⁴ In this case 'chercher l'argent' may well emerge as the central anti-corruption task for the international community in the near future.

There has been a robust challenge from the United States. The Foreign Corrupt Practices Act 1977 (FCPA) extends the jurisdiction of US courts to all American citizens and companies, wherever the offence of bribery is committed, attempted or contemplated. US companies maintain that they lose contracts as a result of bribes offered by European competitors in particular,⁷⁷⁵ hence American

⁷⁷³ See newspapers articles: 'Frankfurt fights corruption war on two fronts', in Financial Times 14 August 1995; 'Anger over bribes ruling', in European 18 April 1996, page 17; 'Germany acts to combat corruption', Financial Times 20 June 1996 page 2.

⁷⁷⁴ Robinson, J (1995) The laundrymen, Pocket Books, London, page 24: 'Corporations do it [launder money] to avoid or evade tax, to defraud their shareholders, to get around currency control regulations and/or to bribe prospective clients.'

⁷⁷⁵ See newspaper articles: (i) 'US companies "lost \$20bn in deals after rivals offered bribes Kantor calls for bribery action' by N. Dunne in Financial Times, 26 July 1996, page 3;

lobbying to see a US-style system operating in Europe. In September 1996 the US Department of Commerce indicated its intention to establish a hot line for US companies to report suspected bribery of foreign officials by non-US companies. The confidential hot line is to be monitored and followed up by the Trade Promotion Co-ordinating Committee (TPCC).⁷⁷⁶

The European response to this pressure has been one of caution, and of reluctance to adopt the American agenda and 'import' ready-made solutions. There are, the author suggests, at least two reasons for this reluctance. The first is historical. For the United States, extra-territoriality has long been understood as a way of influencing conditions of trade beyond the US territory; European powers developed this idea to a much lesser extent. The second reason for caution relates to concern about the effectiveness of the FCPA in particular, and extra-territoriality in particular.

At best, the success of the FCPA can be described as mixed. Extra-territoriality as applied to corruption offences has inherent weaknesses, as the American experience has shown, and in any case the effects of the FCPA have on occasion been circumvented by engaging an intermediary to make illicit payments.⁷⁷⁷ Closer to the

(ii) 'US will demand "no-bribe" pledges by A. Counsell in Financial Times 25 September 1996, page 7. The latter reads: "The TPCC report said that bribery was one of the most difficult and persistent barriers to working abroad. US companies had lost 36 out of 139 international commercial contracts which had come under scrutiny for allegations of bribery, at an estimated cost of \$11bn."

⁷⁷⁶ Ibid.

⁷⁷⁷ See newspaper article: 'Greasing wheels: How US concerns compete in countries where bribes flourish, foreign travel, donations and use of middlemen help them win business, paying for reporters' cabs' in The Wall Street Journal of September 29, 1995; Levy, R (1985) The antibribery provisions

European Union, in Switzerland, where the prosecution of Swiss nationals for corrupt offences abroad is (in theory at least) possible, this power does not seem to have been used in practice.⁷⁷⁸

Given the European Union's structure, powers and competencies, it has developed its own characteristic responses, based in its first pillar and third pillar competencies, rather than adopting either a purely intergovernmental or an extraterritorial approach. US pressure recently may have influenced the pace of the European response rather than its form. Nevertheless, the approach of the Union is still developing, not without difficulty, unproven and no doubt open to improvement. In the closing pages of this chapter some possible improvements will be noted.

6.4. An issue not yet squarely confronted: immunities

The European budget has increased by a factor of 2.7 in ten years, rising from 28 800 million ECU in 1985 to 79 800 million ECU in 1995.⁷⁷⁹ As a result, the financial officers of the European Communities have been called upon to exercise more responsibility on behalf of the European tax payer, in an increasingly complex regulatory

of the Foreign Corrupt Practices Act of 1977 : are they really as valuable as we think they are? in *Delaware Journal of Corporate Law*, 71-95; Bliss, J (1989) *The Foreign Corrupt Practices Act of 1988: clarification or evisceration?* in *Law and Policy in International Business*, 441-469; *The Foreign Corrupt Practices Act: curse or cure?* (1981) in *American Business Law Journal*, 73-86.

⁷⁷⁸ Lachat-Héritier, A (1983) *Commercial bribes: The Swiss answer*, *Journal of Comparative Business and Capital Market Law* number 5, 79-96.

⁷⁷⁹ *European Court of Auditors (1995) Report to the Reflection Group on the Operation of the Treaty on European Union*, May, page 2.

environment. The case law of the European Court of Justice shows that occasionally Community funds have been misappropriated, through the allegedly corrupt behaviour of EC officials.⁷⁸⁰

6.4.1. EC Officials: disciplinary framework

Under Article 260 EC if a Member of the Commission no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct, the Court of Justice may, on application by the Council or the Commission, compulsorily retire him. The Staff disciplinary framework also provides for a wide range of sanctions to be applied by the appointing authority, irrespective of the immunities officials may enjoy. But these disciplinary sanctions, typically, do not extend to custodial penalties or even fines, and are not made public. They can never be seen as a suitable alternative to sanctions imposed by the courts.

Any failure by an EC official to comply with his duties under the Staff Regulations, whether intentionally or through negligence, renders him liable to disciplinary action and penalties which range from a written warning, a reprimand, a deferment of advancement, a relegation in step to downgrading or removal from post and entitlement to retirement pension according to the severity of the misconduct or negligence. Sanctions with regards to post-employment duties such as confidentiality can also be

⁷⁸⁰ See for example cases 46/72 *De Greef v Commission* [1973] ECR 543; 49/72 *Drescig v Commission* [1973] 567; 326/91 *De Compte v European Parliament* [1994] ECR I 2091; and more recently 12/94 *Daffix v Commission*, 28 March 1995, nyr.

applied after the official has left the service.⁷⁸¹ Furthermore where an allegation of serious misconduct is made against an official by the appointing authority, whether this amounts to failure to carry out his official duties or a breach of law, the authority may order that he be suspended forthwith.⁷⁸² Indeed, for the fight against corruption, the possibility of post-employment sanctions is important so that a more subtle form of corruption where the official is granted employment, consultancy contracts or other advantages after (or rather as a result of) his employment with the administration can be dealt with. This practice is usually referred to in the continental literature as 'pantouflage'.⁷⁸³

Nevertheless there has been some scathing criticism of the Staff Regulations. For example the House of Lords, in its 1996 IGC Minutes of Evidence, pointed out that the Staff Regulations were overdue for reform so as to 'make it easier for staff to be reviewed, moved, promoted and sacked'.⁷⁸⁴ The European Court of Auditors, which is also critical of the present arrangements, has argued for an investigative role in disciplinary hearings, since it is within its powers to perform controls by examining

⁷⁸¹ Article 86 of Regulation number 31 OJ Special Edition 159-62, pages 135-200, 1385/62 laying down the Staff Regulations of Officials and the Conditions of Employment of other Servants of the European Economic Community and the European Atomic Energy Community, amended by Regulation 259/68 OJ L (1968) 259/68, and known as 'the Staff Regulations'.

⁷⁸² Article 88 of Staff Regulations.

⁷⁸³ From the French 'pantoufle', which means slipper.

⁷⁸⁴ House of Lords Select Committee on the European Communities, (1995) Inter-Governmental Conference, Minutes of Evidence, session 1994-95, 18th report, July, page 386.

records.⁷⁸⁵

Serious misconduct can include an alleged misappropriation of funds. Such misconduct, however, according to the Disciplinary Board in one case 'justifies a sanction going beyond that recommended by the Disciplinary Board'.⁷⁸⁶ This is in line with Commission sentiment. In response to a Parliamentary question, Jacques Delors replied on behalf of the Commission that as far as Commission Officials were concerned, if there were any case of corruption, criminal proceedings would normally be launched.⁷⁸⁷

Yet in relation to the protection of the financial interests of the European Communities, such prosecutions under the criminal laws of the Member States are rare. This is because provisions sanctioning corruption and bribery in the Member States' criminal laws tend to be addressed to their own nationals, on their own territory. Notwithstanding this discrimination, the prosecution of national officials is also rare. At present only France, the United Kingdom and Ireland have a less restrictive approach, which does not exclude EC officials.⁷⁸⁸ One complicating factor in this already very uneven control

⁷⁸⁵ See White, S (1995) Reflections on the IGC and the protection of the financial interests of the European Communities, AGON October, page 10; also European Commission (1995) Préparation CIG 1996 contribution de la cour des comptes, information aux délégations extérieures de la Commission, info-note number 31/95, June.

⁷⁸⁶ Case 12/94 Daffix v Commission, 28.3.1995, nyr.

⁷⁸⁷ Written question E-2478/94 by Fausto Bertinotti to the Commission (30 November 1994) OJ C (1995) 55/58.

⁷⁸⁸ See De Koster, P (1995) Obstacles causés par le régime d'immunités des fonctionnaires publics, paper given at a conference on the protection of the financial interests of the European Communities held at Sirmione, Italy, July.

space, is that EC officials enjoy immunities, which, as we shall see, have to be lifted if a prosecution is to take place.

6.4.2. Privileges and immunities

EC officials enjoy privileges and immunities set out in the Protocol on the Privileges and Immunities of the European Communities.⁷⁸⁹

In particular, the premises and buildings of the Communities are inviolable. The property and assets of the Communities cannot be the subject of any administrative or legal measure of constraint without the authorization of the Court of Justice. EC officials are immune from legal proceedings in respect of acts performed by them in their official capacity. This immunity extends even after they have ceased to hold office. Each institution is required to waive the immunity wherever it considers that the waiver of such immunity is not contrary to the interests of the Communities.⁷⁹⁰

(i) Test of functional necessity

One important issue is whether these immunities in any way hinder the investigation, or prosecution of allegedly corrupt behaviour. The rationale for an official's privileges and immunities is that they must be necessary to enable him to perform his functions. Accordingly, the immunity referred to under Article 1 of the Protocol on

⁷⁸⁹ Protocol signed in Brussels in 1965, superseding the Protocols on the Privileges and Immunities of the European Atomic Energy Community, of the European Coal and Steel Community and European Economic Community.

⁷⁹⁰ Articles 1, 12(a) and 18, second subparagraph of the Protocol on Privileges and Immunities of the European Communities.

Privileges and Immunities of the European Communities cannot be invoked to prevent EC officials' earnings from being docked. Similarly, Article 23 of the Staff Regulations states:

The privileges and immunities enjoyed by officials are accorded solely in the interests of the communities. Subject to the Protocol on Privileges and Immunities, officials shall not be exempt from fulfilling their private obligations or from complying with the laws and police regulations in force.

In these matters, the institutions and the European Court of Justice have applied the test of functional necessity. The Court of Justice has held it constant that, with respect to administrative or legal measures of constraint, the principle of functional necessity has to prevail. For example, an attachment of earnings affecting the salary of an EC official, does not, according to the Court of Justice, constitute an obstacle in the way of the functioning and independence of the Communities, particularly when the serving of such an order was not opposed by the appointing authority itself.⁷⁹¹

(ii) Immunity from prosecution

Likewise, the immunity from prosecution under Article 12(a) of the Protocol on Privileges and Immunities cannot

⁷⁹¹ For example cases 4/62 Application for authorization to enforce a garnishee order against the High Authority of the European Coal and Steel Community [1962] ECR 41; 64/63 Potvin v Van de Velde [1963] ECR 47; 85/63 Application for authorization to notify the EEC of an assignment of salary [1963] ECR 195; 1/71 Application for authorization to serve an attachment order on the Commission of the European Communities [1971] ECR 363; 1/87 Universe Tankship Incorporated v Commission [1987] ECR 2807; 1/88 SA Generale de Banque v Commission [1988] ECR 857.

be invoked outside the sphere of the official's duties. The European Court of Justice ruled that the immunity against prosecution should be waived in the case of an official prosecuted in a Belgian court following a car accident, since his official duties did not require the use of a car.⁷⁹² Crimes unconnected with the performance of officials' duties do not fall within the scope of the immunity against prosecution.

The Commission considers that it is its right and duty to cooperate with the police and the judicial authorities of the Member States and to comply with any legitimate request for information in so far as its own interests, immunities and privileges are not jeopardized. They are in principle not affected in the case of crimes committed by the Commission's staff unconnected with the performance of their duties.⁷⁹³

With respect to crimes connected with the performance of officials' duties, the appointing authority waives the immunity *if it is not contrary to the interests of the Communities*, which remains disturbingly vague. A positive duty to lift immunities immediately when the protection of the financial interests of the European Communities are at stake would go a long way towards clarifying this state of affairs.

Official secrecy

Under Article 19 of the Staff Regulations officials have a duty of discretion. They must not disclose in any legal proceedings information of which they have knowledge by

⁷⁹² Case 9/69 Sayag and Another v Leduc and others (Reference for a preliminary ruling by the Belgian Cour de Cassation) [1969] ECR 329.

