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Research into economic crime[1]

2000 - 2003

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Extended summary

I. Research background

There is no doubt that economic crime is a phenomenon the extent and seriousness of which has grown dramatically in our society in recent years. Comparison with the state of affairs ascertained regarding this form of crime in 1989 or before that date is basically not possible in view of the subsequent fundamental change in economic relationships in society. Nevertheless, while the share of economic crime in the number of criminal acts recorded from the beginning of the 1990s did not exceed 5 % until 1994, in 1997 it had already reached 7.5 % and in 2002 11 %. The losses caused by economic crime detected are striking: in absolute terms they amount to the sum of CZK 14 billion in 1995 and CZK 44 billion in 2001, which meant nearly 80 % of total losses caused by all detected crime in that year[2]. Here it can reasonably be assumed that in addition a far from insignificant part of economic crime is hidden in what are termed „shadowy numbers", i.e. latent crime – not reported or not detected.

The danger posed to society by economic crime is therefore evident. It is not only a question of the amount of losses caused, though this is staggering. It is also that cases of economic crime have a destructive effect on social awareness, both by directly harming citizens (for example, depositors in financial institutions attacked, employees of what are termed „tunnelled" companies and so on), and by the difficulty in detecting, proving and prosecuting them. Also the fact that a new type of offender appears among those who commit economic crime – qualified professionals, often first time offenders, occupying (and abusing) positions of responsibility in the management structure of companies and institutions can have a negative impact. This may induce the notion that some of these cases and offenders cannot in practice be prosecuted, which will result in a weakening of trust in the institutions and guarantees of a democratic and just state.

It is a paradox, though only seemingly, that the number of victims of economic crime is higher than the number of victims of general crime. For the victims of economic crime are not only those who are the direct targets of criminal attacks, which are usually legal entities operating in the economic sphere or the state, but also people, not only as depositors or employees of organisations attacked but also, for instance, as customers harmed by price manipulations, poor quality products or services, as inhabitants of an area harmed by the behaviour of firms towards the environment, and also as citizens of a state affected by the consequences of lack of funds in the state budget due to tax evasion[3].

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[1] Scheinost M., Baloun V., Kadeřábková, D., Krejčová, S., Nečada, V., Trdlicová, K., Diblíková, S., Macháčková, R., Rozum, J. Výzkum ekonomické kriminality. Praha : IKSP, 2000. 169 stran.

[2] Source: Statistics of Czech Republic Police

[3] Cf. Economic Crime. Strasbourg: Council of Europe, 1981, p. 19.

The new structures of economic relationships in the Czech Republic have also brought new forms of criminal activities in the economic field. Forms emerged that were already known in societies with a market economy but did not exist before in a socialist planned and state controlled economy, but also forms to a certain extent specific and characteristic for the period of transition from a planned economy based on state ownership to a market economy based on private ownership. All these features of the development of economic crime in the Czech Republic more than justify research interest in this phenomenon.

This research into economic crime was carried out between 2000 and 2003. The subject of the research was given the overall name ***economic crime,*** although we are aware that the content of the term *economic crime* has not yet been clearly defined and does not have a uniform and so generally respected terminological content definition either in criminal law theory or in criminology.

For the purposes of the research it was necessary for this reason first of all to address the question of **definition of the subject of it, i.e. economic crime.**

Economic criminal activity differs from other types of crime such as general crime, violent crime, immoral crime and so on primarily in that its activity patterns are in practice identical to the legal economic life patterns, that the same economic tools and the same procedures are used. Economic criminal activities do not only bear a similarity to the legal economic environment in the tools and procedures used, but also in common with it use the same terminology (e.g. costs, revenues, business transactions, accounting transactions, losses and so on*).* To these similarities we can also add with only slight exaggeration one and the same economic interest, i.e. achieving the highest possible financial gain, which of course where economic crime attacks and protection against these attacks come into conflict represents an attempt to minimise the financial gain of the other party.

For the purposes of the research, **a working definition** of economic crime was conceived as *unlawful economic behaviour by which a financial or other benefit was obtained at the expense of a particular economic entity (the state, a business company, a fund, a natural person etc.) which meets the legal characteristics of the facts of specific criminal acts*. Economic behaviour is behaviour which is effected in the economic environment using economic tools and those who conduct it are people who know this environment and know how to use these tools.

