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Creating a Common Market for Fraud and Corruption  
in the European Union: An Institutional Accident,  
or a Deliberate Strategy?

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## ABSTRACT\*

Political and economic integration within the framework of the European Union was designed to lower trade barriers, raise the efficiency of economic exchanges, and promote economic and political development and peace. However, as the financial resources and complexity of EU programs has grown, there is increasing evidence that a significant percentage of the EU's budget has been the victim of corruption. The basic purpose of this paper is to discuss the state of a research project, which was intended to determine whether international organizations such as the EU are just as likely to promote such fraud and corruption as (unintended) side effects of economic and political integration. Those side effects then *lower* the organizations' economic efficiencies, *raise* barriers to trade, and eventually discredit further attempts at multinational cooperation. The broader purpose of the project is to understand how the politics of rent-seeking and interest representation changes as it is reconstituted at the level of an international organization. Do the citizens and governments of the member states bring national patterns of corruption to a supranational regime such as the EU when they become involved, or does the ultimate source of the corruption inhere in the nature of international organizations and their institutional frameworks? Do states see fraud and corruption in an international organization as a marginal cost to be discounted by extensive benefits derived from the organization? Or do they see it as, perversely, one of the extensive benefits of an international organization, which serves as a side-payment to various key constituencies, or as a direct benefit to the policy-maker? This paper reviews the EU's structure, and its enforcement and oversight mechanisms in the CAP and in certain other areas, and suggests that, at best, the member states have manifested benign neglect towards fraud, corruption and regulatory enforcement.

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## **CREATING A COMMON MARKET FOR FRAUD AND CORRUPTION IN THE EUROPEAN UNION: AN INSTITUTIONAL ACCIDENT, OR A DELIBERATE STRATEGY?**

This paper outlines a project, which will attempt to determine whether citizens and governments continue to employ long-standing national patterns of corruption when they become involved in a supranational regime such as the EU, or whether the source inheres in the nature of international organizations. Is corruption and fraud, in other words, the result of national patterns being brought into the international arena, or a negative externality inherent in any international organization? At this point, the paper (and its author) is most focused on whether available evidence can discriminate between hypotheses; that is to say, how do we answer these questions? The first part of the paper raises the general questions and discusses possible definitions of fraud and corruption. The second part presents the research hypotheses and methodology. The third part discusses the hypotheses in light of preliminary evidence.

International politico-economic organizations such as the EU are expected to lower barriers to trade, raise the efficiency of economic exchanges, as well as promote economic and political development and cooperation. This paper takes as its starting point the possibility that international organizations are just as likely to promote, as side-effects, fraud and corruption, in the process lowering the organizations' economic efficiencies, raising barriers to trade, and discrediting further cooperation. Recent instances of possible corruption in the EU's main administrative body (the Commission), the discovery of the fraudulent use or misappropriation of IMF and World Bank funds, as well as some other recent high profile instances of financial diversions in international bodies all serve to highlight the vulnerability of international organizations to corrupt practices. Corruption seriously undermines economic growth and socio-political equality and legitimacy (Mauro 1995; Della Porta and Vannucci 1997; Johnston 1986; Rose-Ackerman 1996). In order to analyze this growing problem, this project will focus on fraud and corruption in the European Union.

### **PART I**

First, fraud and corruption in the EU raise challenging questions for several of the dominant social science approaches to explaining political and economic behavior. Of the three approaches discussed below, agency theory is ill-equipped to deal with a situation in which the agent is also the principal; the international institutionalist perspective shies away from the likelihood that state interests may lie in deliberately tolerating fraud in certain economic

sectors; and cultural arguments are undermined by the possibility that behaviors which were thought to be culture (state)-specific may be universalized through a new institutional context, or may be typical of all governments.

Second, of all international organizations, the EU has gone furthest in integrating the economies of its members, and in being granted political authority by these states, yet the problem of fraud and corruption has been neglected by most policy and academic studies of the EU. The political science literature on international institutions has ignored it. Fraud and corruption are estimated to take 10-20% of the EU's annual budget (Warner 2000). With the recent creation of other regional trading associations (e.g. NAFTA), and suggestions in policy circles that other countries ought to consider an EU—style currency unification, it is critical to know the potential costs, in fraud and corruption, which might be associated with such actions.

Third, the EU has become an enormously important player in the politics and economics of all the European states, members and non-members alike; it has become similarly important in the relations of the European states with the rest of the world.

What then are the sources of this corruption in the EU? Are they an inevitable by-product of that organization's structure and policies? Or, are they the result of *national* behavior patterns being perpetuated and used by the member states and other domestic actors in the newer and larger arena?

### *Definitions*

To study fraud and corruption, we need to know what they are. Fraud is usually defined as the wrongful appropriation of funds in the private sector, or by a private actor against public funds, while corruption is defined as “behavior by a public servant, whether elected or appointed, which involves a *deviation from his or her formal duties* because of reasons of *personal gain*” (LaPalombara 1994: 328, italics in the original; see also Klitgaard 1988, 20-4). Corrupt officials may permit fraud.

Would that it were that simple. The dictionary definition of corruption is that it is an “impairment of integrity, virtue, or moral principle: depravity” (Merriam 1980, 253). It evokes decay and debasement. As Yves Mény states, “corruption constitutes a violation of ethical norms that are protected by law” (1997, 7). Applied to public office, this definition often becomes that quoted above. There is also a sense that an act is corrupt if a public office holder

somehow violates the public interest s/he was mandated to uphold. Corruption signifies the “decay of the capacity of the citizenry and officials of a state to subordinate the pursuit of private interests to the demands of the common good or public interest” (Philp 1997, 24). But what is that public interest? As Mark Philp notes, “the debate... isn’t so much about what corruption is” in that there’s agreement that it involves something “being changed from ... a sound condition to something unsound, debased” (Philp 1997, 29). The problem is in deriving that standard: we are forced to “commit to concepts of the public good or the nature and ends of public domain” (ibid., 30). Standards imply agreement on the definition of the public good. Politics, however, is “partly about the contestation and projection of the public interest” (Philp 1997, 29). Further, it is possible that standards of office vary between levels of administration, across regions even within the same polity. If corruption is the “wrongful exercise of public duty in any community”, we have to decide what the public duty is, either as an absolute, or as defined by the that community. My concern here is with both phenomena occurring “against (the) financial resources and allocative functions” of the EU (Mendrinou 1994: 82; cf. Sherlock and Harding 1991: 22).

If we let the standards be defined by communities, we may have several problems. One is the very real possibility that corruption may corrode community standards, altering its sense of the public interest (della Porta and Vannucci 1999, 10; Philp 1997, 25). If we seek to find the definition in the community’s legal code, we have the problem that the legal system may also contain corrupting laws: “that an act is legal does not always mean that it is not corrupt” (Philp 25; Mény 1996, 311). Campaign financing laws (passed by self-interested politicians) may have the effect of giving legal sanction to behaviors by politicians and political parties which undermine elected and appointed officials’ ability and incentive to uphold some common good, some public interest.

