

TRANSPARENCY INTERNATIONAL (UK)



Report on the Conference

Corruption in the Official Arms Trade

**Convened by TI(UK) in association with
the Swedish Ministry of Foreign Affairs and Trade**

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Transparency International

Otto-Suhr-Allee 97-99
10585 Berlin, Germany
Tel. -49-30-343-8200
Fax -49-30-3470 3912
Email: gdell@transparency.org

Transparency International UK

St. Nicholas House, St Nicholas Rd.
Sutton, Surrey SM1 1EL, UK
Tel. -44-20-8643 9288
Fax -44-20-8710 6049
Email: ti-uk@crownagents.co.uk

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Foreword

Foreword by Leif Pagrotsky, Minister of Trade, Government of Sweden

The Swedish Government has traditionally given high priority to combating corruption in all its aspects. Corruption in the arms trade is one area that has been a target for special focus for us over the last couple of years. There are several reasons for this. The market with its special features makes combating corrupt behaviour especially difficult. Enormous sums are involved. Cutting edge technology, fierce competition and the need for commercial and governmental secrecy makes transparent monitoring of the trade complicated, yet not impossible. The growing support for action within the international community gives momentum to our endeavours, and is also a prerequisite if concrete and substantial results are to be achieved.

Consequently, two years ago Sweden, together with Transparency International, initiated a new project for fighting corruption in the official arms trade. The first visible landmark of our joint endeavours was the Stockholm Colloquium on corruption in the arms trade, that I had the pleasure of hosting in February 2000.

It is encouraging to see that good progress has been made with regard to what was discussed at the first meeting in Stockholm. Some of the issues initially identified at the Stockholm Colloquium were subsequently introduced by the Swedish Presidency into the EU deliberations on combating corruption in the arms trade. It is fair to say that swift results have proved difficult to achieve. The topic is still cloaked in sensitivity and progress demands a delicate touch. However, several concepts stemming from our first negotiations should be explored further.

To move forward and to achieve substantial results, continued and active support is needed from all parties concerned, including the industry. This form of corruption has devastating effects on the whole of society. The waste of resources that corruption causes for both industry and civil society calls for action. The presence of corruption within any society also erodes the entire idea of good governance.

With the results from the Cambridge Conference in hand, showing us a variety of different remedies to the problem of corruption in the official arms trade, I remain convinced of the great importance of the process we have initiated together. To this end, I find it both urgent and rewarding to support and contribute to the initiative we took in the summer of 1999.

Foreword by Peter Eigen Chairman of Transparency International

It is a great pleasure for me to see this meeting in Cambridge, UK, follow on so decisively from the Colloquium hosted by the Swedish Ministry for Foreign Affairs in Stockholm in 2000. The issue of corruption in the arms trade is of great pragmatic importance to all stakeholders, including exporting and importing countries and has profound implications for the welfare of many people, particularly in the developing world, where expenditure on arms can constitute a major diversion of resources from pressing human needs.

As the conference participants agreed, corruption adversely affects both good business practice and political integrity. This recognition will hopefully be the basis for future co-operation among the various stakeholders - including governments, industry and civil society - who have come together in the two conferences. This co-operative approach, and the transparency it requires and demands, is indeed a landmark for the industry and reflects the commitment of stakeholders to combat what can now be openly recognised as a scourge in their midst.

Summary report on the conference on corruption in the official arms trade

Laurence Cockcroft
TI-UK

The objectives of the Conference were :

(a) to examine the ways in which corruption distorts the international market for arms, often placing an unjustifiable burden on low income countries and adding to political instability more widely, especially at the regional level;

(b) to identify key steps to reducing corruption in the arms trade, and in so doing, to build on the preliminary recommendations identified in the Stockholm Colloquium of January 2000 (which provided a reference point for the Swedish government during its Presidency of the EU in 2001).

Participants :

The meeting was convened by the UK chapter of Transparency International acting in close association with the Ministry of Foreign Affairs and Trade of the Government of Sweden, and with support from the Department of International Development of the UK. (Additional financial support was provided by two private foundations and Lockheed Martin). It was attended by a total of forty-eight participants drawn from governments (Sweden and UK), NGOs, the academic research community, arms manufacturing companies and the media (for background purposes). A full list of participants is attached at the end of this report. The meeting was addressed by the Swedish Minister of State for Foreign Trade, Lotta Fogde. It was chaired by Frank Vogl, Deputy Chairman of TI's International Board.

Key findings :

A. Analysis :

(i) the 'defence burden' (military expenditure as a percentage of GDP) is rising in many developing countries, and this expenditure is often competitive within regions; the basis for defining 'effective military expenditure' is unclear. However, some electorates (such as Nigeria's) oppose a reduction in the armed services;

(ii) the 'national security' argument for sustaining the defence industry in major exporting countries is weak, as is the 'job creation' argument (in the UK for example the defence sector accounts for only 0.5% of exports);

(iii) in the course of the 1990s the international defence industry has been globalised; US companies meet 50% of the world market, the UK and France each have a further 15-18%, and Germany and China each have about 1-2%. However, sourcing is complex: EU defence sector exports to the US total US\$1 billion p.a.; South Africa will supply some of the software for the Eurofighter. The collapse of military expenditure within Russia has made Russia more aggressive in its international sale of arms.

(iv) the OECD Convention on Combating Bribery of Foreign Public Officials does not allow member states to make exceptions on the grounds of national security (see Article 5 and Note 27); however in the defence sector 'extortion and passive bribery' are a particular problem which may need to be taken into account. In some states (especially Middle Eastern) the contractual requirement to have a local partner as an intermediary may complicate the definition of a corrupt payment.

(v) in the US the Defence Industry Ethics Initiative represents a serious attempt to promote an ethical approach within the industry, extending to arms exports and going beyond the FCPA; Thales (formerly CSF Thomson) has recently joined this initiative, and has an important in-house programme designed to promote a fully effective integrity system. In the US, financial contributions to political parties may influence the willingness of the Administration to lobby for a particular sale.

(vi) CO-ARM (the EU Common Foreign and Security Policy on Arms Exports) aims to encourage gradual convergence on arms export policy within the EU, and has launched the EU Code of Conduct; to date it has not proved feasible to include an explicit anti-corruption clause in this Code, but CO-ARM remains the most relevant EU vehicle for addressing the question.

(vii) the UN Arms Registry is an important reference point which captures 95% of global arms sales, though it currently excludes China. Its scope will extend to a High Level Group on Disarmament and Development; in mid 2001 the UN Conference on Small Arms took some useful steps in the related small arms sector but did little to address the corruption issue.

B. Recommendations

(i) the defence sector should not receive special treatment from OECD governments but should be treated like any other industry; the active involvement of Ministries of Defence in the promotion of arms sales should be curtailed;

(ii) rather than allow their companies to export arms under complex offset arrangements (usually at the buyers' insistence), OECD governments should require all sales to be made on a transparent basis and ban offset arrangements which are excluded by WTO in all other sectors;

(iii) CO-ARM should give active consideration to promoting the Integrity Pact mechanism in relation to large scale defence contracts and to linking export licences to 'no bribe pledges';

(iv) IFIs and other donors should be tougher in limiting military expenditure;

(v) export control regimes should be based on end user certificates provided by the purchasing country or client rather than the exporter, in order to increase the probability that the stated use is the actual use;

(vi) parliamentary oversight in both the exporting and importing country should be strengthened, or introduced where it does not apply;

(vii) the Defence Industry Ethical Initiative in the US should have an EU counterpart, or alternatively this should become an OECD wide initiative (which might make the Integrity Pact a part of its agenda);

(viii) the General Assembly of the UN should agree to make corruption in the international arms trade an issue, on the basis that it is a threat to peace and security.

Follow up steps :

The principal follow up steps will be as follows :

(i) the Swedish Ministry for Foreign Affairs will activate the question in CO-ARM of the applicability of the TI Integrity Pact to major defence contracts;

(ii) a full Conference Proceedings document will be circulated to all participants and others, including TI chapters;

(iii) a Briefing Paper summarising the key issues and identifying areas for follow up, designed for wider circulation in media and other relevant circles will be produced;

(iv) an ad hoc Steering Committee will be formed to pursue the issues raised, to meet twice per year and include representatives of the corporate sector, the Swedish Ministry for Foreign Affairs and Trade, the UK Department for International Development, and TI (both the International Secretariat and TI-UK). Its first meeting will be in Stockholm in February 2002.

I. Setting the Framework

Key Findings of the Stockholm Conference of February 2000

Anne-Charlotte Wetterwik and Marella Buckley
Swedish Ministry for Foreign Affairs and TI-UK

During the summer of 1999, a co-operation was initiated between the Swedish Ministry for Foreign Affairs (Section for Strategic Export Controls) and Transparency International (TI). This resulted in a colloquium on corruption in the arms trade, held in Stockholm on February 3rd - 6th, 2000. Participants from twelve different countries and four cross-sectional categories were invited to stimulate a constructive, multi-faceted discussion of the problem. For the first time ever, representatives from the defence industry, governments, the military and NGOs/academics met in a shared forum to address the subject.

The two-day meeting was designed as a consultation to determine (i) the mechanisms underlying corruption in the arms trade, (ii) the value of bringing together different interest groups to address the problem, and (iii) what actions this group of experts could propose as a basis for further work. The first day focused on describing the nature of the problem and the mechanisms at work, from the participants' different perspectives. The second day harnessed their expertise to outline a range of concrete solutions. The material contained in the report below represents the immediate findings of the colloquium, providing descriptive input, analysis, and quite precise signposts for future action.

