

TRANSPARENCY INTERNATIONAL (UK)



**Corruption
in the
Official Arms Trade**

**Policy Research Paper 001
April 2002**

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Published by:

Transparency International UK
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St Nicholas Road
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25 April 2002

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Contents

Acknowledgements	2
Executive Summary	3
1 Introduction	8
Box 1 The Arms Factfile	9
2 The Corruption Trail	10
a) Measures of Corruption	10
b) Institutionalisation of Payments	10
c) Corruption - a motor in the arms trade	11
Box 2 South Africa - A Current Case Study	12
3 Impact of Corruption	14
a) Impact on Importing Countries	14
b) Impact on Exporting Countries	15
Box 3 Kick-backs for the Exporters	16
c) Impact on Exporting Companies	17
4 Corruption Pressure Points	18
a) Secrecy	18
b) Arms and National Security	20
c) Competitive Strategy	21
d) Contract Complexity	23
e) Offsets	23
f) The "Ostrich Effect" – concealing bribes through agents	24
g) The "Revolving Door" Syndrome	25
5 Reforming the Exporting Process	26
a) Applying the OECD Convention to the Defence Sector	26
b) Anti-Corruption Conditions for Export	27
c) Public Financial Support for Defence Companies	29
d) Industry Compliance	30
e) Increasing Transparency	32
f) Increasing Accountability	33

6	Reforming the Importing Process	36
a)	Increasing Transparency	36
b)	Promoting Accountability	38
c)	Tracking Commissions	38
d)	Banning Offsets	39
7	Conclusion and Recommendations	40
	Bibliography	43

Acknowledgements and Source Material

This report owes a great deal to the work of Joe Roeber, whose forthcoming book "The Hidden Market," will include a fuller account and detailed examples of how corruption affects and distorts the arms trade. It also is indebted to the participants of Conferences held jointly by TI(UK) and the Swedish Ministry for Foreign Affairs in February 2000 and April 2001. Financial support from DFID is also gratefully acknowledged.

This report has relied on official sources, press reports and other information in the public domain. It is readily acknowledged that some of these sources have limitations and TI(UK) is not in a position independently to confirm or deny their contents. Rather TI(UK) has sought to use published sources to draw reasoned and reasonable conclusions and to highlight relevant issues. It is TI(UK) policy to identify and address the underlying issues in corporate practice and public policy, and not to expose or investigate individual cases.

Executive Summary

1 Introduction

The arms trade is one topic almost guaranteed to generate heated debate. Arguments about its rights to public subsidy are perennial. However, in most discussions about the trade, the extent to which corruption distorts legitimate security purchases is all too rarely considered.

From the diary of Samuel Pepys to the media stories of the present day it is apparent that decisions on military procurement have been subject to corrupt influences. In the twenty-first century, the official arms trade continues to account for a disproportionate total of all corrupt transactions. Estimates from the US Department of Commerce are that 50% of all bribes are paid for defence contracts. Such corruption continues at a high price, paid for by citizens in importing and exporting countries alike. This paper analyses the structure of the industry and the environment in which it operates and analyses why they provide unique opportunities for substantial corrupt payments.

Limiting corruption in the arms industry has thus far been resisted. However, under the new legislation enacted by the UK Government in December last year, the bribery of foreign public officials is now a criminal offence. If this law is to be applied effectively to the arms industry then there needs to be recognition of the unique difficulties of the trade and a set of specific and practical measures to combat corruption such as those set out in this report.

According to measures from the US Department of Commerce and Transparency International, the official arms trade continues to account for a disproportionate total of all corrupt transactions.

2 The Corruption Trail

Periodically, the media contain stories of arms bribe scandals which reveals that there certainly are some cases where it occurs. However, other signs indicate that corruption is more regular and institutionalised than the frequency of its exposure suggests. Of all industries ranked in the 1999 TI Bribe Payers Index, the arms industry was considered the second most likely to involve bribes. The US Department of Commerce Trade Promotion Co-ordinating Committee Report of March 2000 claimed that the defence sector accounted for 50% of all bribery allegations in 1994-1999. Other individual cases, such as the recent Tehelka scandal in India, where journalists posed as arms brokers and successfully bribed defence officials, indicate that the use of commissions is still a widely accepted and expected part of doing business in the arms trade.

Use of commissions is still an accepted and expected part of doing business.

3 The Impact of Corruption

a) Importing Countries

Developing countries account for 60% of the global arms trade.¹ Corruption is the antithesis to good government, which is widely recognised to be essential to economic development. The payment of large commissions to individual officials in defence procurement deals can provide an incentive for the recipient to increase the technical specification of the weapons and even to persuade governments that entire systems should be purchased unnecessarily. The diversion of resources away from pressing socio-economic needs for the sake of corrupt payments is nothing less than a betrayal of the population. Through driving the purchase of weapons in this way, corruption can also destabilise regions and exacerbate arms races (such as that between India and Pakistan). It is also likely that corrupt payments prolong civil conflicts such as those in Angola and Sri Lanka.

b) Exporting Countries

Extensive subsidies are granted to defence industries by exporting governments through export credit guarantees, research and development grants and official and military promotion of defence exports. Public money therefore can be used to subsidise companies who obtain contracts through corrupt means. Government subsidised companies which bribe foreign officials to purchase their weapons undermine the good governance efforts of aid agencies and create damaging policy conflicts between departments. Furthermore, the democracy of the exporting countries is undermined by the diversion of commissions to political party funding. For example, the secret donations of an arms dealer, Karl Schreiber, to the Christian Democrat Party in the 1990s, following a change of

¹ Armaments, Disarmament and International Security SIPRI Yearbook (Oxford: OUP, 2001) p.326

policy, severely besmirched not only the Party but also German democracy.

c) Exporting Companies

Corruption erodes the competitive principles of price, quality and service on which the free market depends. Moreover, with the increasing significance to long-term profitability of company reputation, involvement in a corruption scandal can result in serious losses. This risk is increased where the ethical conduct of senior executives is seen to be questionable, as other employees are then less likely to uphold ethical standards.

4 Corruption Pressure Points

The structure of the arms industry and the environment in which it operates create unique conditions in which corruption can thrive unchecked

The structure of the industry and the environment in which it operates include a set of interdependent factors that facilitate corruption. These factors do not demonstrate the existence of corruption in any individual contract, but together they constitute a political/commercial environment in which unethical conduct can fester, often hidden for many years.

a) Secrecy

The secrecy under which transactions are carried out creates pools of unaccountable money that can easily be used for personal advantage. Government complicity in this secrecy defies any attempt at financial accountability. The current justifications for this secrecy should be questioned as secrecy often seems to work more to the advantage of politicians and officials in purchasing countries than for the defence of their citizens.

b) Arms and National Security

Because of its integral connection with national security, importing governments can claim security justifications for purchasing almost any defence equipment at any price. This can encourage companies to bribe officials to increase the specification of the weapon systems. On the exporting side, the identification made between national security and the success of the arms industry through exports has enabled governments to justify ignoring the corrupt payments made to secure contracts.

Now that the payment of bribes to foreign public officials is illegal, the UK Government has a direct responsibility to ensure that subsidised companies are not obtaining contracts illegally.

c) Competitive Strategy

By comparison with other markets, the market for arms is characterised by relatively infrequent but very high value contracts. As a result, each contract significantly affects the future of the exporting company, particularly in the context of post-Cold War reduction in defence spending. Large commissions which can significantly affect the decision-making process can be hidden in the high value of the contract since they constitute a relatively small extra cost for the company.

By comparison with the cost of losing a bid for such high-value contracts, the extra money needed to cover commissions to key officials appears to be a very small price to pay.

d) Contract Complexity

The complexity and heterogeneity of arms contracts, including arrangements for training and spares over a period of time, make commissions hard to detect. Prices for the same piece of equipment also

fluctuate according to the political relationship between the buyer and seller; this hinders the price transparency that would reveal bribes.

e) Offsets

In offset arrangements, or industrial participation agreements, exporting companies or governments commit to investing in local enterprises as part of the contract. In some cases, these enterprises produce some of the weapon components, and in others they are unrelated. Offsets therefore provide additional inducements to governments to prefer a particular bidder for reasons other than competitiveness over price and quality. Importing governments can use the offset package to justify awarding contracts to companies paying the largest bribes. Complicated offset provisions can also conceal commissions as payments are channelled through local firms, which can be chosen for their political connections.

f) The "Ostrich Effect"

The use of local representatives, agents and "consultants", enables bribes to be paid out of large unspecified "fees" and commissions to key decision makers without any the direct participation of the exporting companies, whose managers will often disclaim any knowledge of what has been done in their interest.

g) The "Revolving Door" Syndrome

The technical and procedural knowledge of defence officials in both exporting and importing countries is prized highly in the private sector, to which officials often move after retiring from government. This can create interdependent relationships where accountability is not rigorously enforced. Whilst not corrupt in itself, this can easily engender conflicts of interests that lead to corrupt practice.

Recommendations

Reforming the Exporting Process

Recommendation 1 – *Applying the OECD Convention to the Defence Sector*

The UK Government should ensure that Part 12 of the *Anti-Terrorism, Crime and Security Act 2001* is backed up by adequate enforcement processes and resources so that it can be used effectively to investigate and prosecute defence companies for bribery of foreign public officials.

Recommendation 2 – *Export Licence Conditions*

Export licensing should be strictly conditional on presentation by exporting companies of rigorous contract-specific no-bribery warranties. These should be reinforced by evidence that companies have in place sufficient internal compliance systems capable of detecting corruption-risk and preventing the payment of bribes. Exclusion from export licences should be used as a sanction against companies or brokers found to have paid bribes. Registration for brokers under the Export Control Act should also include signing a no-bribe warranty.

Recommendation 3 - *Export Credits and Public Support*

Support for arms companies through export credits and the Defence Export Services Organisation should be conditional on the effective implementation of anti-corruption codes of conduct.

Recommendation 4 - *Defence Ethics Initiative*

Drawing on the experience of the US Defence Industry Ethics Initiative (DII) and the Transparency International/ Social Accountability International “Business Principles for Countering Bribery”, the UK Defence Manufacturers Association should develop and implement a similar code to assist in compliance with the *Anti-Terrorism Act* provisions against overseas bribery. Representation should be made to the European Defence Industry Group to press for a corporate ethics “meta-code” containing strong anti-corruption provisions, for individual implementation by defence companies globally.

Recommendation 5 - *Procedures for Whistleblowers*

Defence companies should demonstrate compliance with the *Public Interest Disclosure Act* by having in place mechanisms for whistleblowing which, in line with those recommended by the Nolan Committee and the Financial Services Authority, should include one or more external body to which concerns about corruption may safely and properly be made.

Recommendation 6 – *Transaction Reporting*

Information on the individual value of licences should be included in the UK Annual Report on Strategic Exports. The UK government should continue to push for the inclusion of values in international arms reporting systems.

Recommendation 7 - *Prior Parliamentary Scrutiny*

Prior scrutiny of individual licences should be undertaken by a Parliamentary Committee of both Houses to ensure that sales conform with the UK Consolidated Criteria. This Committee should consider the potential for corruption in the procurement process in the importing country in its advice to the government on whether to award the licence.

Recommendation 8 - National Audit Office Report

The consistent refusal of the UK government to publish the NAO 1992 Report into the Al Yamamah arms sales represents a serious compromise of principles of democratic accountability. The findings of the report should be made public.

Reforming Importing Processes**Recommendation 9 - TI Integrity Pact**

Importing governments should be encouraged at the inter-governmental level and by exporting companies to use Integrity Pacts, including responsible monitors from civil society. The UK and OECD exporting countries should lead by example through using the Pact in their domestic procurement.

Recommendation 10 - Releasing bid criteria

The criteria for bid evaluations should be made public by governments of importing countries and the evaluation of bids should be released to the bidding companies and to a Parliamentary Committee scrutinising procurement decisions. Any subsequent substantive changes to specifications and prices should be fully and publicly justified.

Recommendation 11 - Parliamentary Accountability

Defence procurement decisions should be scrutinised by Parliamentary Committees in all importing countries. Information accessed should include the criteria for bid evaluation and the tenders considered.

Recommendation 12 - Donor Accountability

The UK Government should encourage governments, through offers of technical assistance, to include security sector reforms in their Poverty Reduction Strategy Papers. These should include an audit of procurement practice in the security sector and measures to increase accountability and transparency for security expenditure.