Some scholars try to avoid relativism in their definitions by emphasizing the distinction between politics and markets. In a non-corrupt polity, political authority is separate from market pressures. In a corrupt polity, “market logic” is applied to “political authority” — rights, public property, the legal system, are sold for a price to individual or corporate purchasers (della Porta and Vannucci 1999, 9; Shleifer and Vishny 1998, 91). Many scholars seem to limit the universe of corrupt acts to cases in which these commodified aspects of political authority, of the community, are sold for the personal gain of the office holder. This seems to ignore the fact that the “seller” is often acting on behalf of not just him or herself but for a political party. Further, how do we decide when personal gain ends and public interest begins? As noted below,

political economists hypothesize that politicians are self-interested office seekers.

There is the additional problem that, in many instances, market logic is being deliberately, openly, legally applied to public agencies and policies. The response of some scholars is to argue that an act is corrupt when it “directly subverts the distinction between the interests of the individual or group and the responsibilities of the office” (Philp 1997, 42). The task then is to know what those public office responsibilities are.

In the context of defining corruption as those actions which directly subvert the public interest, rational choice analysis would see politics as inherently corrupt. Individuals are assumed to be self-interested, means-end rational; if civil servants and elected officials somehow uphold the public interest, it is only by accident, an externality of individual self-seeking behaviors. Institutions must exist which create cost-benefit structures that discourage deviation from formal rules and responsibilities (cf. Becker 1968, 172). If politics and corruption are not the same thing, then they are not only by dint of a legal system, which defines the realm of non-corrupt behavior. Something as vague as the “public interest” can’t be countenanced. By definition, the public interest is only the summation of the private interests of all individuals in the population. Political candidates are assumed to seek office for reasons of power and other personal advantages (Mayhew 1974; Downs 1957), not out of a desire to uphold community interests (at best, that is campaign rhetoric). Political parties are organized to facilitate the election of self-interested individuals (Aldrich 1995), not to aggregate general interests or to broadly represent the community. If they do, it is only by dint of the work of (self-interested) constitutional engineers.

Nevertheless, even rational choice scholars usually tacitly assume that there is something known as the “public trust.” Then, corruption occurs “when officials use their positions of public trust for private gain” (Rose-Ackerman 1996, 365). Other scholars make specific reference to the legal system: corruption occurs when private gain is pursued “in a way that violates formal rules” (Manion 1996, 167; Nye 1967, 416; Nas, Price and Weber 1986, 108). Here we are back to the problem that Philp raises, that a corrupt society and polity may have few formal rules for officials to violate. One thinks of the (self-serving) complaints of foreign investors over the lack of rules, lack of transparency, of many of the countries in which they invest, and of efforts of the West to impose its accountancy standards on all countries receiving Western aid, and on multi-national accounting firms working in non-Western

countries (*Financial Times* 6 June 2000, 17). The theory saving assumption is that no matter what the polity, some positions in it have other-regarding aspects and are thought to belong to the community as a whole, to exist for the benefit of the community (positions occupied by “agents” to whom authority has been delegated by “principals” — here, the community).

The fact that we are emphasizing a distinction between public and private interests at all implies a “Western” bias. It was the West, after all, which “invented” that distinction, and the West which has defined political development for the rest of the world as the process of states arriving at political systems which see and incorporate that distinction, with political authority resting on that distinction. It is a hallmark of “advanced” societies (Rose–Ackerman 1996, 365). (For a study of corruption in the EU, it may be possible to hold to that definition, since the EU states were among the main originators of that development criterion). Political corruption assumes a public in whose interests individuals are supposed to act when occupying public offices.

An alternative perspective is to ask what the purpose of political authority is, and then define political corruption as that which subverts it. The general definition might be “political corruption involves substituting rule in the interests of an individual or group for those publicly endorsed practices which effect an ordered resolution to conflicting individual or group interests” (Philp 1997, 42). But, perhaps if that phrase is put simply, we are back to the view that, as stated earlier, corruption occurs when private gain is pursued “in a way that violates formal rules” – the institutions and laws which codify the “publicly endorsed practices” (Manion 1996, 167).

We are not likely to resolve a centuries-long debate on the nature and bases of political authority, nor on the definition of corruption. To design a research program, we have to make pragmatic compromises. For the European Union, one might like to use the EU’s own definition, assuming that it is the “average” of the member states’ differing definitions of corruption. We might also try to specify to what degree the EU’s definition differs from those of the member states (see below on methods).<sup>1</sup> However, the EU has not explicitly presented a definition. There seems to be an implicit understanding that “fraud, mismanagement and nepotism” violate “standards of proper behaviour”, and that those standards must be high for those who hold, or are staff members of,

<sup>1</sup>This could be done through surveys which ask respondents in different categories (politicians, civil servants, business persons, trade unions...) to rank examples of behaviors according to how corrupt those actions seem (cf. Peters and Welch 1978).



EU — level “high public office” (namely, the Commission; CIE 1999, 4-5). No standards have been articulated for the member states.

Another issue which needs clarification is the definition of fraud: is it conceptually or pragmatically different from corruption? In general terms, I am inclined to think so, and will use the following definition: the deliberate cheating of others in violation of a (formal) contract which has the effect of illegally producing financial gain. Clearly the emphasis here is on the *deliberate* nature of the act and on its fiscal impact: fraud involves deception, deceit, and perhaps even extortion in order to gain or retain funds not rightfully (legally) those of the perpetrator (Commission 1998a, 58; CIE 1999, 4). It does not become corruption until it is done by someone who was to be acting in the public interest but who, as has been discussed above, subverts the role of her/his office to obtain private benefits.

I am tempted to define corruption, for the purposes of this research project, as those acts of fraud which are done by or permitted by public officials/office holders and their staffs, yet this may lose some nuances of corruption in which it is public officials whose acts somehow violate and subvert public interests and duties of office.

### *Aims of this Paper*

This paper outlines four hypotheses, each of which is based upon a set of theoretical premises discussed below. Recognizing its preliminary nature, the paper then presents some evidence with which to evaluate the hypotheses. The first premise is an agency hypothesis, which implies that international organizations create new opportunities for fraud and corruption. The second hypothesis takes the intergovernmentalist view to its logical conclusion. It suggests that states (specifically their governments) deliberately tolerate fraud in those sectors where they can reasonably expect to derive economic, and hence potential electoral benefits. Taking my cue from Margaret Levi’s work on states and taxation policy (1998), I call this the “predatory” hypothesis.

The third hypothesis is derived from policy network approaches. It reasons that the EU provides multiple institutional points of access for rent-seekers, and that rent-seeking coalitions will develop across institutional and country boundaries. One would expect to find that current forms of fraud and corruption exploit existing institutional arrangements, and that “corruption coalitions” develop creative means for pursuing their interests. The fourth hypothesis takes culture seriously. It anticipates that member states bring

national patterns of corruption into international organizations, and, thus, that most corruption in EU programs would occur in the states with a “tradition” of corruption, particularly because, it argues, the cultural bases and political institutions which give rise to these “traditions” do not change rapidly (Sabetti 1996; Ross 1997) over time.

### **Arguments about the causes of fraud and corruption.**

Scholarship on the causes of fraud and corruption has been characterized by two broad approaches; the first is based on the tenets of rational choice, the other on cultural analyses.<sup>2</sup> The first consists mainly of economists and legal scholars, focuses on individual agency and incentives in two broad categories: one, when individuals whose responsibility it is to ensure compliance with rules and regulations are themselves “corrupted,” i.e., they do not enforce nor prosecute violations of legal and administrative procedures (e.g. Della Porta 1996). The second occurs when there are opportunities for fraud due to lax regulation, inadequate oversight, or limited procedural requirements (what the World Bank terms “weak institutional capacity”) which are then exploited by various actors (e.g., Geddes and Neto 1992; Kaufmann and Siegelbaum 1996).