⁷⁹³ Case 180/87 Hamill v Commission [1988] ECR 6141.

reason of their duties. Permission must be sought, and will be refused only when where the interests of the Communities so require. An official continues to be bound by this obligation after leaving the service. However this provision does not apply to an official or former official giving evidence before the Court of Justice or before the Disciplinary Board of an institution on a matter concerning a serving or former serving staff.⁷⁹⁴

Duty of assistance

When misconduct is alleged, the appointing authority must give the official assistance. Each Community has a right to assist an official in its service, in particular in proceedings against a person perpetrating threats, insulting or defamatory acts or utterances, or any attack to person or property to which he or a member of his family is subjected by reason of his position and duties. It must also compensate the official for damage suffered in such cases, in so far as the official did not either intentionally or through grave negligence cause damage and has been unable to obtain compensation from the person who did cause it.⁷⁹⁵ An official may therefore sue for violation of this guarantee if an unproven allegation of fraud has been made against him and the appointing authority has failed to protect his reputation. This leaves the institution open to a claim for damages, if for example disciplinary proceedings are taken and allegations turn out to be unfounded, or the official is arrested and prosecuted as a result of information communicated by the appointed authority, and is

⁷⁹⁴ See Schmidt, C (1991) *Le Protocole sur les Privilèges et Immunités des Communautés Européennes*, Cahier de Droit Européen, 61-100, pp 81-82.

⁷⁹⁵ Article 24 of the Staff Regulations.

subsequently acquitted.⁷⁹⁶ One can see that whilst it might be possible for the appointing authority to investigate in-house and protect the reputation of an official in the meanwhile, this might prove more difficult when cooperating with the judicial authorities of the Member States. There is a potential tension between the duty of the appointing authorities to assist officials and the duty to cooperate with the judicial authorities of the Member States.

6.4.3. Immunities and delays

To some commentators, the existence of privileges and immunities in itself does not in fact present a significant obstacle to prosecution.⁷⁹⁷ Indeed immunities are relative⁷⁹⁸ or functional, so their significance must not be overstated. Immunities were never intended to prevent the investigation of serious crimes against the tax payer. But corruption thrives on secrecy and silence⁷⁹⁹ and is by nature difficult to detect.⁸⁰⁰ There may be a sense in which the presence of immunities may make the detection of such crimes even more difficult. As was pointed out in the context of diplomatic immunity:

What limits the scope of a diplomat to perform

⁷⁹⁶ Cases 158/79 Roumengous v Council [1982] ECR 4379; 145/83 Adams v Commission [1985] ECR 3539; 59/92 Caronna v Commission ECHR [1993] ECR II 1129; 180/87 Hamill v Commission [1988] ECR 6141.

⁷⁹⁷ For example, De Koster, op. cit.

⁷⁹⁸ See case 2/88 Zwartveld and others v Commission [1990] 5(1) 3365, page 3372, points 19-20.

⁷⁹⁹ Council of Europe Report, op. cit. page 21.

⁸⁰⁰ See for example Merlin-Calzia, R (1995) Le service central de prévention de la corruption comme possible instrument au service de la défense des intérêts financiers de la Communauté, AGON, July, pages 8-9.

criminal acts? Like any other person guilty of a crime, he must first be detected. Moreover, because of the inviolability of his person and premises, detection is especially difficult.⁸⁰¹

Police investigations may be delayed by the administrative processes involved in waiving immunities. In the 'Tourism Unit' case, which hit the headlines in 1995, there seems to have been a long delay before the immunities of several officials were lifted,⁸⁰² in what turned out to be 'the first inquiry to involve outside investigators (i.e the police) in the 40-year history of the Commission', leading to the early retirement of the director-general of the D-G for tourism (DG XXIII).⁸⁰³ Indeed the lifting of immunities is the gift of the appointing authority, who has to base its decision on the evidence available. Evidence-gathering may be a difficult exercise in such cases.

To conclude, the privileges and immunities of EC officials, respected by recent third pillar measures, pose problems in the investigation of possible corruption. This issue has also been raised in the context of the European Parliament, and of national parliaments too.⁸⁰⁴

⁸⁰¹ McClanahan, G (1989) Diplomatic immunity, principles, practices, problems, Hurst, London, page 128.

⁸⁰² See newspaper articles: 'Audit damns EC tourism unit' European 10 February 1995; 'Immunity lifted on EC suspects', European 24 February 1995; 'EC anti-fraud chief pledges 'no cover-ups'', European 10 March 1995, pages 1 and 19.

⁸⁰³ See newspaper article 'Police anger as tourism chief goes', in The European, 24-30 October 1996, page 26.

⁸⁰⁴ See for example newspaper article: 'Who should judge corrupt MPs?' in Times, November 12, 1996 page 39.

6.5. Towards a credible anti-corruption strategy

Clearly, an anti-corruption strategy needs both increased prevention and repression, with respect to both economic operators and officials. Transparency must be increased in order to defeat the secrecy which naturally surrounds corrupt practices. But increased transparency must be backed up by a credible system of prosecution. The problem has hitherto only partly been addressed within the European Union, and much remains to be done.

6.5.1. Immunities: need for assimilation

With regards to EC officials, a positive duty could and should be placed upon the institutions to lift immunities promptly when an internal investigation shows that EC funds are to be involved. More generally, on the subject of immunities and of elite corruption, DGXX could consider a study on the regimes of immunities politicians and officials enjoy in the Member States with a view to assimilation, as far as the protection of the financial interests of the European Communities is concerned. Without this, the anti-corruption protocol and the convention could prove to be of little value since most officials and politicians handling EC funds seem to enjoy either nationally or internationally determined immunities.

6.5.2. Third pillar action: conditions for effectiveness

With regards to the two proposed third pillar instruments outlined above, it is hoped that a permanent compromise can be reached with regards to the jurisdiction of the European Court of Justice, and that a swift ratification will follow. If the instruments are to work well, mutual assistance should be stepped up. This may be difficult at the moment, since mutual assistance still rests on

instruments unsuited to a single market. In this the exchange of magistrates could go some way towards ameliorating the situation. One cannot help but feel, however, that much more drastic reform is needed in order to try and attain a system which functions with the requisite despatch, and which could easily be extended to new Member States upon accession.

The question remains whether the seriousness with which these issues have been addressed by the Council of Ministers will find echoes in the legislatures of every Member State, or whether procrastination once again will emerge as the villain, as was the case when such issues were first debated in the 1970s. There may be good reason for pessimism on this score. Because corruption refers to several distinct but related problems,⁸⁰⁵ its 'definition' in a particular historical context is far from value-free. Corruption may be likened to a political 'projective test': each political group highlights particular aspects which it sees as ripe for enforcement, and de-emphasises other aspects, according to its own preoccupations, interests and position in the world. In many or perhaps all Member States, political agenda may be the result of political compromise, which may make it difficult to get quick and vigorous implementation of third pillar measures.

The question thus arises - can more also be done within the first pillar?

6.5.3. First pillar action

There is scope within Community law to protect the integrity of the single market by seeking to eradicate commercial behaviour, such as corrupt practices, which

⁸⁰⁵ Gardiner, J (1993) Defining Corruption, Corruption and Reform number 7, pp 111-124.

grant an unfair advantage and distort competition. This could be put in the context of the already existing, and largely successful Community crime prevention space which has evolved mostly since the Single European Act,⁸⁰⁶ with the aim of protecting the single market.

It has been argued in particular that Article 92 EC could be used to ban the tax-deductibility of certain payments, the provision of export credit guarantees concerning illicit payments and the public financing of exports which includes illicit payments⁸⁰⁷ by treating bribes as state aids, which have the effect of distorting competition and impacting on intra-community trade. As part of this strategy, and in view of the growing number of corruption cases involving public procurement, it has been suggested that procurement rules would be tightened up. However the problem of speedy and accurate implementation remains.

Such an approach, once part of the *acquis communautaire*, would in turn become part of the pre-accession strategy for central and eastern Europe through the existing Europe agreements under Article 113 and 228(a).⁸⁰⁸ By

⁸⁰⁶ Vernimmen, G and Missir di Lusignano, A (1995) Editorial of AGON number 9; Dorn, N and White, S Beyond 'pillars' and 'passerelle' debates: The European Union's emerging crime prevention space, in Legal Issues of European Integration, forthcoming.

⁸⁰⁷ Transparency International (1995) The fight against international corruption: what the European Union can do, November.

⁸⁰⁸ The EU now has Europe Agreements with Bulgaria (entered into force 1.2.95), the Czech Republic (1.2.95), Estonia (not yet entered into force), Hungary (1.2.94), Latvia (not yet entered into force), Lithuania (not yet entered into force), Poland (1.2.94), Romania (1.2.95), the Slovak Republic (1.2.95) and Slovenia (not yet entered into force). Each of these agreements stipulate that (i) all agreements between undertakings, decisions by associations of undertakings and concerted practices which have as their project or effect the prevention, restriction or distortion of competition must be

contrast, Partnership and Cooperation Agreements, taken under the same legal basis, impose less constraining duties on the signatory states, such as the duty not to enact or maintain any measure distorting trade between the Community and the signatory state.⁸⁰⁹ Trade and Economic Cooperation Agreements meanwhile, with Articles 113 and 235 as a legal basis, only impose a duty not to impose counter-trade requirements.⁸¹⁰

There has been no direct case law as to whether competition is within Article 113. In 1992⁸¹¹ the Court opined that the Community's power to enter into international agreements in the competition field arose from the competition rules in the EC Treaty.⁸¹² This power remains uncontested to date. More recently, in 1996⁸¹³ the Court opined that Article 235 EC could not be used as a legal basis to justify the Community's accession to the Convention of Human Rights as such accession would entail substantial changes of a constitutional nature which go beyond the scope of Article 235 EC. This could potentially limit the field of action of the Community to enter into international

progressively abolished; (ii) any practices will be assessed on the basis of Articles 85, 86 and 92 EEC and the relevant secondary legislation. The necessary rules for implementation must be adopted by 31 December 1997.

⁸⁰⁹ PCAs have partially entered into force in Belarus, Kazakhstan, Kyrgystan, Moldova, Russian and Ukraine where interim agreements on trade aspects are awaiting ratification.

⁸¹⁰ The TECA with Albania entered into force on 1.12.92. TECAs also apply when the full PCAs have not been ratified yet (see previous note).

⁸¹¹ Opinion 1/92 [1992] ECR 2821 at para. 40.

⁸¹² See McLeod, I, Hendry, I and Hyett, S (1996) *The external Relations of the European Communities*, Clarendon Press, Oxford, pp 271-273.

⁸¹³ Opinion 2/94 re the accession of the Community to the European Human Rights Convention [1996] 2 CMLR 265.

agreements only in areas where it has explicit competence, and whilst emphasising downwards subsidiarity, may well limit the potential for Community-based action to fight corruption.

Procurement

There may be a sense in which, as far as the Structural Funds are concerned neither co-financing nor programming have delivered the expected protection. Firstly, not all operational programmes are co-financed in any case. Community Initiatives, for example, are financed 100% from Community funds and other initiative only require a small participation from the Member States. In other cases, costs have sometimes been inflated in order to lessen the impact on the local purse. Secondly the Commission has argued that it is in the nature of the system of contributing to the financing of programmes, rather than projects, under the Structural Funds that monitoring of compliance with public tendering rules must take place essentially at the level of national authorities. This probably indicates that the Commission is thinking about having shorter-term, better defined projects in the future, whilst subjecting them to rigorous on-the-spot checks.

Procurement rules could be tightened up, as suggested earlier, if it becomes clear that the desired effect can only be achieved by legislative action in the first pillar. This means, in particular, regulating the selection of intermediaries, and monitoring the use of 'emergency' procedures, which allow normal procurement rules to be circumvented when contracts involving EC funds (and others) are involved. Without this tightening of rules, the problem could reach dramatic proportions after the next enlargement.

International Trade: the CCEEs

Outside the Union, it is through the Europe Agreements that there is the most scope to prevent economic crime through procurement rules, although in some cases these rules will not be effective until 1998. Procurement rules, which as we have seen take their place in instruments regulating the (economic) external relations of the European Union have the potential to be of strategic importance in the fight against procurement fraud in an enlarged Union. More is said on enlargement in the following chapter.

With regards to the grey area which concerns projects which offer disastrously low value for money, or which let certain consultants 'cream off' funds destined to help central and eastern Europe, there seems to be a need for the Commission itself to look at the way it awards contracts.

6.5.4. Conclusion

The potential of first pillar instruments to bring about changes in Member States' criminal laws should not be underestimated. Cadoppi stressed that harmonisation of criminal law had already come largely through the European Court of Human Rights, but also through economic regulation.⁸¹⁴ Economic matters being dealt with under the first pillar, measures preventing economic criminality and indeed putting an obligation on the Member States to harmonise their criminal laws have also arisen therefrom. This is the 'Trojan Horse' quality of the first Pillar, which is so often overlooked.

⁸¹⁴ Cadoppi, A (1996) Towards a European Criminal Code? *European Journal of Crime, Criminal Law and Criminal Justice*, Volume 4, Issue 1, 2-17.

Nevertheless there would remain practical and administrative issues requiring attention in order to give effect to first pillar measures against corruption. Such measures would entail cross-directorate cooperation which, unfortunately, does not seem to be forthcoming at the time of writing (September 1996). But it is not beyond the realms of possibilities that this situation could improve rapidly. If so, then first pillar action might be demonstrated to have potential lacking in third pillar action. It would be both an irony and tragedy if an impediment to that demonstration were to be found not in the Member States but in the guardian of the first pillar.

CHAPTER 7. ENLARGEMENT OF THE EUROPEAN UNION

7.1. Whither the CAP?

We are now moving towards a Union where in the future a 'core' may forge ahead by fulfilling EU policy goals, whilst others may well accede only to part of the *acquis communautaire*. In view of the proposed proportional increase in expenditure on structural measures, what might this mean for the future of fraud prevention and enforcement?