Recommendation 13 – Tracking Commissions

Independent scrutiny of specified accounts related to major contracts should be established.

Recommendation 14 - Banning Offsets

The UK should work with other exporters within the WTO to outlaw offsets in defence procurement.

" In what is believed to be Britain's biggest commercial bribery inquiry, police and legal officials have frozen assets in a trust fund controlled by a senior member of the ruling family in the Gulf state of Qatar. Judicial sources say the money is alleged to be the proceeds of commissions paid by arms firms to win contracts for military equipment worth hundreds of millions of pounds during the 1990s. British, German and Italian companies are all said to have made payments in the "cash for contracts" affair. ... The money - which some sources suggest may be up to \$350m, was used to buy property around the world."
Sunday Times (UK), 25th November 2001

1 Introduction

Corruption in the arms trade exists on a scale entirely disproportionate to its share of world trade.¹ Accurate reporting of the volume of arms sales has always been problematic and quantifying bribery is even more so. However, sufficient indications exist to suggest that the arms trade must be given a high priority in any attempt to tackle corruption. Despite accounting for less than 1% of total world trade, (\$33-40bn in 1999),² and less than 10% of the five most corruptible trades, sources from the US Department of Commerce indicate that it accounts for around 50% of all corrupt transactions.³ The level of commissions is unknowable; a conservative estimate would be 10%. However, there are many indications to suggest commissions often run significantly higher, with as much money paid in bribes as legitimate expenditure.⁴ The impact of widespread corruption in such a large and lethal industry is far more than the lost revenue of the commissions. Developing countries account for over half of all arms imports. The irrational incentive supplied by large commissions distorts procurement decisions, diverting public resources from socio-economic to military needs that often lack strategic justification. The resulting increase in weapon procurement can exacerbate regional arms races and prolong civil wars whilst the unaccountable funds created by commissions can distort political processes and even arm terrorist organisations. The UK, as one of the largest exporters of conventional arms should recognise that corruption in the official arms trade is not only contrary to its efforts to promote good governance but is also a significant threat to global security and development.

Corruption abroad has in the past been left to run untouched but the beginning of the twenty-first century provides a unique opportunity to tackle the issue. Since the end of the Cold War, increasing attention has been paid to the conventional arms trade and governments have come under pressure to re-examine their export policies and subsidies. Furthermore, the exposure of more and more corruption scandals has unleashed an international constituency demanding transparency and accountability in all official financial dealings. The success that the anti-corruption agenda has met with has demonstrated that action is not only justified but effective. As a direct result of media exposure and civil society pressure, the Indian

¹ This report is concerned only with the legal trade in conventional weapons of the types listed on the UN Arms Register. It does not deal with the illegal trade or small arms and light weapons.

² Armaments, Disarmament and International Security Stockholm International Peace Research Institute (SIPRI) Yearbook (Oxford: OUP, 2001) p. 334.

³ "The National Export Strategy" Trade Promotion Co-ordinating Committee Report, March 2000, p.11

⁴ High profile cases include the Al Yamamah deal which reached 30%, Sampson, A., The Arms Bazaar in the 90s: From Krupp to Saddam, (London: Hodder and Stoughton, 1991) p.24; the Tussen tank deal that saw the downfall of Kohl included bribes up to 50% of the deal value. "Commissions from arms deals to senior Thai military officers averaged 15-20%." quoted in Pierre A., ed., Cascade of Arms: Managing Conventional Weapons Proliferation (Washington DC: Brookings Institution Press, 1997) p.288.

defence establishment is one example of having accepted the need for greater transparency in all major defence procurement.

Whilst there is a substantial volume of work on the arms trade in general by NGOs, academics and campaigners, combating the corruption which drives the trade has been largely treated as peripheral and corruption has not been subject to analysis.⁵ As leaders in the anti-corruption constituency, Transparency International (UK) focuses on the damaging effect of distorted financing of the official arms trade without passing judgement on the legitimacy of the trade itself. The transparency and accountability that we call for is, however, vital in any attempt to monitor and reduce the sales of weapon systems that contribute to regional destabilisation.

In addressing this issue over the past five years, Transparency International (UK) has initiated research and shared in organising two conferences in Stockholm and Cambridge. This report draws upon the findings of these conferences and provides a systematic analysis of the mechanism of the trade and how it is affected by corruption. The first and second sections will highlight the *indications* suggesting such a high degree of corruption within the arms industry and outline a current case study. The third will focus on the damaging *impact* of corruption and why urgent action is needed. Section four outlines *why* the arms trade is so susceptible to corruption and sections 5 - 8 discuss effective ways to achieve reform of the exporting and importing processes through action from governments, industry and civil society.

⁵ A brief survey of the following revealed that none contained articles that focused on corruption: *World Policy Journal* since 1999, Centre for Defense Information since 1994, *Peace Research Abstracts* Vol. 38, University of Bradford Department of Peace Studies publications. Neither Willett and Batchelor, Disarmament and Defence: Industrial Adjustment in South Africa SIPRI, (Oxford: OUP, 1998) nor the SIPRI Yearbook 2001 section on factors affecting price of weapons address the issue of corruption. (p.334)

Box 1

Arms Factfile

Top Arms Exporting Countries

% of world transfers 1996-2000

US	47%
Russia	15%
France	10%
UK	7%
Germany	5%

Top Arms Importing Countries

% of world transfers 1996-2000

Taiwan	12%
Saudi Arabia	8%
Turkey	5%
South Korea	5%
China	5%

Source: SIPRI Yearbook, Armaments, Disarmament and International Security (Oxford: OUP, 2001) p. 326

Top Arms Exporting Companies 1999

		<i>Arms Sales</i>	<i>Profit</i>	<i>Jobs</i>
		<i>\$m</i>	<i>\$m</i>	
1 Lockheed Martin	USA	17,930	382	149,000
2 Boeing	USA	15,600	2,309	197,000
3 BAE Systems	UK	15,470	1,804	71,150
4 Raytheon	USA	11,530	404	105,300
5 Northrop Grumman	USA	7,070	467	44,600

Source: SIPRI Yearbook, Armaments, Disarmament and International Security (Oxford: OUP, 2001) p. 307

These data are from company reports and archives, questionnaires and news reports but contain some estimates.

2 The Corruption Trail

"Between mid-1994, when the OECD adopted anti-bribery recommendations, through April 1999, we have learned of significant allegations of bribery by foreign firms in 294 international contract competitions valued at \$145 billion. ...About half of the bribe offers are for defence contracts."

"The National Export Strategy", Report of the Trade Promotion Co-ordinating Committee, US Department of Commerce, March 2000, p.11

⁶ Public works contracts and construction were ranked first. The BPI is based on a survey of 779 respondents in 14 countries including senior company executives, chartered accountants, chamber of commerce officials, commercial lawyers and bank officials..

⁷ Transparency International Global Corruption Report 2001 p.47. A crore is 10m rupees (US \$215,000)

⁸ *The Nation* (Pakistan) 26 September 2000

Publicly accessible evidence of corruption in the arms trade rests on known corruption scandals which represent only a small proportion of arms transactions. However, these scandals can be viewed in two ways. Either they are the few who have deviated from the fundamentally sound and scrupulous practices of the trade, or they are those unfortunate enough to be exposed whilst the rest of the industry knows that their only deviation is in their capture rather than their crime. If the former is true, then corruption should be dealt with on a case by case basis, but if the latter is true then clearly industry-wide, global solutions are needed to change the structure and nature of the trade. This report concludes that the balance of probability is with the latter.

a) Measures of Corruption

Supporting this contention is the fact that the US Department of Commerce Trade Promotion Co-ordinating Committee 2000 Report attributed half of all allegations of bribery in overseas transactions to the defence sector. Furthermore, Transparency International's 1999 Bribe Payer's Index ranked the arms industry the second most likely to involve corrupt payments, although it did not differentiate between frequency and value of bribes paid. New data including these factors will be published in the forthcoming 2002 index.⁶

b) Institutionalisation of payments

Refuting the idea that corrupt payments are the exception rather than the rule in the trade are the corruption scandals which reveal how far bribery is standard practice. For example, the case of the 'Tehelka tapes' in India, where journalists, posing as arms salesmen filmed politicians accepting substantial bribes, strongly suggests that such payments were not regarded as out of the ordinary or further investigation by the officials in question would have revealed their true source.

"While an interim report by the Central Vigilance Commissioner on irregularities in defence deals gathers dust in the Defence Ministry, the Tehelka tapes provided stunning disclosures of the nexus of middlemen, politicians, military officers and their civilian counterparts "who make hundreds of crores cranking the machinery of Indian defence".⁷

That corruption is particularly an issue in the defence industry is also evident in Pakistan where the former chief of the defunct Accountability Bureau claimed in an interview in September 2000 that US\$1bn were paid to senior military officers in kickbacks in eight defence deals. The amount, he alleged, was more than the combined misappropriations in all the civilian projects his team had investigated.⁸ Corrupt payments in the form of commissions were so institutionalised

“Clearly bribery continues to be pivotal in many export competitions, with the alleged bribing companies winning the lion’s share (an estimated 90%) of the contract decisions involving bribes. Most of the bribe-giving companies come from among the 29 OECD member nations and a few foreign multinational firms consistently are alleged to be making the most bribe offers”

“The National Export Strategy”, Report of the Trade Promotion Co-ordinating Committee, US Department of Commerce, March 2000 p.11

⁹ *Financial Times* (UK) 20th December 1997; Phythian, M., The Politics of British Arms Sales since 1964 Manchester University Press, 2000 p. 94-95

¹⁰ *Ibid* p. 85,

¹¹ *Ibid* p.90

¹² *International Herald Tribune* 22 March 2002.

¹³ Global Corruption Report 2001 p.47

¹⁴ Evidence from Global Witness to the TI(UK) Cambridge Conference April 2001

¹⁵ Presentation by General Williams to the TI(UK) Conference, April 2001

in defence procurement in Saudi Arabia that allegations of insufficient payment of commissions were the subject of a 1997 High Court Writ (A No. 1828). Aerospace Engineering Design Corporation (with reputed Saudi interests but incorporated in Panama) sued Rolls Royce plc for their alleged failure to pay contracted commissions on the sale of aero-engines to the Royal Saudi Air Force. The writ (which was strenuously defended and subsequently withdrawn) alleged that commissions had only been paid up to 8% of the whole price whereas the contracted commissions were at a rate of 15% up to certain base prices and 100% on prices above base.⁹

Not only are commissions expected by importing officials but they are expected by supplying companies. The Thorn EMI company handbook for senior staff stated in the early 90s that only commissions of over 12% needed to be cleared by the Board.¹⁰ Corruption cannot be written off as a problem of the developing world about which nothing can be done. Just as the majority of defence exporters are from OECD countries, so are the majority of the commissions (see quotation opposite). Moreover, officials in OECD countries are by no means above receiving commissions. Gordon Foxley, Director of Ammunition Procurement at the UK MOD 1979-1984, was found guilty of charging 5% commission in return for allocating contracts to three European companies.¹¹ Box 3 also gives examples of recent high profile cases involving kick-backs to exporting officials.

c) Corruption - a motor in the arms trade

These indications suggest that corrupt payments are an accepted and integral part of arms contracts. The prospect of payments can substantially alter purchasing decisions, not only between companies but also changing entire systems. The cost of Taiwan’s purchase of frigates in the early 1990s was substantially increased by the switch of supplier from South Korea to France. According to a recent report by Taiwan’s Control Yuan, the anti-graft body of the Taiwanese government, the switch was strongly influenced by pay-offs. The displacement volume of the frigates increased by 50% and the cost of the purchase rose to \$2.8bn. The French foreign Minister, Ronald Dumas, who orchestrated the significant shift in French policy to enable the sale, was convicted last year for receiving improper payments from a Christine Deviers-Joncours, a lobbyist employed by Elf-Aquitaine, one of the firms employed in the sale.¹² In Sri Lanka, independent observers have alleged that a major factor prolonging the civil war was the reluctance of politicians and officials to lose the lucrative pay-offs from procuring arms.¹³ Similarly, Angola’s peace accord of 1994 was soon undermined by weapons deals with the government which were dependent on covert payments to politicians and personalities not only in Angola but also in France.¹⁴ General Ishola Williams of Nigeria blamed corruption for the massively inflated defence budget required to pay private airlines to fly Nigerian troops to Liberia when Air Force planes only needed a few spares to have been enabled to perform the same task.¹⁵

The forces driving this process are both profit-seeking officials in importing countries and exporting companies willing to pay the extra needed to secure the contract. Such contracts are usually approved by exporting governments, who have taken little action to combat the corruption involved. Whilst TI(UK) recognises that action to restrain corruption in the arms trade has to occur on all sides, this report focuses primarily on the response of OECD governments and their exporting companies, in particular the UK.