When studied and collated, the findings provided the basis for two linked programmes of specific action defined in subsequent months by the Swedish Ministry for Foreign Affairs and Transparency International (TI). The Swedish programme will be particularly focused on Sweden's Presidency of the EU in the first half of 2001. TI has designed a related 18-month project to address corruption in the arms trade, which will be managed by TI-UK, the UK chapter of Transparency International. Further information about these two future programmes is available from the addresses in the appendix. This joint report summarises the discussions and findings of the Stockholm colloquium.

Section 1. Problem Areas

1.1. Some Key Characteristics of the International Arms Trade

From the outset, the participants agreed that the arms trade has certain characteristics that make it particularly vulnerable to corruption. Some of these "problem areas" were later addressed in the colloquium's proposals for solutions.

1.1.1. The Market

Changes in the structure of the industry: After the fall of the Berlin Wall, defence spending dropped very significantly. In many countries the industry has had to undergo major structural changes involving mergers, down-sizing and capacity-reduction. But it is still plagued by over-capacity, making competition unusually fierce for whatever business there still is. This competitive environment is exacerbated by the structure of defence ordering.

Ordering patterns: Orders for defence equipment are few, large and randomly distributed both geographically and over time. For manufacturers, getting an order can mean the difference between survival and bankruptcy, which makes each order crucially important and adds greatly to the pressures on companies to succeed in bidding situations. This, in turn, can make them more vulnerable to demands for bribes, and less scrupulous about the means used to get orders than they might be in more balanced market conditions.

Financial scale: From the perspective of the importers, the sheer size of the orders makes the trade a prime candidate for corruption. Bribes on orders of such high monetary value are likely to be bigger than in many other industries. Due to the scale of the orders the amount requested for a bribe can be concealed relatively easily.

Lack of market transparency: Through the interaction of a number of factors, the trade in arms is opaque to a degree not found in any other major manufacturing industry. The contributing factors include: first, procurement procedures that are often obscure and unaccountable; second, technically sophisticated products that lead to heterogeneous, incomparable contracts; and third, a commercial packaging of contracts too complicated as to reveal the actual price relationships.

Market segmentation: The conditions just described mean that there is a lack not only of price transparency but also of a real "market", in the sense of how markets are ordinarily understood to function. Arms markets are *segmented*, meaning that the same product can be offered at widely different prices without comparison. (Even if the expertise were available to make such comparisons, and even if political processes did, unusually, permit such comparisons to be made, there is as yet no effective price-related or technical basis for such surveillance of illicit procurement decisions.)

1.1.2. Opacity

Secrecy: Something that sets the arms industry apart from other industries is the extent of the secrecy which covers all aspects of the business, providing a cloak under which any procedures can flourish without oversight.

Commercial secrecy: Commercial secrecy is considered by the manufacturers to be necessary in order to stay competitive in highly contested bidding-situations.

Governmental secrecy: governments tend to be involved at a high level in the decision-making process both around arms exports and arms imports, and tend to impose their own, further degree of secrecy on the transactions, in the name of national security. But even a legitimate need for secrecy from the security perspective may well, in the present climate, cover up inappropriate aspects of a transaction. So the mechanisms that balance on the one hand, governmental control and discretion, and on the other, transparency, do need to be

addressed more carefully. Most of the colloquium-participants considered that not all countries enforce adequate control mechanisms around procurement at present.

Price-opacity: The secrecy that usually surrounds defence budgets tends to prevent a sufficiently thorough analysis of the different items of expenditure. There can also be a lack of transparency too around the actual number of participants in the decision-making processes. Although a linked chain involving manufacturers, their representatives, and both exporting and importing governments may contribute to the contracting process, the final price is known only by a few. Rarely, even after the deal has been closed, are the conditions of arms contracts made public.

Political sensitivity: The market also has a political nuance because the procurement of new defence systems is often linked to political decisions and geo-strategic considerations. Due to the sensitivity of arms-sales agreements from the perspectives of security and political relations, governments may permit themselves to deviate from standard procurement procedures. The producing government may also be influenced because of the defence industry's major role as an employment-provider.

1.2. The Impact of Corruption in the Arms Trade

Burdens on taxpayers: On the importing side, the public treasury of developing countries may bear the cost of much of the bribery that inflates the price of their procurement-contracts. On the exporting side, the public treasury may be called upon to finance defaults of imports insured by export credit guarantee facilities.

Impact on development: Special awareness should also be raised about the situation of developing and post-conflict countries. Here bribes can motivate a superfluous expenditure on defence-material, wasting budget-resources that may be needed for the most basic social provisions. A national reputation for rampant corruption will also tend to discourage foreign investment.

Impact on national and regional stability: Corruption can also have serious side-effects for overall security and stability. Arms-contracts that involve personal bribes or unwarranted "commissions", rather than being solely defined by an objective, expertly-assessed need for precise amounts of particular defence-equipment, can cause an influx of unnecessary or inappropriate arms which can disturb the delicate balance of a region's security.

1.3. Monetary Temptations and Political Pressures

Low public sector salaries: government and military officials in numerous developing and transition countries barely earn a living wage. On this basis, it is understandable that they might be sorely tempted by bribes. However, the major bribes or "grand corruption" cannot be explained on those grounds, and the bribes or unwarranted "commissions" attainable through arms contracts do tend to be on this grand scale.

The "revolving door syndrome" : This is a term used to describe a situation where senior employees of the military and civil service subsequently shift into posts with private companies. The colloquium pointed out that this relatively common practice might be

conducive to corruption in two different ways. Firstly, a government employee or military official may, in the hope or understanding of subsequently gaining a lucrative post in the private sector, be influenced to help get a procurement contract awarded to a particular company. Secondly, once a former military or civil service official does move on to a job with an arms manufacturer, the insider knowledge and personal contacts that he carries with him into the company environment may help to facilitate further corrupt deals.

Political pressure from selling governments: Monetary bribes are only one way of influencing procurement decisions. Some industry representatives present at the colloquium considered it to be quite common for exporting country governments to deploy political pressure at the highest levels of government to promote the cause of domestic manufacturers in an international bidding process. As a result, other exporting country governments may feel encouraged to tolerate corrupt practices on the part of their industry as a means of redressing the “imbalance” caused by competition from countries with greater political influence.

1.4. Other Factors Facilitating Corruption

Integrating corruption into the competitive process: In discussing the mechanics of corruption, some industry representatives protested that bribery on a large scale was not an option at all, citing the highly competitive nature of the arms trade, and asserting that high quality and low prices really were the two most important determining factors in procurement decisions. They contended that the costs of large-scale bribery would simply be too great for a company to include in its pricing if it wanted to remain competitive.

Against this line of argument, it was suggested by some participants that in a market environment characterised by corruption, it would be natural for all competing companies to automatically include the cost of required bribes into their overall price – thereby neutralising the limiting effect competition might have had on the size of such bribes. The cost of corruption would then be fully absorbed by the taxpayer in the procuring country. Alternatively, to the extent that exporting country legislation does not curb the practice of openly or secretly including the cost of bribes among legitimate business costs, the price of corruption may be absorbed in part by the taxpayer in the exporting country. The lack of market transparency that characterises the arms trade provides sellers with an ideal environment for transferring the cost of a bribe back to the buyer by simply setting higher prices to compensate for the cost. As a practical example, the “Al-Yamama” contract with Saudi Arabia was cited. Several hundred million dollars were estimated to have been paid in bribes to secure that contract, despite ostensibly stiff competition among the bidders. This would have been impossible if the limiting effect of competition had not been neutralised in some way.

Absorbing the cost of bribery through secondary contracts: Some participants at the meeting raised the question of follow-on contracts for the maintenance of materiel and other related services. The promise of a lucrative secondary contract could make it worthwhile for a company to bear the cost of a bribe during negotiations for the main contract. But representatives from industry maintained that this was unlikely to be the case, at least when the equipment in question was produced and sold in large numbers. The market for maintenance and other secondary services was then dominated by smaller, more specialised companies who specialised on that segment of the market, making the prospects for gaining secondary contracts very difficult for the manufacturer of the original equipment.

1.5. Risks associated with the Use of Agents and Middlemen

The risks and advantages of agents: Agents often play an important role in international arms contracts. Buyers may employ agents in order to avoid direct contact with potential suppliers, ostensibly to lessen the opportunities for the latter to exercise inappropriate influence on the procurement process. Companies use independent local agents in order to avoid the costs involved in establishing a local office, which is the alternative means of acquiring the necessary local contacts and day-to-day information about the ongoing procurement process, as well as for the important task of gathering intelligence on competitors. Agents can also play an important role in providing producers with a better understanding of the buyer's precise requirements and of the local operating environment for the equipment in question. But in addition to these advantages to using a local agent, participants agreed that there exists a risk that the agent could act as an active instrument in attempts to corrupt the procurement process.

It is not only corruption, but also breaches of commercial confidentiality that constitute a risk in the use of agents. For instance, if a company decides to establish a local office, an agent may play a vital role in recruiting local personnel. It would be relatively easy for that agent to place within the local office personnel loyal to himself rather than to the company employing them. In some cases, an agent may even be involved in the local activities of several different companies engaged in the bidding process.