As to *why* it happens more often in some places or times than others, political economists emphasize several factors. All are, however, based on the nature of incentives facing an individual, and the associated costs and benefits. The key factor behind corruption is the discretionary power of bureaucrats and the demand for the resources they control (Rose-Ackerman 1978; Ibid. 1999; Ades and Di Tella 1997, 1023-4; Gray and Kaufmann 1998, 8; Mauro 1998, 12). In fraud, the focus is on the risk of detection and extent of penalties balanced against pecuniary benefits. Indeed, most of the research on fraud and corruption focuses on the incentive structures of government bureaucrats (Ades and Di Tella 1997; Leff 1964; Schleifer and Vishny 1993; Bag 1997).

The solution, according to many political economists, is to introduce “market competition” into previously regulated and subsidized areas (Bliss and Di Tella 1997: 1005). As Mauro (1998, 11) argues, “Since the ultimate source of rent-seeking behavior is the *availability* of rents, corruption is likely to occur where restrictions and government intervention lead to the presence of such excessive profits.” The implication is that there is more fraud where the

<sup>2</sup>This project is not directly concerned with the debate about the effects of fraud and corruption on economic growth, political stability, or related phenomena. For that, see Johnston 1986; Bliss and Di Tella 1997; Della Porta and Vannucci 1999; Heidenheimer 1969; Mauro 1995.

government intervenes in particular market sectors, i.e., agriculture in the case of the EU.

The legalistic approach to a solution argues that corruption can be curbed through more and better oversight and stronger sanctions – the latter raising the costs of corruption, the former the likelihood that those costs will have to be paid. Institutions must monitor programs and enforce rules, sanctioning infractions. The key is to avoid any office having a monopoly (or even overwhelming discretion) in the distribution of a resource (Manzetti and Blake 1996; Andrews and Montinola 1998; cf. Banfield 1975: 600; Sherlock and Harding 1991: 25). In this view, the failure to increase enforcement stems from the vested interests of those who profit from corruption, and from devoting inadequate resources to enforcement.

The legal and political economist views, emphasizing human agency and incentives, imply that the EU's fraud problem is due to a corruptible bureaucracy, the existence of programs that are vulnerable to fraud by third parties, and too few checks and balances to counter administrative monopolies (despite the many levels of authority and decision-making). However, the political and legal solutions fail to take into account the peculiar structure of international organizations, including the possible differences in attitudes towards corruption which may affect member countries' institutional responses to corruption, and its peculiar principal/agent structure: we have the conundrum that the member states, as principals, have delegated *to themselves* the collection and distribution of an enormous percentage of the EU's budget, and have also delegated *to themselves* the operation of most of its regulatory structure. Thus, much of the time, the agent is also the principal. If combating corruption involves policing the agents, then it is the member states which must be controlled.

The political economist and legalist approaches also fail to recognize the fact that governments and international organizations often have strong policy reasons for not allowing the so-called free market to operate in specific sectors. Many of the EU's most important and expensive programs (e.g. Common Agricultural Program, Structural Funds) were deliberately created to counter free market forces. Furthermore, research shows that, depending on how they are implemented, market reforms toward a "free" market "can be used as new means to pursue corrupt ends" (Manzetti and Blake 1996, 662; Johnson, Kaufmann and Zoido-Lobaton 1998; Kaufmann and Siegelbaum 1996).

## **Corruption and Fraud in International Organizations**

What implications and hypotheses can we draw from the literature on international institutions? It is often claimed that international organizations (“regimes”) raise the “anticipated costs of violating others’ property rights” (Keohane 1984: 97; cf. Garrett 1992), thus reducing the costs and risks of economic interaction. Some have argued that corruption, as a form of rent-seeking and hence a source of economic inefficiency, is destined to decline as national economies grow interdependent and are more exposed to international economic competition (Kitschelt 1996). That pressure presumably would apply to organizations such as the EU, which face competitive external pressures which should make corruption costly. Yet, while that expectation may be rational at the macro-level, the “micro-motives” of individuals, firms, political parties and also governments still could make it rational to engage in corrupt practices.

The rationalist perspective, which has dominated the field, “assumes that states rely on (international) institutions when doing so will promote their interests” (Martin 1997, 7; cf. Keohane 1984; Moravcsik 1998). States agree to international institutions when doing so will further some national interest (I am ignoring how *that* interest is defined or discovered), provided there are rules to sanction non-cooperative behavior (cheating). Yet one hallmark of an international organization’s legal system is its inability to do just that.

Scholars of international regimes persist in arguing that regimes, by the fact that they exist, have at least a rudimentary legal system. The reasoning is that states would never agree to cooperate and pool or delegate sovereignty if there were no way to discover and sanction non-cooperative behavior. That the legal forces are inadequate would be explained by states’ inherent concern with retaining sovereignty. If so, for a state to be rational and to agree to an international organization, the benefits of the organization would have to far outweigh the risks of others cheating, or the state would have to see, as part of the benefits, the possibility of itself cheating the others to a greater degree than the others could cheat it.

Applying this assumption to the states’ perspective first, states see fraud and corruption in an international organization as a marginal cost to be discounted by the varied benefits derived from the organization. One of these benefits may actually be the fraud, which serves as a side-payment to various key constituencies, or as a direct benefit to the policy-maker (cf. Shleifer and Vishny 1998; Ales and Di Tella 1997).<sup>3</sup> In both cases, the costs are borne by

<sup>3</sup>Margaret Levi’s “Predatory Theory of Rule” provides a detailed justification for a

diffuse, unorganized individuals spread across the member states. Second, taking a rationalist approach one step further, the effect of the international institution may be that of broadening the arena for those actors already inclined to corrupt behavior, providing them with new opportunities and resources. Implicitly recognizing this possibility, Italy's Treasury Minister at one time said of southern Italy, it "is not just an Italian problem but a European problem" (*New York Times*, 15 Nov. 1998, A1).

Indeed, the EU's peculiar institutional arrangements may contribute to fraud, as well as explain why there has not been more and better action to deal with it. For example, while the Commission supervises budget expenditures, 80% of the disbursement thereof is in the hands of the member states. Most of the EU's "own resources," such as funds obtained from the Common External Tariff and the Value Added Tax, are collected for it by the members. Thus, should a member government find it politically useful to tolerate fraud in a particular economic sector (e.g. agriculture), the fact that it has jurisdiction over EU funds within its territory lowers the risk of discovery. Most of the detection and pursuit of fraud and corruption, as well as the prosecution of it, are reserved to the policing and legal systems of the specific member states. In effect, this makes EU fraud a collective action problem (cf. Frey 1991, 13-19): member states are able to free ride on, or defraud, the EU because the harm caused is dispersed across all the members, while the gains are country-specific.

These possibilities are not addressed by the current scholarship on international regimes. The major recent work on the subject of European integration contains no mention of corruption or fraud, and writes as if the European Union's legal system is adequate to the task (Moravcsik 1998). Moravcsik goes on to explain that states have no problem delegating sovereignty for "adjudication, implementation, and enforcement" because those "are narrower functions." Governments "can afford looser control and greater efficiency" (1998, 76-7). But it is difficult to see how allowing the policing and enforcement of EU rules to be carried out primarily by the 15 member states' interior, judicial and defense ministries could be seen as a delegation of sovereignty. I would argue that governments have retained tight control, and lost potential efficiencies.