Box 2 South Africa - A Current Case Study

One recent defence procurement that has attracted corruption allegations is South Africa's 1998 £3bn Strategic Defence Procurement package involving British, German, Swedish and Italian companies.

Chronology

Following the Defence Review of 1995-6 and subsequent negotiations, the South African government announced the purchase of corvettes, submarines, fighter trainers, fighters and helicopters in September 1999. Almost immediately, corruption allegations were made by an opposition MP and the Auditor General undertook a review of the procurement process and recommended a full forensic audit. This was taken on by the Parliamentary Public Accounts Committee who, in turn, called for an investigation by four relevant authorities including the Special Investigation Unit (SIU) chaired by Judge Heath, which was the only body constitutionally able to recommend stopping the deal. The other bodies were the Ombudsman, the Auditor General and the National Director of Public Prosecutions. The government throughout acted on the defensive, trying to cover-up the allegations and maintain the contract. They blocked the involvement of the SIU which led to Heath's resignation. The Joint Investigative Committee Report on the Strategic Defence Procurement Package, 15 November 2001 (JIT Report), cleared the government of unlawful or improper conduct, stating that the government's acquisition policy "compares favourably with defence procurement policies in the UK and Australia". It criticised "certain officials of the government departments" but maintains that their faults cannot "be ascribed to the president or the ministers involved". Since the publication of the report, there have been further arrests and extensive accusations of whitewashing by the opposition.

Corruption Controversy

The corruption allegations have arisen because of irregularities in the tender evaluations in certain of the main and sub-contracts. Following the loss of the R10bn contract for fighter trainers, the Italian manufacturer AerMACchi considered legal action after the Minister of Defence, the late Joe Modise, insisted that the tender criteria be changed to enable consideration of a "non-costed" option (Minuted in the 29 June 1998 meeting of the Air Force Command Council.) This allowed the significantly more expensive BAe Hawk 100 to win the tender. This irregularity was noted by the Auditor General's report as "a material deviation from the originally adopted value system. This ultimately had the effect that a different bidder... at a significantly higher cost, was eventually chosen on the overall evaluation". The Umkhonto we Sizwe Military Veterans Association (MKMVA), of which Modise was a founding trustee, had received an R5mn donation from BAe shortly before the June 1998 meeting. (*Mail and Guardian* (SA), 02 November 2001).

Controversy also centres on the conflict of interest of Chippy Shaik, Head of Acquisitions at the Department of Defence. The JIT report claims that he played a pivotal role as Fund Manager of the Special Defence Account from which the procurement was to be funded. His brother, Schabir, was a company shareholder in Africa Defence Systems, (ADS) which was mandated by the defence procurement agency, Armscor, to provide South African partners for foreign suppliers, integrate the projects and co-ordinate the purchase of corvettes for the Navy. However, ADS was also bidding to win subcontracts itself. Schabir Shaik was also a director of Thomson-CSF (now Thales International),

a significant shareholder in ADS which then won the contract to supply the control systems for the corvettes. Richard Young, the Managing Director of another local bidder, Communications Computer Intelligence Integration (C²I²), previously identified by the Navy as the preferred supplier for the information management system, alleges that ADS abused its position to influence the changes in specifications for the systems that not only sidelined the products developed by C²I² but also compelled the government to retain Thomson-CSF as their exclusive supplier.¹⁶

Press reports have also suggested that the requirement that sub-contracts be placed with local companies could also have afforded further opportunities for private interests of officials to be served. Agusta SpA, which won the contract to supply helicopters, only did so following a preliminary deal with both ADS and its 20% shareholder, Futuristic Business Solutions (FBS) which has two directors who were closely related to Modise. Again, the more expensive option was taken as the Bell Helicopters were around R3mn a unit less than Agusta. The marketing Director of Bell Helicopter confirmed on the M-Net programme Carte Blanche that "Chippy" Shaik had "strongly suggested" that if Bell wanted the helicopter contract on offer, the company should enter into a partnership with FBS. Other sources within the company confirmed that they were told that FBS was the only acceptable option as an empowerment partner. In preliminary enquiries, FBS had requested "administration fees" of R1mn per month as well as a large sum payment when Bell got the contract. "After discovering FBS amounted to no more than a receptionist and a fax machine," Bell refused and subsequently lost the bid. (*Mail and Guardian (SA)* April 5, 2001) In investigating the subcontracts, the JIT Report found that "project teams and senior personnel in the employ of Armscor and the Department of Defence played a significant role in the selection of subcontractors" which undermined the "fair and competitive process".¹⁷

Other members of the ANC have also been implicated as representatives of the European and Aeronautic Defence and Space Company (EADS) admitted that it "rendered assistance" for the purchase and early delivery of 30 luxury cars during the course of its negotiation of a \$25m contract. The ANC whip, Tony Yengeni, acquired a Mercedes four-wheel drive and expensive saloon, and eventually faced charges brought in late 2001. (*Financial Times (UK)* 9 April 2001)

Was the Price Right?

Throughout the procurement process, evidence suggests that price was not the priority that the 1998 White Paper clearly indicated that it should be. The "technology level should be appropriate, driven by affordability and cost-effectiveness."¹⁸ An affordability study was undertaken in August 1999, but only after Modise had initialled the contracts for the three submarines. The report of the Auditor-General in September 2000 recommended a full forensic audit of the procurement precisely because he was unable to explain why it was significantly more expensive than other available options.

Clinching the Contract - the Role of Offsets

Crucial to the government's support for the purchase have been "Industrial Participation" agreements by the contracting companies. "Much has been said about the cost of the acquisition. The Government wishes to reiterate that the Cabinet weighed all the trade-offs, and decided that the process was in the best interest of the country" (Statement by the South African Government in response to the JIT report, 15 November 2001) The offsets were initially supposed to be worth R110bn, and create 65,000 jobs. However, BAe maintains that only a minimum of 30% of the offset investment has to come from abroad which questions its value as an injection of foreign currency. Sweeping away the mystification surrounding the offset deals, Business Day commented on 27 November 2001; "*Take the much-hyped announcement last week that BAe and Saab have facilitated an investment in timber mills in Mpumalanga. Not only is the investment a small \$60m but it turns out that much of that was sourced locally, from the Industrial Development Corporation. And this is not an aberration*"

¹⁶ "Aide Memoire", www.cci.co.za, para. 68

¹⁷ JIT Report Chapter 10.2.4.4

¹⁸ White Paper on South African Defence Related Industries, 1998, Chapter 4 para. 25.4

3 Impact of Corruption

"It erodes public confidence in political institutions and leads to contempt for the rule of law. It distorts the allocation of resources, inflates spending on public procurement and undermines competition in the market place. It has a devastating effect on investment, growth and development." OECD Observer, Anti-Corruption Policy Brief, September 2000

"In many developing societies, where a majority of people earn barely two dollars a day, this can only be regarded as an unforgivable betrayal of public trust" Nazir Kamal, UN Disarmament Secretariat¹⁹

¹⁹ Presentation to the TI(UK) Cambridge Conference, April 2001

²⁰ *Daily Star* (Bangladesh), 26 April 2000, Global Corruption Report, 2001 p. 47
The Independent (Bangladesh) 24 January 2002

²¹ *The News International* (Pakistan) 01 January 2002

²² Global Corruption Report p.34-5 The Arms Bazaar, p.20

²³ Collier and Hoeffler 'Regional Military Spillovers' Presentation to the UN Small Arms Conference, July 2001

²⁴ See Global Corruption Report 2001 p. 46-8 for the prevalence of corruption

a) Impact on Importing Countries

i) Diversion of public resources:

Corruption in defence procurement poses a serious threat to global security and development. Extensive funds are used to procure defence equipment. When these are inflated by tempting offers from Western exporters they add to the debt burden of the importing country and divert foreign exchange and resources away from pressing socio-economic needs. This is exemplified in Bangladesh, whose situation has been exacerbated by disastrous natural phenomena. In the face of such needs, the government White Paper on corruption during the Awami League's rule claimed that misappropriations of Tk4bn (US\$75m) had occurred during the purchase of MIG 29 fighter jets from Russia. The Parliamentary Standing Committee on Defence is investigating allegations of kickbacks in another contract involving the purchase of frigates worth Tk5bn (US\$90m) from South Korea.²⁰ In Pakistan, Admiral Mansur is alleged to have cost the Pakistan exchequer over Rs 500 crores (\$82m) through extortion in his three years as Chief of the Naval Staff.²¹

ii) Destabilisation of regimes

Accusations of widespread corruption, throughout the developing world and the Middle East, often expressed through opposition organisations disillusioned by how far corruption has undermined democracy, may well destabilise governments. Investigations and prosecutions of several heads of government in South-East Asia in 2001 were linked to corruption in military procurement and were accompanied by widespread political unrest. The excessive military spending of the Shah of Iran encouraged by corrupt payments has also been noted as a significant factor in the 1979 revolution.²²

iii) Impact on regional instability

Escalating military expenditure, artificially inflated by the incentive of commissions is likely to provoke a response in neighbouring countries where there is existing tension. The 2001 World Bank study by Collier and Hoeffler calculated that spending by neighbouring countries is likely to end up at more than double the initial increase.²³ This escalation is currently evident in the stand-off between India and Pakistan, an area where the prevalence of corruption is well documented.²⁴

“No taxpayer in any donor country should be asked to contribute to the Swiss bank accounts of corrupt Third World Politicians”
Baroness Chalker²⁵

²⁵ *Sunday Nation*, (Kenya) 1994

²⁶ TI(UK) Submission to the International Development Select Committee inquiry into Corruption, October 2000

²⁷ Richard Caborn answer to Michael Jack, Hansard, 6 December 1999 Col 362W.

²⁸ Gerald Steinberg in Ravinder Pal Singh, Arms Procurement Decision Making Vol. 1: China, India, Israel, Japan, South Korea and Thailand SIPRI (Oxford: OUP, 1998) p. 124

²⁹ *The Times* (UK) 21 December 2001; *The Guardian* (UK), 12 January, 2002; *The Guardian* (UK) 19 December 2001

³⁰ February 2000 DFID UK Symposium, Quoted in Ingram, P. and Davis, I., The Subsidy Trap: British Government Support for Arms Exports and the Defence Industry Saferworld and The Oxford Research Group, 2001 p.46

b) Impact on Exporting Countries

i) Misuse and diversion of resources

Financing corrupt deals through export credit guarantees and subsidies to the arms trade is a misuse of government revenue. *Le Monde* reported in 1998 that the French export credit agency, COFACE had funded around £2 billion in bribes in the armaments industry in the previous three year period.²⁶ Given that on average, 27% of the UK's Export Credit Guarantee Department support has been for the defence industry between 1994-9, with a high point of over 50% in 1998-9, it seems likely that a significant percentage of this has also funded corrupt payments.²⁷ Direct government funding for military assistance can also be abused. In Israel, Brigadier-General Rami Dotan, (Israeli Air Force), whilst Chief of Equipment and Acquisitions was convicted of accepting over \$10m for bribes whilst responsible for Israeli military procurement, funded by US Financial Military Assistance.²⁸

ii) Policy inconsistency

Corruption is the antithesis of good government, which is widely recognised to be essential to economic development. The substantial funds devoted to good governance programmes by DFID can be significantly undermined by corrupt arms transactions facilitated by UK companies. Recent sales of defence equipment to both Tanzania and India have generated heated debate over whether the sale is in the best interest of the recipient country and consistent with statements of international objectives by the UK government. Where defence purchases are encouraged by bribery by UK companies, justifying their legitimacy is entirely inconsistent with good governance programmes.²⁹

“It is important that the reformers in developing countries are not undermined by those who wish to sell them arms which are either inappropriate for their needs, or beyond their capacity to afford.”

Rt Hon Clare Short MP, Secretary of State for International Development³⁰

iii) Subversion of democratic and public accountability.