Commission or bribe? : In discussing the use of agents the colloquium also considered the issue of the appropriate level of remuneration for an agent. The lack of clear norms for the appropriate size of a legitimate commission can open the way for "commissions" so disproportionate that they are in effect bribes by another name. A legitimate commission might well have to cover taxes or similar fees in the purchasing country. But a disproportionately large compensation for little or no legitimate service could function as a means of transferring the funds required for the placing of bribes.

Kick-backs – the systemic implications of bribery: It is important to underline that bribes are not always paid by a producer to a buyer. Rather, bribes or – as the French put it, "rétro-commissions" – may also be used to influence decision-makers in the producing country. Ultimately, a climate of bribery and kick-backs can infect the producing company as well, spreading high up in the company structure and eroding employee and efficiency. A culture of corruption has wider political implications also for a producing country : if bribery becomes a feature of export policy decision-making, it can have a considerable negative impact on public confidence in the government and the political system of that country, with potential harmful effects reaching far beyond the defence industry sector.

Section 2. Corrective Measures

After having discussed the nature of corruption in the arms trade, participants of the colloquium turned to the question of what scope there was for limiting the opportunities for corruption in that sector. The following is a summary of their conclusions and suggestions in different areas.

2.1. A Growing Anti-Corruption Environment

Cross-border co-operation: The risks associated with corrupt practices in the arms trade are rising. Cross-border co-operation between law enforcement authorities is rapidly increasing. Through the 1997 OECD Convention on Combating the Bribery of Foreign Public Officials in International Business Transactions, the international community has gained its first potentially effective instrument for co-ordinating efforts against business-related corruption. International efforts against drug-trafficking, organised crime and money laundering are bringing to light questionable transactions in the arms trade as well. Largely because of the drug issue, banking secrecy is no longer as impenetrable as it once was, and can more easily be breached also in the interest of combating non drug-related crime and corruption. A "critical mass" of opinion seems to have accumulated, asserting that corruption is no longer an acceptable phenomenon. The political will to deal with the problem is emerging in an increasing number of countries. Calls for better regulation are also coming from significant sectors of the defence industry itself, who would prefer to focus competition on the less unpredictable factors of price and quality. Industry representatives also underlined that the various arms corruption scandals that have come to light in recent years have encouraged the rapid development of effective systems of self-regulation. It must be considered a sign of the times that a broadly based meeting such as the Stockholm Colloquium was possible to bring about.

US anti-bribery legislation: Representatives of US defence industries described their internal best-practice systems, and what they see as the unilaterally rigorous controls imposed by their own domestic anti-corruption legislation, the Foreign Corrupt Practices Act (FCPA). The US system of foreign military sales (FMS) was also discussed briefly as an example of how exports are managed through the US government, lessening the scope for corrupt practices. One feature of the present system is that prices are kept within strict limitations, reducing the scope for bribery.

Greater international control: The current trend of international commercial mergers, supported by initiatives such as the LOI (under which Europe's six main arms-manufacturing countries are exploring ways of co-ordinating regulatory systems affecting their defence industries), will lead to a situation where the few remaining, large companies will be subject to a degree of international scrutiny that will make corrupt practices much more difficult to employ. Collective oversight will lessen the scope of what individual governments might have allowed in the name of national security.

International arms control: Existing arms control measures constitute a transnational fabric of international agreements on non-proliferation, rules for trade, export controls, controls over methods of selling, and regulations governing the inducements commonly offered by exporters. However, it makes little sense to try to subject the trade to such controls while leaving corruption in place as a powerful method to evade them. Thus a programme for curbing arms-trade corruption is a logical part both of the larger arms control picture, and the growing international intolerance for corruption in general.

2.2. Transparency and Awareness

Network building: The participants resolved to use the Stockholm Colloquium as an opportunity to begin creating anti-corruption networks within each of the groups represented at the colloquium. The furtherance of such coalitions and "working groups" was considered a high priority for future work. Such transparent anti-corruption networks would be a direct counterpoint to the opaque networks of patronage and bribery which currently control much procurement activities.

Export-licensing authorities: It was underlined by the participants that corruption is not only a problem in purchasing countries but also in producing countries, where the licensing authorities may be susceptible to bribery. Attention should therefore be given to strengthening the internal anti-corruption measures in many producing countries.

OECD Convention on Combating the Bribery of Foreign Public Officials in International Business Transactions: It was agreed that this convention still was in a developmental phase, both in terms of securing wider adherence, and in terms of fuller implementation where it has been ratified. The colloquium noted that knowledge of the convention is surprisingly weak among decision-makers in the defence materiel sector.

Dissemination of research: It was emphasised that NGOs and independent research institutes (like SIPRI, the Stockholm International Peace Research Institute) can provide the basis for a more sustained, well-informed focus on the problem, as compared to the media's brief, episodic coverage of the issue.

The media: The media's role in the process should not be underestimated. For instance, the Foreign Corrupt Practices Act in the US would not have been possible had not cases like the Lockheed scandal first been exposed and widely reported. Similarly, the extensive media coverage of the Bofors scandal probably influenced the speed with which a stronger legal framework was set in place in Sweden.

Transparency through the media: Attention from the media can help protect those who investigate, or choose to step forward and reveal, information. As an example of how hard it can be to achieve transparency and openness even in a democratic system, Israel's censorship-system was discussed. The system was motivated by that country's security situation, but also had the effect of raising a very palpable barrier to any open discussion on defence industry corruption.

Democratic transparency: The electorate should be encouraged to call for greater transparency both in the case of arms being procured with public money, and in the case of arms being exported with the support of public officials and/or subsidised with public money.

2.3. Self-Regulatory Measures for Industry

The International Chamber of Commerce's "Guidelines on Extortion and Bribery in International Business Transactions": There needs to be greater awareness and support for these guidelines, hopefully leading to a wider application.

More transparent price-setting: Industry's price-setting mechanism needs to be better defined so as to increase collective price transparency.

Integrity pacts for arms contracts: Transparency International's integrity pacts (like the ones successfully used in one of the world's largest infrastructural projects, the Hong Kong Airport) are legally-binding agreements that protect specific contracts from bribery. The pact is established between all parties involved in the bidding process, guaranteeing that no bribes will be asked for or paid. The colloquium found that there is definite scope for developing such pacts to offer protection for arms procurement activities. The implementation of integrity pacts can also serve as a formidable PR-instrument both for companies and governments, creating an international reputation for honest dealing which is likely in turn to attract further contracts and investment, as well as increasing the trust of shareholders and the electorate. The colloquium recommended that the specific implications of applying integrity pacts to arms procurement could be explored in future work.

Leverage from shareholder value: Pressure from shareholders can instil a vital incentive in industry to avoid behaviour that could jeopardise their company's reputation. However, reputation-based leverage from shareholders will only emerge as a secondary reflex in response to prior pressures from the wider civil culture. Crucially, awareness must first be raised in the public and the media. This will then affect shareholder culture and these will exercise an effective "watchdog" pressure on industry itself.

2.4. International Rules

Fully implementing the OECD Convention on Combating the Bribery of Foreign Public Officials in International Business Transactions: The colloquium participants agreed that high priority should be assigned to a wider ratification of the OECD convention. Thereafter, the implementation process would need to be closely evaluated, preferably with an expert Working Group to assess the need for fuller implementation of the convention in relation to the defence industry, alongside other industries known to be particularly vulnerable to corruption in international trade.

Significantly, all the delegates agreed that fullest implementation of the convention in relation to the defence industry would have a similar effect globally to that of the unilateral FCPA on the US market, and would go a long way towards resolving the problems evoked in the course of the colloquium. Thus it should be a core goal of future work, and this idea gained particular support from national officials charged with overseeing implementation of the OECD convention. It was pointed out that fuller implementation of the convention would create a more level playing field for industry. Two particular aims in OECD convention work should be firstly, to focus on markets that are particularly affected by bribery (like the arms market), and secondly, to address countries who are not to date signatories to the convention, and who are significant players in those corruption-prone markets.

The European Union Code of Conduct on International Arms Transfers: The colloquium also considered the existing EU Code of Conduct on arms exports to present an interesting possibility for introducing tighter regulations. Sweden undertook to explore this possibility during its presidency of the European Union in the spring of 2001.

Other International fora: The colloquium saw a need for co-ordination between measures to control corruption on the supply side and on the demand side. One suggestion was to design a declaration for buyer countries, based on the OECD Convention. The World Trade Organisation was also mentioned as a possible forum for increasing transparency in the procurement situation.

2.5. National Anti-Corruption Measures

Reassessing governmental and commercial secrecy: The criteria for both state and commercial secrecy should be redefined, in such a way that only really key sensitive data are protected. This would open the door for more transparency around arms procurement.

Holding companies responsible: One of the representatives from US industry gave a detailed description of his company's compliance programme under the US FCPA. One of his core statements was his honest admission that the "big stick" approach seems to be the most effective way of curbing corrupt practices in the private sector. The "big stick" in this case meaning far-reaching legislation, fully implemented, leading to prosecutions with significant penalties. For instance, one of the FCPA's main principles stipulates that executives in a company cannot claim to be unaware of their company's potential or actual wrongdoing. Most US-based multinationals have therefore set up a "due diligence" programme designed to detect, for example, any unexplained escalations in an employee's lifestyle. Asset verification can be an effective way of catching a bribe-taker.