Some institutionalist scholars suggest that fraud is an unintended perspective such as this (1988). The political economy research on rent-seeking by policy-makers (governments), not just by interest groups, also leads to this expectation (Mitchell 1990, 90; McChesney 1991, 74; Appelbaum and Katz 1987, 686).

consequence of creating new institutions (Pierson 1996), with multiple levels of policy networks and informal arrangements (CIE 1999; Pappi and Henning 1999). What may appear to be fraud or corruption is merely a form of incompetence and a reflection of inadequate resources: the inability of officials and businesses to apply EU regulations because of their extreme complexity, their contradictions, the lack of staff, and the competing jurisdictions to which they are subject (Siedentopf and Ziller 1988; Pag and Wessels 1988, 169).<sup>4</sup> Yet, pushing the idea of state interests in international institutions to its logical conclusion implies that fraud may be an *intended* consequence of creating new institutions, or at least a consequence surreptitiously welcomed by states as a useful tool in domestic political competition. After all, states can be selective in the areas to which they devote policing power, spending proportionately more resources on those which clearly affect state revenues (François and Vandercammen 1988, 34) and government electoral futures.

Fraud may indeed occur when principals cannot exercise sufficient oversight. A number of scholars have argued that the EU can, in fact, be best understood as an organization playing host to various principal/agent relations (Dogan 1997; Franchino 2000; Pollack 1997). Having delegated certain powers to (new) supranational institutions, the member-states may be seen as the principals, and the staff of these institutions as the agents. This view implies that reducing EU fraud will be largely a matter of restricting the behavior of the agents. However, in the case of the EU, the principals designed the institutions so that much of the implementation authority and responsibility remains with them, thus turning themselves into their own agents. This creates an opportunity, if not an outright incentive, for the principal, as agent, to cheat.

## **Policy Networks**

In a challenge to the inter-governmentalist view that state interests largely account for policy developments in the EU, a number of scholars point to “multi-level governance” and “policy networks” which appear to have emerged in the EU (Bache 1998; Hooghe 1996; Keck and Sikkink 1998; Marks, Hooghe and Blank 1996; Mazey and Richardson 1996; Rhodes, Bache and George 1996). These networks, with criss-crossing, transnational layers of governance and/or interest group linkages between actors with converging interests and/or policy expertise, may begin informally and become institutionalized. According to this literature, policy networks informally link a variety of actors to EU institutions, allow for the pursuit of interest, and account for most policy

<sup>4</sup>Philp notes that incompetence is not corruption because the former does not actively challenge the distinction between public authority and private interests (1997, 42-3).

formation and output. Strategies are heavily influenced by available venues, including transnational coalition partners (cf. Guiraudon 2000). States do not necessarily encapsulate these interests and then represent them at the negotiating table. Studies up to now have only dealt with legal, or at worst clientelistic, policy networks. But if the EU's structure, and its relationship to its members, fosters the development of such networks, and if corruption is one of the means used by states to pursue interest, we should expect the EU to yield new corrupt networks as well (cf. Cartier-Bresson 1997).

### **Cultural Sources of Corruption**

Another category of scholars suggest that cultural patterns are significant, and can lead to differences in the use of discretionary power as well as in the legal definition of what constitutes corruption or fraud (Hood 1996; Mény 1992).<sup>5</sup> Research on culture tends to explain corrupt practices as manifestations of norms and standards which are state and even regionally specific (Banfield 1958; Geertz 1973; Hedetoft and Kastoryano 2000; Klitgaard 1988; Médard 1997; Putnam 1993). Scholars in this field contend that the very institutional structures which the agency and institutionalist approaches claim foster or inhibit corruption and fraud are culturally derived, and culturally embedded. Strategies and behavior patterns are culturally dependent (Ross 1997, 46-7). According to this view, corruption and fraud in international organizations are national "exports", traceable to particular country—or regionally—based cultures. If corruption is defined as abuse of public office for private gain, with abuse, gain and the responsibilities of public office defined by a community's standards ("publicly endorsed"), then it is inevitable that culture, broadly understood, becomes a variable. From the cultural perspective, culture is also a factor, because if the agents to which the management of most EU programs and finances is delegated are also the principals, then the level of fraud and corruption will vary according to the traditions and standards of each principal.

## **PART II: RESEARCH HYPOTHESES, AND METHODOLOGY**

The implication of the agency and institutionalist perspectives is that the state will, then, "cheat," or, in the case of the EU, be involved in or tolerate fraud in various sectors both for the gain of the governing parties, and for political gain (via economic benefits to key constituents). The implication of the network approach is that the sources and extent of corruption vary according to actors'

<sup>5</sup>The political economy, or agency, approach tends to introduce culture as an "error term" when agency and incentive structures do not explain outcomes (Rose-Ackerman 1978, 229; North 1981, 50-7).

creative responses to institutional opportunities. The culturalist perspective expects that those states which succumb to the temptation to cheat will be those with a prior tradition of domestic fraud and corruption.

I have distilled the arguments to four hypotheses. First, if the agency hypothesis that international organizations create new opportunities for fraud is correct, then I expect to find that the frequency of fraud in EU programs has been relatively proportionate across the four countries, and that any increases will demonstrate roughly the same ratio when institutional and programmatic changes in the EU create new incentives.

If the second (the “predatory”) hypothesis, that states (specifically their governments)<sup>6</sup> deliberately tolerate fraud in those sectors where they can reasonably expect to derive economic, and hence potential electoral benefits, is correct, I would expect to find the rate and amount of abuse of EU programs to increase in the period prior to a scheduled national election (recognizing that some elections are called early).<sup>7</sup> The increase(s) would most likely be in those sectors which are major constituents and supporters of the dominant party parties in the governing coalition. I would expect enforcement mechanisms to be state-centered, with little role given to the supranational institutions, and I would expect enforcement to be weak. I would expect that those who profit from fraud or irregularities have political links to those who write and/or enforce the rules.

Third, if the policy network approach is correct, we should see corruption and fraud networks developing, utilizing multiple levels of access and across a many states. In some ways, this hypothesis only predicts that underlying fraud and corruption in the EU are intricate, tangled arrangements between actors at a variety of levels and in a variety of states: If there is multi-level governance sustained by policy networks, then there is multi-level fraud sustained by criminal networks. The EU will have created a transnational, internal market for fraud.

Fourth, if the cultural hypothesis that member states bring national patterns of corruption into international organizations is correct, I expect to find that most corruption of EU programs occurs in the states with a “tradition”

<sup>6</sup>By “government” I am following standard European usage of the word: the parties or party currently holding the cabinet and office of prime minister (cf. Steiner 1998, 63).

<sup>7</sup>This hypothesis parallels the logic of research on the political manipulation of the economy (“pump priming”) for electoral purposes, but imputes a deliberate, rent-seeking motive to the state and its current government.



of corruption: more so in Italy and Belgium, less so in the case of France, and even less in the UK. I would also expect that parties which have a history of illegal financing will have incorporated EU programs into those financing arrangements.