7.1.1. Background: anticipated enlargement

The Community has been subjected to a regime of rapid enlargements and its budget has increased exponentially, as well as CAP expenditure. Poland and Hungary are now first in line for accession, followed by the Czech and Slovak Republics, and Bulgaria and Rumania as soon as they can satisfy the economic and political conditions required. The Baltic States are to follow suit. Turkey, Malta and Cyprus have also formally applied to join. It is expected that on the very optimistic assumption that the 1996 Inter-Governmental Conference comes to an early and successful conclusion, entry talks with an undetermined number of states should start in late 1997.

It is already clear that a union of 20 Member States, or even as many as 27 by next century, cannot be run on the same lines as a union of twelve or fifteen. Back in 1972 Spinelli had already predicted that the enlargement of the Community would not automatically bring a better balance to agriculture, but that it might, on the contrary, increase the desiquilibria.⁸¹⁵ At the Essen summit (1994) the then president of the Commission,

⁸¹⁵ Spinelli, A, 1972, *The European adventure, Tasks for an enlarged Community*, London, Charles Knight & Co, page 69.

Jacques Delors made it clear that the European Union would have to reform its own policies to cope with eastern enlargement, including reform of the CAP and the Structural Funds. In fact the CAP has grown in size and complexity in order to remedy the 'desiquilibria' aggravated by a regime of rapid enlargements, and in order to maintain a common market in agriculture.

7.1.2. CAP: major obstacle

Notwithstanding attempts at trimming the CAP, its size is still such that it has been described as the major obstacle to further enlargement.⁸¹⁶ Estimates as to how much the budget would have to increase if the four Visegrad countries joined the Union and the present level of CAP intervention was extended to them vary between an increase of 40 to 70 billion ECU.⁸¹⁷ That is to say, some commentators estimate that a doubling of the budget would be needed in order to extend the present system at the next accession. In realpolitik, this is impossible. Yet a radical reform of the CAP promises to be a political minefield. It has been pointed out that the agricultural lobby is an 'insider' in the policy community and has been the most consistently powerful economic interest in

⁸¹⁶ See Baldwin, R (1994) *Towards an integrated Europe*, London Council for European Policy Studies; also Sutton, M (1994) *Transition to the European Union?* in *Economies in transition Eastern Europe and the former Soviet Union*, London, Economist Intelligence Unit.

⁸¹⁷ The following reports were commissioned by Directorate-General I of the European Commission: Buckwell, A (1994) *Report on the feasibility of an agricultural strategy to prepare the countries of central and eastern Europe for EU accession*; Tangermann, S and Josling, T (1994) *Pre-accession agricultural policies for central Europe and the European Union*; Tarditi, S and Senior-Nello, S (1994) *Agricultural strategies for the enlargement of the European Union to central and European countries*; Mahé, L-P (1995) *Agriculture and enlargement of the European Union to include the central and eastern European countries Transition with a view to integration or integration with a view to transition?*

the EC.⁸¹⁸ It is therefore to be expected that the lobbies would oppose preferential treatment being given to central and eastern european agricultural products. As far as Structural Funds are concerned, it has been acknowledged that they still have an important role to play in the completion of the single market, and in promoting economic and social cohesion, but that they need to be deployed to underpin this force for convergence more effectively. It has been suggested that in an enlarged union they should be better geared to local development needs and that they should give more support to programmes which involve more than one country, particularly in financing trans-European networks in the areas of transport, telecommunications and energy. This would strengthen their role in stimulating investments in which there is a shared interest, and would also provide crucial support for the creation of new infrastructure in the single market by supplementing other sources of financing, including loans floated on the capital markets.⁸¹⁹

Unfortunately, programmes which involve more than one country have hitherto offered particularly poor value for money, and have attracted fraud. An increase in such programmes would therefore entail an increase in UCLAF's workload, since its task is primarily to coordinate transnational investigations. From the ascendent position of Structural Funds will not necessarily follow a movement downwards (in subsidiarity terms) of control to the Member States. In fact one can safely predict a substantial enlargement in UCLAF's personnel, whose task it is to deal with complex trans-national investigations.

⁸¹⁸ Collins, N (1990) The European Community's farm lobby, Corruption and Reform (5) 235-257.

⁸¹⁹ Opinion on the Single Market in 1994 OJ (1996) C 39/70.

7.2. Prevention/enforcement in an enlarged Union

As we have seen, extending present agricultural policies to the CCEEs could lead to a considerable increase of the present EC budget. This would not be acceptable to the main contributors (Germany, France and Italy). Although Germany and the UK see scope for reductions in regional and CAP funding, this is likely to be resisted by the main contributors as well as the mediterranean countries and compromises will have to be sought.⁸²⁰ There seem to be three possible 'ideal type' scenarios for future enforcement, which are mooted below. The first possibility illustrates a situation where 'classical enlargement'⁸²¹ takes place, with the CCEEs taking on the full *acquis communautaire*, after transition periods of varying lengths. The second possibility is that connected with 'partial membership', where the CCEEs only take on part of the *acquis*, namely the second and third pillars of the present Treaty establishing the European Union. A mixed scenario is also possible, with parallel systems (CAP, Structural Funds) in operation. All these scenarios have different implications for anti-fraud enforcement, as we shall see.

(i) Classical enlargement

Such a scenario could involve the (reformed) CAP and Structural Funds being extended to the CCEEs and the Customs Union is extended to include them. The whole *acquis communautaire* is taken on gradually, which means that all measures relating to the protection of the financial interests of the European Communities apply

⁸²⁰ See European Parliament News, 13-17 February 1995.

⁸²¹ De La Serre, F (1996) *L'élargissement aux PECO: Quelle différenciation?* Revue du Marché Commun, number 402, November, 642-655.

after an agreed period of time.

(ii) Partial membership

By contrast, partial membership through accession to only the second and third pillars would theoretically entail exclusion from first pillar re-distribution policies, such as the CAP and Structural Funds, until the full *acquis* is taken on at a later stage. This would be an enlargement firstly looking to the free movement of goods (already greatly encouraged by the extension of the Community transit system to the Visegrad countries), but without free movement of persons. The Customs Union would not at first be extended to the CCEEs. In an ideal type partial membership scenario, the CCEEs do not at first benefit from the redistributive policies of the Union any more than they do at present, so enforcement problems remain at first unchanged. In such a scenario, it seems important that both redistributive policies and first pillar measures be taken on simultaneously. The 'decoupling' of the two could prove financially disastrous for the Union.

(iii) Mixed membership

A mixed scenario is also likely, where parallel systems develop. A 'compromise' may involve a complex re-organisation of funds to fit in with the various levels of integration. This is, for example what Buckwell envisaged, with regards to the CAP:

A separate CAP could be designed for the countries of eastern and central Europe which would operate *alongside*⁸²² the existing CAP for the EU.

⁸²² Emphasis added.

Parallel Structural Funds may also be put in place, to deal with the specific problems experienced in the CCEEs. Enforcement, as a result, may become highly contingent and may include areas with the enforcement characteristics of a fragmented union (i.e. with third pillar measures awaiting ratification), and others with the enforcement characteristics of an integrated union (i.e. first pillar measures in place, with third pillar measures awaiting ratification) leading to (more) uneven enforcement and a degree of unpredictability throughout the Union.

CHAPTER 8. CURRENT PROPOSALS FOR DEVELOPMENT OF THE LEGAL SPACE

In this penultimate chapter, the author looks at the latest proposal to protect the financial interests of the European Communities, a *Corpus Juris*. The description of this proposal - which is reproduced in full in an appendix - is preceded by a very brief overview of the existing legal space, in so far as it relevant to EC fraud. Unfortunately, from the point of view of the author, the *Corpus Juris* does not look like a very likely prospect in the very short term, and so, having noted its most interesting features, she concludes on the basis of existing institutional and legal arrangements.

8.1. The existing legal space

The evolution of control bears witness to the increased heterogeneity of the legal space. Measures to prevent and combat fraud affecting the EC budget, either directly or indirectly, can now be found not only in sectorial economic regulations under the first pillar, under Article 235 EC, under various K articles, but also in international conventions.

8.1.1. Crime prevention: a diversity of approaches

The role of Community law in preventing criminal activities generally was outlined in detail by the Commission at the ninth United Nations Conference in May 1995,⁸²³ It is in this wider context of Community crime prevention that the numerous sectorial rules for the protection of the financial interests of the European

⁸²³ Vernimmen, G and Missir di Lusignano, A (1995) Editorial of AGON number 9.

Communities, and procurement rules can also be located.⁸²⁴

Additionally, Article 209a EC creates an obligation on the Member States to treat fraud affecting the EC budget in the same way as fraud affecting national interests, but it has yet to be used as legal basis, the more ambiguous Article 235 having hitherto been preferred.⁸²⁵

If action by the Community shall prove necessary to attain, in the course of action of the operation of the common market, one of the objectives of the Community and this Treaty has not provided the necessary powers, the Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament, take the appropriate measures. (Article 235 EC)

Article 235 EC retains some of the distinctive characteristics of the first pillar: the Commission has a right of initiative and the Court of Justice has jurisdiction to rule on disputes.⁸²⁶ But the advantage of the article is that, given political consensus in the Council, it offers the possibility of going beyond express powers in the first pillar, in furtherance of the objectives of the Community. Both the 'PIF' Regulation

⁸²⁴ Dorn, N and White, S (1996) Beyond 'Pillars' and 'Passerelle' debates: the European Union's emerging crime prevention space, *Legal Issues of European Integration*, forthcoming early 1997.

⁸²⁵ Vervaele, J (1996) L' Application du droit communautaire: la séparation des biens entre le premier et le troisième pillier? *Revue de Droit Pénal et de Criminologie*; also Vervaele, J (1995) Criminal law in the European Community: About myth and taboos in AGON number 7.

⁸²⁶ Article 169 EC.

and the proposed Regulation⁸²⁷ concerning on-the-spot checks and inspections by the Commission (See chapter 1) have Article 235 EC as a legal basis. It has been argued that Article 235 EC provides the legislator with the necessary flexibility to meet some of the challenges of integration. It has also been suggested that Article 235 EC should be used more widely, and in particular that it could be used as a legal basis to establish penal sanctions.⁸²⁸ Generally, learned commentators⁸²⁹ have opined that the time had come for the 'penal landscape to be re-constituted'⁸³⁰ and for the Community to have a 'compétence dans le domaine répressif' - which would enable it to establish uniform sanctions for breaches of Community regulations.

However, in matters relating to the repression of fraud and corruption the Member States have chosen, since 1995, to take action within the inter-governmental framework. One reason for such action being preferred within an intergovernmental framework has been the Member States' reluctance to prejudice their control of policing or

⁸²⁷ See UCLAF (1995) Proposal for Council Regulation concerning on-the-spot checks and inspections by the Commission for the detection of frauds and irregularities detrimental to the financial interests of the European Communities, SEC(95\09151final and General Secretariat of the Council DG FII (1996) amended draft for the subgroup on protection of financial interests, 30 April.

⁸²⁸ Missir di Lusignano, A (1996) La protection des intérêts financiers de la Communauté, Journal des Tribunaux Droit Européen, 18 April, page 78.

⁸²⁹ See Schockweiler, F (1995) La répression des infractions au droit communautaire dans la jurisprudence de la Cour, Seminar on judicial cooperation in criminal matters in the European Community, Luxembourg; Labayle, H (1995) La protection des intérêts financiers de la Communauté, Revue Europe, March, Ed. Techniques.

⁸³⁰ Delmas-Marty, M (1994) Pour un droit commun, Seuil, Paris, see chapter on 'La recomposition d'un paysage'.

criminal law.⁸³¹ In general, the entry into force of conventions relating to the European Union space has been protracted, with few improvements since 1993.⁸³² This is one of the arguments often used in an attempt to 'move' law-making to the first pillar. A number of conventions also have been concluded under the aegis of the Council of Europe in order to further cooperation in judicial matters. However, as a rule, entry into force has been protracted. For example, as of 1996, the money laundering convention had been ratified by only five Member States within the European Union.

8.1.2. Creative cross-overs or uncertainty?

A certain amount of 'cross-over', or 'enchevêtrement'⁸³³ has occurred between legal bases. This has not escaped the notice of the Committee on Civil Liberties and Internal Affairs who, on the subject of the choice of legal bases for the two 'PIF' instruments, opined that because of their parallel contents, both should have been submitted in the same institutional context:

The ['PIF'] Convention and the proposal for a ['PIF'] Regulation on the materialities of the penalties are both operative at the level of criminal/administrative law and no clear distinction can be drawn in terms of content and legal nature justifying their being assigned to two different

⁸³¹ Anderson, M et al (1995) Policing the European Union, Clarendon Press, Oxford, page 198.

⁸³² Delmas-Marty, M (1996) Vers un espace judiciaire Européen, *Corpus Juris* portant dispositions pénales pour la protection des intérêts financiers de l'Union Européenne, September, pp 4-9.