Banning companies from funding political parties: The problem of party political funding was brought up as a potential source of corruption. In other words, the act of helping to finance a political campaign might later assist a company in obtaining favourable decisions, even though none of those involved could explicitly be accused of corruption. Some NGO representatives suggested that party funding should not be permitted from the defence industry, and the OECD and the EU were mentioned as international fora that might be able to encourage such a ban.

An ombudsman : A national ombudsman might usefully be appointed, with powers to scrutinise even the highest levels of political authority and their involvement in arms procurement decision-making.

The role of parliamentarians: It was underlined by some participants that national parliaments in some countries could usefully be engaged in pushing for greater transparency and more stringent procedures in the arms procurement area, and that this group should therefore be included in further seminars and networking activities.

A "hot-line" or "clearing-house": Both from an investigative and a preventive perspective, it was suggested that some sort of "hot-line" and/or "clearing-house" function for information on corrupt practices would be very useful. Such a function could make it easier for companies to report if they receive a request for a bribe, and could also provide advice to all parties on best practices in the arms procurement area and on legal remedies available. Such a hot-line or clearing-house should have a national base, but also an international perspective.

Whistleblower protection: Those disclosing sensitive information on corruption should be guaranteed safety and confidentiality by law. The labour relations and management systems

of both private and public sectors therefore need to be carefully assessed and reformed, to ensure that employees never face a choice between tolerating corruption in their work environment, or losing their jobs and their prospects of re-employment.

2.6. Promoting and Making Use of Research

Academic research on secrecy and on national procurement practices: Academic research programmes could usefully focus on assessing the levels of secrecy required in arms procurement and it could show the impact on the procurement process of both commercial and national security restrictions on information. Such work could take a comparative approach, covering different countries' procurement practices, and the various legal frameworks underpinning them. (This research could build upon studies already undertaken by one of the colloquium's academic contributors.)

An international manual of best practices in arms transfers: The participants agreed that a process of this sort needs a solid academic foundation. To this end, TI and SIPRI expressed interest in the possibility of co-operation. One area of co-operation could be to design a best-practice manual for companies, and for producer- and buyer countries.

Fact sheets and short bulletins of data: The academic findings of a research-institute could be transformed by TI into information-packs and fact sheets for use in lobbying governments and raising public-awareness.

Section 3. Next Steps - The Contexts for Action

The Stockholm Colloquium on Corruption in the Arms Trade proved that there is substantial interest in- and scope for co-operation within and between the different groups present. Each group however has its own motives and context for such co-operation.

3.1. Industry

The defence industry is currently going through a period of rapid change. Their business environment is characterised by intense competition due to post-Cold War downsizing of military establishments, by large-scale corporate mergers, by increasing transnational regulation, and by extensive involvement in offset agreements in the context of arms procurement. Many manufacturers are themselves acknowledging the need for new legal instruments and clearer guidelines for the conduct of business.

3.2. Governments

Western governments are deeply involved in the international restructuring of the defence industry, and in the multilateral procurement contracts that are increasingly common in the arms sector. There are important ongoing international efforts in the anti-corruption area and countries which already have strong anti-corruption legislation have a strong interest in promoting the fullest implementation of the OECD convention against bribery. Governments in developing and transitional countries are acutely aware of the direct and indirect costs of corruption, and the way arms procurement irregularities in particular distort the rational allocation of scarce resources.

3.3. Civil Society

Civil society is also emerging, and being encouraged to emerge, as a stakeholder in good governance world-wide. A basic requirement of good governance is transparency – whereby governments and the private sector allow their transactions to remain visible and comprehensible to civil society. Increasing awareness has already led to, among other things, the appearance of a world-wide anti-corruption movement that has grown important cross-sectoral roots in the past decade, and is likely to continue to deepen its influence on particular industries over the years ahead.

**To plant a seed of reason
Statement at the Cambridge Conference**

Lotta Fogde
Minister of State for Foreign Affairs, Sweden

Distinguished participants,

It is a privilege for me to address this auditorium and a great pleasure, personally, to see that the process that was initiated at the Stockholm Colloquium last year has resulted in this follow-up meeting in Cambridge. I am impressed by the agenda and the seriousness of the approach.

The topic of corruption is increasingly prominent on the international agenda. The adoption of the OECD Convention on the Prevention of Bribery of Foreign Public Officials in International Business Transactions is a clear confirmation that political awareness of the cost of corruption for society has grown, and that there is strong support for co-ordinated action to tackle this complex phenomenon.

At the national level, the US Foreign Corrupt Practices Act has demonstrated that national legislation can play an important role in this area as well. And the sustained efforts by Transparency International have provided both impetus and ideas to ongoing efforts both at the national level and internationally.

This improving anti-corruption climate sets the stage for a more focused effort to tackle the particularly difficult and sensitive area of corruption in the arms trade. The seminar held in Stockholm last February was a promising start. I hope that this meeting will confirm the validity of the conclusions in Stockholm and provide further impetus to what needs to become a sustained process if we are to reach the results that I am sure we all wish to see.

I would like to touch upon three ideas that may be especially useful to develop further at this time. Two concerns deal with the questions 'what we want?', and 'who we should involve?'. The first point is directly linked to Sweden's ongoing EU presidency.

After the Stockholm Colloquium last year the Swedish government embarked on the task of integrating some of the findings from the meeting into our work within the European Union. In view of our upcoming Presidency we brought these ideas up during the bilateral contacts that normally take place in the preparatory phase. The initial responses showed us that this is a topic that needs to be treated with particular care, if we want to see concrete results fairly quickly.

For example, our first idea of trying to amend the EU Code of Conduct by introducing a commitment in the area of *how* we sell European arms, not just *what* we sell and to *whom*, failed to achieve the support of all EU Member States. Governments were not just opposed to the idea for competitive reasons. Some were also worried that any efforts to change the content of the Code at this time could turn out to be counter-productive. We had to conclude that the EU was not yet ready for that approach.

So we had to think again. We have now decided to work in the issue of corruption in the arms trade through the EU Common Foreign and Security Policy Working Party on Conventional Arms Exports - COARM. The work within COARM is aimed at increasing the dialogue between Member States in the export control area with a view to encouraging a gradual convergence of national arms export policies.

Our first step in introducing corruption as a topic on the COARM agenda was to present the report of the Stockholm Colloquium at an informal seminar arranged with Saferworld in Brussels in January this year. Representatives from COARM attended that meeting and were given an introduction to the topics covered by the Stockholm seminar. Our next step will be to informally table feasible proposals for work in COARM. Something that is easier said than done.

It is important to underline the limitations of the COARM. The group is primarily responsible for questions related to the export side of the arms trade. And yet - COARM is the only EU working group concerned with arms trade issues, and it includes all the major arms producers in Western Europe. Over the last few years the need to provide support for an integration of the European defence industry has brought these countries closer together, and at the same time broadened the scope of issues that may usefully be brought up in the COARM context.

After careful consideration, we believe that the most effective way forward would be to introduce COARM to the idea of Integrity Pacts for arms procurement processes. This concept was developed by Transparency International for general use in procurement processes mainly in the civilian area, but we think that it is extremely relevant for military procurement as well. It is the only idea we have come across that offers a clear-cut solution to a problem that otherwise plagues the corruption issue: How to assure industry that adhering to good practices will not lead to them losing markets to less scrupulous competitors.

An important challenge lies in adapting the Integrity Pact concept to the particular features of arms procurement. For instance: the operation of an integrity pact presumably involves a minimum of transparency in order to function as intended, both in order to build confidence among the different participants in a procurement process, and to enable monitoring of compliance. Arms procurement processes are not famous for their high degree of transparency in any country. I would like to suggest that this meeting discusses the issue of whether the original Integrity Pact concept needs to be modified in any way to take into account the specifics of arms trade, and provide us with any recommendations you might feel appropriate, in order for Sweden to be able to furnish COARM with an input which is as useful and relevant as possible. You could provide us with valuable help here.

To create a level playing field, an Integrity Pact for arms procurement would need to retain certain key features of the original model. Such as an agreement not to offer, accept or request bribes, signed by the purchasing government and all bidders. In signing up to such an agreement the bidders should also provide for similar undertakings from all subcontractors, agents or middlemen, as well as its own undertaking to disclose all payments made to these groups. As in the original concept, a company code of conduct, or compliance programme, should not be made mandatory. But in practice companies implementing such programmes would probably get an edge, since they achieve a greater degree of comfort.

The great advantage of discussing this issue at this meeting is that once again representatives of different actors in the procurement process have been brought together in an open and

constructive atmosphere. I can think of no better setting for tackling the question of what may need to be done to make the Integrity Pact concept relevant for the arms trade.

I turn now to my second topic. The introduction of an Integrity Pact in arms procurement poses particular problems in the verification area. This is due to the high level of secrecy normally maintained with reference to national security considerations. Parliamentary involvement could perhaps in some cases provide a possible solution to the problem of allowing oversight without completely lifting the blanket of secrecy.

In designing the Stockholm seminar we focused on four groups: governments, industry, the military establishment and finally academia or NGOs. In retrospect, we should have included parliamentarians as a special group from the start, because, among other things, the discussion in Stockholm served to highlight the important role that parliamentarians could play in this context.

With their special position and responsibilities in a democratic society, parliamentarians are uniquely placed to increase the degree of oversight that can be exercised over arms procurement. They have a natural platform through their key role in budgetary matters, and a formalised relationship to the higher levels of government decision-making. It would mean a great deal if pragmatic initiatives were to be introduced in parliamentary work in different parts of the world.