To begin the research, I conducted interviews with EU officials in UCLAF (now OLAF),<sup>8</sup> the European Parliament's budgetary control committee (COCOBU), DG Competition (IV), DG Regio (XVI), and the Court of Auditors. The records of the European Court of Auditors, which issued its first report in 1978, may be considered primary documents to assess the site and frequency of irregular uses of EU funds. Such irregularities are the first indicator of possible fraudulent and corrupt activities, and these first signs can then be substantiated by referring to investigations carried out by COCOBU and UCLAF/OLAF. Major national newspapers and weekly investigative journals can provide secondary corroboration of prominent and particularly egregious cases.<sup>9</sup>

Coding states for fraud and corruption is no easy task, and warrants the use of multiple measures. One measure relies on survey data, such as that which generates the rankings of Transparency International, correlated with those of other corruption indices, such as the Business International Corporation's Country Assessment Service (68 countries for 1980-1983 and 30 countries for 1971-1979; see Mauro 1995, 683). TI's rankings begin in 1995; but TI has also compiled, from other sources, rankings covering 1980-1993. Economists and political scientists have indicated a general acceptance of the rankings (e.g., Ades and Di Tella 1997; Lancaster and Montinola 1997). If states do not rapidly increase or decrease their levels of corruption (cf. Cox 1987), then it would be possible to extrapolate backwards in time, and possibly it would be reasonable to assume that the relative standing of my four cases has been stable (TI's historical data bear this out, though there have been changes in the precise scores the countries have received).<sup>10</sup>

Regarding documentation, Court of Auditor reports and OLAF reports, as well as reports from similar national agencies, are difficult to use consistently. Reporting procedures vary by year and by country. Cases are usually not isolated by country or sub-national region, but by economic sector (e.g., fraud against the VAT). Moreover, descriptions in the reports are sketchy. Some countries do not keep track of reported domestic cases; it is only in recent years that states have been required to report suspected fraud to the EU (to UCLAF/OLAF), and their compliance with this mandate, and with

<sup>8</sup>Respectively, Unité coordinatif de la lutte anti-fraude; Office Européen de lutte anti-fraude.

<sup>9</sup>Of course, any enumeration of cases will be approximate; it is highly unlikely that complete accuracy is possible. However, using the resources enumerated will produce a significant improvement over what now exists (nothing), and can be cross-checked through interviews with officials (cf Lancaster and Montinola 1997, 193).

<sup>10</sup>Transparency International, "Historical Comparisons" consulted at <http://www.gwdg.de/~uwwv/histor.htm>

the mandate to send follow-up reports on the prosecution and fund recovery, has been uneven (but perhaps that in itself is an indicator, albeit very difficult to quantify). It also seems to be impossible to know whether a country reporting a high level of fraud or irregularities is just good at detecting those phenomena, whether they are being forthright in reporting, or whether they do have high levels (cf. HL 1989).

## **PART III EVIDENCE**

### *Structure of the EEC/EU*

Established in 1958, the EU originally consisted of the Commission, the Council, the Parliament, and the Court of Justice. The Commission's remit has been to propose and oversee the implementation of "legislation" and to oversee and enforce the member states' adherence to the articles of the Treaties. It now has 20 Commissioners, who act essentially as cabinet ministers overseeing a set of "general directorates" which run the day to day operations of the EEC. Upon unanimous nomination by the member states, and after approval *en bloc* by the Parliament, the Commissioners are collectively appointed to a five year term. The Council has long been the primary locus of power in the EU, as it is comprised of the member states' cabinet ministers who vote on and amend proposals coming from the Commission. During the twice yearly formal meetings of the Prime Ministers (and the French Head of State), they attempt to reach agreement on difficult issues (such as monetary union), and give direction to the Commission's proposals. The European Parliament initially was nothing more than an advisory body, or a nod to "democracy." Its members began to be directly elected by citizens in 1979, and not until 1993 did the Parliament gain any significant influence on EU policy making. The European Court of Justice (ECJ) was established mainly to keep the supranational institutions in check, not to enforce the member states' adherence to the Treaties and regulations (Alter 2000). It secondarily was meant to clarify interpretations of the legal texts of the Treaties.

In 1977, almost twenty years after the EEC's founding, and in response to adverse publicity about fraud, the member states launched a Court of Auditors to provide audits of the EEC's budget. In 1992 they accorded the Court status as a completely independent institution with the obligation to provide a statement of assurance as to the regularity and legality of expenditures in the EU's budget (Harden, White and Donnelly 1995). In 1988, again in response to adverse publicity, this time via press reports on findings of the Court of Auditors, the EEC created a separate "anti-fraud unit" to facilitate the Commission's efforts to coordinate the detection and prosecution of fraud

amongst the member states. This agency, “UCLAF”, was modified and re-named OLAF after questions about the management of the Commission itself, leading to the Commission’s resignation in 1999.

I now turn to the hypotheses themselves. First, regarding agency theory, Commission interviews indicated that most fraud takes place where most of the money is—that is, fraud against the EU budget is proportionate for the amount of funds a country receives for any given program. Thus, it seems the EU does provide new opportunities for all countries to exploit its budget. Some officials noted that EU funds are seen as a “gift” or “freebie” and so the member states do not subject those funds to the same strict controls they do their own funds. That view was countered by a UK Audit official, who noted that all EU funds are reviewed by the same procedures and held to the same stringent standards as domestic-origin funds. In the country often said to have marked regional cultures — Italy — Court of Auditor officials noted that irregularities and waste, if not also outright fraud, are present throughout Italy, there are no regional (and, implicitly, cultural) differences.

While most scholars of international relations assume that states do not join international organizations if there are not adequate means of preventing other states from cheating on the agreement, the EU’s structure suggests that, provided they all have similar opportunities for cheating, states may create international organizations with little regard for rule enforcement. Indeed, the EEC originated with very weak legal enforcement mechanisms pertaining to the actions of the member states. Access to Community legal remedies is generally weak throughout the member states and uneven across them (Conant 2002; . The member states have been keen to establish costly subsidy programs, but not keen to establish policing mechanisms. Only those states, such as the United Kingdom, which have been major net contributors to the EU budget, have pushed hard to increase anti-fraud enforcement procedures and investigations. The extent of subsidies, the tolerance for abuse, the lack of cooperation with EU authorities investigating such abuse, along with the fact that EU citizens have a voice only in the weakest of EU institutions (the European Parliament) can lead one to question the intentions of the member state governments – do they regard fraud merely as an externality of the Common Market?

Agency theory expects that institutions strongly affect actor behavior, and that, for the most part, cultural/normative differences are irrelevant. The actual evidence may not support that view. Each of the member states has anti-fraud, anti-corruption and auditing offices, as well as the ability to prosecute corruption and fraud. Each of them also has competence in the investigation

and prosecution of competition law violations (Laudati, 1995). There are variations in some of the powers granted these institutions, and it may be worth exploring these, and especially their political origins, or the political coalitions behind them, further. In France, the degree of independence of the judiciary seems to have been more a matter of political interests than of legal, institutional authority. And when the Finance Inspectorate itself takes bribes and kickbacks on audits it is legally authorized to conduct, then it does not seem to matter much that like other countries, Italy in this case, has a Finance Inspectorate with auditing and policing powers.<sup>11</sup> Perhaps like patronage (Shefter 1994), we can speak of a “constituency for corruption and fraud”.