A special sub-group of economic crime, ***financial crime,*** was defined in the research *as deliberate unlawful activity against an asset committed in connection with financial investment business and directed against it.* These acts have mostly been committed in collective investment in the financial and capital market in connection with the activities of banks, investment companies and funds, dealers in securities and pension funds. What is termed ***money laundering***, or legalising of unlawful gains, i.e. *activities serving to conceal the existence, factual nature and final use of income obtained in an unlawful manner* can also be regarded as a special sub-group.

This concept of economic crime may extend beyond the scope of criminal law in force. The level of an attack on a protected interest, or the „degree of seriousness“ of such an attack, then determines whether civil, commercial and administrative law is to be strengthened in prosecuting this attack or replaced by criminal law.

This means that research attention was also where possible devoted to economic behaviour which is considered as undesirable and harmful, even though it does not contravene criminal law currently in force, and consequently links between criminal law standards and non-criminal legislation regulating economic relationships were also studied.

The aim of the research was:

- progressive definition of the concept of economic crime and related categories with greater precision and systems criteria of the issue studied
- description of economic crime in the Czech Republic in terms of describing the situation, the main forms and selected activities, development trends, or international background
- analysis of relevant legal regulations covering prosecution of economic crime in the Czech Republic, also with respect to existing standards and recommendations of international organisations
- description of possible risk factors in society, including legislative problems
- formulation of eventual proposals based on research findings

II. Methods used

A comparatively wide range of **research methods and techniques** were used during the research project linked with the phases of the research and the nature of the issue examined. The following were used in particular:

- *analysis of statistical data*, particularly Czech Republic Police statistics and judicial statistics
- *secondary analysis of relevant studies, materials and sources available* on the problem examined, for example documentation from the Office for the Protection of Economic Competition, The Czech Economic Chamber, control bodies, banks, materials from professional conferences in other countries on financial crime, articles in professional journals and so on
- *study of the development and analysis of relevant legal standards in the Czech Republic* (the Criminal Code, the law on bankruptcy and settlement, the law on administration of taxes and levies) and documents and recommendations of international organisations
- *case studies* linked with empirical material available (particularly based on court files and public prosecutors' offices)
- *analysis of court files* on closed cases of economic and financial crime of a representative sample of files requested on cases closed in 2000 and 2001 with a final court verdict. A total of 115 court files were obtained and analysed. The following were studied in these files: the legal evaluation of the criminal activity, the length of the proceedings, problems of proof, the nature of evidence used, modus operandi – the nature and the method of commission of the criminal activity, the amount of loss caused, linkage to the non-criminal area, targets attacked (harmed), verdicts, offenders
- *Administration of a questionnaire to staff of institutions engaged in the conduct of criminal proceedings (the police, public prosecutors' offices, courts);* a total of 219 completed questionnaires were obtained
- *Consultations with selected experts* (for example from the Financial Headquarters for Prague, the Central Finance and Tax Headquarters of the Czech Ministry of Finance, a specialist department of the Supreme Public Prosecutor's Office in Prague, the Bank Asssociation, ČS Obchodní banka, Komerční banka)
- *Analysis of the press and sources on the Internet* as an auxiliary source of information

III. Research findings

The research findings were formulated in the final report in a number of separate sections. First of all, the research was directed at the development of criminal law: preparation of a summary of the most important provisions of the Criminal Code regulating economic crime together with statistics on criminal activity detected which is given weight in the particular provisions of the Criminal Code. The basic factors affecting the quantitative and structural occurrence of economic crime activities were analysed, particularly the influences of the social environment and the legal framework. Then the current state of the occurrence of economic crime and how it differs from development in the past was described. The researchers also looked briefly at the issue of proceeds from crime and their legalisation. In view of the fact that the issue of financial crime studied within the scope of this research had been summarised and published in a separate concluding study, only a brief outline of this phenomenon in the Czech Republic was included in the summary report on research into economic crime, supplemented by a specific study of the development and the problems of the banking sector in the Czech Republic. An attempt was made in a separate chapter to characterise the typical methods of committing specific types of criminal act in the economic area.

A separate section was also devoted to an analysis of research findings relating to targets attacked by criminal activity in the economic sphere (the state, financial market institutions, business and commercial companies, entrepreneurs etc.) and to those committing this criminal activity. The activity of judicial authorities in prosecution of economic crime, and the issues of proof, criminal proceedings and sentences imposed were analysed. Great attention was also given to the non-criminal area, i.e. legal standards regulating economic processes and relationships (for example, the Commercial Code, tax law, the law on bankruptcy and settlement and so on), and findings relating to criminal and non-criminal standards.