⁸³³ Tulkens, F (1994) Les fraudes communautaires: Un observatoire pénal Européen, in *Déviante et Société*, vol 18, number 2, pp 215-226.

institutional frameworks (EC Treaty and Title VI of the Treaty on European Union).⁸³⁴

As a result of this 'cross-over', and looking at precedents in the fight against fraud affecting the EC budget, it is difficult to predict, for example, under which legal basis the protection of the Community's VAT-based income would take place. The protection of VAT revenue is a more difficult issue at the level of the institutions, since the EC only receives a small percentage of national VATs, which nevertheless constitute over 50% of the total EC budget. However since fiscal frontiers were abolished in 1993, and the transitional system established, VAT collection can no longer be described as a 'national' revenue collecting system. VAT evasion affects the EC budget and there is scope for creative fraud prevention of an international nature in that area too.

Looking at what has happened since the adoption of the Treaty on European Union, one finds increasing interpenetration between the legal bases (for example between 100a, 235 and K.3). Yet the frontiers of this increasingly diversified legal space are being tested by a proposal, explored below, which has the effect of putting the relationship between Community law and national criminal laws back very firmly on the agenda.

8.2. The *Corpus Juris* proposal

The difficulties of dealing with fraud within the Union, the breakdown of the transit system, and projects for expansion of the Union to the CCEEs, make clear the need for the Community to devise more effective action not

⁸³⁴ European Parliament (1995) Report on the joint guideline of the Council on the proposal for a Council regulation on protection of the Communities' financial interests, 23 November, consultation procedure.

only at local level and nationally, but also internationally. In 1995, the Commission began to argue that assimilation, cooperation and harmonisation (the three goals hitherto pursued) could provide but an incomplete and thus unsatisfactory answer to the protection of the financial interests of the European Community. The '*Espace Judiciaire Européen*' project was launched, and in the autumn of 1996 a draft for a unified body of rules to deal with criminal offences affecting the budget, and to establish a discrete prosecution service, or *Corpus Juris* (CJ henceforth) was produced by a team of experts.⁸³⁵

It easy to see why the Commission came to the conclusion that assimilation, cooperation and harmonisation were insufficient. Firstly, assimilation on its own does not guarantee effective sanctions. In addition, for economic operators, assimilation means that treatment continues to differ from Member State to Member State. Secondly, cooperation remains marred with difficulties. Conventions dealing with cooperation matters are dependent upon the ratification of all the Member States, which means that a number remain un-implemented to date. This applies equally to Council of Europe Conventions, Conventions relating to the Schengen area, and third pillar conventions specific to the protection of the financial interests of the European Community. It is widely acknowledged that cooperation still relies on outdated, less than speedy mechanisms, such as the delivery of rogatory letters through diplomatic channels (see chapter 6). Furthermore, incompatibilities between national

⁸³⁵ Report on substantive law: E. Bacigalopulo, G. Grasso and K. Tiedemann; report on rules of competence and extraterritoriality: C. Van den Wyngaert, D. Spinellis and N. Jareborg; report on evidence, appeals and interpretation: M. Delmas-Marty and J. Spencer; report on rights of the defense by C. Cirese. (French only).

legislations, and 'asymmetries'⁸³⁶ between national investigating and prosecuting agencies make cooperation highly complex in practice. Van den Wyngaert⁸³⁷ has argued that even if all the above texts were duly ratified by all and implemented, the resulting situation would still be one which falls short of establishing the recommended⁸³⁸ extra-territoriality and universal competence in criminal matters. With respect to harmonisation (much of which still depends upon the ratification of 'PIF' third pillar instruments), matters relating to procedure and evidence, as well as matters relating to the determination of criminal liability, for instance, remain un-harmonised. The Commission believes that this leads to slow, and inefficient enforcement.⁸³⁹

Bearing in mind the above, the Commission has asked whether it is sufficient, and satisfactory just to pursue the three 'traditional' objectives (assimilation, cooperation and harmonisation), and to wait for incremental improvements to occur through the slow convergence of national systems. This concern is voiced

⁸³⁶ This term was first coined by Van den Wyngaert in 1995, and refers to the lack of correspondence between national agencies performing similar tasks. For example, a French investigating magistrate carrying out an investigation may have to liaise not with an English magistrate, but with any of several British agencies endowed with investigative powers.

⁸³⁷ Van den Wyngaert, C (1996) Etude espace judiciaire européen Groupe thématique no 2 Règles de compétence et extra-territorialité, May.

⁸³⁸ Delmas-Marty, M (1994) Rapport Final - Etude comparative des dispositions législatives, réglementaires des états membres relatives aux agissements frauduleux commis au préjudice du budget communautaire in rapport de synthèse, étude sur les systèmes de sanctions communautaires, SEC 1994(93), OOPEC.

⁸³⁹ Delmas-Marty, M (1996) Vers un espace judiciaire Européen, *Corpus Juris* portant dispositions pénales pour la protection des intérêts financiers de l'Union Européenne, September, pp 1-18.

by Delmas-Marty in her introduction to the CJ.

A cette étape de la construction européenne, se pose la question de savoir si l'on peut encore se contenter de ces trois voies, et se résigner à attendre des années pour observer quelque amélioration du système répressif.⁸⁴⁰

The draft CJ is in response to the bold suggestion that the only way to combine justice, clarity and effectiveness is to pursue 'unification'. Such unification of criminal justice systems, in areas concerned with the protection of the financial interests of the Community, was felt to be 'only a step away from harmonisation'.⁸⁴¹

A brief summary of the CJ's contents can now be given. As of January 1997, the CJ was not available in English, was in early draft form, and seemed likely to incur many changes over the coming period. Title I of the CJ deals with principles of criminal law (Articles 1-17) and Title II deals with criminal procedure (Articles 18-35). Part 1 of Title I lays down common definitions for various offences: budget fraud (Art 1); procurement fraud (Art 2); corruption (Art 3, which duplicates definitions found in the Protocol to the 'PIF' Convention); offences related to EC officials abusing their powers and making unwarranted payments (Art 4 and 5); breach of confidentiality by EC officials (Art 6); money laundering (Art 7); *association de malfaiteurs* (Art 8); penalties (Art 9). It is envisaged that for offences described in

⁸⁴⁰ Ibid, page 17.

⁸⁴¹ See Delmas-Marty, M (1995) *La criminalité économique internationale: Pour une politique criminelle a stratégie diversifiée*, *Le Trimestre du Monde*, premier trimestre (Dossier Mafias et criminalité transnationale), pp 83-90.

Articles 1 to 8, prison sentences of up to five years or more would be inflicted and/or a fine of up to a million ECU. Exclusion from future benefits or from competing for procurement contracts is also foreseen. Part 2 of Title 1 defines criminal liability of individuals and businesses (Art 10-14). Part 3 lays down rules to ensure that penalties are proportional, and for dealing with aggravating circumstances and concurrent offences (Art 15-17).

Title II, which deals with procedure, is in four parts. Part 4 (Art 18-24) lays down rules for the establishment of a MPE (Ministère Public Européen, or European Prosecution Service) to investigate and prosecute in matters defined in Art 1-8. The MPE would be independent from the Commission and the Member States, and would investigate matters in its own right, though its chief prosecutor, based in Brussels, and prosecutors working from a specialist court in each of the Member States. Part 5 (Art 25-28) lays down procedural guarantees, and Part 6 (Art 29-33) lays down the rights of the accused, and rules for the admissibility of evidence. Part 7 (Art 35) defines the subsidiary role of national law in relation to the CJ: the *lex fori* would apply whenever the CJ fails to provide rules.⁸⁴²

8.3. Can the *Corpus Juris* be more than an idea?

The CJ has been welcomed by some key European *pénalistes* whose main concern, of course, is efficient *répression* of crimes affecting the EC budget. Such a body of rules is meant to supplement, and not replace existing provisions. Further diversification, or creative use of the legal space can therefore be envisaged.

⁸⁴² For a detailed analysis of the *Corpus Juris*, see White, S (1997) *Corpus Juris: Beyond harmonisation*, forthcoming.

8.3.1. *Legal basis: discussion*

The CJ aims to establish a centralised repressive system, with prescribed penalties (including prison sentences) applying throughout the Union. Thus it appears that the CJ would be a major break with the approach hitherto adopted, rather than a small step away from harmonisation, as Delmas-Marty has argued.⁸⁴³ Furthermore, it is difficult to see how it might fit into present legal architecture.

In a video linked conference between ALPFIEC and the European Commission, which took place on 16 January 1997, the author had the opportunity to ask the Commission representative what legal basis was envisaged for the CJ, and whether the Commission had hitherto received any reaction to the CJ from any of the Member States' executives. The response was that the Commission felt that the CJ could be adopted under Articles 100a and 189b, which together allow for the adoption of measures for the approximation of laws, and with the aim of establishing the internal market, by a qualified majority and with the fullest available participation of the European Parliament. It was too early for detailed responses from the Member States' executives.

The suggestion that any instrument to protect the financial interests of the Communities should be placed under the first pillar should not unduly surprise. The Commission is only reiterating its well-rehearsed argument that matters relating to Community finances should be placed under the Community pillar. The argument that such a measure should be taken by qualified majority is a recognition that it is controversial, and therefore likely to be blocked should unanimity be required, for

⁸⁴³ See introduction to the CJ.

example under Article 235 EC.

Council Directives which aim to harmonise rules in order to prevent financial and other crimes in the internal market environment have already been adopted under Article 100a. For example Council Directives 91/308⁸⁴⁴ on money laundering, 92/109⁸⁴⁵ on precursors, 89/592⁸⁴⁶ on insider dealing all have Article 100a either as a sole legal basis, or as a conjoint legal basis with another article. What these directives have in common is that, although penal measures may be mentioned in their preambles, they do not figure in the texts of the directives proper, which however refer to 'prohibitions', 'penalties', requiring Member States to 'take appropriate measures' in order to prevent criminal opportunities from being created through the internal market. However, the word 'penal' seems to have been banished from qualified majority first pillar instruments so far, so the ambition to introduce a veritable *tranche* of penal measures, as represented by the CJ, is a very considerable ambition.

8.3.2. *Specificity of the Corpus Juris*

An issue arises in relation to the specificity of the CJ. The CJ is aimed specifically at the protection of the financial interests of the European Community. But it is suggested, in the introduction to the CJ itself, that its innovatory character makes it a suitable prototype for exploring the possibilities of centralising prosecutions

⁸⁴⁴ Council Directive 91/308 OJ (1991) L 166/77, on prevention of the use of the financial system for the purpose of money laundering.

⁸⁴⁵ Council Directive 92/109 OJ (1989) L 370/76, on the manufacture and the placing on the market of certain substances used in the illicit manufacture of narcotic drugs and psychotropic substances.

⁸⁴⁶ Council Directive 89/592 OJ (1989) L 334/30, coordinating regulations on insider dealing.

in areas other than those concerned with the protection of the financial interests of the European Communities. For example, the argument that harmonisation of criminal law has failed to protect the European Union's economic interests could, in the view of the author, be extended to several other areas, such as the smuggling of radioactive waste, drugs, and trans-national environmental crimes, all of which damage EU economic and wider interests. So far, there has been little discussion of the possibilities of creating supranational jurisdiction in order to deal with such 'pan-EU' crimes more efficiently. In fact, hitherto, supranational jurisdictions have been restricted to the 'big issues' of war crimes and human rights. In this perspective, the CJ would, if implemented, represent a major cultural shift in legal thinking.

8.3.3. *Looking to the IGC*

It is possible that CJ will create a great deal of controversy in some of the Member States. How willing would the UK executive be, for example, to relinquish part of its sovereignty associated with prosecution? It is equally possible that many Member States will simply ignore this proposal. Certainly, it raises in rather stark form the problems of competency which were noted in the Introduction to this thesis. One must wait for the outcome of the IGC to find out what further changes are likely to occur within the European legal space, and whether they would make the adoption of a *Corpus Juris* any easier. The present author is by no means adverse to this proposal, but doubts whether it can be agreed in the short or medium term. In any event, as can be now be concluded, it would not be sufficient.

CONCLUSION

From the institutional point of view, 'PIF' is one area where the European Court of Justice cannot be accused of activism, but where the interests of the European Parliament and of the Commission have fruitfully coincided in the 1990s. Provoked by the powerful duo, the Council has acted, albeit slowly, due to the requirement for unanimity that anti-fraud measures usually demand. But it has been argued that the Commission is now acting at the limit, or beyond its powers. The proposed on-the-spot check Regulation, in particular, has provoked the ire of the French Assembly, which pointed out that checks were already carried out by several agencies, and that additional checks would impose a disproportionate burden on administrations responsible for the management of EC funds in the Member States. Such criticism has to be taken seriously, if the spirit of cooperation between the Commission and national administrations is to be nurtured, and if the Commission is not to become overburdened, as it has increasingly become so in the competition field, to the point of looking at ways of handing back regulatory activity to the Member States (on the grounds of subsidiarity!). The proposed on-the-spot checks Regulation does raise a fundamental question: are ever-more penetrating supervisory powers for the Commission the way forward? Would this approach be viable in an enlarged Union?

The author argues that economically and fiscally radical approaches which focus on reducing opportunities for fraud or corruption should be prioritised. This means, first and foremost, completing the single market. In this the proper implementation of Article 99 EC could go some way towards reducing opportunities for crime. A radical approach to the protection of VAT resources, for example, must include a move to the definitive system, together

with further harmonisation of indirect taxation. The persisting disparities in excise rates, although not having a direct effect on Community finance, encourage a black market in sensitive products, which in turn undermines EC income, in the shape of import duties.