The third and final issue I wanted to mention is that there is probably also another area where early work could be useful: that regards developing an anti-corruption best practices guide for industry. A number of companies in different fields have over the years developed ethical programmes - that work represents a very valuable starting point for efforts to develop a guide or model specifically designed with the peculiarities of the arms trade in mind. I believe there may be interest in industry for this kind of initiative and I think that we could profitably bring up the issue of industry adherence to such guidelines in the EU context as well.

With these brief remarks, I would like to wish this distinguished gathering a profitable and stimulating series of discussions that point the way forward to a sustained effort by all the groups represented here today. I think we will need to accept that this is not an area for quick fixes. Results will require considerable staying power from all of us. But in terms of the importance of the problem the goal is certainly worth the effort. So let us together plant a seed of reason.

Some economic aspects of the arms trade

Samuel Brittan
The Financial Times

Arms and the Market Economy

I was originally asked to talk about the strengths and weaknesses of the economic case for the arms industry. But if you are any kind of market economist you do not have to make a case for or against particular industries. This is best left to the market. Government attempts to decide which industries should expand or which should contract have been uniformly disastrous, whether Gosplan in the former Soviet Union or the lesser attempts of European countries to 'pick winners'.

But every sensible market economist should accept that the market must operate within a framework of law and moral convention. Investment bankers are not permitted to finance firms that sell poison to children (or even adults) and there are strong constraints for example on the emission of lead into rivers or on pollutants into the chain of foodstuffs. Above all we do not subsidise businesses to engage in these harmful activities. When these rules break down there is an understandable outcry. My contention simply is that exports of arms to dubious regimes should come within the sphere of what is out of bounds.

Ideally, such moves should be internationally co-ordinated. But there is no case for moving at the pace of the slowest. When the British slave trade was prohibited early in the 19th century or children were prohibited from working in the mines, it was said that other countries would take the trade away. That was also said about the export of opium to China. What the economic observer can point out is that the cost of following the moral course is not enormous and does not require great heroism on the part of our leaders.

There may be some people who would like to stop all arms production or all arms exports. But so long as we believe in having armed forces and belonging to alliances such as Nato then we need an arms industry. Indeed, there is too little specialisation inside Nato because of the desire to protect domestic interests; and many of the overspill gains now supposed to be obtained from arms exports to dubious regimes could be reaped instead by greater specialisation within Nato. All that those of us who are pacific rather than pacifist should aim to halt is the sale of arms to governments or places likely to use them for external aggression or internal repression.

Rampant Fallacies

I first became interested in the weakness of the economic case for supporting arms sales at the time of the British Arms for Iraq scandal. The main justification offered for stretching the law to encourage arms sales was the jobs and export argument. These were the very same arguments used to keep open uneconomic coal mines and to protect manufacturing industry, which has been in a long term decline as a proportion of national income in most western countries.

The difference is that it is mostly left-wing political parties that want to support manufacturing and mining while it is right-wing parties that want to support agriculture and arms. But it is equally nonsensical in both cases.

The basic fallacy is what has sometimes been called the lump of labour fallacy. This supposes that there is a specific list of jobs to be done and that, if employment declines in one sector, the workers and other resources will just waste away. It ignores one of the key assumptions of economics: that there is normally a circular flow of income in which money spent equals incomes earned and that, apart from special conditions of slump or boom purchasing power, is conserved; and that when spending falls in one area it rises in another.

Those who believe in the lump of labour idea can hardly explain how it is that other jobs arose to take the place of the handloom weavers or the drivers of horse drawn carts - or for that matter the replacement of pack asses by wheeled traffic at the dawn of history. Nor can it explain how it is that, despite the multiplication of population and the multiple rise of productivity in the last two centuries, most people who want them still have jobs.

I returned to the subject when the jobs argument was trotted out against the idea of a foreign policy with an ethical dimension, by those who wanted to undermine it instead of strengthen it. Towards the end of 1999 I gave a lecture on ethics and foreign policy. I came to the conclusion that there was no moral or logical argument for limiting concern about human rights to one's own country. But in practice intervention often made matters worse rather than better. I could be much more definite on the undesirability of sending arms to dubious regimes, quite apart from the fact that they could end up being used against the countries that sold them.

On March 28, 2001, I gave a fairly comprehensive talk to the Royal Society of Arts in London on the ethics and economics of arms exports. In that lecture I outlined, as far as I was able, the steps that the British government has taken to limit the sale of arms to dubious regimes for dubious purposes. Many of these efforts have, of course, an international dimension and fulfil various international undertakings.

I also cited the criticisms of non-governmental organisations (NGOs), as far as I found them plausible, that the government had not gone far enough. To take one obvious instance: there has been a continued British sale of Hawk parts to Zimbabwe. There are other such instances. Apparently the UK is still selling military aircraft to India despite that country's recent nuclear tests. The only reason why there are no such sales to Pakistan is because of the military coup in that country. Yet the Indian sub-continent is probably the part of the world most subject to the risk of nuclear conflagration.

I was facing in two directions. On the one hand I was urging governments to go much further in their arms curbs; but on the other I was trying to defend the efforts already made. You only have to look at some of the noises coming out of Washington, or from the British Conservatives, to see that rollback is a real danger.

I then went on to suggest that the dangers to jobs or national balance of payments from losing some export orders were highly exaggerated. In many cases there would be a gain from removing taxpayers' subsidies. Here I felt much more on my home ground and I gave a resume of the various mercantilist arguments for saying that the government had to promote a favourable balance of payments by any means with which it could get away.

The heyday of mercantilism was in the 16th and 17th centuries. It was succeeded in the late 18th and 19th centuries by an increasing freedom of both trade and capital movements, and a reliance on automatic market mechanisms to look after the balance of payments. Under the influence of the Great Depression and two world wars there was a retreat back to the mercantilist view.

I am unfortunately old enough to remember slogans such as 'The Dollar Drive' or 'Export or Die'. Indeed there are numerous legacies of this period still with us in Britain - for instance the Queen's Award for Industry, the use of royal visits to promote overseas sales, the export promotion activities of the DTI and the Defence Department and, above all, the government sponsored Export Credit Guarantee Department. Finally, I quoted some industrial studies on the impact of a cut of a third in British arms exports, which suggested that this would have a minuscule effect on the national economy, much smaller than many industrial adjustments which we have already undergone in manufacturing, coal mining and many other sectors.

I can supply copies of the full lecture to anyone who is interested; and there will ultimately be copies on my web site as well as a reprint in the RSA Journal. But rather than try to go beyond the summary I have already given it might be more interesting for you, and certainly for me, to offer a few further reflections of a more informal kind.

Incentives to Corruption

First, on the connection between bribery and arms sales. The Stockholm Report rightly makes a great deal of the incentives on the side of arms buyers to look for various side payments and on the exporting firms to offer them.

The key element emerging from it seems to be the concentration of decisions, especially in emerging countries, in the hands of a few officials who are very poorly paid in relation to the very large sums in which they deal. One might also add the relative insignificance of these bribes to equipment manufacturers who can offer very attractive kickbacks, which amount to only a small proportion of their turnover.

In all these aspects the situation is remarkably similar to the markets for heavily capital intensive development projects such as dams and other expensive developments. Indeed the companies involved are often the same. So are the financing sources. And so is the bad argument: that if one government does not quietly subsidise its own suppliers another country will get the business.

I would like to concentrate on another analogy, that with the drugs trade. This applies particularly to illegal or semi-legal exports of arms, e.g. to countries on banned lists or for purposes which have been concealed in the export permit applications. The analogy with drugs lies in the very heavy element of risk involved. There is the risk of detection, involving in extreme cases the threat of jail. There is the aggravated risk of non-payment. There are the personal risks of violence and untimely deaths inflicted by the domestic opponents of those receiving the arms.

One of the few nearly incontrovertible principles of economics is the tendency to comparable packages of rewards for those engaged in alternative activities. Somebody making or buying refrigerators will be satisfied with the normal going rate of return, although he would obviously hope for more. Those engaged in selling or buying drugs or arms will need extra

cash rewards to offset the risks. Thus I do not see any early end to corruption other than measures to reduce the size of the trade by operating on the side of either demand or supply, or preferably both.

Small Arms

This leads me to one thing I have learned in the course of my investigations, which goes beyond the generalities of free trade theory. It is the contrast between the evil effects of small arms exports and those of heavy equipment, including aircraft. As usual there is no sharp dividing line, but the extremes are easy enough to outline. I have been particularly struck by the fact that a number of thoughtful observers in the academic world, among commentators and even among industrialists, who make a reasoned case for supporting some sales of military equipment, are fiercely opposed to a proliferation of small arms exports, which they readily agree has led to the deaths of many millions of people in Africa and elsewhere.

Small arms sales cannot be controlled just by limiting export credit subsidies. Many of these sales come from former Communist countries which have large stocks surplus to domestic requirements and which easily get into the hands of unscrupulous people. The direct culpability of western governments is limited to their encouragement of small arms sales to governments that they regard as legitimate rather than rebels. The obvious riposte is that some legitimate governments will do pretty nasty things with these arms, which in any case can easily fall in the hands of so-called rebels.