The findings compiled in this research can be summarised relatively easily and briefly. The working definition of economic crime made for the purposes of this research was shown to be productive and can be regarded as a contribution to further discussion on definition of this category of crime. It also confirmed that financial crime can be considered in terms of its characteristic features and also in terms of the targets victimised as a specific sub-group of economic crime.

It is not necessary to stress again the danger of the consequences of economic crime in the economic field, the close resemblance of its technical procedures to normal economic activities and, because of this similarity, the complexity of documenting and successfully prosecuting it. More than with other types of crime it is also a feature of economic crime that it is very difficult to determine the boundary between unethical behaviour, behaviour which makes use of all possibilities at the very borderline of legislation in force, and behaviour which goes beyond the boundary of criminal law.

Economic crime has an exceptional social and economic impact on the internal stability of a state. In addition to other aspects, it affects the basic income raising elements of a state (taxes, customs duties, levies), the endangering of which casts doubt on the long-term and efficient functioning of the state mechanism. A significant part of its manifestations is a complex civil law, economic and criminal law problem, the solution of which requires special

expertise and constant updating of knowledge both of staff of legislative bodies and staff of state administration authorities and bodies responsible for criminal proceedings.

One of the most important achievements in the 1989 post-November changes in the law is unquestionably elimination of distinctions between individual types of ownership, which meant loss of justification for special criminal law protection favouring social ownership, but on the other hand adequate regulations and perhaps sanctions were not stipulated for transfer of this ownership into private hands and for the fundamental change from a planned to a market economy.

The suddenly acquired chance of freedom to do business without proper definition of the boundaries (limits) of economic competition, the real and sometimes also ill-judged support of some „enterprising“ individuals at the beginning of the 1990s, all this created the conditions for the committing of unlawful financial machinations and also various new forms of economic crime (what is termed tunnelling, and asset and tax fraud).

The Criminal Code in force, Act No. 140/1961 Coll., has been revised many times since November 1989. Although there have been fundamental changes in the general and also the special section of the Criminal Code, revisions have often only reacted principally to the immediate needs called for by the dynamics of criminality and there were only a few in-depth changes in the conceptual framework of the criminal law.

The present criminal code contains individual facts covering criminal activity in the economy, many of which were only incorporated or newly formulated after 1989. In our opinion, however, the effectiveness of these criminal law provisions is still inadequate and bodies responsible for criminal proceedings are unable to prosecute economic crime quickly and to the full extent. The evident links between a whole range of facts associated with business activity and the non-criminal legal standards regulating the economic sphere and economic behaviour are also essential. In particular the quality and transparency of these non-criminal standards are the subject of criticism from staff of bodies responsible for criminal proceedings, as has come to light from the research carried out.

It should be noted that the criminal law does not have the resources to be able to eliminate or reduce significantly factors which give rise to economic crime. It is only of a subsidiary nature in the economy. The scope of criminal prosecution is restricted by the principle of the supportive role of penal repression. This means that penal repression is applied only as a last resort, where other means, mainly of an economic nature, do not suffice.

Functioning market economies have sufficient self-cleaning regulatory mechanisms which we do not have here: the effort to „control“ the economy by law and the effort to capture criminal activity in this field as precisely as possible also stem from this. This endeavour is, however, quite counter-productive and this opinion is confirmed by constant references to inadequate legislation. On the other hand the view can be expressed that the greater the detail in which any criminal activity is described, the easier it is to find loopholes to get round the wording of the law.

The decisive influence in this area must be played by tools other than those of criminal law. This is in particular an efficient non-criminal framework for business and economic competition. This should include corresponding regulation of legal relationships connected with entrepreneurial and with economic activity in general, including rules enabling the

enforceability of a breached right as quickly as possible. Factors such as adequate control mechanisms and efficient state apparatus also play an important role. The existence of effective non-criminal sanctions for breach of non-criminal legal standards and an emphasis on their application should for this reason play one of the key roles in preventing economic crime.

There is no doubt that excessive and not particularly clearly formulated regulation of the economic environment is in no case a preventive element for the occurrence of criminal activities in the economic area and does not provide a clear guideline for the work of bodies responsible for criminal proceedings when prosecuting. The state of non-criminal legislation is not in itself regarded as the determining cause of economic crime but its lack of transparency, its complexity and specialist demands on the bodies responsible for criminal proceedings lead to an undesirable situation as regards the length of court hearing of complicated economic crime cases.