There are clear indications that it is not only public officials of importing countries who are corrupt. Box 3 points to cases of high ranking officials who have siphoned off millions from arms deals. Donations to party/campaign funds are perhaps the most dangerous form as they can change government policy and even election outcomes. The German sale of 36 tanks to Saudi Arabia in 1991 has been mired in controversy as the Foreign Minister, Hans-Dietrich Genscher, initially blocked the sale and then changed his mind. Volker Neuman, Chairman of the

³¹ BBC News January 25, 2001

³² 'Challenging International Bribery: Third Annual Report on the OECD Anti-Bribery Convention', 2001

Parliamentary Committee investigating Kohl's connection with the sale, said that it was known that the firm, Tussen, had paid over \$100m worldwide in bribes to get the contract. Completion of the deal was shortly followed by a \$500,000 donation to the CDU by Karl Heinz Schreiber, the arms dealer orchestrating the sale.³¹ Such scandals can fell governments but more significantly can undermine the foundations of democracy.

"Corruption by and of public officials is a serious threat to governments and the rule of law." US Department of Commerce³²

Box 3

Kick-backs for the Exporters

"The reality is that there are those who abuse positions of power in all political systems.... The difference between industrialised and developing countries is not moral commitment, but systems that constrain, catch and punish corrupt behaviour." Rt Hon Clare Short, MP³³

UK - "Neither Mr Aitken's nor Mr Ayas' lawyers made any attempt yesterday to deny the Guardian's disclosures that Mr Ayas had arranged a string of multi-million pound commission deals from British arms companies, while his partner Jonathan Aitken was lobbying, as arms sales minister, for Saudi Arabia to buy the weapons systems". *The Guardian*, (UK) 6 March 1999.

France "Former foreign Minister, Roland Dumas was forced to resign as head of the Constitutional Council - France's top legal authority. The scandal arose in France over allegations that Dumas' former mistress, Christine Deviers-Joncours, received hefty payments from then state-owned Elf-Aquitaine to lobby Dumas for approval of the 1991 sale of six Lafayette frigates to Taiwan by another state firm, Thomson-CSF". Reuters, September 25, 2000.

China - Gerald Segal, of the International Institute for Strategic Studies claims that the anecdotal evidence for the key role of the children of officials (Red Princes) in the export network is indisputable... "but it is impossible to know how much money they have made and how decisions regarding arms are arrived at".³⁴ This desire to make money for themselves and their families has been argued to be a major motive for Chinese exports.³⁵

Russia - Discussions in open documents include references to the extortion of money from MAPO (a Russia arms manufacturing firm) by officials in the Ministry of Justice in return for tax concessions in 1994-5. Abuse of office by senior ministers and presidential officials is alleged in the case of arms exports to China in 1993-4 where the first deputy Prime Minister circumvented proper processes, sidelining MOD objections to the sale and assisting the Sukhoi enterprise with strong interest in sales to China. Allegations also centre on the state export company, Rosvooruzhenie 1993-2000 and its use of private banks to divert payments for arms exports away from the manufacturing companies and into private accounts.³⁶

³³ Global Corruption Report 2001, p. 143

³⁴ Segal in Pierre, A., Cascade of Arms (Cambridge: World Peace Foundation, 1997) p.209

³⁵ John Lewis, Hua Di, and Xue Litai, "Beijing's Defense Establishment: Solving the Arms-Export Enigma" *International Security* XV 1991

³⁶ Ian Anthony, Presentation to TI(UK) Cambridge Conference, April 2001

"Nobody wants a contract that is going to sacrifice the reputation of our company" Howard Weissman, Lockheed Martin Corporation³⁷

³⁷ Howard Weissman, Presentation to TI(UK) Cambridge Conference, April 2001

³⁸ Aibel, H., "The Corporate Interest in Combating Corruption" in TI-USA 'Corporate Anti-Corruption Programs, A Survey of Best Practices' 1996

³⁹ The Politics of British Arms Sales since 1964 p.94

c) Impact on Exporting Companies

i) Market Distortion

Whilst an effective short-term expedient, in the long-run corruption in all industries erodes the competitive principle of comparability of price and quality on which the free market depends. Howard Aibel, writing for TI-USA argues that bribes add to the cost of the product without adding to the value. Whilst they may assist in dumping obsolete/over-priced goods, the enterprise often loses its competitive edge.³⁸

ii) Reputational Value

The perceived importance of the reputational value of companies has drastically increased in the last decade. A good reputation is widely viewed as a company's single most important enduring assets and key to long-term shareholder value. Therefore, there is now greater potential for damaging company profitability through implication in corruption scandals. The enthusiasm of Lockheed Martin to be seen to be combating corruption following their role in scandals in both the 1970s and 1990s shows that this also applies to the defence sector.

Furthermore, whilst it was always ethically dubious to use company funds to pay bribes to secure contracts, since 14 February 2002 and the entrance of Part 12 of the *Anti-Terrorism, Crime and Security Act 2001* into UK law, making corrupt payments is to use company capital to commit crime.

iii) Employee conduct

Less than ethical conduct at high levels can also leave companies vulnerable to petty corruption lower down, or to exposure to publicised accusations by employees with knowledge, leading to higher personnel retention costs to maintain loyalties. Aibel argues that once dubious accounting practices have to be employed to conceal bribes there can be no clear way to ascertain the true destination of the funds. Even where commissions are accepted practice, such as in the Thorn EMI case noted above, setting limits to illegal payments does not work. Despite the fact that the company handbook for senior staff stated that only commissions above 12% had to be cleared by the board, a 25% commission was paid with the authority of the Chairman in 1994.³⁹

"The private sector has an immense interest in solving this problem, because corruption not only increases the costs and hinders competitiveness of companies, but corruption can undermine our market economy system and finally even our society."

President Henkel of the Federation of German Industry

"What gives the defence industry its unique position- and creates its unique susceptibility to corruption - is the complicity of governments in its claim for secrecy. If this is thought to be damaging ... the basis of this claim for special treatment and the justification for government complicity should be rationally analysed"
Joe Roeber⁴⁰

⁴⁰ Joe Roeber, Presentation to TI(UK) Cambridge Conference, April 2001

⁴¹ For example, figures from SIPRI Yearbook 2001 on the market share of exporting countries result in a different top 5 list from those of the International Institute of Strategic Studies The Military Balance 2000-2001.

⁴² Opening of the Stockholm Colloquium on Corruption in the Arms Trade, Feb 4, 2000

⁴³ "The Release of Information on Defence Related Exports" MOD July 1996

4 Corruption Pressure Points

The structure of the industry and the environment in which it operates is made up of a set of interdependent factors that facilitate corruption. These factors do not demonstrate the existence of corruption in any individual contract, but together they are conducive to creating a political/commercial environment in which unethical conduct can fester.

a) Secrecy

The most significant factor contributing to the high level of corruption found in the arms industry is the secrecy surrounding decisions. Procurement products and prices remain under the opaque veil of national security and defy attempts at scrutiny. Despite the best efforts of academics, multi-lateral organisations and concerned governments to establish the components of arms transfers and patterns of expenditure, the standard sources reach different conclusions. None of them can document procurement prices more detailed than the aggregate value of national expenditure or licensing.⁴¹ This uncertainty reflects not only on the complexity of the issue but also the inadequacy of the official information available.

i) Exporting Countries

"I believe that decisions that cannot stand public scrutiny should not be taken in the first place."

Mr. Leif Pagrotsky, Swedish Minister for Trade⁴²

Democratic governments should operate under an assumption of transparency in all situations, only subject to clearly defined and justified exceptions. In explaining why defence exports should be one of those exceptions, a 1996 UK MOD review gave four reasons.⁴³ The first two argued on the grounds of competitive advantage from confidentiality but whilst prices and specifications should not be revealed during negotiations there is no good reason why the commercial considerations of the arms industry should be given any different treatment than those of any other industry. Secondly, secret negotiations were said to prevent competitor export governments from finding information about export opportunities. In the context of the increasing international interdependence of the arms industry following its restructuring, it is unlikely that single nation export opportunities can be concealed successfully. The third and fourth reasons related to the security concerns of recipient states and the adverse effect that disclosure would have on bilateral relations.

"Proximity to unaccountable money generates greed"
Peter Clark, US Department of Justice ⁴⁴

These reasons can disguise both misconceived strategy and corruption. Whilst the genuine security concerns of allies cannot be dismissed lightly, exports made for the sake of the industry rather than to strengthen alliances can use secrecy to conceal the corrupt activities of the arms companies. There is a direct trade-off to be made between the value of the sale and the principles of democratic accountability. Secrecy to protect the sale is maintained only at a clear cost. With reference to the Al Yamamah deal, an astonishing compromise was made by the UK government in its refusal to publish the 1992 National Audit Office Report which investigated allegations of commissions. This compromise is unacceptable. The Quadripartite Select Committee of the House of Commons who review the Annual Report on Strategic Exports said in a letter to the Government of 12 January 2001 that they could not accept that:

"the danger of damaging bilateral relations with a country can be sufficient reason not to engage in debate on the merits of exporting goods to that country...we do not think it can be seriously suggested that the sensitivities, real or imagined, of the intended recipient should weigh heavily in the balance against the need for democratic accountability for such important decisions." (HC 467 2000-01 para.61)

ii) Importing Countries

Secrecy in procurement decisions must be adequately monitored if significant resources are not to be lost to corruption. In his examination of the procedures surrounding procurement decisions by the Indian Army, Ravinder Pal Singh wrote "How far the armed services follow the prescribed procedures depends on individuals at the highest levels of national decision making and their attitudes to public accountability".⁴⁵ It is not surprising that a system where financial accountability depends on the personal integrity of senior officers results in substantial corruption such as that surrounding the Bofors deal in the late 1980s. A SIPRI study investigating the barriers to achieving greater transparency found that secrecy worked more in the interest of the officials and the companies than the public purse or security.⁴⁶ As a result, the barriers to greater transparency more often sprang from lack of political commitment than genuine national security reasons. In the case of Taiwan, they concluded that political and financial accountability need not undermine military priorities and that, following the scandals of the 1990s, greater accountability in defence procurement was crucial in strengthening democracy.

*"Defence officials' use of the excuse of secrecy in the interests of national security has hampered the rational formulation and effective implementation of arms procurement policies."*⁴⁷

⁴⁴ Chief Prosecutor for the US Foreign Corrupt Practices Act, 1977, quoted at TI(UK) Cambridge Conference, April 2001- Workshop on Secrecy in the Arms Trade, Joe Roeber, Rapporteur.

⁴⁵ Arms Procurement Decision Making Vol. 1 p.55

⁴⁶ Ravinder Pal Singh Arms Procurement Decision Making Vols. 1-2 SIPRI, Oxford, 1998 and 2000

⁴⁷ *Ibid* Vol.2 p.181

"The prime contracts have always been couched in the term strategic procurement/ acquisitions. And once you couch the acquisitions in those words, it means the government, the executive can basically make any decisions they like". Richard Young, MD of C²I² interviewed on SAfm, 16 November 2001

b) Arms and National Security

i) Strategic Considerations

Almost any contract decision can be justified through invoking "strategic considerations". This was again evident in the South African purchase outlined in Box 2 where the wording of the Auditor General's report was allegedly changed to infer that decisions on the submarine systems were made on 'non-cost risk factors' to justify the purchase of the more expensive product. The JIT Report concluded that

"strategic considerations in some cases also led to Programme Managers having to accept technical values that were lower than the parameters set in the user specifications and which carried higher risks"⁴⁸

Such "strategic considerations" can be abused to influence the contract allocation towards the buyer who exerts the greatest political pressure or offers the biggest bribe.

ii) Perceived imperative of promoting sales

The strategic justifications for exporting arms have been seen by many governments as a sufficient foreign policy imperative to justify taking little or no action to combat the corruption involved. Companies actively supported by a government which has in the past taken no action to ensure the proper conduct of the sale have no incentive to eliminate corrupt payments from their list of competitive tactics. However, the justifications for the export imperative are clearly open to question. For example one frequent claim is that is that supplying arms can be a vital way to strengthen bilateral alliances.⁴⁹ This is not always the case. In the debate over the UK Arms Exports Bill, Lord Ahmed argued:

The short-term approach of providing military equipment or assistance to strategically important states ignores the long-term implications of arming countries in a region that is susceptible to change."⁵⁰

In some circumstances it backfires entirely, which Sampson would argue was the case during the Gulf War.