As far as import duties are concerned, the whole of which accrue to the budget, 'Europeanising' national Customs authorities, by increasing their identification with the task of collecting common revenue, seems an important step. This could go some way towards ensuring that Customs' powers of deterrence are restored in the single market environment, and beyond. In these areas of the budget (VAT, import duties), where the Member States exercise their sovereign tax-raising powers, the penetrating powers of the Commission to perform inspections are likely to be resented, and constructive but relatively hands-off approaches need to be prioritised at Community-level.

On the expenditure side of the budget, the enforcement space remains very uneven, with most checks and inspections falling on to the EAGGF Guarantee Section, and most anti-fraud appropriations spent there too. The Structural Funds remain fairly un-policed, and the Member States tend to escape financial liability for any misappropriation of funds. This is worrying in view of the plan which has been mooted to give Structural Funds an enhanced role and a larger share of the budget, in anticipation of the next wave of enlargement. The type of Structural Funds held to be best suited for the post-1999 period are transnational Community initiatives. Transnational initiatives seem to have been particularly vulnerable to fraud in the past, and to increase their use would in turn entail more work for (an enlarged?) UCLAF, whose job it is to coordinate trans-national investigations. Any such move (towards more Structural

Funds of a transnational nature), the author believes, should also be accompanied beforehand by an American-style multi-disciplinary 'Criminal Impact Assessment', to which the European Court of Auditors could be a major contributor. That way, criminogenic schemes could be detected *in utero*, and either avoided altogether or re-drafted to reduce the obvious (or less obvious) opportunities for crime they create.

Tighter financial accountability and a credible anti-corruption strategy could help achieve some protection of vulnerable sectors, such as procurement expenditure. A credible anti-corruption strategy, however, means paying attention to the role of political corruption as well as corruption involving *fonctionnaires*, confronting squarely the issue of immunities, and generally dealing with the wider international and organised crime dimensions of this phenomenon. Riding on the mid 1990s political impetus to consolidate the European Project prior to monetary union, and looking back at the amount of creative law-making that has already occurred to protect the budget, further progress should be possible.

It has not been the objective of this work to address 'pillars' questions. Nevertheless it is to be hoped that the in-depth understanding offered here of Community control in the protection of the financial interests of the European Communities will contribute to the wider debate on crime in the Union. The danger of white collar crime, flourishing in the 'grey zone' where otherwise legal and unambiguously criminal activities occur, must be more effectively addressed. More can be done at Community level to reduce the opportunities for a rise in crime that too easily could swamp intergovernmental third pillar action or even a supranational criminal law system. It is in this wider context that the *Corpus Juris* represents the most ambitious attempt to deepen the legal

space. That level of ambition is both its great virtue and its potential Achilles' heel.

In conclusion, it is maintained that the interests of the European tax payer and citizen could be served by greater economic and fiscal integration. Necessary measures include the completion of the single market, the integration of Customs forces, and harmonisation of insolvency regimes. In other words, the centre of gravity for effective action should be economic and fiscal radicalism in the classical, Treaty of Rome tradition, without which the criminal law radicalism epitomised in the *Corpus Juris* would be icing without any cake.

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APPENDICES

APPENDIX A: GLOSSARY OF TERMS AND ABBREVIATIONS

ALPFIEC	Association of Lawyers for the Protection of the Financial Interests of the European Communities
CAP	Common Agricultural Policy
CCC	Community Customs Code
CCEES	Countries of central and eastern Europe
CCT	Common Customs Tariff
CEMA	Customs and Excise Management Act
CFSP	Common Foreign and Security Policy
CIS	Customs Information System
CJ	Corpus Juris
COCOLAF	Comité Consultatif pour la coordination dans le domaine de la lutte AntiFraude (French acronym), in English: Advisory committee for the coordination of fraud prevention
CPS	Crown Prosecution Service
CFS	Community Support Framework
DPP	Director of Public Prosecution
DTI	Department of Trade and Industry
EAGGF	European Guarantee and Guidance Fund
EC	European Community (term used since the entry into force of the treaty on European Union)
ECJ	European Court of Justice
ECU	European Currency Unit
EIB	European Investment Bank
EDF	European Development Fund
EFTA	European Free Trade Association
EP	European Parliament
ESF	European Social Fund
EUA	European Unit of Account
FIFG	Financial Instrument for Fisheries Guidance
FCPC	Foreign Corrupt Practices Act (US)
GATT	General agreement on Tariffs and Trade
GNP	Gross National Product
GSP	Generalized System of Preferences
IACS	Integrated Administrative and Control System
IBAP	Intervention Board in Agricultural Product
IGC	Intergovernmental Conference
IRENE	Irrégularités, ENquêtes, Exploitation - irregularities, investigations, exploitation
IRU	International Road Transport Union
JHA	Justice and Home Affairs
MAFF	Ministry for Agriculture Fisheries and Food
MPE	Ministère Public Européen: European Prosecution Service

OJ Official Journal of the European Communities
(OJ L: series L, legislation; OJ C: series C, communications)

OOPEC Office of the Official publications of the European Communities

'PIF' Protection des intérêts financiers de la communauté; in English protection of the financial interests of the European Communities

SAD Single Administrative Document

SCENT System for a Customs Enforcement Network

SEM 2000 Programme to improve financial management launched by the Commission in 1995. Its full name is Sound and Efficient Financial Management, SEM 2000

SFO Serious Fraud Office

SME Small and medium sized enterprise

SOA Statement of Assurance

SOID Scottish Office Industry Department

SPD Single Programming Document

TCI Temporary Committee of Inquiry

TECA Trade and Economic Cooperation Agreement

TIR Transport International Routier - in English International Road Transport

TPCC Trade Promotion Co-ordinating Committee

UA Unit of Account

UCLAF Coordinating unit for the fight against fraud

VAS Verification and Audit Section

VAT Value Added Tax

WTO World Trade Organisation

APPENDIX B: COUNCIL REGULATION 2988/95

Council Regulation 2988/95 of 18 December 1995 on the protection of the European Communities financial interests, OJ (1995) L 312/1.

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 235 thereof,

Having regard to the Treaty establishing the European Atomic Energy Community, and in particular Article 203 thereof,

Having regard to the proposal from the Commission,¹

Having regard to the opinion of the European Parliament,²

Whereas the general budget of the European Communities is financed by own resources and administered by the Commission within the limit of the appropriations authorized and in accordance with the principle of sound financial management; whereas the Commission works in loose cooperation with the Member States to that end;

Whereas more than half the Community expenditure is paid to beneficiaries through the intermediary of the Member States;

Whereas detailed rules governing this decentralized administration and the monitoring of their use are the subject of differing detailed provisions according to the Community policies concerned; whereas acts detrimental to the Communities' financial interests must, however, be countered in all areas;

Whereas the effectiveness of the combating of fraud against the Communities' financial interests calls for a common set of legal rules to be enacted to be enacted for all areas covered by Community policies;

Whereas irregular conduct, and the administrative measures and penalties relating thereto, are provided for in sectoral rules in accordance with this Regulation;

Whereas the aforementioned conduct includes fraudulent actions as defined in the Convention on the protection of the European Communities' financial interests;

¹ OJ No C 216, 6.8. 1994, p.11.

² OJ no C 89, 10.4. 1995, p. 83 and opinion delivered on 30 November 1995 (not yet published in the Official Journal).

Whereas Community administrative penalties must provide protection for the said interests; whereas it is necessary to define general rules applicable to these penalties.

Whereas Community law has established Community administrative penalties in the framework of the common agricultural policy; whereas such penalties must be established in other fields as well;

Whereas Community measures and penalties laid down in pursuance of the objectives of the common agricultural policy form an integral part of the aid systems; whereas they pursue their own ends which do not affect the assessment of the conduct of the economic operators concerned by the competent authorities of the Member States from the point of view of criminal law; whereas the effectiveness must be ensured by the immediate effect of Community rules and by applying in full Community measures as a whole, where the adoption of preventive measures has not made it possible to achieve that objective;

Whereas not only under the general principle of equity and the principle of proportionality but also in the light of the principle of *ne bis in idem*, appropriate provisions must be adopted while respecting the *acquis communautaire* and the provisions laid down in specific Community rules existing at the time of entry into force of this Regulation, to prevent any overlap of Community financial penalties imposed on the same persons for the same reasons;

Whereas, for the purposes of applying this Regulation, criminal proceedings may be regarded as having been completed where the competent national authority and the person concerned come to an arrangement;

Whereas this Regulation will apply without prejudice to the application of the Member States' criminal law; Whereas Community law imposes on the Commission and the Member States an obligation to check that Community budget resources are used for their intended purpose; whereas there is a need for common rules to supplement existing provisions;

Whereas the Treaties make no provision for the specific powers necessary for the adoption of substantive law of horizontal scope on checks, measures and penalties with a view to ensuring the protection of the Communities' financial interests; whereas recourse should therefore be had to Article 235 of the EC Treaty and to Article 203 of the EAEC Treaty;

Whereas additional general provisions relating to checks and inspections on the spot will be adopted at a later

stage,

HAS ADOPTED THIS REGULATION:

TITLE I

General principles

Article 1

1. For the purposes of protecting the European Communities' financial interests, general rules are hereby adopted relating to homogenous checks and to administrative measures and penalties concerning irregularities with regard to Community law.

2. 'Irregularity' shall mean any infringement of the provision of Community law resulting from an act or omission by an economic operator, which has, or would have, the effect of prejudicing the general budget of the Communities or budgets managed by them, either by reducing or losing revenue accruing from own resources collected directly on behalf of the Communities, or by an unjustified item of expenditure.

Article 2

1. Administrative checks, measures and penalties shall be introduced in so far as they are necessary to ensure the proper application of Community law. They shall be effective, proportionate and dissuasive so that they provide adequate protection for the Communities' financial interests.

2. No administrative penalty may be imposed unless a Community act prior to the irregularity has made provision for it. In the event of a subsequent amendment of the provisions which impose administrative penalties and are contained in Community rules, the less severe provisions shall apply retroactively.

3. Community law shall determine the nature and scope of administrative measures and penalties necessary for the correct application of the rules in question, having regard to the nature and seriousness of the irregularity, the advantage granted or received and the degree of responsibility.

4. Subject to the Community law applicable, the procedures for the application of Community checks, measures and penalties shall be governed by the laws of the Member States.

Article 3

1. The limitation period for proceedings shall be four years as from the time when the irregularity referred to in Article 1(1) was committed. However, the sectoral rules may make provision for a shorter period which may not be less than three years.

In the case of continuous or repeated irregularities, the limitation period shall run from the day on which the irregularity ceases. In the case of multiannual programmes, the limitation period shall in any case run until the programme is definitely terminated.

The limitation period shall be interrupted by any act of the competent authority, notified to the person in question, relating to investigation or legal proceedings concerning the irregularity. The limitation period shall start again following each interrupting act.

However, limitation shall become effective at the latest on the day on which a period equal to twice the limitation period expires without the competent authority having imposed a penalty, except where the administrative procedure has been suspended in accordance with Article 6(1).

2. The period for implementing the decision establishing the administrative penalty shall be three years. That period shall run from the day on which the decision becomes final.

Instances of interruption and suspension shall be governed by the relevant provisions of national law.

3. Member States shall retain the possibility of applying a period which is longer than that provided for in paragraphs 1 and 2 respectively.

TITLE II

Administrative measures and penalties

Article 4

1. As a general rule, any irregularity shall involve withdrawal of the wrongly obtained advantage:

- by an obligation to pay or repay the amounts due or wrongly received,
- by the total or partial loss of the security provided in support of the request for an advantage granted or at the time of the receipt of an advance.

2. Application of the measures referred to in paragraph 1 shall be limited to the withdrawal of the advantage

obtained plus, where so provided for, interest which may be determined on a flat-rate basis.

3. Acts which are established to have as their purpose the obtaining of an advantage contrary to the objectives of the Community law applicable in the case by artificially creating the conditions required for obtaining that advantage shall result, as the case shall be, wither in the failure to obtain the advantage or in its withdrawal.

4. The measures provided for in this Article shall not be regarded as penalties.

Article 5

1. Intentional irregularities or those caused by negligence may lead to the following penalties:

(a) payment of an administrative fine;

(b) payment of an amount greater than the amounts wrongly received or evaded, plus interest where appropriate; this additional sum shall be determined in accordance with a percentage to be set in the specific rules, and may not exceed the level strictly necessary to constitute a deterrent;

(c) total or partial removal of an advantage granted by Community rules, even if the operator wrongly benefitted from only a part of that advantage;

(d) exclusion from, or withdrawal of, the advantage for a period subsequent to that of the irregularity;

(e) temporary withdrawal of the approval or recognition necessary for participation in a Community aid scheme;

(f) the loss of a security or deposit provided for the purpose of complying with the conditions laid down by rules or the replenishment of the amount of a security wrongly released;

(g) other penalties of a purely economic type, equivalent in nature and scope, provided for in the sectoral rules adopted by the Council in the light of the specific requirements of the sectoral rules adopted by the Council in the light of the specific requirements of the sectors concerned and in compliance with the implementing powers conferred on the Commission by the Council.

2. Without prejudice to the provisions laid down in the sectoral rules existing at the time of entry into force of this Regulation, other irregularities may give rise only to those penalties not equivalent to a criminal penalty that are provided for in paragraph 1, provided

that such penalties are essential to ensure correct application of the rules.