But beyond urging a tightening up of controls, there is something that western governments can do. Most of the governments concerned value their economic relations with the West. They receive aid from organisations such as the IMF, the World Bank or the EBRD. In addition, many of them are negotiating to enter the European Union. If a clampdown on the export of Kalashnikov rifles and similar weapons were made a condition both of aid, and of admission to the EU we might see much more forceful action. As far as I know, the topic was not even mentioned in the various IMF negotiations for loans to Russia, or in discussions with the Ukraine, which is a more important source of small arms.

Equipment and Credit

When we come to large and heavy equipment and aircraft the issues are fairly well known. The elimination of official aid for export credits could cut out a great deal of the most objectionable items and we would be left with trade with other NATO countries, and other allies such as Australia and New Zealand. The argument that the US or Britain needs to export Tornado fighters to countries like Saudi Arabia is extremely weak. Even if it were advisable to keep the present regime in existence, surely the history of neighbouring Iran and Iraq - to go no further - shows the very strong possibility that this military aid will not work and that the aircraft and rockets will end up in the hands of hostile regimes.

As for the argument about oil supplies, I have never seen why the US, Britain and France cannot - like other western countries - buy their oil on the international market, remembering that Middle Eastern countries often need to sell the oil even more urgently than we need to buy it. It is very interesting that this so-called argument of economic strategy usually comes from foreign ministries rather than ministries of finance or economics.

Why Size Matters

There is one aspect of the argument that I still need to explain more fully. That is the relationship of the a priori argument about the circular flow of income and the automatic

adjustment of the balance of payments to numerical estimates of the size of the sector involved. I have cited studies to show that arms exports used to account for about 120,000 workers and for some half per cent of UK exports. A cut of approximately a third would eliminate the most dubious items and affect about 40,000 jobs in the first place while many of the workers involved would soon find other jobs.

But suppose we were talking about 50 per cent of total exports or four or five million workers? Would this affect the argument? The answer is mainly in the time dimension. Any change in the pattern of demand leads to some adjustment problem. If the adjustment is large, care has to be taken by monetary and fiscal policy to maintain total demand; special efforts have to go into retraining; and there is a case for phasing out the change, if at all possible, to give those concerned time to adjust. But when we are talking about a modest fraction of a small and declining industry these adjustment problems are second order. Obviously a few constituencies are involved; but the change is much less than the normal adjustments which take place in a typical year through economic circumstances without any change of policy.

Policy Suggestions

Finally, I come to a question that I am often asked by friends in government circles. What additional measures will you like to see taken? Those who know more about the details of the arms trade than I do are best placed to advise on the specifics. But let me end with a few suggestions nevertheless. It goes without saying that full support should be given to UN efforts to limit small arms exports. But what else can an individual government do? I hope conference members will excuse me if I couch my recommendations in terms of British policy and leave others to adapt them to the circumstances of their own countries.

1. DFID Intervention

One of the greatest safeguards against the irresponsible grant of licences for arms exports is the ability of the British Department for International Development (which it did not have under previous governments) to object to arms contracts on the basis that they are harmful for the recipient country's development. Unfortunately, it can still only do this on a case by case basis. It is often difficult to argue that one small and limited delivery would have much impact either way. If the department were able to take a cumulative view of all the licences requested by or granted to a particular country, this would be a great step forward.

2. Greater Transparency

Despite the improved UK Report on Strategic Exports, the criteria for approving them are still not clear. We need a list - covering military aircraft and dual use products as well as other arms - of countries to which complete bans apply, ones where there are no restrictions and intermediate cases. In the latter we need a clear statement of the criteria, covering the quantities and kinds of arms which might be allowed.

3. Arms sales should be permitted only to actual or potential allies

4. End subsidies. Absolutely no official export credit for arms exports of any kind. Even permitted exports in uncontroversial cases should have to pay their way.

5. Governments should use their influence on international aid organisations including the IMF, the World Bank, the EBRD and other regional banks on the following lines:

- a) Take a much stricter line on excessive investment in military hardware at the expense of genuine development. To do this these agencies would have to return to their original functions and not become arms of US and NATO diplomacy.
- b) Insist on enforcement of a clampdown on small arms exports - other than in restricted and permitted categories - as a condition for receiving any aid at all.

These steps might seem technical and modest, but if carried out effectively they would lead to a slow revolution in arms policy.

6. There should be an independent audit of the costs and benefits of all UK arms sales. This might well be carried out by the National Audit Office.
7. Official export credit agencies should have to earn the normal rate of return on capital applicable to other public investments.
8. The abolition of the ECGD itself. This might now appear far fetched and utopian, but would be less so if the other steps were taken.

I was tempted to conclude with a more resounding moral statement, which would not be too difficult. But the most important thing is to keep going in the right direction in the face of the counterattacks to be expected by every kind of interest group and prejudiced viewpoint.

* I am indebted to another speaker at the Cambridge Conference for these two suggestions.

Corruption in Russia's arms export trade

Ian Anthony
Arms Control in Europe

Introduction

In the early 1990s, corruption was seen by many experts and international organisations as a marginal and transitory phenomenon in Russia, something that would be eliminated as economic conditions developed. With the passage of time, however, attitudes have changed. In the late 1990s, corruption came to be identified as 'a central, structural feature of the logic of political and economical behaviour'¹ and, as such, one of the main threats to political, social and economic development in Russia.

As one Russian analyst expressed it, public policy had seen 'a complete merging of money and power at a personal level—a situation for which even the word "corruption" is no longer apt'. The situation is said to have reached a point where Russia could no longer continue to function as a state in the accepted sense of that word because high and low criminality had converged to the point where 'corrupt officialdom pervades the economy and organised crime pervades officialdom'.² Moreover, official Russian statements describe a deteriorating situation. Recent estimates have suggested that the value of bribes paid amounts to 4 per cent of Russia's GDP.³ Interior Ministry statistics suggest a roughly 25 per cent increase in the number of economic crimes investigated in 2000 compared with 1999. Russian Prosecutor-General, Vladimir Ustinov, has reported that federal and regional political elites are now associated with criminal groups in ways that make law enforcement extremely difficult. Consequently, according to Ustinov, the legal system tends to concentrate its efforts on small offenders at low levels of officialdom and does not tend to investigate senior officials or politicians.⁴

On coming to office, President Vladimir Putin listed the establishment of the 'dictatorship of laws' as one of his primary objectives. To try to achieve this objective he has taken a series of political, legal and administrative steps. Political steps have included statements intended to underline the seriousness of the issue and the high priority attached to reducing corruption and criminality. Legal steps have included the investigation of individuals and organisations suspected of criminal behaviour. Administrative steps have included efforts to reorganise the criminal justice system, the replacement of some officials (usually by current or former security service personnel) and the creation of new anti-corruption organs and units. In conditions where widespread corruption is acknowledged among public officials and within the military establishment it seems unlikely that the sale of arms and military equipment is conducted with complete integrity.

¹ Peter Rutland and Natasha Kogan, 'Corruption and the Russian Transition', *The Harriman Review*, Sept. 1999.

² For an overview of these conditions see the various reports of the Russian Organized Crime group within the Organized Crime Project, Center for Strategic and International Studies (CSIS) Washington DC. In particular, *Russian Organized Crime and Corruption: Putin's Challenge*, CSIS Washington DC 2000.

³ *RFE Newsline*, vol. 5 No. 13 Part I, 19 Jan. 2001.

⁴ 'Russian prosecutor-general alarmed over corruption', BBC World Service, 12 Jan. 2001 at URL http://news.bbc.co.uk/low/english/world/europe/newsid_1113000/1113850.stm.

In Russia, private actors do not carry out the arms trade. The main manufacturers of arms and military equipment are either state owned or enterprises in which the state owns a controlling interest. These enterprises rarely find their own customers. Military-technical co-operation with foreign states has been carried out mainly via state trading companies whose employees have been drawn from the armed forces and security services. Military-technical co-operation can only be carried out on the basis of permits issued by state authorities and each transaction requires a licence issued by the government.

The objective of this paper is to examine public source information about Russia's arms trade to try and answer the following questions. What kinds of sales practice are taking place? Are these practices corrupt? What actions are being taken to reduce the risk of corrupt actions?

It should be stated at the outset that none of these questions can be answered in a comprehensive or definitive manner using available public sources (at least, not from those available to the author). However, public sources are considered sufficient to identify questions to which answers are required and to describe problems that would need to be addressed as part of an effort to create an arms export system in which the risks of corruption are reduced to a minimum.

To what extent should Russians be concerned with corruption in the arms trade, given the other problems facing their society? In general surveys, six negative consequences of corruption are often cited.⁵ These are:

- Erosion of public confidence in political institutions;
- Growth in contempt for the rule of law;
- Distortion in allocation of public resources;
- Undermining of free and open competition;
- Disincentive to foreign investment, with a corresponding reduction in growth and development;
- Denial of access to necessary public services.

If the administration of the arms trade in Russia suffers from widespread corruption, several of these consequences could be anticipated. However, examining corruption in the arms trade should be seen as one element of a wider discussion in Russia about standards in public life.

Should it concern other countries if the Russian arms trade is influenced by corruption? Although it is not the dominating player that it was during the Cold War, Russia remains very important to the international arms market. Credible estimates put the average value of Russian arms exports at over US\$ 2 billion a year over the past 5 years.⁶ This probably understates the importance of Russia as an arms supplier and indicators based on the volume of supplies give it a prominent place in international comparative terms.