The predatory hypothesis, that states deliberately tolerate fraud and/or try to create EU institutions and rules, which facilitate it, appears beyond testing. However, there is evidence that states were not diligent in their anti-fraud efforts: the structure of the EU, its main program (CAP), and what one scholar has termed the “chimera” of enforcement mechanisms (Harding 1997) do not reflect member state concern with fraud or its control.

### **Relationship between Structure and Fraud**

The vast majority of the EEC’s budget goes towards varieties of agriculture subsidies, known as the Common Agricultural Policy (CAP). French President Charles de Gaulle’s main argument for the CAP was that French industry could not afford to subsidize its agriculture on its own. There was no question of NOT subsidizing agriculture, it was merely a matter of spreading the costs. Germany agreed (Moravcsik 1998). In 1958 when the member states met to elaborate plans for the CAP, 23% of the French population was in agriculture, 35% in Italy, 15% for Germany, 14% for the Netherlands, 13% for Belgium and 17% for Luxembourg. Agriculture was 12% of France’s GDP, 14.6% of Italy’s, and 8% for Germany (von der Groeben 1985, 71-2). All six founding states had costly and elaborate market support and quota systems, which were politically unthinkable to eliminate or reduce. Parties and politicians who had tried to do so destroyed or jeopardized their political futures (Keeler 1987, 77-8; Warner 1998; Moravcsik 1998, 179-97). Thus, the political solution was to harmonize systems and create the CAP. Until the 1980s, the CAP grew to consume almost 80% of the Community’s budget. At that point, some CAP programs were re-worked and put under the “Structural Funds” rubric, making it appear that agriculture was taking up less of the annual budget (now about 50%, with another 10-20% granted via the Structural Funds).

<sup>11</sup>Cases reported in *Tribunali di Milano e Napoli* (1996), pp. 27-31.

The substantial price differentials from what the world market would pay, and duties paid or avoided depending on country of origin or destination, and product composition and quality, create significant incentives to commit fraud. For instance, import duties may vary by 15% per kilo depending on whether the product was high quality prime beef, or offal (Sieber 1998, 6). Through the 1980s, there were 400 different classifications for milk, and 80 for beef (House of Lords 1989, 17). With prices on the world market often five to ten times lower than in the EC, and with the exporter eligible for a “refund” to compensate for his “loss”, export fraud in dairy, beef and cereals has been substantial.

Further contributing to the potential for fraud is the fact that in many member states, including several of the biggest agricultural producers (France, Germany, Italy), agricultural policy and administration is heavily influenced by the very groups meant to be regulated. Ties between many governing parties and the farming organizations are strong (Conradt 1993; Heinze 1992; Keeler 1987; von Carmon-Taubadel 1993). In France, for instance, the national farmers’ unions have official voice on the many national and regional and local farm administrative bodies which write the rules and manage the programs (Keeler 1987). In many countries, for the purposes of various subsidies and crop “interventions” (in which the product never goes to market but is put in storage or destroyed), it is the local farmers cooperative which “verifies” the extent of the crop and issues the subsidy check for the farmer. The Court of Auditors has noted that Italy gives farmers ten days advance notice of upcoming inspections of declared field plantings (instead of the permitted two), and that French authorities also routinely give farmers more than the EU stipulated 48 hour warning. Required field measurements sometimes are not carried out (CA 1997, 79). After describing a CAP management system in Italy, an Italian judge and legal scholar stated bluntly, “(i)t goes without saying that the division of responsibility between the authority responsible for providing financial support and that responsible for monitoring is absurd” (Giordano 1990, 56) As the monitoring system is “absurd”.

UCLAF officials indicated some suspicion that member states tolerate some forms of fraud because of the economic benefits it brings. The examples cited involved the two busiest ports in Europe, Rotterdam and Hamburg, from which fraudulent transfers of goods have frequently taken place (UCLAF interview, 4 June 1998; cf. CA 1997, 21). The Netherlands and Germany both profit from being the main point of transfer for goods entering and leaving Europe; only after other German Länder complained that too much trade (hence jobs and tax revenue) was, for no obvious economic or logistical reason, going through Hamburg did the German government criticize lax

procedures at the Hamburg port. This is not a signal that a member state government itself makes corrupt use of EU funds, but that it may have an interest in tolerating administrative weaknesses when they work to its economic and political benefit. As a legal scholar notes, “the member States are rather indulgent” towards dubious, even fraudulent, practices (Delmas-Marty 1981, 97).

Further supporting the hypothesis that member states tolerate fraud when it serves their economic interests is the fact that where states stand to lose the most, they are noticeably more assiduous in their monitoring and enforcement exercises. For products on which the states impose high excise taxes, tax evasion due to fraud produces a significant loss for the states themselves. Tobacco products, especially cigarettes, due to the high VAT on them, are an area in which states have an incentive to cooperate, and UCLAF/OLAF has been positive about the cooperation it received from Spain, Portugal, France and Greece. Officials remarked that Belgium is indifferent, seeing the cigarette trade, even illegal, as benefitting its port; and that the Netherlands is less cooperative because a high volume of cigarettes going through Rotterdam represents a large economic benefit to the area (UCLAF interview, 4 June 1998). A House of Lords study noted that “The vast bulk of VAT collected by Member States is destined for the national exchequer. This sector is therefore unusual: any fraud by an individual would affect national revenues much more than Community revenues.” Predictably, in view of states’ pecuniary interests, the Commission’s concern is not just that importers and others are evading the VAT, but on ensuring “that the Member States paid over the correct amount to the Commission” (HL 1989, 14). We see again the pattern of member states not delegating supervisory authority, not delegating adequate powers so that the supranational agency can actually monitor compliance: although the Commission is required to check whether each member state’s “VAT own Resource contribution has been correctly established ... (t)he Commission was conscious of its limited powers to conduct investigations in this area. It was also dissatisfied about its access to Member States’ VAT statistics to calculate the contributions due” (HL 1989, 14).

Clearly, the states’ priorities have not been on control systems. In a 1994 report, the Italian Court of Auditors lamented the “weakness of inspection services” in the Ministry of Agriculture, and noted that the Ministry itself had signaled its structural inadequacies in the area of control, which meant that Italy was barely, if at all, meeting the minimum inspections required by the Community. The report concluded that the central fraud inspection office was

unable to carry out its duties.<sup>12</sup> An indication of the extent of the problem is evident in the fact that the EU has no commonly applied definition of fraud.<sup>13</sup> Thus, what constitutes fraud in Germany may not constitute fraud in Belgium. There is considerable variation across states in how the Community's interests may be represented in a legal procedure concerning Community funds. From the Community's perspective, when it comes to obtaining legal standing, it is best if the fraud occurred in Belgium, France, Luxembourg or Spain. There is also considerable variation in applicable penalties, with member states obligated only to ensure that penalties have a deterrent effect (an unenforceable obligation). European legal scholars have raised doubts about the effectiveness of the states' existing penalties, including their deterrent effects (Delmas-Marty 1994, 61). States' priorities are clear in the fact that it was 37 years after the EEC was established that they passed the first framework legislation meant to make it possible to harmonize penalties for fraud against Community funds. Yet as of 2002, they have not followed through with actual harmonization. This, along with the open borders of the internal market, encourages forum shopping (Grasso 1989, 254-5).<sup>14</sup> So too does variation in the effectiveness of member states' legal systems. It is perhaps no surprise that Italy seems to have a comparative advantage in "producing" fraud.