According to the opinion of staff of the bodies responsible for criminal proceedings, the greatest problems in prosecuting economic crime are difficulty in proving it, then the great demands on specialisation in an economic issue (from which follows a certain dependence of these bodies on court expert witnesses who prepare expert opinions) and also the vast quantity of documentation which has to be studied and assessed in connection with the cases prosecuted. The excessive complexity of non-criminal legislation was naturally also mentioned.

There is equally no doubt, of course, that the quality of criminal law regulation has great weight, particularly for criminal law evaluation and for the actual prosecution of criminal acts. Here too there are elements which can be worked out more suitably, though it is probably not particularly important what place they have or will have in systematic codification of criminal law. Criminal law theory could contribute in this respect.

To a majority of the staff of bodies responsible for criminal proceedings (55 %), current practice in imposing sentences for economic criminal offences appears rather lenient or too lenient, but on the other hand only 5 % of the respondents (12 judges, no public prosecutor and no police officer) inclined to this opinion. Just under a third of the respondents (32 %) consider current practice suitable.

Nearly two thirds of the respondents recommend greater use than at present of one of the sentences not linked to imprisonment for those who commit economic crime offences, particularly forfeiture of assets and fines.

At least two thirds of the respondents think that use of non-criminal sanctions imposed in administrative proceedings is effective for prevention of economic crime.

Two thirds of the respondents do not think that it is necessary to change the existing prison sentence terms for facts relating to economic crime. Where they show an opinion for change of sentence terms, a clear majority propose an increase in sentence terms, particularly for criminal offences causing very high losses.

Not even good quality criminal and non-criminal legal regulation in itself, however, guarantees effectiveness and success in the fight against crime. A continuing problem is insufficient staffing and material provision for prosecuting economic crime and lack

of specialisation in all bodies responsible for criminal proceedings. Correct interpretation and application of criminal law regulations require a qualified approach on the part of sufficiently specialised bodies responsible for criminal proceedings and other state institutions.

Another necessary factor for combating these criminal activities successfully is the required specialist knowledge of the economic climate, economic tools, the possibilities of their functional use, basic knowledge of normal economic activities and basic knowledge of the sanctioned boundaries between behaviour that is still legal and that which is already criminal. For this reason it is probably suitable to continue to deepen the specialisation of bodies responsible for criminal proceedings, to encourage the need of their individual officers to deepen their theoretical and practical knowledge, which will undoubtedly also bear fruit in the area of greater professional self-confidence and one of the desirable benefits may also be the so much awaited enrichment of the judicature from the economic area. It is very encouraging that it is precisely in this direction of further training that both public prosecutors and judges have great interest and have precisely formulated specific requests for departmental forms of training.

From analysis of the material available it was possible to state a number of more general findings relating to economic crime, particularly in the sense of showing that there is a range of facts and phenomena which make the activities of those who commit economic crimes easier or increase the negative impacts of this form of crime.

The high latency of economic crime, also recognised by staff of bodies responsible for criminal proceedings, is evidently also accompanied by a certain degree of organisation and international overlap, even though it is the case that economic crime is mostly committed in a relatively primitive manner, using simple plans of action. It is, of course, also the case that organisation is not proved and prosecuted in economic crime; it is also the case that massive losses in the order of millions of CZK are caused in a primitive manner. In addition to the entities which are the direct targets of criminal attacks and are harmed by them, there is in the case of economic crime a typical wide range of persons indirectly harmed (employees for whom insurance contributions have not been paid, for instance, fund members or investors who have lost their deposits or shares, customers of banks suffering losses and so on).

In a number of cases there are indications that criminal activity is being or may be committed (there are clearly suspicious activities, breach of norms, the clearly difficult financial position of the offender or company), but those around the offender or offenders do not react to these signals for various reasons and so enable it to continue or develop. Economic crime, however, is made possible not only by indifference or tolerance of those around but also by the gullibility of victims or the use of impressive advertising (promises by cooperative savings banks that deposits will go up in value by 17-30 % p.a. should in themselves be suspicious; even so they have attracted a number of customers).