"The speed with which Saddam had first built up his arsenal, and then turned it against his suppliers, made nonsense of the diplomats' justification for selling arms; that they were an extension of foreign policy which could bring influence to bear on the recipients and that they could bring stability to unstable regimes."⁵¹

Another strategic justification for the government promotion and subsidy of exports is that of maintaining and strengthening a domestic arms production capacity. The validity of this has been widely challenged not only by the media (most prominently in the

⁴⁸ JIT Report Chapter 10.2.4.6. This referred to the decision by the South African government to procure Turbomeca engines which had more risks and were more expensive but it was considered strategically more important for Turbomeca to get the contract.

⁴⁹ HMG Policy on Strategic Exports can be found at, www.mod.gov.uk/deso/policy

⁵⁰ House of Lords Hansard, 8th January 2002, Col. 492

⁵¹ The Arms Bazaar p.24

“The relationship between the defence industry and the MOD is unusual and inevitably open to suspicion. Therefore, it is all the more important to provide transparency and accountability in this relationship. and be able to demonstrate that DESO provides an unquestionable benefit to the national interest”
Select Committee on Defence, 2nd Special Report, 1999, para.12

⁵² "The Economic Costs and Benefits of UK Defence Exports" Malcolm Chalmers, Neil Davies, Keith Hartley and Chris Wilkinson, Centre for Defence Economics, University of York, November 2001; Stephen Martin 'The Subsidy Savings from Reducing UK Arms Exports' *Journal of Economic Studies* 26:1 1999; Samuel Brittan, 'The Ethics and Economics of the Arms Trade', *Royal Society of Arts Journal* August 2001; Ingram, P., and Davis, I. "The Subsidy Trap; British Government Support for Arms Exports and the Defence Industry" Saferworld and Oxford Research Group, July 2001; Tony Purton, MCIPS, Memorandum to House of Commons Defence Committee, September 1997 'The Systemic Failures of the MOD's Defence Procurement System'.

⁵³ In 2000, world military expenditure was 40% lower than it had been in 1987
Armaments, Disarmament and International Security 2001 p. 302

⁵⁴ *The Economist* (UK) 23rd December, 2000

⁵⁵ The Politics of British Arms Sales p. 94

person of Sir Samuel Brittan) and NGOs, but also by MOD defence economists and Tony Purton, MOD Director of Contracts (1988-93).⁵² Whilst UK Defence Policy lies outside the scope of this paper, it could be argued that in the past, governments, such as the UK Government in the Al Yamamah contract and the French Government in the Taiwan frigate sale of 1992 have used these justifications to view winning the contract as so important that they have turned a blind eye to the corrupt payments made to secure it.

Support for the defence industry by the government is not only financial. The British armed forces regularly participate in defence industry days to promote products abroad, and Government Ministers of the highest level make representations in favour of UK companies. The bids by BAe to participate in Chile's ten year procurement programme in spring 2002 were supported by visits by both the Defence Minister and the Foreign Secretary. British bids to supply aircraft to India in late 2001 were reinforced by representations made in India at the Prime Ministerial level. When the sale of British exports has such a high profile, extra precautions should be taken to ensure that there is no corruption involved. Moreover, because of the significance of government involvement to the success of the industry, arms companies should respond to governmental pressure to act themselves in combating corruption.

c) **Competitive Strategy**

One of the most significant reasons why governments have placed more emphasis on securing the contract than on the integrity of the procurement process is that of the intense competition faced by arms exporters. The arms market relies on periodic large value contracts rather than a constant stream of small value orders. Whilst this is true in any era, the frequency of the contracts has declined significantly since the end of the Cold War.⁵³ Hence each contract can be vital for the future of a company or even a national industry. This is still the case despite the extensive restructuring that the industry has undergone in recent years.⁵⁴ It has been argued that intense competition would be a factor likely to reduce the use of bribery as corrupt payments would increase the cost of the product. However, it is more likely the case that paying the additional cost of bribes is considered a small price to pay for insuring the future of the company. In a situation where performance and price comparisons of the major Western weapons systems reveal relatively little difference, contracts rest on additional inducements. Just such a crucial contract for determining the future of companies and even the national industry was the UK-Saudi Arabia Al Yamamah contract which accounted for at least 20% of all UK arms export employment for over a decade and which provoked widespread commission allegations.⁵⁵

"Payments to key people able to influence decisions by Government is an accepted part of the price to be paid by any contractor or Government securing an overseas order"
Frank Nurdin, Racal Executive

The institutionalisation of corruption as a competitive weapon was revealed in the 1977 Old Bailey trial of Lieutenant Colonel David Randel which exposed a network of British and Iranian middlemen paid by Racal, with the knowledge of DESO, to secure defence contracts. In giving evidence, Frank Nurdin, a Racal Executive admitted that

"Payments to key people able to influence decisions by Government is an accepted part of the price to be paid by any contractor or Government securing an overseas order"

but defended this practice by saying,

"It was a great achievement to sell British arms to Iran against formidable American opposition"⁵⁶

Over ten years later, Sir Peter Levene, Chair of Defence Procurement, gave evidence to the Public Accounts Committee in April 1989, defending allegations regarding the role of DESO in the payment of commissions.

"We are not involved in commissions, we are not involved.... I must say that as we all know... this is a very competitive business. You have to be competitive to survive."⁵⁷

It can be seen that the pressures of intense competition in an industry where bribes are readily received and concealed has meant that exporting governments, whilst not encouraging the commissions, have almost certainly sanctioned their use as a competitive weapon.

i) Competition exacerbated by political inequality

The use of corruption as a competitive weapon is even more tempting when other bidders are exerting greater political pressure. Corruption in arms sales cannot be seen in isolation but interacts with the political implications of each sale. Where one supplier can link an arms contract to other major commitments then it clearly puts other bidders at a great disadvantage who may feel that they need to resort to paying bribes to compete. For example in the case of the South Korean purchase of F-X fighter jets in Spring 2002, the US Department of Defense was alleged to have placed strong political pressures on the Korean decision makers to award the contract to Boeing.⁵⁸ The other main contender, which achieved higher ratings in the technical evaluation process, was from France, whose government was not able to wield such political clout. The arrests of South Korean Air Force Colonels on charges of receiving bribes from the French company could be seen as manipulation by the Korean government to enable them to buy the Boeing, or, if proven, it could be viewed as the tactic of a less powerful exporter, competing against the 'corruption of big politics.'

⁵⁶ Quoted in *The Guardian* 19 January 1978 in Ibid p.89

⁵⁷ 'Public Accounts Committee Ministry of Defence: Support for Defence Exports', Minutes of Evidence 26 April 1989.

⁵⁸ *Hangyore* (ROK) 14 March 2002

"The U.S. Government policy on Offsets in Military Exports views certain offsets to be economically inefficient and market distorting"⁵⁹

⁵⁹ 'Offsets in Defense Trade: An Annual Report to Congress' US Department of Commerce 2001

⁶⁰ Presentation to TI(UK) Cambridge Conference, April 2001

⁶¹ *The Observer* (UK) 19 March 1989, 30 April, 1989

"In Sweden we cannot foster such political power and influence for the government to sell our systems. In this context you have the corruption of big politics. "
Bertill Hellstrom, Ericsson⁶⁰

d) Contract Complexity

Arms contracts involving technically complex products require expert understanding to distinguish their relative merits, thus reducing the core of decision makers. The contracts are tailored to the specific needs of the buyer, and can include arrangements over spares and/or training over differing periods of time. The opacity resulting from such heterogeneous contracts makes it very difficult to establish a normal selling price for a weapon, and thus ascertain whether importers are paying excessive costs that conceal bribes. One example of where price differentials could have been used to conceal commissions was in the £500mn order by Jordan in the spring of 1989 for Tornados. When Margaret Thatcher appealed to Helmut Kohl for help in distributing the risk of providing export guarantee cover, an anonymous letter was sent to the German foreign office alleging that Tornados, which cost the RAF and the Luftwaffe approximately £25mn each were being sold to Jordan for over £35mn. *The Observer* had previously alleged that huge commissions of up to 30% were paid to rulers and middlemen, and that bribes were paid to British citizens with close contacts to the government but Sir Colin Chandler, the head of DESO at the time, maintained that the discrepancy was a matter of more expensive support services.⁶¹ These price discrepancies are not unusual. An analysis by Roeber of the unit prices of 15 weapon systems from 1970-1990 revealed that prices fluctuated regardless of production costs and acceptable margins. Such price opacity undoubtedly facilitates the concealment of substantial commissions.

e) Offsets

The unusual nature of the arms markets is also illustrated by the prevalence of offsets, or industrial participation agreements, where the sale is conditional on foreign investment by the bidding company either in local enterprises that will manufacture components for the deal or in unrelated enterprises. Such agreements are outlawed in all other government procurement by Article XVI of the WTO Plurilateral Agreement on Government Procurement but offsets are often the deciding factor in defence contracts. This was true in the South African purchase where the more expensive BAe Hawk was considered a better option because of the accompanying offset deals (see Box 2).

The value of offsets is certainly questionable and most exporters are opposed to them, including the US (see quotation opposite). Offsets are designed to generate the foreign exchange

“There are, of course, good and valid reasons why agents may be engaged to perform legitimate services, and be paid an appropriate amount for such services. However, agent's commissions are a traditional avenue for the concealing of bribes.”

Transparency
International Integrity
Pact

⁶²Antonakis, paraphrased by Stelios Alifantis and Christos Kollias in Ravinder Pal Singh, ed., Arms Procurement Decision Making Volume II: Chile, Greece, Malaysia, Poland, South Africa and Taiwan SIPRI, (Oxford: OUP, 2000)

⁶³Said K. Aburish, Pay-off: Wheeling and Dealing in the Arab World (London: Andre Deutsch, 1985) p. 1 quoted in The Politics of British Arms Sales, p. 86

⁶⁴Ibid p.95;
The Guardian (UK) March 26, 2001

necessary to make the purchase. However, problems and delays occur as co-ordination between the officials responsible for implementation and the contracting companies is often lacking, there are no penalty clauses in the case of non-fulfilment and the lack of technological infrastructure has often prevented successful absorption of technology by any but the largest companies.⁶² In the non-comparable, non-transparent arrangements that surround them, the potential for corrupt manoeuvres is extensive. Companies use offsets as an alternative inducement to reducing prices. Equally, importing governments can use them as alternative justification for awarding the contract to the more expensive bidder. The combination of these factors can create situations where offset arrangements conceal hefty commissions.

f) The "Ostrich Effect" - concealing bribes through agents

Whilst representatives have legitimate tasks in assisting companies to operate in unfamiliar cultures and styles of government, there is no doubt that the use of middlemen facilitates the payment of large bribes to decision makers. Said Aburish, who acted as an intermediary and went on to write a book on the role of commissions in the Middle East, described the intermediary's role as consisting of "providing the company with an advantage over its competitors by securing the co-operation of someone in power, or with power and influence, to promote its interests... in return for a commission/bribe which is shared by the intermediary and his political mentor".⁶³ The opportunity for abuse is clear not only through the sums of money involved but also because of the reassuringly remote relationship between the bribe and company Head Office. In the bribery allegations surrounding Dassault Aviation SA's bid to supply South Korea with Rafale fighter jets, a spokesman for company communications claimed:

“It's a business practice that local agents give favors with no strings attached. Above all, Dassault Aviation has nothing to do with the case. Its local agents seemed to have provided the money as a simple favor for the Colonel's working level officials.” *The Korea Times (ROK)*, 12 March 2002.

Intermediaries on the receiving end of bribes do not only exist in importing countries as the substantial payments to the son of the French President demonstrated in the 1980s.⁶⁴ It is vital that measures to curb corruption in this industry are sufficient to cover the actions of agents acting on the companies' behalf, wherever they are located. The technical complexity of the arms contracts, the secrecy in which negotiations are couched and the blanket justification of national security substantially limit the number of people who can understand the contract and combine to render the few decision makers particularly susceptible to corruption.