While there has been an increase in the powers of the ECJ and the Parliament, it is noteworthy that the Commission's only means of "enforcement" has been to bring member states before the ECJ for "infringements" of the EU Treaties or regulations. Yet, even in cases of obvious corruption, such as when a Greek minister tried to cover up a case of fraud against Community funds in 1986, the Court has never had the power to impose penalties. Only recently did the member states, via the Council, agree

<sup>12</sup>*La Stampa*, 14 Aug. 1994

<sup>13</sup>In 1995, the member states agreed to a "Convention" which included a common definition of fraud. As of 1999, only Germany and the Netherlands had ratified it; as of 2001, a few more states had, but the Commission would not list the states which had NOT ratified it.

<sup>14</sup>As Grasso elaborates, reaching a noteworthy conclusion, "the financial interests of the Community receive very varied protection under the various criminal law systems. The differences concern the nature or level of the penalty, the definition of punishable acts and the applicability of certain general institutions ... With regard to criminal law in the economic field, marked differences between various countries with respect to sanctions for criminal acts of identical negative value could constitute a phenomenon likely to distort competition. In particular, where provision is made for fines for infringements, the risk of criminal sanctions may become a commercial risk in many cases. Thus the amount of the fine becomes a cost that can be reflected in the price of the finished product. Consequently, if between two Community countries there is a difference in the level of penalties, firms established in the country with the lighter penalties have a clear competitive advantage."



to give the Commission the right to levy and collect fines for violations of market competition rules, and to withhold future subsidies in agriculture and regional development. As late as 1989, there were no Community regulations for minimum standards of customs inspections of goods leaving or entering the EEC. The states set up their own implementing provisions. Likewise for the administration of agricultural programs, in which, on the basis of unverified statements by the states of their need, the Commission automatically grants funds to the states. Only later, during the annual accounting procedure, are the states required to account for expenditures, reporting irregularities. And at that point, with the money spent, they have no incentive to do so: should they not be able to recover funds from the individual or business in question, they owe the Community those funds. As the House of Lords noted in 1988, “Member States have been unwilling to notify the Commission of established fraud unless they are certain to collect the amounts due (from the fraudster), or unless they will not be required to pay up the sums to the Community. The result is that (to quote a European Parliament report) the Commission ‘has little idea of what is actually going on.’” (HL 1989, 13).

Aggravating the situation is the fact that while most agricultural and other trade is transnational, both within the Community and between it and third countries, administrative and judicial systems are national. Ten years ago, the Court of Auditors reported that the “Member States’ control systems are not designed to cope effectively” with that situation. While there have been ad hoc efforts, and some work by the Commission, to improve coordination, the Member State governments have done little to overcome the significant gap between the scope of the Community’s internal market (and international trade) and their nation-state based legal and administrative systems. Gathering of evidence requires cooperation between numerous national and local jurisdictions, evidence admissible in one state is not in another; the suspect(s) may have to be extradited (which generally does not happen in revenue crimes), and the bank accounts may be in Switzerland (not an EU member) or offshore.<sup>15</sup> These conditions have allowed not only domestic special interests to take advantage of Community programs, but also organized crime and third country nationals.<sup>16</sup>

<sup>15</sup>As the House of Lords noted in 1988, “Traditionally revenue offences have not been extraditable. This reflects the international law principle that states do not assist one another to enforce their revenue law, and this principle has not been adapted to take account of Community law, under which Community money belongs in effect to all Member States.” (House of Lords 1989, 30).

<sup>16</sup>Weighing against the hypothesis are statements from DG Competition and DG Internal Market officials that the states generally act in good faith, on occasion they may be “economic” with the facts they report to the Commission, and that most cases of non-

The rational choice institutionalist perspective would account for these feeble monitoring and enforcement mechanisms with reference to principal-agent dynamics. The states could not agree on or find a method of ensuring that, if they delegated real administrative, monitoring and enforcement powers to supranational institutions, the agents would not “behave in ways that diverge from the preferences of the principals” (Pollock 2000, 6). Yet this could imply that the concern of the member states is that the agents would be *too* effective in monitoring the behavior of the principals! If the concern of the member states were that other states would be defecting from the Treaties’ obligations, then a supranational institution would have been better situated than each of them individually to monitor the behavior of the other states. It appears as though the states have made various agreements they don’t really want to keep, and the best way to not keep them is to retain the bulk of administrative, monitoring and enforcement powers.

Alternatively, the historical institutionalist perspective would argue that fraud is an unintended, unforeseen consequence of the EU’s structures, and that the reason states have not adequately addressed the problem is that the current institutional structures raise the costs of change. Yet when sufficiently motivated by domestic economic concerns, states have shown a striking ability to change their domestic and supranational institutions—the introduction of the euro is a prime example.

### *Policy Networks*

The policy network hypothesis is supported at least by the multiple references made in Court of Auditor and OLAF reports about organized crime, criminal networks, being the major perpetrators of fraud in the EU/against the Community budget. It is known that much of CAP fraud is coordinated by organized crime syndicates which operate in many countries: the Commission counts at least fifty known syndicates (Commission 1998a, 20). These observations are similarly echoed in European Parliament reports. EU fraud cases typically involve nationals from at least two member states, often three or more, and the EU nationals usually work in coordination with non-EU nationals in Eastern Europe, or the Third World. As judged by a comprehensive study of Community fraud in France and Germany between 1960 and 1982, criminal networks developed almost immediately in response to the opportunities created by the institutions of the EEC (Roche-Pire and

compliance are not “political” or related to fraud or corruption but to misunderstandings or different interpretations of directives. Interviews, DG Competition, DG Internal Market, Brussels, 7 Feb. 2001.

Delmas-Marty 1982).

### *Culture as a factor*

The cultural hypothesis is both upheld and contradicted by statements from interviewees, and from the documentary record. As a Commission official noted, one of the biggest fraud cases (in the European Social Funds, a subset of the Structural Funds) opened in the Netherlands in the late 1990s, where one might not have expected it. Another official commented that member states do seem to have different norms and standards, while several others argued that, as said above, the amount of fraud and what country it occurs in depends on the volume of funds and the specific mechanisms in EU programs. Inquiries about regional variations within countries on the application of Regional policies and competition yielded similar statements. An official dealing with Italian regional policy stated flatly that northern regions could be just as problematic as southern, and that if the south seems to have more problems, it is because of institutional features of southern regional governments, many of which retain the authority to make what are essentially administrative decisions. Hence, when a regional government falls, no one can “sign the checks” or authorize program implementation. One could argue about whether that institutional feature, which predominates in the south, is itself a result of cultural traits, or of “political history”. A public procurement officer in the UK noted that in EU negotiations about procurement rules, it is the northern states that would prefer looser procedures to facilitate efficient contracting, and the southern which argue that the rules must be fixed and detailed to prevent fraud and corruption (author interviews, Jan.-Feb.-March, 2001, Brussels, London). This implies that there are differences in public norms across states.