Article 6

1. Without prejudice to the Community administrative measures and penalties adopted on the basis of the sectoral rules existing at the time of entry into force of this Regulation, the imposition of financial penalties such as administrative rules may be suspended by decision of the competent authority if criminal proceedings have been initiated against the person concerned in connection with the same facts. Suspension of the administrative proceedings shall suspend the period of limitation provided for in Article 3.
2. If the criminal proceedings are not continued, the suspended administrative proceedings shall be resumed.
3. When the criminal proceedings are concluded, the suspended administrative proceedings shall be resumed, unless that is precluded by general legal principles.
4. Where the administrative procedure is resumed, the administrative authority shall ensure that a penalty at least equivalent to that prescribed by Community rules is imposed, which may take into account any penalty imposed by the judicial authority on the same person in respect of the same facts.
5. Paragraphs 1 to 4 shall not apply to financial penalties which form an integral part of financial support systems and may be applied independently of any criminal penalties, if and in so far as they are not equivalent to such penalties.

Article 7

Community administrative measures and penalties may be applied to the economic operators referred to in Article 1, namely the natural or legal persons and the other entities on which national law confers legal capacity who have committed the irregularity and to those who are under a duty to take responsibility for the irregularity or to ensure that it is not committed.

TITLE III

Checks

Article 8

1. In accordance with their national laws, regulations and administrative provisions, the Member States shall

take the measures necessary to ensure the regularity and reality of transactions involving the Communities' financial interests.

2. Measure providing for checks shall be appropriate to the specific nature of each sector and in proportion to the objectives pursued. They shall take into account existing administrative practice and structures in the Member States and shall be determined so as not to entail excessive economic constraints or administrative costs.

The nature and frequency of the checks and inspections on the spot to be carried out by the Member States and the procedure for performing them shall be determined as necessary by sectoral rules in such a way as to ensure uniform and effective application of the relevant rules and in particular to prevent and detect irregularities.

3. The sectoral rules shall include the provisions necessary to ensure equivalent checks through the approximation of procedure and checking methods.

Article 9

1. Without prejudice to the checks carried out by the Member States in accordance with their national laws, regulations and administrative provisions and without prejudice to the checks carried out by the Community institutions in accordance with the EC Treaty, and in particular Article 188C thereof, the Commission shall, on its responsibility, have checks carried out on:

(a) the conformity of administrative practices with Community rules;

(b) the existence of the necessary substantiating documents and their concordance with the Communities' revenue and expenditure as referred to in Article 1;

(c) circumstances in which such financial transactions are carried out and checked.

2. In addition, it may carry out checks and inspections on the spot under the conditions laid down in the sectoral rules.

Before carrying out such checks and inspections, in accordance with the rules in force, the Commission shall inform the Member State concerned accordingly in order to obtain any assistance necessary.

Article 10

Additional general provisions relating to checks and

inspections on the spot shall be adopted later in accordance with the procedures laid down in Article 235 of the EC Treaty and Article 203 of the EAEC Treaty.

Article 11

This Regulation shall enter into force on the third day following its publication in the *Official Journal of the European Communities*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 18 December 1995.

For the Council
The President
J. Borrell Fontelles

APPENDIX C: CORPUS JURIS

I - DROIT PÉNAL

Art.1 - Fraude au budget communautaire

1 - Est définie comme infraction pénale la fraude affectant le budget des Communautés européennes, en matière des dépenses comme en matière de recettes, lorsque l'un des comportements suivants a été commis soit intentionnellement soit par imprudence ou négligence grave:

- a) présenter devant l'autorité des déclarations incomplètes, inexactes ou basées sur de faux documents, concernant des faits importants (pour l'octroi d'une aide ou d'une subvention ou pour la liquidation d'une dette fiscale) pouvant porter préjudice au budget communautaire;
- b) omettre de fournir des informations sur les mêmes faits aux autorités compétentes au mépris d'une obligation d'informer;
- c) détourner des fonds communautaires correspondant à une subvention ou à une aide régulièrement obtenue.

2. N'est pas punissable celui qui corrige ou complète les déclarations ou renonce à la demande formulée sur la base de faux documents, ou encore informe les autorités sur les faits qu'il a omis de signaler, avant que le fait ait été découvert.

Art. 2 - Fraude en matière de passation de marchés

Est définie comme infraction pénale la fraude commise à l'occasion d'une procédure d'adjudication en matière de passation des marchés, lorsque les faits de fraude sont susceptibles de porter atteinte aux intérêts financiers des Communautés. La fraude consiste dans l'accord occulte sur les offres avec les concurrents, ou la menace, la promesse ou la tromperie des concurrents, ou dans la collusion avec le fonctionnaire chargé de l'adjudication.

Art.3 - Corruption

Aux fins du présent texte le terme fonctionnaire désigne tout fonctionnaire tant 'européen' que 'national'.

Par fonctionnaire 'européen' on entend:

- a) toute personne qui a la qualité de fonctionnaire ou d'agent engagé par contrat au sens du Statut des fonctionnaires des Communautés européennes;

b) toute personne mise à la disposition des Communautés européennes, par les Etats membres ou par tout organisme public ou privé, qui y exerce des fonctions équivalentes à celles qu'exercent les fonctionnaires ou autres agents des Communautés européennes;

L'expression 'fonctionnaire national' est interprétée par référence à la définition de 'fonctionnaire' ou 'officier public' dans le droit national de l'Etat membre où la personne en question présente cette qualité aux fins de l'application de son droit pénal.

2 - Sont définis en infraction pénale les faits de corruption passive et de corruption active qui porte atteinte, ou sont susceptibles de porter atteinte, aux intérêts financiers des Communautés européennes.

3 - Par corruption passive on entend le fait, pour un fonctionnaire, de solliciter ou d'agréer, directement ou par interposition de tiers, pour lui-même ou pour un tiers, des offres, des promesses ou tout autre avantage de quelque nature qu'il soit:

a) pour qu'il accomplisse un acte de sa fonction ou un acte dans l'exercice de sa fonction, de façon contraire à ses devoirs officiels;

b) pour qu'il s'abstienne d'accomplir un acte de sa fonction, ou un acte dans l'exercice de sa fonction, que ses devoirs officiels lui demandent d'accomplir.

4 - Par corruption active on entend le fait, pour quiconque, de faire ou de donner, directement ou par l'interposition de tiers, des offres, des promesses ou tout autre avantage, de quelque nature qu'il soit, à un fonctionnaire, dans son propre intérêt ou dans l'intérêt d'un tiers:

a) pour qu'il accomplisse un acte de sa fonction, ou un acte dans l'exercice de sa fonction, de façon contraire à ses devoirs officiels;

b) pour qu'il s'abstienne d'accomplir un acte de sa fonction, ou un acte dans l'exercice de sa fonction, que ses devoirs officiels lui demandent d'accomplir.

Art 4 - Abus de fonction

1 - Est défini comme infraction pénale le fait du fonctionnaire qui:

a) soit décide l'octroi d'une subvention, d'une aide ou d'une exonération de droits en faveur d'une personne qui n'y a manifestement pas droit;

b) soit intervient, directement ou indirectement, dans l'octroi de subventions, d'aides ou d'exonération de droits à des entreprises ou en relation à des opérations où il ait quelque intérêt personnel.

2 - La sanction devra être aggravée lorsque le dommage causé dépassera 100 000 ecus.

Art 5 - Malversation

1 - Est défini comme infraction pénale l'abus de confiance des fonctionnaires communautaires dans leurs fonctions d'administration de fonds provenant de budget communautaire. L'infraction consiste dans le fait, pour un fonctionnaire communautaire formellement autorisé à disposer de fonds provenant de budget communautaire, ou à contracter des obligations à la charge de la Communauté, d'abuser de ses pouvoirs en causant un dommage aux intérêts qui lui ont été confiés.

2 - La sanction devra être aggravée lorsque le dommage causé dépassera 100 000 ecus.

Art 6 - Révélation de secrets de fonction

1 - Est défini comme infraction pénale la révélation illicite de secrets de fonction par le fonctionnaire, lorsque le secret a pour l'objet une information acquise dans l'exercice, ou en vertu de l'activité professionnelle de celui-ci, notamment lors d'une procédure concernant le contrôle des recettes ou l'octroi des aides et subventions.

2 - Cette disposition n'est pas applicable dans le cas où la loi, ou un règlement, impose ou autorise la révélation de secret, ou quand il y a consentement de la personne dépositaire de secret.

Art 7 - Blanchiment et recel

1 - Est défini comme infraction pénale le blanchiment des produits ou du profit des infractions prévues aux articles 1 à 6.

Par blanchiment on entend:

a) La conversion ou le transfert de biens provenant d'une des activités criminelles visées à l'alinéa précédent ou d'une participation à une telle activité dans le but de dissimuler ou de déguiser l'origine illicite desdits biens ou d'aider toute personne qui est impliquée dans cette activité à échapper aux conséquences juridiques de ses actes;

b) la dissimulation ou le déguisement de la nature,

de l'origine, de l'emplacement, de la disposition, du mouvement ou de la propriété réels de biens ou de droits y relatifs provenant d'une des activités criminelles visées à l'alinéa précédent ou de la participation à une telle activité.

2 - Est défini comme infraction pénale le recel de produits ou du profit des infractions prévues aux précédents articles 1 à 6.

Par recel on entend l'acquisition, la détention ou l'utilisation de biens provenant d'une des activités criminelles visées à l'alinéa précédent ou d'une participation à une telle activité.

Art 8 - Association de malfaiteurs

1 - Est définie comme infraction pénale l'association de malfaiteurs au détriment du budget communautaire.

2 - Par association de malfaiteurs on entend le fait que deux ou plusieurs personnes s'associent, en se donnant une organisation adéquate, en vue de réaliser une ou plusieurs des infractions visées aux articles 1 à 7.

Art 9 - Peines

1 - Sont prévues comme peines principales, communes à toutes les infractions définies aux articles 1 à 8:

a) pour les personnes physiques, la peine privative de liberté pour une durée de cinq ans au plus et/ou l'amende jusqu'à un million d'Ecus, pouvant être portée jusqu'au quintuple du montant de l'infraction;

b) pour les personnes morales la mise sous surveillance judiciaire pour une durée de cinq ans au plus et/ou l'amende jusqu'à un million d'Ecus, pouvant être portée jusqu'au quintuple du montant de l'infraction;

c) la confiscation des instruments, des produits et du profit de l'infraction;

d) la publication de l'arrêt de condamnation.

2 - Sont prévues comme peines complémentaires pour les mêmes infractions:

a) pour le délit prévu à l'article 1, l'exclusion des subventions futures pour une durée de cinq ans au plus;

b) pour le délit prévu à l'article 2, l'exclusion

des marchés futures pour une durée de cinq ans au plus;

c) pour les délits prévus aux articles 3 à 6, l'interdiction de la fonction publique communautaire et nationale pour une durée de cinq ans au plus.

Art 10 - Elément moral

Pour toutes les infractions définies ci-dessus (art. 1 à 8), la faute intentionnelle ou dol est nécessaire, à l'exception de la fraude communautaire (art.1) pour laquelle l'imprudence grave, est suffisante.

Art. 11 - Erreur

1 - L'erreur sur les éléments essentiels de l'infraction exclut le dol, l'imprudence grave pouvant être néanmoins sanctionnée dans le cas de fraude communautaire.

2 - L'erreur sur la prohibition, ou sur l'interprétation de la loi, exclut la responsabilité au cas d'une erreur inévitable par un homme prudent et raisonnable. Si l'erreur était inévitable, la sanction sera diminuée, ce qui exclut alors la possibilité pour le juge de prononcer le maximum de la peine encourue (supra, art.9).

Art. 12 - Responsabilité pénale individuelle

1 - Tout individu peut être déclaré responsable des infractions définies ci-dessus (art. 1 à 8) en tant qu'auteur, instigateur ou complice:

a) est auteur de l'infraction celui qui commet les faits incriminés ou qui participe, comme coauteur, à la commission de l'infraction;

b) est instigateur de l'infraction celui qui, par don, promesse, menace, ordre, abus d'autorité ou de pouvoir aura provoqué à l'infraction ou donné des instructions pour les commettre;

c) est complice de l'infraction, celui qui sciemment, par aide ou assistance, en a facilité la préparation ou la consommation.

Art. 13 - Responsabilité pénale du chef d'entreprise

1 - Au cas où l'une des infractions définies ci-dessus (art. 1 à 8) a été commise pour le compte de l'entreprise par une personne soumise à leur autorité, sont également responsables pénalement les chefs d'entreprise, ou tout autre personne ayant le pouvoir de décision ou de contrôle au sein d'une entreprise, qui, en connaissance de cause, ont donné des ordres, laissé commettre l'infraction ou omis d'exercer les contrôles nécessaires.

2 - Une délégation des pouvoirs et de la responsabilité pénale n'est valable que si elle est partielle, précise et spéciale, si elle correspond à une organisation nécessaire à l'entreprise et si les délégataires sont réellement en situation de remplir les fonctions déléguées. Cette délégation n'exclut pas la responsabilité générale de contrôle, de surveillance et de choix du personnel, et ne concerne pas les domaines propres du chef d'entreprise tels que l'organisation générale du travail au sein de l'entreprise.