"There is evidently a need for legislative measures, where conflict of interest might amount to a breach of duty, and to regulate the post-employment activities of officials,"

Financial Times (UK) 16 November 2001

⁶⁵ The Subsidy Trap p.45

⁶⁶ Ikegami-Andersson in Arms Procurement Decision Making Vol. 1 p.169

g) The "Revolving Door" Syndrome

In exporting countries, a limited number of decision makers take on different roles at different times. Over 2000 UK MoD civil servants and armed forces personnel joined British and foreign defence companies and management consultancies during 1985-95. These included two former heads of DESO, one who went on to become a director of BAe and the other the Chairman of Vickers.⁶⁵ This "Revolving Door" Syndrome noted by Air Marshal Sir Timothy Garden (rtd), whilst not corrupt per se, could easily engender conflicts of interest for senior MOD officials and military personnel looking beyond retirement and occurs in both exporting and importing countries.

The extensive opportunities for corruption in such a system can be seen in the example of Japan, where defence bureaucrats are encouraged to retire early to work as 'amakudari' consultants in the defence industry. This caused serious corruption scandals in the 1990s⁶⁶. In South Africa, the late Joe Modise, on retiring as South Africa's Minister of Defence in 1999, became Chairman and a major shareholder in Conlog, which was given a significant stake in the national armaments package. Whilst the JIT report cleared him of impropriety, the Director of Public Prosecutions, Bulelani Ngcuka described the situation as "extremely undesirable".

Whilst the Anti Terrorism Act criminalises all bribery of foreign officials, applying the legislation to the arms industry will necessitate rigorous, enforceable measures

⁶⁷ The five are Argentina, Brazil, Bulgaria, Chile and Slovenia. In addition, Organisation of American States members are similarly covered by the 1996 Inter-American Convention against Corruption although Brazil has so far failed to ratify either.

⁶⁸ These three are Brazil, Chile and Turkey. However, Slovenia has only introduced partial implementation.

⁶⁹ These were Lockheed officials imprisoned in 1995 for paying bribes of \$1m to an Egyptian official to secure influence in obtaining a \$79m contract for three C-130 Hercules aircraft in 1989.

5 Reforming the Exporting Process

a) Applying the OECD Convention to the Defence Sector

With the incorporation of the OECD 1997 Convention on "Combating Bribery of Foreign Public Officials in International Business Transactions" into UK law with the passage of Part 12 of the *Anti-Terrorism, Crime and Security Act 2001*, a vital legislative tool has been given to the fight against corruption.

"The purpose of the Convention is "to prevent bribery in international business transactions by requiring countries to establish the criminal offence of bribing a foreign public official, and to have in place adequate sanctions and reliable means for detecting and enforcing the offence".

OECD Anti-Corruption Policy Briefing September 2000

The Convention removes any argument that the UK cannot be expected to act unilaterally on this issue. Its signatories account for over 75% of world trade and include five non-OECD members.⁶⁷ The Convention has been ratified by 33 out of the 34 original signatories and at the time of printing, had entered the legal systems of all but three.⁶⁸ It is enforced by a two-stage process of mutual evaluation which first confirms that national legislation adequately implements the text of the Convention, and then checks enforcement. The first round of this second phase is due to be completed by 2005.

Its American precursor, the US Foreign Corrupt Practices Act of 1977, demonstrates that whilst such laws can act as a deterrent, achieving prosecutions requires an effective investigatory infrastructure. Since 1977 there have been 53 criminal cases with 93 defendants across all sectors. Two thirds of the sentences of imprisonment since 1990 were for defence company officials.⁶⁹ Similar progress in the UK under the *Anti-Terrorism, Crime and Security Act* will require effective investigatory procedures. Transparency International (UK) has recommended that responsibility for investigating and prosecuting serious corruption should be expressly conferred on the Serious Fraud Office rather than left to the Crown Prosecution Service. Promoting mutual legal assistance between countries should also continue to be a high priority in the UK to assist this investigative process.

The Convention requirement for “adequate sanctions and reliable means for detecting and enforcing the offence” should apply equally to the arms trade as to any other. The Convention expressly states in Article 5 that “Investigation and prosecution of bribery of a foreign public official... shall not be influenced by national economic interest, the potential effect on relations with another State or the identity of the natural or legal persons involved.” However, there are two provisos in UK law which may prevent investigation and prosecution of defence industry cases. First, the code of the Crown Prosecution Service notes as a factor against prosecution that “details may be made public that could harm sources of information, international relations or national security.” Secondly, any prosecution for a corruption offence requires the consent of the Attorney General, who is a member of HM Government. Whilst it is currently government policy to retain this requirement there has been requests by both the Law Commission and the OECD Working Group on Bribery in International Business Transactions to consider its repeal.⁷⁰

Recommendation 1 - *Applying the OECD Convention to the Defence Sector*

The UK Government should ensure that Part 12 of the *Anti-Terrorism, Crime and Security Act 2001* is backed up by adequate enforcement processes and resources so that it can be used effectively to investigate and prosecute defence companies for bribery of foreign public officials.

b) Anti-Corruption Conditions for Export Licences

Currently the criteria set out in all export control regulations including the EU Code of Conduct on Arms Exports, the international Wassenaar Arrangement (which includes Russia and China) and the UK Consolidated Criteria, relate to the end-use of the goods rather than the process by which they are procured. However, given the threat that corruption poses to global security and sustainable development, there is clearly a case for incorporating anti-corruption conditions regarding the procurement process into export criteria at both national and international levels.

The validity of incorporating anti-corruption criteria into export credits has already been recognised by the UK government and the OECD. Following the November 2000 OECD Working Party on Export Credit and Credit Guarantees recommendation that agencies should include a requirement for anti-bribery undertakings by companies, the Export Credit Guarantee Department now requires a warranty by exporters and banks that:

⁷⁰ Code for Crown Prosecutors (para 6.5(i)); Law Commission Report (No 248) Legislating the Criminal Code, para 7.26; Corruption Country Report for the UK issued by the OECD on 27 June 2000

Attaching responsibility to individuals for complying with the code of conduct would ensure effective enforcement

“I can tell you that false declarations in these letters have led to very senior executives losing their jobs.”

Chairman, Royal Dutch/Shell Group of Companies⁷¹

⁷¹ Sir Mark Moody-Stuart, former Chairman of The Royal Dutch/Shell Group of Companies, Speech to the European Parliament Conference, 15th April 1998

“We declare that neither we nor to the best of our knowledge or belief, anyone acting on our behalf with due authority or with our prior consent or subsequent acquiescence has engaged or will engage in any corrupt activity in connection with the contract or any related agreement, undertaking, consent, authorisation or arrangement of any kind.”

Whilst this requirement represents welcome progress, it still has significant limitations. ECGD is understood to conduct a measure of due diligence to ascertain whether the warranties reflect the truth by examining the size of commissions, services for which commissions are paid and place of payment. If it is breached in a contract requiring export insurance then that insurance will be invalidated and, in the case of a loan, the company has to compensate ECGD for all loss and expenses incurred. However, these sanctions only come into force in the case of an admission of corrupt activity or a conviction by a court in a competent jurisdiction. ECGD also claims that on the basis of legal advice it cannot operate a “blacklist” or veto of companies which have been found to have engaged in corrupt activities.

To reinforce confidence in the exporting companies, a requirement for a similar warranty should be extended with additional safeguards to the granting of export licences. To ensure that this warranty reflects the truth, companies should also have to confirm that they have in place policy statements prohibiting bribery, reinforced by management systems and compliance procedures necessary to support these statements, and sufficient to cover the conduct of any agent acting on their behalf.

One recommended compliance system which has been most effective in the oil industry, where it has been used by industry leaders such as Shell, is the company annual sign-off letter. This letter contains a declaration by all levels of management denying the involvement of the company in any corrupt practices, attaches responsibility to the individual and exposes them to criminal sanctions under the anti-bribery law if found to be false. Every chief executive in a wholly or majority owned Shell company must sign an annual “letter of representation” which states that the accounts are correct and that

“Neither the company nor its representatives has been party to the offering, paying or receiving of bribes”.

This is taken very seriously by employees as false declarations have had serious consequences.

Arms companies should be given no subsidies that do not require rigorous adherence to comprehensive anti-corruption commitments

Sanctions

The implementation of such rigorous company anti-corruption policies and internal compliance systems should give some measure of confidence that applicant companies take these warranties seriously. However, civil sanctions in addition to the criminal penalties under Part 12 are both easier to apply and are potentially more damaging to exporting companies. Sanctions if the warranty is found to be false should include denial of export licences or exclusion from further contracts and export credits. This has a precedent in 1994, when the US State Department barred issuance of export licences to Lockheed's Aeronautical Systems Company Division because of indictment on FCPA charges.

Further Application

The current system in the UK, where companies are given an advance opinion by the MOD on whether the licence is likely to be approved has meant that the actual granting of a licence can be seen as a formality. Thus it is particularly important that in issuing the advance opinion, the MOD emphasises the significance of the no-bribe warranty and the possibility that a false warranty will forfeit the prior approval. Furthermore, the system for registration of brokers to be introduced under the Export Control Act should also require that brokers have to sign a no-bribery warranty before being registered.

Recommendation 2 – Export Licence Conditions

Export licensing, should be strictly conditional on presentation by exporting companies of rigorous contract-specific no-bribery warranties. These should be reinforced by evidence that companies have in place sufficient internal compliance systems capable of detecting corruption risk and preventing the payment of bribes. Exclusion from export licences should be used as sanctions against companies or brokers found to have paid bribes. Registration for brokers under the Export Control Act should include signing a no-bribe warranty.

c) Public Financial Support for Defence Companies.

Significant subsidies are granted to the UK national arms industry in the course of promoting arms exports (see section 4bii). Whilst the debates for and against this subsidy will not be rehearsed here, it is certainly the case that in no situation should arms companies receive government incentives to obtain contracts via bribery. It is therefore clear that the UK government should take responsible measures to ensure that the advantages to defence

"A strong disclosure regime is a pivotal feature of market-based monitoring of companies and is central to shareholders' ability to exercise their voting rights. . . Insufficient or unclear information may hamper the ability of the markets to function, may increase the cost of capital and result in a poor allocation of resources. Disclosure also helps improve public understanding of the structure and activities of enterprises, corporate policies and performance"
 OECD Principles of Corporate Governance

⁷² The OECD Principles of Corporate Governance were developed in 1998 followed by the updating of the ICC Rules of Conduct in 1999 to prohibit extortion and bribery for any purpose.

⁷³ Initial attempts at verification using a peer review team failed on grounds of commercial sensitivity. Compliance is now monitored through an industry annual report based on questionnaires submitted by members.

companies received through the granting of export credits and support from the Defence Exports Services Organisation are only given to companies with the anti-bribery policy commitments reinforced by compliance and management systems set out in 5a).

Recommendation 3- Export Credits and Public Support

Support for arms companies through export credits and the Defence Exports Services Organisation should be conditional on implementation of anti-corruption codes of conduct.

d) Industry Compliance

i) Code of Conduct

The effectiveness of an anti-bribery requirement relies on a far-reaching compliance process to be introduced throughout the company. Recent years have seen a great expansion of interest in developing general principles of corporate governance and many organisations including TI have produced their own guidelines.⁷² All of these emphasise transparency as crucial to the interest of the company and the industry. One useful precedent can be found in the US Defence Industry Ethics Initiative (DII) which has proved an effective source of advice and support for implementation of the FCPA. The DII's 50 members include almost all top 20 contractors in the US and overall, the group represents around 50% of the prime contract awards to the top 100 companies.

The initiative has three purposes: to increase standards of ethical conduct by employees, to promote self-policing and to share best practices through an annual report and forum.⁷³ The DII incorporates six principles which could act as general guidelines for a similar code for the Defence Manufacturers Association in the UK. All companies have to have in place,

- A written code of conduct,
- Training and orientation of employees concerning the code, particularly important for those employees dealing with potential trading partners and agents,
- A mechanism to surface concerns regarding corporate compliance without fear,
- Self-governance through implementation of monitoring systems including disciplinary actions and voluntary disclosure,
- Shared best practices,
- Public accountability through transparent accounting practices

Further guidance about dealing with specific bribery concerns and how to monitor the activities of agents and

representatives can be found in Transparency International's "Business Principles for Countering Bribery", developed in association with Social Accountability International and in the ICC booklet "Fighting Bribery - a corporate practices manual" which lists a number of red flags, which alert companies to possible illicit activities by agents and sales representatives. It is clear that genuine compliance with such a code will only occur if there is a commitment at the highest level of management and if ethical principles are fully integrated into primary company objectives and human resource policies.

