

# Economic Fraud in International Business: Forms and Implications

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## Abstract

*This paper aims to highlight the main forms of economic fraud, such as mortgage fraud, charity fraud, identity fraud, insurance fraud and immigration fraud, and how the funds resulted from these illegal activities are converted into white-money by money laundering and used as funds deriving from legitimate sources. The whole process is affecting the economy and political stability of the countries in which they occur, and hence such activities must be forcefully fought and joined forces should take strong measures, in order to destroy such organizations. This paper is an attempt to explain the concept, significance and implications of the above process.*

**Key words:** economic fraud, money laundering, mortgage fraud

**J.E.L. classification:** K420

## 1. Introduction

Economic fraud is a type of criminal activity that appears when someone obtains money of other goods/properties, and handles them in an illegitimate way, with the intention of obtaining profit from these actions. These fraudulent activities usually include some form of fraudulence, stratagem, corruption or wrongful use of power, which places them on a different position than a common theft. In international economy, fraud and financial crimes can take different patterns. We will further analyze the most frequent forms of financial fraud, such as charitable fraud, mortgage fraud, insurance fraud, identity fraud, immigration fraud and money laundering.

Money laundering is the procedure by which a considerable sum of money that originates from an illegitimate activity, such as white-collar crimes, organized crime, terrorism and drug smuggling is moved into apparently legitimate businesses, in order to camouflage the provenience of the funds. In simple terms, it is converting black money into white money. If the actions are successful, the criminal organization that generates these actions, gain control over the funds and covers them in a legitimate umbrella.

Money laundering is an international issue. Criminal organizations have the intention to act in foreign jurisdictions with flexible and tolerant financial laws, as they relocate the illegitimate funds, with the agility and easiness of online transactions (Perri *et al*, 2011, p.46).

As compared to street crimes, the above forms of economic fraud and money laundering are modern crimes. Sometimes, they are referred to, as victimless crimes, but the reality is that they are not crimes targeting a specific victim, but they are crimes targeting communities, societies, and even states, economies, governing bodies, rules of the government, and the whole world. They have become a worldwide menace (Makarenko, 2004, p.141).

This paper will further analyze the main forms of financial and economic fraud and how the result of such actions are linked to criminal organizations and even terrorism, thus resulting in having a crucial role in financing their activities.

## **2. Theoretical background. Economic fraud – mechanisms and implications**

### **Mortgage fraud**

Mortgage fraud is a form of crime that involves some form of falsification or inaccuracy in mortgage documents. For example, a buyer, mortgage broker or other real estate qualified person that completes fake documents and forms, or gets hold of an exaggerated property appraisal is committing mortgage fraud. Usually, fraud involves two parts: the part that issues false information and the part that uses that information to make the deal.

Experts found that this is the most rapidly growing category of white-collar crime (Poole, 2007). Criminals can get access to large amounts of money in short periods of time, which makes mortgage fraud very alluring as opposed to the high-risk actions of drug distribution. A few cases of mortgage fraud have been related to terrorist activities. In 2006, Nembr Ali Rahal, in Michigan admitted he was guilty of mortgage fraud so as to avoid being charged in addition with terrorist activities. During investigations, inside the home of the defendant were found books, posters and recruitment videos of the Hezbollah terrorist organization. Rahal had illegally disposed of more than \$500,000 by using false information on a mortgage application (Poole, 2007). In another matter brought to the court of Michigan State, more than \$200,000 were gained by mortgage fraud and cigarette smuggling, by Mohammed Krayem and Youssef Kourani and shipped to the Hezbollah Chief of Military Security for Southern Lebanon (Poole, 2007). Ahmad and Musa Jebril were found guilty of mortgage fraud, in June 2005, in addition to stealing almost \$250,000 from different bank accounts and up to \$400,000 from dozens of people (Poole, 2007).

### **Charitable fraud**

Charitable fraud consists of misleading people in order to obtain money from them, by giving them the false belief that they are contributing to charity funds. They most frequently dispose of materials and booklets that lead people to believe they are part of different charity organizations and ask donors for contributions in money to the unreal charity fund.

Charity funds are a suitable cover for gathering large sums of money for criminal organizations and according to the expert Steven Emerson, "charities played a key role in the September 11 attacks" (Emerson, 2002). Charities are functioning under essentially more lax laws and requirements as opposed to financial institutions and that makes them particularly attractive to terrorists. The considerable amount of money and other assets possessed by charitable organizations is leading to the conclusion that even if a small part of these funds are transferred to terrorist organizations, we are facing a great threat (FATF, 2008). For example, in 2008, Holy Land Foundation was found guilty of transferring millions of dollars to the terrorist group Hamas, over a period of 13 years, money obtained through money laundering and tax fraud (Emerson, 2002).

### **Identity fraud**

Identity fraud includes all types of crime, in which a person illegally obtains and uses someone else's personal/financial information (social security numbers, card PIN numbers). This is one of the most rapid-growing crime. Trash cans and other unsecured locations, along with the Internet are used as sources for the personal information.

Identity fraud was qualified as federal crime, since 1998, when the US Congress passed a law that indicates as criminal offender a person which "knowingly transfers or uses, without lawful authority, a means of identification of another person with the intent to commit, or to aid or abet, any unlawful activity that constitutes a violation of Federal law, or that constitutes a felony under any applicable State or local law." By the Theft Penalty Enhancement Act, 2004, penalties for "aggravated" identity theft were increased by 2 additional years for general offenses and 5 additional years for terrorism-related offenses (FindLaw, online).