Art. 14 - Responsabilité pénale des groupements

1 - Sont également responsables des infractions définies ci-dessus (art. 1 -8) les groupements ayant la personnalité morale, ainsi que ceux ayant la qualité de sujet de droit et étant titulaire d'un patrimoine autonome lorsque l'infraction a été réalisée pour le compte du groupement par un organe, un représentant ou toute personne agissant en son nom ou ayant un pouvoir de décision, de droit ou de fait.

2 - La responsabilité pénale des groupements n'exclut pas celle des personnes physiques, auteurs, instigateurs ou complices des mêmes faits.

Art. 15 - Mesure de la peine

Les peines applicables aux infractions définies ci-dessus (art 1 à 8) doivent être prononcées en fonction de la gravité du fait, de la faute de l'auteur et du degré de sa participation à l'infraction. Seront notamment pris en considération la vie antérieure de l'accusé, son éventuelle récidive, sa personnalité, ses mobiles, sa situation économique et sociale, et en particulier ses efforts pour réparer le dommage causé.

Art 16 - Circonstances aggravantes

1 - Sont définies comme aggravantes les circonstances suivantes:

- a) Le résultat frauduleux poursuivi est réalisé;
- b) Le montant de la fraude ou du profit poursuivi avec l'infraction est supérieur à 200 000 Ecus;
- c) l'infraction est réalisée dans le cadre d'une association de malfaiteurs.

2 - En cas de circonstance aggravante, la peine privative de liberté (ou, le cas échéant la mise sous surveillance judiciaire) est nécessairement appliquée et la durée maximale des peines encourues est portée à sept ans.

Art. 17 - Peines encourues au cas de concours

d'infractions

1 - Dans le cas où une même personne doit répondre de plusieurs infractions définies ci-dessus (art. 1 à 8), sera appliquée une peine unique, déterminée sur la base de la sanction qui aurait été encourue pour l'infraction la plus grave, augmentée jusqu'au triple; la peine ainsi déterminée ne pouvant dépasser la somme des sanctions qui auraient été infligées pour chaque infraction.

2 - Lorsqu'un même fait constitue une infraction pénale selon la réglementation communautaire et selon la réglementation nationale, seule la première doit être appliquée.

3 - En tout autre cas de concours, l'Autorité compétente doit tenir compte, dans la détermination de la sanction, des sanctions déjà infligées pour le même fait.

II - PROCEDURE PÉNALE

Art. 18 - Statut et composition du Ministère public Européen (MPE)

1 - Pour les besoins de la recherche, de la poursuite, du jugement et de l'exécution des condamnations concernant les infractions définies ci-dessus (art. 1 à 8), l'ensemble des territoires des Etats membres de l'Union constitue un espace judiciaire unique.

2. Le MPE est une autorité de la Communauté européenne, responsable pour la recherche, la poursuite, le renvoi en jugement, l'exercice de l'action publique devant la juridiction de jugement et l'exécution des jugements concernant les infractions définies ci-dessus (art. 1 à 8). Il est indépendant tant à l'égard des autorités nationales qu'à l'égard des organes communautaires.

3. Le MPE est composé d'un procureur général européen (PGE) dont les services sont installés à Bruxelles et de Procureurs européens délégués (PED) dont les services sont installés dans la capitale de chaque Etat membre, out tout autre ville ou siège le tribunal compétent en application de l'article 26.

4. Le MPE est indivisible et solidaire:

a) l'indivisibilité implique que tout acte accompli par l'un de ses membres est réputé accompli par le MPE; que tous les actes de la compétence du MPE (en particulier les pouvoirs d'investigation énumérés à l'article 20) peuvent être accomplis par l'un quelconque de ses membres; et que, avec l'accord du PGE, ou en cas d'urgence sous son contrôle, chacun des PRD peut exercer ses fonctions sur le territoire de l'un quelconque des Etats membres, en

collaboration avec les services du PED installés dans cet Etat membre;

b) La solidarité impose, entre les différents PED, une obligation d'assistance.

5. A l'égard du MPE, les ministères publics nationaux (MPN) sont également tenus d'une obligation d'assistance.

Art. 19 - Saisine du MPE et mise en mouvement de l'action publique

1 - Le MPE doit être informé de tous les faits pouvant constituer l'une des infractions définies ci-dessus (art. 1 à 8), tant par les autorités nationales (police, procureurs, juges d'instruction, agents des administrations nationales telles que le Fisc ou les Douanes) que par l'organe communautaire compétent, à savoir l'UCLAF (Unité de Coordination de la lutte antifraude). Il peut également être informé par dénonciation de tout citoyen ou par plainte de la Commission. Les autorités nationales ont l'obligation de saisir le parquet européen au plus tard au moment de la 'mise en accusation', au sens de l'article 29, par. 2., ou de l'emploi de mesures contraignantes telles que, notamment, l'arrestation, les perquisitions et saisies ou le placement sur écoutes téléphoniques.

2 - Si l'enquête menée par une autorité nationale vient à révéler l'existence de l'une des infractions définies ci-dessus (art. 1 à 8), le dossier doit être aussitôt transmis au MPE.

3 - Informé des faits par quelque moyen que ce soit, le MPE peut soit être officiellement saisi par les autorités nationales, soit se saisir d'office.

4 - La décision de poursuivre, qui vaut ouverture d'une information, peut être prise par le MPE quel que soit le montant de la fraude. Tenue par la légalité des poursuites, le MPE doit exercer celles-ci dès lors que l'une des infractions visées (art. 1 à 8) paraît constituée. Il peut cependant, par décision spécialement motivée aussitôt communiquée à la personne qui l'a informé, comme à celle qui a dénoncé l'infraction à ses services ou porté plainte contre celle-ci:

a) soit déférer aux autorités nationales les infractions de faible gravité ou qui affectent principalement des intérêts nationaux;

b) soit classer l'affaire sans suite, si l'accusé, ayant reconnu sa culpabilité, a réparé le dommage et restitué, le cas échéant, les fonds irrégulièrement perçus;

c) soit accorder l'autorisation de transaction à l'autorité nationale qui en a fait la demande, selon les conditions énumérées ci-dessous (art. 22, par. 2,b).

Art. 20 - Pouvoirs d'investigation du MPE

1 - Afin de permettre la manifestation de la vérité et de mettre l'affaire en état d'être jugée, le MPE conduit, à charge et à décharge, les investigations relatives aux infractions définies ci-dessus (art. 1 à 8). Ses pouvoirs sont répartis entre le Procureur general européen (PGE), les procureurs européens délégués (PED) et, le cas échéant, les autorités nationales désignées à cet effet, selon les règles qui suivent.

2 - Les pouvoirs propres du PGE comprennent:

a) La direction générale des investigations et leur délégation à un ou plusieurs PED dans les conditions et limites définies ci-après (art. 20, par.3);

b) la coordination des investigations menées tant par les PED que par les services de police nationaux et les administrations nationales compétentes et, le cas échéant, par l'UCLAF; cette coordination pouvant prendre la forme de recommandations orales ou écrites aux services concernés;

c) l'évocation d'affaires dont l'enquête révèle qu'elles concernent en tout ou en partie des infractions définies ci-dessus (art. 1 à 8)

3 - Peuvent être soit exercés par le PGE soit délégués aux PED, au cas d'enquête relative aux infractions définies aux articles 1 à 8, tous les pouvoirs suivants:

a) l'interrogatoire du suspect, dans les conditions respectant ses droits énumérés ci-dessous (art. 29);

b) la collecte des documents, et/ou des données informatisées nécessaires à l'enquête et, le cas échéant, le transport sur les lieux de l'infraction;

c) la demande adressée au juge d'ordonner une expertise dans les conditions définies ci-dessous;

d) les perquisitions, saisies et écoutes téléphoniques ordonnées, conformément à la règle énoncée ci-dessous (art. 25), après autorisation d'un juge ou sous contrôle et pratiquées dans le respect des droits de l'accusé (art. 31);

e) les auditions des témoins qui acceptent de coopérer avec la justice et, le cas échéant, des témoins obligés à comparaître dans les conditions

indiquées ci-dessous.

f) la notification des charges à l'accusé, dans le respect des droits énoncés ci-dessous (art. 29);

g) la demande de mise en détention ou de placement sous contrôle judiciaire, pour une période au maximum de 6 mois, renouvelable pour 3 mois, lorsqu'il y a des raisons plausibles de soupçonner que l'accusé a commis l'une des infractions définies ci-dessus (art. 1 à 8) ou des motifs raisonnables de croire à la nécessité de l'empêcher de commettre une telle infraction ou de s'enfuir après l'accomplissement de celle-ci; cette demande, écrite et motivée, devant être adressée à l'autorité judiciaire nationale compétente en application des règles posées ci-dessous (art. 24 et 25), l'exécution de ces mesures étant organisée dans le pays où l'arrestation a eu lieu.

4 - Les pouvoirs délégués aux PED peuvent faire l'objet d'une subdélégation partielle, limitée ratione materiae et ratione temporis, adressée à une autorité nationale (autorité de poursuite, police, ou toute autre administration compétente comme le Fisc ou les Douanes) qui devra respecter l'ensemble des règles résultant du corpus européen.

Art. 21 - Clôture de la phase préparatoire

1 - Lorsqu'il estime que les investigations sont terminées, le PED décide, sous le contrôle du PGE, soit de rendre une décision de non-lieu, soit de renvoyer l'affaire en jugement.

2 - La décision de non-lieu est notifiée à la Commission européenne, à l'accusé, et à toute organe ou personne qui avait informé le MPE, dénoncé l'infraction à ses services ou porté plainte contre celle-ci, au sens défini ci-dessus (art. 19, par. 4).

3 - La décision de renvoi, notifiée dans les mêmes conditions que le non-lieu (art. 21, par.2), mentionne les nom et adresse de l'accusé, la description des faits et leur qualification, ainsi que l'indication de la juridiction de renvoi. Elle est soumise au contrôle de l'autorité judiciaire nationale compétente selon les règles définies ci-dessus (art. 25) qui, après vérification de la régularité de la procédure, saisit la juridiction de jugement compétente et adresse à l'accusé une convocation précisant le jour et l'heure de sa comparution.

Art. 22 - Exercice de l'extinction de l'action publique

1 - Pour les infractions définies ci-dessus (art. 1 à 8),

le MPE exerce l'action publique auprès de la juridiction de jugement (désignée comme il est indiqué ci-apres, art. 26), selon les règles en vigueur dans l'Etat dont elle relève. La partie poursuivante nationale peut, le cas échéant, exercer l'action publique à ses côtés, si des intérêts nationaux sont également adressés à la partie poursuivante nationale et le dossier lui est communiqué en temps utile.

2 - Pour ces mêmes infractions, l'action publique s'éteint, à l'exclusion de toute mesure nationale de grâce ou d'amnistie, par la mort du prévenu (ou la dissolution s'il s'agit d'un groupement), la prescription ou la transaction:

a) en ce qui concerne la prescription, le délai est de cinq ans, à compter du jour où l'infraction a été commise si dans cet intervalle, il n'a été fait aucun acte d'investigation ou de poursuite; s'il en a été effectué dans cet intervalle, l'infraction ne se prescrit qu'après cinq années révolues à compte du dernier acte. En toute hypothèse, la notification des charges au suspect interrompt la prescription;

b) en ce qui concerne la transaction, elle est exclue en cas de récidive, port d'armes, usage de documents falsifiés ou si le montant de la fraude est supérieur ou égal à 50 000 Ecus. Dans les autres cas, elle peut être proposée par les autorités nationales au MPE, tant pour des affaires relevant de la compétence nationale (cf. art. 19, par.4,a), que pour les affaires de compétence européenne, sous les conditions suivantes: le défendeur reconnaît librement sa culpabilité, les autorités disposent d'indices de culpabilité suffisants pour justifier le renvoi en jugement, la décision de transiger est rendue publiquement, l'accord conclu respecte le principe de proportionnalité. En cas de refus, le MPE doit, s'il y a lieu, évoquer l'affaire.

Art. 23 - Exécution des jugements

1 - Lorsque le jugement de condamnation devient définitif, il est aussitôt transmis par le MPE aux autorités de l'Etat membre désigné comme lieu d'exécution de la décision, certaines peines comme la confiscation, la privation de droits ou la publication de jugement différents(s) de celui de l'emprisonnement. Le MPE est responsable, aux côtés de l'autorité nationale compétente, pour ordonner et contrôler la mise à exécution du jugement lorsque celle-ci n'est pas automatique. En principe l'exécution des peines est régie par les règles en vigueur dans l'Etat membre désigné comme lieu d'exécution de la décision. Toutefois le MPE veille à l'application des règles communes suivantes sur tout le territoire des Etats de l'union européenne:

a) toute période de détention accomplie par l'accusé à raison des mêmes faits, dans quelque Etat et à quelque moment de la procédure que ce soit, est déduite de la peine d'emprisonnement prononcée par la juridiction de jugement;

b) nul ne peut être poursuivi ou condamné pénalement dans un Etat membre en raison d'une infraction définie ci-dessus (art 1 à 8) pour laquelle il a déjà été soit acquitté, soit condamné par un jugement définitif, dans l'un quelconque des Etats membres de l'union européenne;

c) toute décision de condamnation pour l'une des infractions définies ci-dessus (art. 1 à 8) doit prendre en considération dans la détermination de la peine les règles définies ci-dessus (art. 17) pour les concours d'infractions.

2 - Le MPE autorise s'il y a lieu, le transfert lorsque la personne condamnée à une peine privative de liberté demande à être incarcéré dans un Etat membre autre que celui désigné par le jugement de condamnation.