The establishment of financial market institutions (cooperative savings banks, investment funds, pension funds and so on) was very easy, and the credibility of the founders, who sometimes came from a very dubious environment, was not questioned. It was relatively easy to „anaesthetise“ statutory bodies, to transfer real power to certain individuals and in practice to exclude internal control, and external control was not performed for quite a long time; in general, control activity in the economic sphere was clearly very inadequate. Offenders took advantage of loopholes in laws (for instance, cooperative savings banks could not perform certain activities themselves but could set up subsidiary companies which were in

a position to carry out these activities and so forth). Significant problems were caused by the possibility of owners of limited liability companies to establish new companies without major problems, without any liabilities of a previous company being settled. Generally it was confirmed that breach of non-criminal norms setting rules for economic life (the law on accounting, on investment companies, on securities etc.) is relatively frequent and at the same time inadequately controlled and penalised.

As far as offenders are concerned, though it was confirmed that there are intelligent people among those who commit economic crime, and there is a manifest tendency for a higher level of education among them (some forms are typical for the group referred to as „white collar"), it is also the case that economic crime, at least as far as the Czech environment is concerned, is far from being only the domain of such offenders. A substantial number of them obtained their knowledge through their own business practice rather than by acquiring formal economic qualifications and it was also shown that offenders with a lower level of education are also capable of causing very high losses. What is alarming is that around a fifth of crime perpetrators are re-offenders, indicating that even persons already convicted have relatively easy access to the business sphere. It seems that for the Czech environment until recently gullibility and lack of experience of victims rather than high qualifications and creative capability of offenders has until recently made it relatively easy for this criminal activity to be committed. Evidence for a certain prevailing „simplicity" of offenders is also provided by the fact that proceeds from criminal activity were allocated decidedly more for their own use than for investment in expanding current or creating new legal economic activities.

It was shown that certain „hangers-on" – providers of services (legal, economic, financial etc., arrangers of contacts, loans etc.) for payment (commission), which often proceeds without documentation, may live off those committing economic crime; the service providers themselves usually cannot be legally prosecuted, even though the danger of this „entourage" to society is considerable. Offenders naturally also often take advantage of the tolerance and assistance of colleagues (who sign receipts without checking them, entrust power of attorney, allow documentation to be inspected and so on), and this is regarded as permissible breach of norms in the interests of friendly favours. In general it is shown that in a number of companies and institutions there is completely inadequate internal control of their own staff. Even in banks and other financial market institutions it was shown that there was clearly frequent breach of legal norms regulating their activity and of internal regulations and there was inadequate control over the activities of managers and members of statutory bodies both on the part of these institutions themselves and on the part of external auditors and supervision authorities. In banks in particular there also seems to be a typical attempt to avoid criminal prosecution of their own staff and to resolve cases discovered as far as possible internally.

Linked to this to a certain extent is carelessness and lack of diligence on the part of companies in employing persons who have already been convicted or whose mistakes have come to light before – it was often found in the documentation analysed that positions involving handling funds were entrusted to persons who have already been convicted, even for embezzlement; a teller of a bank who was responsible for a loss was left in a position where she had access to clients' accounts etc.

The situation of original producers on the market, who under the pressure of competition and limited demand try to put their products on the market or sell them for any

price, can be regarded as one of the factors which enable criminal activities to become more widespread; as a result, they entrust their products to traders (agents), without checking their reliability and ability to pay their liabilities.

In most prosecutions for economic crime in the last few years the number of persons indicted has risen (this is typical, for example, under § 250b – loan fraud), which on the other hand is an indication of the growing effectiveness of prosecuting this form of crime and also the greater effectiveness of the work of bodies responsible for criminal proceedings. It is of course the case that the number of offenders convicted for economic crime compared with the number of persons who are prosecuted for this form of criminal offence continues to be substantially lower for economic crime than for property crime, or in comparison with the total number of persons prosecuted and convicted. For example, in 2002 (even though comparison in one year is naturally for many reasons imprecise and only indicative), the proportion of offenders convicted compared with the number of persons prosecuted for economic crime amounted to 40 %; for property crime this was 64 % and for the total number of persons prosecuted 70 %. This again confirms the complexity and difficulty of criminal proceedings in cases of economic crime. In the future it will undoubtedly be interesting to note whether the propose law on the criminal liability of legal entities will show positive results in the effectiveness of prosecutions for economic crime and on the other hand whether the anticipated additional new forms of criminal behaviour following entry to the European Union will affect economic crime.