According to Judith Collins, an expert in identity fraud at the Michigan State University Identity Theft Crime and Research Lab., every act of terrorism that took place against the United States involved a case of identity fraud (Koerner, 2005). Collins indicates that: 5 percent of all identity fraud cases are linked to terrorism and 2 percent especially to Al-Qaida (Koerner, 2005). The Al-Qaida terrorists that took part in the September 11, 2001 attacks opened 14 fraudulent bank accounts by using different fake or stolen names (Koerner, 2005). Identity theft eases the terrorist

actions by avoiding watch lists, hides the criminal location, helps terrorist funding and facilitates unauthorized access to locations such as airline gates or border crossings (Gartenstein and Dabruzzi, 2007). The 9/11 Commission Report states that "travel documents are as important as weapons" for the terrorist planning to commit these kind of actions (Commission Report of 9/11, 2004).

### **Insurance fraud**

Insurance fraud is referring to any fraudulent activity with the purpose of gaining payment from an insurance company. This kind of fraud is carried out by persons from different professional groups such as lawyers, doctors, salespersons, insurance agents. Anyone who makes false allegations of loss or suffering with the intent to gain funds from insurance companies is guilty of committing insurance fraud.

This type of fraud is affecting everyone, as it raises insurance costs for the industry in general, costs that ultimately lay down on population in general. The annual amount of insurance fraud reaches over 150 billion dollars. The clandestine nature of the actions carried out of the criminal in order to commit insurance fraud makes the insurance fraud detection difficult.

Insurance fraud schemes can be either hard or soft fraud.

- Hard Fraud: the accident, injury or other loss is deliberately faked in order to get hold of money from insurance companies.
- Soft Fraud: small lies are told by usually honest people to their insurance company in order to obtain claim.

### **Credit/debit card fraud**

Credit/debit card fraud consists of the theft of the identity by disposing of another person's credit card information for the purpose of removing funds from it. Examples include:

- 1) Illegal obtains, takes, signs, uses, sells, and buys, using someone else's credit or debit card information;
- 2) Use of the personal card, although being aware of the fact that it is revoked or expired or that the account does not have enough money to make the purchase/transaction;
- 3) Sells goods or services to another person, although being aware of the fact that the credit/debit card used for the transaction was obtained illegally or it is being used unauthorized.

Credit card fraud is usually included in one of the below categories of fraud: application fraud and account takeover.

- Application fraud is referring to an illegal opening of credit card accounts in another person's name. This case is facilitated by the easy access to personal information about another person, in which's name the credit card will be obtained.
- Account takeovers is usually linked to existing accounts. The criminal disposes of sufficient personal information about another person, as to be able to change its billing address. The original credit card is reported missing, in order to be able to obtain a new one and use it for fraudulent acquisitions.

### **Immigration fraud**

Immigration fraud can take different patterns and schemes in different territories but the main forms are the sale, providing, or transfer of legal visas, misstating the reasons for traveling and falsification or alteration of a visa.

In USA it is reported that most cases of immigration fraud are linked to individuals lying about their situation to look for refuge in the USA, but terrorism and smuggling are also not to be ignored in these cases. Immigration fraud is one of the first steps taken by criminals and terrorists in an endless line of criminal activities. It is the act that facilitates them the entry into different countries. Persons who have committed terrorist acts against the USA or helped by raising money for terrorist organizations have taken part in immigration fraud, such as Ramzi Yousef, the mind behind the first World Trade Center attack in 1993, used false identification documents (Elderidge, 2004). The Counsel to the 9/11 Commission, issued a report in 2005, "Immigration and Terrorism" that analyzes the actions of 94 foreign-born terrorists who acted in USA between 1990s and 2004 and the result is that 59 of them are guilty of immigration fraud on top of terrorist activities.

## Money laundering

Money laundering is an issue that has gained increasing significance after the 9/11 events. Since then, it was largely recognized and accepted that it is one of the main sources for terrorist activities funding. The globalization process and the communications revolution have made this crime international, and the financial features of the crime have transformed into more complex features, due to ever-evolving technology. The spread of international banks all over the world has facilitated the transmission and the disguising of the origin of funds. It provides material for drug dealers, terrorists, arms dealers, and corrupt officials. Laundering enables criminal activities to continue.

## 3. Findings and conclusions

Financial fraud has a destructive effect on state's economy, government, and social prosperity. John McDowell and Gary Novis of the Bureau of International Narcotics and Law Enforcement Affairs, state that these actions affect business decisions, raise the risk of bank collapse, overtakes control of economic guidelines away from the governing bodies, damages a state's reputation, and opens the territories to drug traffic, and other criminal activities.

The infiltration of dirty money into legitimate financial sectors and nations accounts can affect their economy, and politic security. Economic crimes have a disastrous consequence on a state's economy, by reason of the casualties of these crimes are much various and much larger than those in other forms of crime.

We can conclude that fraud is an international problem and should engage international attention and concerns. International cooperation is mandatory in order to limit its effects. Criminal organizations employ entire teams of experts such as accountants, attorneys, and financial advisors to help them reach their goal by camouflaging the illegitimate funds and converting them into legitimate funds. The connection between white-collared crimes, political power, enforcing agencies and criminal organizations must not be ruled out.

The global essence of these criminal actions ask for international collaboration between the law enforcement institutions, in order to investigate and prosecute these crimes. Law enforcement institutions should be well aware of the dynamics of financial fraud, which evolves constantly and finds more and more advanced ways of action.

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