Russia has every right to participate in the international arms trade, within an agreed international normative framework and in accordance with its own stated national policies. Agreements on military-technical co-operation with foreign states are regarded in Russia as a matter of major importance for foreign and security policy. The decisions about what to export and to which recipients should be seen as matters of legitimate international concern.

⁵ See, for example, Enery Quinones, Head of OECD Corruption Unit, 'What is corruption?', *OECD Observer*, No. 220 April 2000.

⁶ Konstantin Makienko, 'Preliminary Estimates of Russian Performance in Military-Technical Cooperation with Foreign States' in 2000', *CAST Journal*, Jan-Feb. 2001, pp. 5-7.

Definitions

A range of definitions of the word corruption are in use. However, a common element is the issue of how to generate respect for a system of rules. A legal approach regards laws as creating a system of rules. In this definition corruption is a synonym for various 'white collar' or economic crimes motivated by financial gain. Such crimes include bribery, fraud and embezzlement. However, the abuse of influence might also be motivated by factors such as career advancement or favouritism towards friends and relatives. This definition of corruption includes the following issues: whether or not current laws are adequate, how they might be enforced more effectively or how they might be supplemented and modified.

A second approach sees corruption within a broader framework that takes into account not only laws but also social, political and moral questions in an attempt to reason about which actions are right and which are wrong. In this definition, stress is laid on defining acceptable behaviour.

These approaches use many of the same words in different ways. For example, in the first approach the word 'right' is linked to actions that can be taken without risk of sanction. In the second approach the word 'right' is linked to actions that are morally justifiable. In the first approach the word 'duty' is also linked to the risk of sanctions in cases where certain actions are not taken. In the second approach the word 'duty' is linked to a code of behaviour that individuals would be bound to follow even if no punishment would follow from failure to comply.

How might these ideas apply in the Russian context? The first approach has emerged from a legal tradition different from that practised in Russia, where laws were essentially the catalogue of commands issued by the sovereign and required no further justification or explanation.

The second approach has emerged from the practice of democracy. In particular the tendency of citizens in a democracy to ask themselves the question 'why should I obey?'⁷ In Russia citizens have not traditionally questioned the authority of their government or its officials in open forums for fear of the consequences. On the other hand, there is a lot of anecdotal evidence that Russians have become accustomed to circumventing or evading laws, decrees and declarations with which they disagree.

Put in this context one begins to get a picture of how formidable the challenges are to addressing corruption in Russia's arms trade. To get a picture of the kinds of problems that confront analysts and practitioners in this area it is useful to summarise some public information about allegations of corruption in Russian arms trade and then to consider these allegations in a wider perspective.

Allegations of corruption in the Russian arms trade

In examining allegations of corruption contained in open sources it is impossible to be certain about what occurred because information in the public domain is (a) incomplete and (b) not possible to verify. Therefore, this brief description should be regarded as illustrative of practices that are probably occurring rather than as a full and accurate picture of events. The text is an effort to shed some light on the question of corruption and is not offered as a full

⁷ For this reason democratic systems are sometimes referred to as 'government by explanation'.

account of particular events. In considering the issue of corruption in Russian arms trade it is important to keep in mind that although contacts between Russia and foreign customers are managed by the state, different parts of the state apparatus are responsible for different types of activity.

Agreements on military-technical co-operation with foreign states are discussed and agreed at the highest level within the government. These high-level deliberations produce a framework agreement that includes the types of equipment and forms of co-operation that are authorised for a particular country. Without an agreement of this kind no arms exports will be authorised to that particular country.

Russia has established bilateral commissions with important customers to discuss in detail the elements of bilateral military-technical co-operation. The commissions elaborate a package of arms and equipment. A mixed team including representatives of the government, the armed forces and industry form the Russian delegation. These representatives are present for the most part to provide technical information and support rather than negotiating on behalf of their enterprise with a foreign customer.⁸ In many cases there are two or more Russian enterprises able to provide a particular item of equipment or a service to the foreign customer. However, in deciding which company to include in the final contract, the foreign customer will tend to be guided by recommendations of the Russian side that are channelled through a state agency rather than making independent contacts with different Russian enterprises.

Since 1993, responsibility for negotiating the details of contracts has rested primarily with the state trading company Rosvooruzhenie or with another of the several state trading companies that were created after this date. From the perspective of Russian industry there are two decisive points in this procedure.

1. Whether a foreign customer is accepted as a legitimate market for Russian equipment.
2. Whether their product is identified by the Russian state trading company as the preferred choice to be offered to a customer.

In conditions where export orders have come to be a more important source of revenue than orders by the Russian government, these decisions may be decisive for some enterprises in the Russian defence industry. The Soviet Union left a vast inventory of equipment, much of which is still in operational condition but which is surplus to the requirements of the Russian armed forces. The Ministry of Defence is responsible for determining how to dispose of this equipment. They may choose to keep the equipment in reserve, decommission and destroy it or as a third alternative they may choose to export it, providing these exports are conducted within the framework of agreed procedures.

These points create the framework within which most of the allegations of corruption in Russian arms trade should be examined.

Allegations of abuse of office by senior political figures

One type of allegation to be found in open source discussions of Russia's arms trade is the abuse of office by senior political figures. These figures are sometimes of ministerial rank (including Deputy Prime Ministers) or senior officials within the Presidential administration. At least two different types of abuse of office can be exemplified by specific cases reported in open sources.

⁸ Though the commission meetings do provide enterprise representatives with an opportunity to describe those products that are available.

It is alleged that on occasion the office and authority of the President has been abused in decision making when there was opposition to a particular arms export from one or another powerful constituency represented in the regulatory process. During 1993 and 1994 the Russian Ministry of Defence had serious reservations about the expansion of military-technical co-operation with China. In particular the Ministry of Defence was opposed to the transfer to China of air power (advanced combat aircraft and air defence systems) and the transfer of manufacturing know-how and capability. Within the inter-agency review process for arms export regulation the objections of the Ministry of Defence would have been sufficient to prevent authorisation for transfers of this kind.

Under these circumstances, it is alleged, individuals intervened directly with President Yeltsin to overcome the objections of the Ministry of Defence. Rather than following consultation procedures that would have allowed all parties to put their case for and against a particular policy line, President Yeltsin was presented with a draft decision prepared by a group that favoured one particular outcome. Other interested agencies were not given an opportunity to help prepare this draft, review it before it was presented to the President or hold their own consultations with the President prior to his decision. The two individuals named were Oleg Soskovets, First Deputy Prime Minister and Chairman of the Interdepartmental Commission on Military Co-operation with Foreign States, and Alexander Korzhakov, Chief of the Presidential Security Service. Having secured a decision from the President authorising the establishment of relations with China that included a list of permitted equipment types and forms of co-operation, the opposition of the Ministry of Defence was effectively neutralised. Mr Soskovets was closely connected to the defence industry through his background in the special metals sector. He was alleged to be acting on behalf of certain Russian enterprises, notably the Sukhoi enterprise located in Komsomolsk na Amure, with a strong interest in sales to China.

Another figure within the Presidential apparatus accused of abuse of office is Boris Kuzyk. Kuzyk, a former GRU (military intelligence) officer, worked within the office of the Presidential administration supervising the activities of the state arms trade company Rosvooruzhenie. Kuzyk worked at the Ministry for Foreign Economic Relations within the Main Department for Military-Technical Co-operation (GUVTS) in 1993 before moving to the Main Administration for Budget and Financing within the Ministry of Defence, where he worked on issues of military co-operation with foreign countries. When the State Committee for Military-Technical Co-operation with Foreign States was created in 1994 (a body that reported direct to the President) Kuzyk moved to the Presidential administration.⁹ It is alleged that Kuzyk used his influence within the Presidential administration (i.e. his personal ties to General Korzhakov) and the State Committee to undermine the position of agencies opposed to particular arms exports within the inter-agency review process. Alexander Kotelkin, himself a former GRU officer, was the General Director of state trading company Rosvooruzhenie (discussed further below) between 1993 and 1997.

To what extent is this kind of activity, assuming it occurred, corrupt? Answering this question would require information about the motivations and precise actions of the individuals involved.

Public information can put together a circumstantial case pointing to a suspicion of corruption. First, the individuals involved did not find themselves accused only once but in

⁹ This State Committee was abolished in 1996.

fact the same names were implicated in a range of different occurrences where corrupt practice was alleged.¹⁰ Second, individuals involved subsequently found senior positions within enterprises that were direct beneficiaries of the decisions that they allegedly influenced.¹¹ At the same time, these same events could be seen as a form of bureaucratic politics. In a system where decisions were difficult to take because one or more agency took advantage of its blocking power a direct appeal to higher authority may be the only way forward. Individuals with inside knowledge of issues and government institutions may be attractive recruitment targets for the defence industry. The kind of information required to make a case of corruption could only be gathered by an official inquiry carried out by an independent investigator. To the extent that allegations of abuse of power by Presidential aides were investigated during the Yeltsin presidency, the investigators were said to lack authority and independence. In the case of General Korzhakov, President Yeltsin came close in his memoirs to admitting that he shielded an individual that he regarded as a loyal servant and close friend in conditions where there was at minimum a case of corruption to answer.

A second type of abuse of office can be seen in the allegation that senior officials in the Ministry of Justice attempted to extort money from the manufacturing enterprise MAPO in exchange for tax concessions. MAPO is a production facility near Moscow at which MiG-29 fighter aircraft are manufactured, including 8 of 10 MiG-29 aircraft purchased by India in 1994–95.¹² It is alleged that an adviser to the Ministry of Justice proposed that MAPO could in effect receive relief from taxes owed to the Russian government in exchange for a personal payment taken from money received from the sales to India.