Recommendation 4 - Defence Ethics Initiative

Drawing on the experience of the US Defence Industry Ethics Initiative, and the Transparency International/ Social Accountability International "Business Principles for Countering Bribery", the UK Defence Manufacturers Association should develop and implement a similar code to assist in compliance with the *Anti-Terrorism Act* provisions against overseas bribery. Representation should be made to the European Defence Industry Group for a corporate ethics "meta-code", containing strong anti-corruption provisions, for individual implementation by defence companies globally.

ii) Facilitating Whistleblowing

Whistleblowers have proved to be a key source of information in the majority of the cases brought under the FCPA and are likely to be equally useful for prosecutions under Part 12 of the *Anti-Terrorism, Crime and Security Act*. The need for implementation of a mechanism where employees can voice concerns about corporate compliance without fear, (the third principle of the US DII) has been reinforced by the UK *Public Interest Disclosure Act* of 1999 which has been heralded to provide the most far-reaching protection for whistleblowers.⁷⁴ Defence manufacturers should demonstrate that following this Act they have publicised to their employees mechanisms to enable responsible disclosure of malpractice within the company as well as proper outside bodies with whom a corruption concern can be raised. The government should also ensure that at least one public body is nominated to represent the interest of tax payers. This could be the DTI Export Licensing Authority and/or the National Audit Office.

⁷⁴ For further details on the *Public Interest Disclosure Act*, see the Public Concern at Work website www.pcaw.co.uk

“We conclude that recent events bear out the importance of full, accurate and open reporting to Parliament of arms transfers by the Government and its agencies.”

House of Commons
Quadripartite
Committee, July 2000⁷⁵

⁷⁵ HC 467 para. 69 The Quadripartite Committee is formed of members of the Defence, Foreign Affairs, Trade and Industry and International Development Select Committees. It was formed in 1999 to scrutinise the UK Annual Report on Strategic Exports.

⁷⁶ See Mariani, B. and Urquhart, A. ‘Transparency and Accountability in EU Arms Exports’, Saferworld, December 2000. They argue that for reports to be effective, it should include the quantity and value of goods covered for all export licences granted and denied.

⁷⁷ Annex E of HC 212
March 2001

Recommendation 5- Procedures for Whistleblowers

Defence companies should demonstrate compliance with the *Public Interest Disclosure Act* by having in place mechanisms for whistleblowing which, in line with those recommended by the Nolan Committee and the Financial Services Authority, should include one or more external body to which concerns about corruption may safely and properly be made.

e) Increasing Transparency

i) UK Annual Reports

Transparency of arms sales through a comprehensive, accurate and accessible annual national report is a vital precondition of achieving effective accountability. The EU Code of Conduct 1998 recognised this in incorporating a discretionary annual report on defence exports. However, despite significant progress, the annual reports of most states leave much to be desired.⁷⁶ The UK reports are currently considered to represent best practice but for the purpose of monitoring corruption, the 2001 report still has significant shortcomings. Following a recommendation from the Quadripartite Committee, the Committee of the House of Commons established in 1999 to scrutinise the reports, the 2001 report gives the total value of licences issued for each recipient country, but no information on the values of individual licences on the grounds that this would compromise commercial confidentiality and national security (see section 4a) above). The necessity for commercial confidentiality about licence values in an annual report published significantly after the contract has been awarded is questionable. In its review of EU reports in December 2000, Saferworld argued that to be effective, the annual reports should not only include the quantity but the value of goods to be licensed. The Government has made some progress in this by providing the Quadripartite Committee with information in a confidential memorandum about the values of individual licences for selected requested countries.⁷⁷ Such information in conjunction with a description of the goods licensed could undoubtedly reveal the vast differences in prices of the same exports which could point to the potential for corrupt payments. The Committee should therefore request values of licences in a confidential memorandum in all cases under scrutiny. This information could then be used to highlight concerns to the Government about the likelihood of corrupt transactions in particular cases.

ii) International Arms Reporting

The most far-reaching global attempt to achieve transparency of weapon procurement since the 1930s is the

As well as tackling corruption, “Properly developed transparency measures can make an effective and sustained contribution to improving security among neighbours in the international community”⁷⁸

⁷⁸ Bates, G., and Mak. J. N., Arms, Transparency and Security in South East Asia (Oxford: OUP) 1997 p.3

⁷⁹ The categories are battle tanks, armoured vehicles, combat aircraft, attack helicopters, naval vessels and missile launchers.

⁸⁰ The reviews by groups of experts in 1994, 1997 and 2000 have failed to result in any improvements. The group of experts mandated in 1999 to study the issues of brokers could not agree on recommendations.

UN Register of Conventional Arms (UNROCA). Operational since 1991, it captures over 90% of the global trade in seven main categories of conventional weapons, many of which feature in corruption scandals.⁷⁹ Participation is voluntary but grew annually until 2000. Since 1992, over 150 states have participated at least once and on average 90 countries make returns to the register. However, the absence of China is significant and participation among developing countries, particularly African states, is low. Whilst the volume of trade it records is impressive, the level of information it provides is limited. No price values are recorded and weapons are listed only by the number of items bought in a certain category.

The records of exporting and importing countries for the same transaction rarely tally, as there is some confusion over the classification of transactions which is taken advantage of by those reluctant to use full disclosure. Successive attempts to increase its effectiveness through meetings of Groups of Experts have failed.⁸⁰ The Wassenaar Arrangement also keeps a register of arms transfers although it is not so widely known as the UNROCA. However, it also lacks information on the pricing of weapons and similar attempts to expand the scope of its reporting in December 1999 supported by the UK were blocked in negotiations.

Recommendation 6 - Transaction Reporting

Information on the individual value of licences should be included in the UK Annual Report on Strategic Exports. The UK government should continue to push for the inclusion of values in international arms reporting systems.

f) Increasing Accountability

i) Prior Parliamentary Scrutiny

Prior Parliamentary Scrutiny of individual export licences has been the subject of much debate during the passage through the UK Parliament of the long awaited Export Control Bill. Opponents of the idea argue that prior scrutiny would introduce delays and jeopardise the competitiveness of the national arms industry; although both the USA and Sweden employ such systems. The UK Export Control Bill represents some progress towards formalising Parliamentary responsibility but still does not allow for prior Parliamentary scrutiny of individual export licences. This is contrary to the recommendations of the Quadripartite Committee who have the support of a large cross-party group of MPs and peers, and who have successively revised

“Active parliamentary participation in and scrutiny of the decision making process are necessary to end the secrecy culture”
Dr Vincent Cable MP⁸¹

⁸¹ Standing Committee B Debate on the Export Control Bill, 19 July, 2001

⁸² The recommendations of the Quadripartite Select Committee on prior Parliamentary scrutiny are set out in their reports of July 2000 (HC 467) and March 2001 (HC 212)

⁸³ Amendments 56 and 82. See Lords Hansard 7 February 2002 Col 860-876

⁸⁴ An important safeguard given the effect of Article 9 of the Bill of Rights 1689.

⁸⁵ “The Consolidated EU and National Arms Export Licensing Criteria”, 26 October 2000, HC 199-203W. For the UK Government commitment to good governance see para.51, “Eliminating World Poverty: Making Globalisation Work for the Poor” White Paper on International Development, December 2000, Cm5006

their recommendations to take account of Government concerns about licence delays and confidentiality.⁸²

The most advanced proposal under serious consideration by the Government is that proposed by Lord Campbell Savours.⁸³ The Defence Export Scrutiny Committee would be a Committee of Parliamentarians, (rather than a Select Committee), with a similar structure to the Intelligence and Security Committee. This consists of one peer and eight senior MPs, it has full access to all information but its reports remain secret and purely advisory. Full responsibility for the decisions would rest with the Minister and the Department and all decisions regarding the grant or refusal of a licence will therefore remain susceptible to judicial review.⁸⁴ These proposals have strong cross-party and public support. Most recently, an Early Day Motion (EDM) signed by over 170 MPs including a number of former Defence Ministers stated;

“That this House believes that specified defence export licence applications should be subject to prior scrutiny by a committee comprising honourable Members of Parliament.”(EDM 826, 6 February 2002)

Prior scrutiny would not only provide greater monitoring for the destination and end-use of weapons but could also be crucial in the fight against corruption. Consideration of whether the export would significantly undermine sustainable development is the eighth criterion in UK licensing decisions, and widespread corruption severely undermines the good governance that the UK government recognises as an indispensable requirement for sustainable development.⁸⁵ Therefore, the Committee should take account in their analysis of the potential for corruption in the procurement process and strongly recommend further examination by the licensing authority of cases where there is evidence or reason to suspect possible corruption.

Recommendation 7 - Prior Parliamentary Scrutiny

Prior scrutiny of individual licences should be undertaken by a Parliamentary Committee of both Houses to ensure that sales conform with the UK Consolidated Criteria. This Committee should consider the potential for corruption in the procurement process in the importing country in its advice to the government on whether to award the licence.

“If we can’t see the report and it goes right to the heart of the problem, what does the PAC exist for?”

Dr Kim Howells, MP
The Observer (UK) 10
May 1992

⁸⁶ *The Guardian*, 21
October 1985

⁸⁷ *Independent* (UK)
12.March 1992 and 23 June
1997; House of Lords
Hansard, 7 April 1998
quoted in Campaign
Against the Arms Trade
Memorandum to the
International Development
Committee Enquiry on
Corruption, October 2000

ii) **Publication of the 1992 National Audit Office Report**

The culture of secrecy and concealment that has encouraged government complicity in arms sales (see Section 4a) is nowhere better demonstrated than in the consistent refusal of the UK government to publish the 1992 National Audit Office Report into corruption in the sale of Tornado and Hawk aircraft to Saudi Arabia in the Al Yamamah contract. Immediately after the first stage of the £20bn deal was signed in 1985, allegations began of commissions of £600m.⁸⁶ Following demands for an official investigation led by Alan Roberts, the Labour Defence Spokesman, the National Audit Office began an investigation which was completed in 1992. However, in March 1992, the Public Accounts Committee agreed not to publish its findings. The Chairman, Robert Sheldon MP, refused to disclose the report even to the Committee members, simply stating that there was “no evidence of fraud or corruption”. Sheldon claimed that the reason the report was not published was the “highly sensitive situation regarding jobs in the defence industry” and that “The Saudis would have been upset.”

Despite criticisms by the Labour party before 1997, and a pledge by the former Labour Defence Spokesman, Martin O’Neill MP that a Labour government would re-open the inquiry the Labour government has also refused to publish the report. Defence Minister Lord Gilbert told the House of Lords that publication was not possible because the report “refers to matters which are confidential between the Governments of the United Kingdom and Saudi Arabia”⁸⁷

The consistent refusal of the government to publish the report raises questions regarding the use of secrecy to protect officials and jobs at the expense of democratic accountability. This has been noted by a cross-party group of MPs who signed an Early Day Motion (812) in February 2002 which called for publication of the report and greater transparency in arms sales. Any commitment to greater transparency should be reinforced by the publication of this report.

Recommendation 8 – *Publication of the NAO Report*

The consistent refusal of the UK government to publish the NAO 1992 Report into the Al Yamamah arms sales represents a serious compromise of principles of democratic accountability. The findings of the report should be made public.

"The Pact's effectiveness rests on the binding commitment on all sides not to bribe, nor accept bribes, nor to collude with other bidders, to disclose all payments, and to report the violation of the Integrity Pact by other bidders during the bidding or the execution of the service".

TI (Pakistan), Press Release 27 February 2002

6 Reforming Importing Processes

a) Increasing Transparency

i) Transparency International Integrity Pact

In order to create a level playing field and remove the scope for accusations of corruption, in public procurement decisions, fundamental change in importing countries could be brought about using the Transparency International Integrity Pact. This reassures companies that their competitors are not using bribery and prevents the cost of the procurement from being inflated by corrupt payments. It establishes confidence in government procurement and encourages foreign investment. In such a Pact, government officials and representatives of all contracting parties commit themselves not to demand or accept, or to pay, offer or promise any bribe, favour, or other advantage (including relevant information). The contract also includes provisions against collusion, against design biased in favour of one supplier and in support of disclosure of payments to agents and other intermediaries.