### **A word about corruption**

Because elections are still member state based, including those for the European Parliament, corruption is largely a member state problem, not, despite the extensive publicity in 1999, a problem within the supranational EU institutions such as the Commission. Newsworthy cases such as Elf in France, shady financing of Helmut Kohl’s CDU in Germany, Enimont in Italy, and the lesser known but more frequent local and regional cases have at their base efforts by political parties and politicians to attain more financing. Decentralization in the name of democratization in many European countries has brought with it the need for more elections (to regional and local

governments), and, inevitably, for more parties, politicians and their campaigns to be funded. While those needs have not been adequately met with legal funding, neither has the need for more oversight. Corruption most often occurs through kickback schemes on public works contracts, contracts which account for 10-20% of the combined GDP of the EU states. And, to the extent that these collusive arrangements violate the EU's many regulations on public procurement, it is here that corruption intersects with the EU. The EU seems to be working at cross-purposes: in promoting more democracy through decentralization while promoting more competition in government contracting, the EU and its states are creating a huge demand for party financing while shrinking the supply (traditionally met partly through kickbacks and other illegal payments on public works contracts).<sup>17</sup> *That*, however, must be the subject of another essay.

Minor cases of corruption, involving customs officials or other inspectors, have on occasion been documented in relation to fraud against the Community funds. It has not been possible yet to trace the connection between what appear to be domestic cases of corruption and Community funds or regulations. This is a subject of my research at the time of writing. It is not possible to say whether national governments (and their party coalitions) and other political parties are involved in EU fraud—if they were, it would amount to corruption. But, returning to the discussion of the definition of corruption, it may be enough that the member states have been negligent in pursuing Community fraud, in allowing its growth—have they not permitted the corrupting of the bases of the Community? As some would say, to the extent that the member state governments have facilitated by neglect (deliberate or benign) the degeneration of the Community's founding ideals, they have corrupted it (d'Aubert 1994; d'Aubert 1999).

## **Closing Remarks**

In March of 1999, the entire European Commission, including its president, was forced to resign under pressure from the European Parliament. A "Committee of Independent Experts" (CIE), appointed by the Parliament, had published a report exposing considerable mismanagement and possible fraud within the Commission and its Directorates. The report also noted problems with the administration and capabilities of UCLAF. While the Commissioners were not all found to have personally engaged in fraudulent activity, they were

<sup>17</sup>Parties also have been financed through a variety of legal means, which have also been diminishing. Yet illegally gained funds have clearly constituted a significant if not specifiable portion of their resources.

found to have “allowed, or even encouraged, conduct which, although not illegal *per se*, was not acceptable” (CIE 1999, 9.3.1). Within the Commission’s Directorates, however, fraud found an easy target: lax oversight, insufficient or unqualified personnel, and programs which mandated rapid awarding of contracts (e.g. CIE 1999, 6, 7.8). The “MED” program, to give aid to the southern Mediterranean countries after the Gulf War, is but one example. As the CIE report states, the program’s main goal was “to channel the cooperation funds by means of subsidies to non-governmental organisations,” avoiding member state government offices. The Commission contracted with a consultancy to set up a network of private firms to administer the program. The conditions under which the private firms were chosen were dubious, the Commission’s response time when alerted to irregularities was very slow (CIE 1999, 3.1-3.4), and there were conflicts of interest between the Commission and the private firms, and between the several private firms (CIE 1999, 3.5). That the Commissioners’ escaped direct charges of fraud and corruption is largely due to the CIE’s restrictive definition of fraud. If one adopted the International Monetary Fund and World Bank’s definition, “the use of public office for private gain” (Gray and Kaufmann 1998, 7; cf. Lancaster and Montinola 1997, 188), then one might find more instances; for example, the case of Edith Cresson, cited above, whose staff member appears to have conducted work on behalf of Commissioner Cresson’s political career in France, rather than carry out any EU responsibilities (CIE 1999, 8.1).

Allegedly in order to better “police” the Commission and its bureaucracies, UCLAF was transformed into OLAF (*Organisation de la Lutte Anti-Fraude*): a general anti-fraud office, with, nevertheless, restricted powers of investigation, and no possibility of bringing prosecution (House of Lords 1999, Part I, 15). Its powers vis-à-vis the member states were not increased. The changes made appear to be largely cosmetic, indicating the reluctance of the member states, the so-called “principals,” to subject themselves and their actions as agents administering EU programs, to any effective oversight.

This paper has raised the possibility that some types of fraud and corruption are a deliberate strategy on the part of member state governments. They and their key economic allies benefit from it, while the costs are borne by a diffuse group which is incapable of unseating them. This hypothesis does not help us decide whether all member state governments will do this, or merely those with a tradition of using corruption or patronage in their own countries. What little evidence I have found has produced mixed answers. It does seem safe to say that where a member state government’s electoral interests are threatened by EU fraud, the member state government is more likely to support anti-fraud action.

The Commission's resignation in 1999 provided the states with a convenient scapegoat for EU fraud: the Commission. The latter is indeed an example of the problems and difficulties associated with the unique institutional structure of the EU: in contrast to standard parliamentary democracies, the Commission's leadership is not responsible to a legislative body. Commission membership is not derived from the European Parliament; the European Parliament can only oust the entire Commission, and the member states can only recall their own respective nationals. The Commission does have to justify its expenditures and contracts to the Court of Auditors and European Parliament, but despite a recent change in the relationship between the new (Prodi) Commission and the Parliament (September 1999), it is likely that many years will go by before the Commission is held wholly responsible for its actions (CIE 1999).

Ironically, although the solution to fraud problems in the Commission may lie in giving it (and the European Parliament) more powers, particularly overlapping powers and an EU-level policing and customs agency (cf. Andrews and Montinola 1998), the member states now have the excuse they need to avoid doing so. Why give *more* power to a badly run institution? Unfortunately, the Santer Commission's failings have taken the focus away from the areas where the most costly fraudulent activities take place: the programs administered by the member states, including the preferential tariff agreements (House of Lords 1999, Part I, 2).

There is, of course, no guarantee that by making the EU's structure more like a parliamentary system (federal or centralized), fraud and corruption will be reduced. Italy, Greece and Belgium immediately come to mind as reasons for pessimism. The European Parliament's relative "innocence" may be a function of its being relatively powerless, in comparison to the Commission and the member states. If institutional position and opportunities are what fuel fraud, then strengthening the Parliament could result in yet another locus for activities the EU would like, in principle, to discourage.

In addition, Commission and Court of Auditor officials are reluctant to rank member states according to how corrupt they perceive them to be, or to say which states tend to have the most fraud. Occasionally an official would note that a particular country, or region ("the northern states") tended to comply with a set of rules, but because being explicit about fraud in the member states against the Community is perceived to be "too political," officials will not implicate particular states. They are also reluctant to name specific cases.

This paper has outlined fundamental questions pertaining to international organizations: can an institution like the EU, which both draws and depends upon national preferences, personnel, and institutions, succeed in constraining the various forms of fraud and corruption which have, at least at times, characterized the practices of its members? Can an international organization be structured so as to minimize the incentives and opportunities for each member state, its economic actors and citizens, to exploit the organization's collective funds? If it was meant to solve a collective action problem for national interest maximizing states, can it also not become a victim of those interests? Answers to those questions will contribute to our understanding of the sources of fraud and corruption; how culturally bound or country-specific is corruption's definition and practice? Is it mainly a question of institutional structure and agent incentives, and of the operation of international institutions?

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