3 - En application de la règle générale de subsidiarité du droit national (art. 35), les juridictions nationales doivent se référer aux règles posées dans le corpus européen et, en case de lacune, appliquer la loi nationale. En toute hypothèse, elles sont tenues de motiver la peine par référence aux circonstances particulières propres à chaque affaire, en application des règles définies ci-dessus (art. 15 à 17).

Art. 27 - Recours auprès des juridictions nationales

1 - Toute décision de condamnation prononcée contre une personne déclarée coupable de l'une des infractions définies ci-dessus (art. 1 à 8) doit pouvoir faire l'objet d'un appel du condamné à faire rejurer l'affaire, en droit et en fait, par une juridiction supérieure appartenant à l'Etat dans lequel la condamnation a été prononcée en première instance et appliquant, comme la juridiction du premier degré, les règles posées dans le corpus européen et, en cas de lacune, dans la loi nationale.

2 - L'appel est également ouvert, en cas d'acquiescement total ou partiel, au MPE en tant que partie poursuivante, la Commission pouvant se joindre à lui, comme partie civile, sur les seuls intérêts civils.

3 - En cas d'appel du seul condamné, la juridiction saisie ne peut aggraver la peine.

Art. 28 - Recours auprès de la Cour de Justice des Communautés européennes (CJCE)

1 - La Cour de Justice est compétente pour statuer en matière d'infractions définies ci-dessus (art. 1 à 8) dans trois cas:

a) à titre préjudiciel sur l'interprétation du corpus et des éventuelles mesures d'application;

b) à la demande d'un Etat membre ou de la Commission sur tout différend concernant l'application du corpus;

c) à la demande du MPE ou d'une autorité judiciaire nationale sur les conflits de compétence relatifs à l'application des règles posant le principe de territorialité européenne, en ce qui concerne tant le ministère public (art. 18 et 24) que l'exercice de la garantie judiciaire par les juridictions nationales (art. 25 à 27).

2 - Lorsqu'une question d'interprétation est soulevée ou un conflit de compétence élevé devant une juridiction d'un des Etats membres, cette juridiction peut, si elle estime qu'une décision sur ce point est nécessaire pour rendre son jugement, demander à la Cour de justice de statuer sur cette question.

3 - Lorsqu'une telle question ou conflit est soulevée ou élevée dans une affaire pendante devant une juridiction nationale dont les décisions ne sont pas susceptibles d'un recours juridictionnel de droit interne, cette juridiction est tenue de saisir la Cour de justice.

Art 29 - Les droits de l'accusé

1 - Dans tout procès ouvert pour une infraction définie ci-dessus (art. 1 à 8), l'accusé bénéficie des droits de la défense qui lui sont accordés par l'article 6 de la Convention européenne des droits de l'homme et l'article 10 du Pacte international de l'ONU sur les droits civils et politiques.

2 - Une personne ne peut être entendue comme témoin mais doit être considérée comme accusé à partir de tout acte constatant, dénonçant ou révélant l'existence d'indices graves et concordants de culpabilité à sa charge et, au plus tard, lors du premier interrogatoire par une autorité connaissant l'existence de tels indices.

3 - Dès le premier interrogatoire, l'accusé a le droit de connaître le contenu des charges existant contre lui, le droit d'être assisté du défenseur de son choix, et le cas échéant d'un interprète. Il se voit reconnaître le droit de se taire.

Art. 30 - Les droits de la Commission comme partie civile

1 - La Commission européenne, dans la mesure où la Communauté est victime d'un dommage directement causé par l'une des infractions définies ci-dessus (art. 1 à 8), peut se constituer partie civile auprès du juge compétent, soit pendant la phase préparatoire, soit à l'ouverture de la phase de jugement. Elle peut demander au juge de prendre des mesures conservatoires et d'ordonner, le cas échéant, la réparation du dommage.

2 - La constitution de partie civile, quand elle est déclarée recevable, confère à la Commission les droits et prérogatives d'une partie au procès: communication du dossier, notification des actes de la procédure, assistance d'un avocat, présence à l'audience, participation à l'administration de la preuve, exercice des voies de recours en ce qui concerne les intérêts civils (cf. art. 27).

Art 31 - La charge de la preuve

1 - Toute personne accusée de l'une des infractions définies ci-dessus (art. 1 à 8) est présumée innocente jusqu'à ce que sa culpabilité ait été établie légalement par un jugement définitif ayant acquis l'autorité de la chose jugée.

2 - Sous réserve des obligations de produire certains documents pouvant résulter du droit national ou du droit communautaire, nul n'est obligé de contribuer de manière active, directement ou indirectement, à établir sa propre culpabilité.

Art. 32. Les preuves admises

1 - Sont admises dans les Etats membres de l'union européenne les preuves suivantes:

a) les témoignages soit directs, soit présentés à l'audience par une liaison audiovisuelle lorsque le se trouve dans un autre Etat membre, soit recueillis par le MPE sous la forme d'un 'procès-verbal européen d'audition' impliquant que l'audition soit faite devant un juge; que la défense soit présente et que lui soit accordée la possibilité de poser des questions; enfin que l'opération soit enregistrée par video;

b) Les interrogatoires de l'accusé soit directs, soit recueillis par le MPE sous la forme d'un procès verbal européen d'interrogatoire' impliquant que l'interrogatoire soit fait devant le juge, que l'accusé soit assisté d'un défenseur de son choix ayant eu communication du dossier en temps utile et au plus tard 48 heures avant l'interrogatoire et, le cas échéant, d'un interprète, enfin que l'opération soit enregistrée par video;

c) les déclarations de l'accusé, indépendamment de tout interrogatoire, dès lors qu'elles ont été faites devant l'autorité compétente (MPE ou juge), que l'accusé a été préalablement averti de son droit à se taire et à bénéficier de l'assistance d'un défenseur de son choix et que les déclarations ont été enregistrés par tout moyen;

d) les documents présentés par un expert-comptable désigné par la juridiction compétente parmi les personnes physiques ou morales figurant sur une liste européenne agréée par les Etat membres sur proposition du MPE, soit au cours de la phase préparatoire, soit au début de la phase du jugement;

e) les documents que l'accusé a été obligé de produire dans une enquête préliminaire administrative, sauf dans l'hypothèse où une telle obligation serait assortie de sanctions pénales.

2 - Les présentes dispositions n'excluent pas l'applicabilité d'autres modes de preuve considérées comme recevables au regard du droit national en vigueur dans l'Etat dont relève la juridiction de jugement.

Art. 33 - L'exclusion des preuves obtenues en violation des règles de droit

1 - Dans une poursuite pour l'une des infractions définies ci-dessus (art. 1 à 8) une preuve doit être écartée si elle a été obtenue par les organes communautaires ou nationaux soit en violation des droits fondamentaux consacrés par la CESDH, soit en violation du droit national applicable, sans être justifiée par les règles européennes précipitées.

2 - Le droit national applicable pour déterminer la question de savoir si la preuve a été obtenue légalement ou illégalement doit être le droit du pays où la preuve a été obtenue. Lorsqu'une preuve a été légalement obtenue dans ce sens, on ne doit pas pouvoir opposer à l'utilisation de cette preuve le seul fait que l'obtention aurait été illégale dans le pays d'utilisation. Mais on doit toujours pouvoir apposer à l'utilisation d'une telle preuve le fait que son obtention, bien qu'apparemment conforme au droit du pays où elle a été obtenue, a violé les droits consacrés par le CESDH ou les règles européennes (art. 31 et 32).

Art. 34 - Publicité et secret

1 - Les investigations menées sous la direction du MPE sont secrètes et les autorités qui participent à ces investigations sont tenues au respect du secret professionnel.

2 - Les audiences devant le juge des libertés peuvent être rendues publiques si l'ensemble des parties y consentent, sauf si la publicité est de nature à nuire au bon déroulement de l'enquête, aux intérêts d'un tiers, à l'ordre public ou aux bonnes moeurs. En toute hypothèse, il est interdit aux medias de publier en cours de procès des informations relatives aux éléments de preuve.

3 - Le jugement doit être rendu publiquement, mais l'accès de la salle d'audience peut être interdit à la presse et au public, pendant la totalité ou une partie du procès, dans les conditions prévues par l'article 6, paragraphe 1 CESDH. Cette publicité peut inclure l'enregistrement et la diffusion audiovisuelle du procès si le droit national de l'Etat concerne le prévoit et dans les conditions qu'il impose.

Art. 35 La susidiarité du droit national par rapport au corpus européen

Le corpus des règles définies ci-dessus en droit substantiel (art.1 à 17) et en procédure (art. 18 à 34) est applicable sur tout le territoire des Etats membres de l'Union européenne. En cas de lacune du corpus, la loi applicable est celle du lieu où l'infraction est poursuivie, renvoyée en jugement, ou, le cas échéant, celle du lieu d'exécution de la condamnation.

APPENDIX D: RESPONDENTS (IN ALPHABETICAL ORDER)

Andrew, C - Investigation Division - Customs and Excise - London

Asprey, R - Finance Policy Adviser - Intervention Board - Reading

Bryans, T - Department of Agriculture - Belfast

Da Cuna, C - Court Clerk - VAT and Duties Tribunal - London

De Angelis, F - Director, DGXX - European Commission

Dickson, W MBE - HEO Investigation Customs and Excise - Belfast

Eigen, P - Chairman - Transparency International, Berlin (interviewed in London)

Dogherty, W - Agriculture Department Solicitors - Belfast

Ferguson, W - Director of Public Prosecutions - Belfast

Filkin, E - Customs Adjudicator - London

Gallagher, T - Surveyor Investigation Customs and Excise - Belfast

Gardner, I - Legal Service, EC specialist - National Farmers' Union - London

Graham, M - Head of Fraud Unit, Intervention Board, London (now UCLAF).

Granados, P - DTI - London

Hamilton, P - Coopers and Lybrand Chartered Accountants - London

Harrison, C - Barrister - MAFF Legal Department - London

Howarth, M - National Farmers' Union - London

Howse, P - Assistant Director - Serious Fraud Office - London

Inghelram, J - Administrator Legal Service, European Court of Auditors

Kuhl, L - Administrator, UCLAF

Lark, S - Indirect Tax Information Officer - Titmuss Sainer Dechert - London

Leigh, L - President of ALPFIEC , Professor of Criminal Law - London School of Economics

Lester, D - Registrar - VAT and Duties Tribunal - London

Lynch, E - DTI Legal Service - London

McCLeary, J - Head of Legal Division - Intervention Board - London

Mc Farlane, G - Director of Customs and International Trade Taxation - Titmuss Sainer Dechert - London

McGilway, S - Manager - Debt Management - Intervention Board - Reading

McKay, F - Head of Verification Section European Social Fund, Department of Employment, London.

McGinn, P - Assistant Solicitor - Departmental Solicitor's Office - Belfast

Missir di Lusignano, A - Assistant Director DG XX

Oldcorn, J - Group Manager - Payments - Securities and Debts - Intervention Board - Reading

Raponi, D - Assistant Director, DG XXI, European Commission

Rennie, D - Budget and Central Unit Customs and Excise - London

Rogers, P - Surveyor, Investigation Customs and Excise - Belfast

Roper, M - Budget and Central Unit, Customs and Excise - London

Smyth, I - EC Committee, House of Lords - London

Spence, S - Litigation lawyer - MAFF - London

Spicer, S - Debt Recovery Administration Section MAFF - London

Tatton, J - Regional Service Centre MAFF - Reading

Todd, J - Superintendent - City of London Police

Tomlinson, J - MEP

Usher, N - Auditor, European Court of Auditors

Wallace, D - Head of Branch B, Financial Management MAFF - London

Weyns, E - UCLAF (central and eastern Europe)

Yewdall, R - Principal National fraud and Investigation
Department - Coopers and Lybrand Chartered Accountants.

APPENDIX E: TABLE OF CASES

European Court of Justice cases (in alphabetical order)

145/83 Adams v Commission [1985] ECR 3539

61/79 Amministrazione delle Finanze dello Stato v
Denkavit Italiana [1980] ECR 1205

199/82 Amministrazione delle Finanze dello Stato v San
Giorgio [1983] ECR 3595

50/76 Amsterdam Bulb BV v Produktschap voor Siergerwassen
[1977] ECR 137, [1977] 2 CMLR 218.

C-326/88 Anklagemyndigheden v Hansen [1990] ECR I-2911

4/62 Application for authorization to enforce a garnishee
order against the High Authority of the European Coal and
Steel Community [1962] ECR 41

85/63 Application for authorization to notify the EEC of
an assignment of salary [1963] ECR 195

1/71 Application for authorization to serve an attachment
order on the Commission of the European Communities
[1971] ECR 363

118/76 Balkan v Hauptzollamt Berlin-Packhof [1977] ECR
1117

309/85 Barra v Belgium and the City of Liege [1988] 2
CMLR 409

146, 192 and 193/91 BayWa and others v BLM [1982] ECR
1503

Bourgoin S A and others v Ministry of Agriculture and
Food [1986] QB 716

C-46/93 and C-48/93 Brasserie du Pêcheur v Germany and R
V Secretary of State for Transport, ex parte Factortame,
judgement of 5 March 1996, nyr

122/78 Buitoni v FORMA [1979] ECR 677

C-26/88 Brother International v HZA Giessen [1989] ECR
4253

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