Similarly, it specifies sanctions in the form of forfeiture of bid or performance bonds, liability for damages to the Government office and the competing bidders, and exclusion (blacklisting) from future procurement processes. The Pact should cover all activities related to the contract from the earliest design, the bidding and contracting up to the completion and operation. The Pact can be applied without changing local laws through establishing contractual rights and obligations of all the parties to a government contract. Supervision occurs through full public disclosure of all relevant data regarding the selection and implementation, as well as through the involvement of responsible and suitably qualified or experienced civil society representatives either directly or through delegation to independent professionals. Corruption does represent a legitimate concern for civil society groups who can play a significant role as watchdogs on the defence sector through the Pact.

It has been used with some success in Argentina, Colombia, Italy and South Korea on civilian contracts and most recently in Pakistan, by the Karachi Water and Sewage Board where use of the Pact is claimed to have saved 75% of the expected consulting fees.⁸⁸ The most promising case for use of the Integrity Pact in Defence procurement may be in India, where the Indian Ministry of Defence is actively discussing its adoption.

⁸⁸ Transparency International Press Release, 27th February 2002

"Competition policy is also one of our weapons against corruption. So is a sound public procurement system."

Rt Hon Clare Short MP,
16 February 2000

"What is most serious in the rumour-ridden F-X project is that our defense authorities have failed to learn a lesson from past arms purchases embroidered by corruption and suspicion... The Defense Ministry should have set forth strict evaluation criteria and the selection process should have been transparent."

Seoul Chungang Ilbo
(South Korea) 13 March
2002

⁸⁹ WTO Government Procurement: The Plurilateral Agreement, June 2001, Article XVII

Recommendation 9 - TI Integrity Pact

Importing governments should be encouraged at the inter-governmental level and by exporting companies to use Integrity Pacts including responsible monitors from civil society. The UK and OECD exporting countries should lead by example through using the Pact in their domestic procurement.

ii) Bid Criteria Transparency

Controversy over the award of several contracts including the South African (see Box 2) and South Korean F-X purchases has rested on unclear criteria for bid evaluation and allegations that the criteria were changed during negotiations. As a result of these controversies there have been widespread calls for greater transparency in the bid process. The criteria for bid evaluation should be publicly accessible, and the reasons for rejecting each bid should be made known to the bidding companies and to a Parliamentary committee scrutinising the procurement process when the award of the contract is announced. The WTO Plurilateral Agreement on Government Procurement states that procuring entities should supply on request a statement explaining procurement practices and procedures and an explanation of why the bid was rejected.⁸⁹ All importing governments should follow this procedure in defence contracts thus making it less likely that companies can win contracts on the strength of bribery.

Furthermore, to ensure that the evaluation process is free from the influence of personal advantage for officials serious consideration should also be given to the development of an international team of defence experts which could advise heads of government about the technical specification of weapons best suited to meet their stated security needs.

Recommendation 10 – Releasing bid criteria

The criteria for bid evaluation should be made public by governments of importing countries and the evaluation of bids should be released to the bidding companies and to a Parliamentary Committee scrutinising procurement decisions. Any subsequent substantive changes to specifications and prices should be fully and publicly justified.

“The security sector should be subject to proper accountability, transparency and discipline, in the same way as all other parts of the government budget.”

Rt Hon Clare Short,
MP⁹⁰

Initiatives to prevent money-laundering in the UK are particularly relevant to the arms industry, where commissions are notoriously difficult to detect

⁹⁰ Rt Hon Clare Short MP, Secretary of State for International Development, International Institute of Strategic Studies, 4 February 2002

⁹¹ Arms Procurement Decision Making, Vols. 1 and 2

b) Promoting Accountability

i) Parliamentary Accountability

The SIPRI study on defence procurement found that despite a plethora of different procurement practices, most countries lacked the necessary institutions and structures to ensure accountability.⁹¹ Expenditure on defence procurement should be scrutinised by a Public Accounts Committee with full access to the bids, specifications and documents in order to hold government expenditure to account.

Recommendation 11 - Parliamentary Accountability

Defence procurement decisions should be scrutinised by Parliamentary Committees in all importing countries. Information accessed should include the criteria for bid evaluation and the tenders considered.

ii) Donor Accountability

Development agencies have in the past been reluctant to take on security related issues. However, there is an increasing realisation of the significance of a responsibly managed security sector in an environment of severely limited resources. The security sector and off-budget defence expenditure should be included in the range of public performance issues already considered by agencies and the World Bank in designing loan packages. As part of the good governance agenda, particular attention should be paid to the procurement process rather than purely to levels of expenditure. Some steps towards this have already been taken in the US in the implementing legislation following the 1994 Uruguay Round. This requires that the President report to Congress on countries that fail to adequately address corrupt procurement practices. Further use of these reports should be made to encourage reform of procurement processes.

Recommendation 12 - Donor Accountability

The UK Government should encourage governments, through offers of technical assistance, to include security sector reforms in their Poverty Reduction Strategy Papers. These should include an audit of procurement practice in the security sector and measures to increase accountability and transparency for security expenditure.

c) Tracking Commissions

Given the factors which make corruption in the arms trade peculiarly difficult to detect, (as outlined in Section 4) tracing the funds involved in the transaction could assist

significantly in the detection of corrupt payments. The *Sunday Times* article from November 2001 quoted at the beginning of the report concerned a deposit of over £100m in a Jersey trust fund which was traced back to the Qatar Minister of Defence. The report alleged that the money was received in connection with procurement deals with European companies. The payments came to light primarily due to actions by financial regulators and the investigation was carried out by police and judicial agencies.⁹² The current initiatives in the UK and elsewhere to tighten money-laundering procedures are an encouraging development. However, in the case of large scale defence contracts, further provision could be made by tasking an independent public body to monitor the accumulation of the aggregate of transactions on all the bank accounts used to implement a particular contract. Any discrepancies between the aggregate amount and contract value would indicate improper payments.

Recommendation 13 – Tracking Commissions

Independent scrutiny of specified accounts related to major contracts should be established.

d) Banning Offsets

Offsets, or industrial participation agreements, where investment is promised in return for awarding a contract, are prohibited by the WTO under Article XVI of the Plurilateral Agreement on Government Procurement. However, Article XXIII exempts national security and national defence from the whole Agreement. Prohibiting offsets in defence contracts would also significantly reduce some of the space for corrupt manoeuvres and encourage greater comparability and competition based on price and quality of weapons. The US Department of Commerce submits an annual report on offsets in defence exports to Congress, monitoring their role in the awarding of contracts. The UK should also evaluate the role of offsets and their real purpose. The Netherlands and Norway are investigating the possibility of banning offsets in defence procurement unilaterally. The UK Government should work with these and other exporters to include offsets in the range of issues considered by the WTO Working Group on Transparency in Government Procurement.

Recommendation 14- Banning Offsets

The UK should work with other exporters within the WTO to outlaw offsets in defence procurement.

⁹² Jersey Financial Services Commission, Serious Fraud Office and the Financial Crimes Unit of the Jersey Police *The Sunday Times* (UK), 25 November 2001.

*"Governments cannot hope to tame corruption without the help and support of their people."*⁹³
TI Source Book

7 Conclusion and Recommendations

Corruption in the official arms trade is not an amorphous, creeping phenomenon without definable causes or solutions. It is an integral aspect of the arms trade which has been exacerbated by the scramble for emerging markets, the oil crises of the 70s and the fierce competition following the end of the Cold War. It has been allowed to fester and increase, fuelled by secrecy and the vague definitions of "national interest".

The attitude to corruption by companies and governments is often one of reluctant acceptance. In an interview with a senior defence industry businessman, Roeber was told "No company would pay bribes if they didn't have to", which Moody-Stuart confirms is the predominant attitude held by exporting companies in all industries. He further estimates that 50% of those involved in both buying and selling are 'reluctant accomplices' in a system where 'everybody does it.'⁹⁴

If this is the case then inertia is the only enemy of reform and a powerful constituency can be mobilised to achieve effective change. This report demonstrates that corruption can, however, be analysed, deconstructed and tackled in a systematic, multi-lateral and effective way.

Whilst the recommendations focus on the role to be played by governments and industry, the role of civil society and the media should not be underestimated. Investigative journalism has a crucial role in sustaining the momentum for reform and exposing allegations of corruption whilst NGOs can hold governments to account and play a vital monitoring role in the use of the Integrity Pact.

TI(UK) calls upon the UK Government and the British defence industry to implement the 14 recommendations set out below.

Recommendations

Recommendation 1 – *Applying the OECD Convention to the Defence Sector*

The UK Government should ensure that Part 12 of the *Anti-Terrorism, Crime and Security Act 2001* is backed up by adequate enforcement processes and resources so that it can be used effectively to investigate and prosecute defence companies for bribery of foreign public officials.

⁹³ Pope, J., TI Source Book 2000 Confronting Corruption: The Elements of a National Integrity System (Berlin: Transparency International, 2000) p.134

⁹⁴ Moody-Stuart, G., Grand Corruption (London: World View Publishing, 1997) p.138

Recommendation 2 – *Export Licence Conditions*

Export licensing should be strictly conditional on presentation by exporting companies of rigorous contract-specific no-bribery warranties. These should be reinforced by evidence that companies have in place sufficient internal compliance systems capable of detecting corruption risk and preventing the payment of bribes. Exclusion from export licences should be used as sanctions against companies or brokers found to have paid bribes. Registration for brokers under the Export Control Act should include signing a no-bribe warranty.

Recommendation 3- *Export Credits and Public Support*

Support for arms companies through export credits and the Defence Export Services Organisation should be conditional on the effective implementation of anti-corruption codes of conduct.

Recommendation 4 - *Defence Ethics Initiative*

Drawing on the experience of the US- Defence Industry Ethics Initiative (DII) and the Transparency International/ Social Accountability International “Business Principles for Countering Bribery”, the UK Defence Manufacturers Association should develop and implement a similar code to assist in compliance with the *Anti-Terrorism Act* provisions against overseas bribery. Representation should be made to the European Defence Industry Group for a corporate ethics “meta-code”, containing strong anti-corruption provisions, for individual implementation by defence companies globally.

Recommendation 5- *Procedures for Whistleblowers*

Defence companies should demonstrate compliance with the *Public Interest Disclosure Act* by having in place mechanisms for whistleblowing which, in line with those recommended by the Nolan Committee and the Financial Services Authority, should include one or more external body to which concerns about corruption may safely and properly be made.

Recommendation 6 - *Transaction Reporting*

Information on the individual value of licences should be included in the UK Annual Report on Strategic Exports. The UK government should continue to push for the inclusion of values in international arms reporting systems.

Recommendation 7- *Prior Parliamentary Scrutiny*

Prior scrutiny of individual licences should be undertaken by a Parliamentary Committee of both Houses to ensure that sales conform with the UK Consolidated Criteria. This Committee should take into account the potential for corruption in the procurement process in the importing country in its advice to the government on whether to award the licence.

Recommendation 8 – *National Audit Office Report*

The consistent refusal of the UK government to publish the NAO 1992 Report into the Al Yamamah arms sales represents a serious compromise of principles of democratic accountability. The findings of the report should be made public.

Recommendation 9 - *TI Integrity Pact*

Importing governments should be encouraged at the inter-governmental level and by exporting companies to use Integrity Pacts including responsible monitors from civil society. The UK and OECD exporting countries should lead by example through using the Pact in their domestic procurement.

Recommendation 10 – *Releasing bid criteria*

The criteria for the bid evaluation should be made public by governments of importing countries and the evaluation of the bids should be released to the bidding companies and to a Parliamentary Committee scrutinising procurement decisions. Any subsequent substantive changes to specifications and prices should be fully and publicly justified.

Recommendation 11 – *Parliamentary Accountability*

Defence procurement decisions should be scrutinised by Parliamentary Committees in all importing countries. Information accessed should include the criteria for bid evaluation and the tenders considered.

Recommendation 12- *Donor Accountability*

The UK Government should encourage governments, through offers of technical assistance, to include security sector reforms in their Poverty Reduction Strategy Papers. These should include an audit of procurement practice in the security sector and measures to increase accountability and transparency for security expenditure.

Recommendation 13 – *Tracking Commissions*

Independent scrutiny of specified accounts in major contracts should be established.

Recommendation 14- *Banning Offsets*

The UK should work with other exporters within the WTO to outlaw offsets in defence procurement.

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