The Russian Ministry of Justice has the power to instruct bailiffs to confiscate property up to a value sufficient to cover tax debts owed by an enterprise to the Ministry of Finance. According to a complaint filed with the Office of the General Prosecutor by MAPO, a named individual (Alexei Belobokov) proposed to MAPO company officers that he could arrange for property seizure unless a bribe of US\$ 10 million was paid to the account of a named commercial firm. Alternatively, if the bribe was paid, he could inform the Ministry of Finance that MAPO had made payments and so reduce the debt liability of the enterprise.¹³

These allegations, if true, would certainly amount to corruption by any definition. However, in this case the individual involved was not in a position to carry out the threat that was made. Senior executives at MAPO would certainly know that Belobokov, as a political adviser, did not have the authority to take such a decision. To take a decision of this kind would require the involvement of a senior figure, probably at least of ministerial rank.

Allegations related to the operations of Rosvooruzhenie

Rosvooruzhenie was created in November 1993 and liquidated in November 2000. Many allegations of corrupt practices between 1994 and 1999 centre on the state export company Rosvooruzhenie. Rosvooruzhenie was accused of different kinds of corrupt practice during its lifetime.

¹⁰ For example, Mr Soskovets and General Korzhakov were central figures in the allegation that President Yeltsin's election campaign included the use illegal payments.

¹¹ For example, Mr Kuzyk is now the senior executive at the New Concept Company, which manufactures defense electronic and avionics systems.

¹² The other two aircraft were made in Nizhny Novgorod.

¹³ 'Russian Justice Ministry Official Arrested for Bribery', *ITAR-TASS World Service* (in Russian), 2 Nov. 1998; Ivanova, Y., 'He demanded bribe of \$10 million', *Sovetskaya Rossiya* (in Russian), 3 Nov. 1998, reproduced in 'Official allegedly sought bribe to cut MiG sale tax debt', *FBIS Daily Report-Central Eurasia*, (FBIS-SOV-98-307), 3 Nov. 1998.

One example relates to the destination of US\$ 400 million believed to have been paid by the United Arab Emirates for Russian air defence systems.¹⁴ The payment was made to the private bank InterFinInvest. After paying taxes and commissions for services, Rosvooruzhenie is entitled to retain 5–7 per cent of revenues for its own purposes.¹⁵ The remainder of money received should be paid to enterprises that participated in production of the items exported. However, most of the money received from Abu Dhabi was, it is alleged, never paid to the design bureau and enterprises that were responsible for producing the equipment sold. InterFinInvest, it is alleged, transferred the money out of Russia via a series of bank accounts in Russia and the Baltic Republics.¹⁶

Similar allegations have been made about revenues from the sale of armoured vehicles and multiple launch rocket systems to Kuwait in 1994. Although general explanations of how the money was used have been provided, it was not explained who were the recipients of this money and which services they had provided in return for payment.

In 1999 the Main Control Directorate of the Presidential Administration carried out an audit at Rosvooruzhenie. It was apparently discovered that the company maintained many accounts in different banks. Of these many accounts, 116 were empty. 20 different banks held the empty accounts. Of these 20 banks some were in Russia and some in other countries. According to press reports, the function of the different accounts is suspected to be the movement of money produced either through payment for arms exports by foreign customers or money provided by Russian financial institutions to finance the Russian arms trade.

According to Rosvooruzhenie, most of this money was returned to the defence industry. Rosvooruzhenie only retained revenue to cover its own expenses. These expenses are of different kinds. First, the costs of maintaining the organisation itself and second, fees that Rosvooruzhenie must pay for various services on which it relies.

In 1994–95 Rosvooruzhenie established 8 regional offices in Russia in places where the main elements of the Russian defence industry were located. While several of these offices were closed after 1996, at least some of them were re-opened after 1998. Rosvooruzhenie also established offices in 33 countries that were actual or anticipated markets for Russian arms. Rosvooruzhenie contracted with other Russian agencies for certain services that it cannot provide itself. The main examples are the physical delivery of equipment to foreign customers and training of foreign military personnel in the use of Russian weapons and equipment.

Training of foreign personnel is co-ordinated and carried out by the 10th Department, Russian Ministry of Defence responsible for International Military Co-operation. This service was provided to Rosvooruzhenie against payment. Delivery of equipment may be carried out by personnel from the Russian armed forces through a contract between Rosvooruzhenie and the Ministry of Defence. Where the items concerned require specialised skills or logistics this may be the only option available. However, a commercial contractor may be used to deliver items. In the mid-1990s the use of commercial contractors by Rosvooruzhenie became common. One that is referred to in public sources is the Kargotrans company. Although

¹⁴ The systems were S-300 air defense missile complexes.

¹⁵ This is a significant increase on the 0.4 per cent of revenues said to have been retained by state trading organizations during the Soviet period.

¹⁶ Sergei Pluzhnikov and Sergei Sokolov, 'Rosvooruzhenie: Crime Kingpin', *Sovershenno Sekretno* (in Russian) No. 11, Nov. 1998, pp. 6–12, in *FBIS Daily Report-Central Eurasia* (FBIS-SOV-98-345), 11 Dec. 1998.

registered as a private company, this firm was apparently formed at the suggestion of Rosvooruzhenie, which is also its main customer.¹⁷

A second allegation is that Rosvooruzhenie has colluded with banks in two ways while developing and implementing its investment strategy. First, Rosvooruzhenie is said to have invested the money that it holds to finance arms export production in accounts that generate rates of interest significantly below the market rate. The banks in which the money is invested use it in other financial markets and generate large revenues. Second, Rosvooruzhenie is alleged to delay payments to enterprises and so benefit from the interest earned during the period before money is transferred. Rosvooruzhenie officials, it is alleged, benefit personally from the revenues created by the return on these investments. The Moscow National Bank and the ONEKSIM Bank are mentioned in public accounts of these allegations. Information about these transactions was published at a time when several Russian banks crashed. Rosvooruzhenie was among the investors that had accounts in the banks that crashed.¹⁸

A third allegation is that the foreign representatives used by Rosvooruzhenie in other countries are far more numerous than required and sometimes connected by personal or family ties to senior Rosvooruzhenie officials. Malaysia and Turkey are countries mentioned in public accounts of such practices.

A fourth allegation is that Rosvooruzhenie maintains foreign representatives in countries with which bilateral arms exports are managed through inter-governmental commissions. Such countries include Bulgaria, China, India, Syria and the United Arab Emirates. In these countries the type and number of armaments to be provided are determined by the intergovernmental commission concerned, though Rosvooruzhenie is responsible for contract negotiation.

At their root, the allegations of corruption state that money paid for Russian military equipment by foreign customers never reaches its rightful owners in Russia but is instead siphoned off by unauthorised actors at some point after payment by the customer. This raises two types of questions. How much money is raised and who are its rightful owners? To answer these questions it is necessary to look at the way in which Russian arms exports were managed during the 1990s and in particular to look at the place of Rosvooruzhenie within that system.

A brief overview of the management of arms exports from Russia 1991–2000

The discussion of managing Russia's arms trade centres on three different kinds of participants. First, the state trading companies. Second, enterprises within the defence industry. Third, the armed forces and the Ministry of Defence.

¹⁷ Much of the public information about Kargotrans was generated when a Kargotrans cargo aircraft delivering Su-27 fighter aircraft to Viet Nam crashed near Irkutsk (where the aircraft were manufactured) in 1997.

¹⁸ Boris Petrov, 'Rosvooruzhenie no longer facing opposition in the Military-Industrial Complex, *Pravda* (in Russian), 14 Apr. 1998, pp. 1–2, reproduced in *FBIS Daily Report-Central Eurasia*, 22 Apr. 1998, *Rossiskaya Gazeta* (in Russian), 21 Oct. 2000, reproduced in *FBIS Daily Report-Central Eurasia* (FBIS-SOV-2000-1103), 21 Oct. 2000.

The state trading companies

During 1991 and 1992, trading companies emerged in Russia to try and facilitate arms exports.¹⁹ These companies (Oberonexport, Spetsvneshtekhnika and Promexport are the best known) were staffed with individuals that had experience of managing international arms transfers gained during the Soviet period. Oberonexport recruited individuals mainly from former personnel from the former Soviet GIU (Main Engineering Administration). Spetsvneshtekhnika recruited personnel from the former Soviet GTU (Main Technical Administration) and the GUSK (Main Co-operation and Joint Labour Administration) within the Ministry for Foreign Economic Relations. Many of the individuals concerned were or had been military intelligence officers from the Soviet military intelligence organisation, GRU.

Rosvooruzhenie was created in November 1993 by a Presidential decree (No. 1932-s) that was not published. The more specific principles and procedures to govern activities of Rosvooruzhenie were contained in a government decision that was also not published. However, it is known that the President both appointed and removed the General Director of the company while the government appointed and removed the First Deputy General Director. It is believed that Rosvooruzhenie reported directly to Department 5 of the Presidential Security Service. As noted above, the head of the Presidential Security Service, General Alexander Korzhakov, was a close confidant of President Yeltsin and is believed to have played an important role in organising the diary of the President. Department 5 of the Presidential Security Service included 19 former GRU officers. Among the 19 were at least three (Alexander Kotelkin, Boris Kuzyk and Sergei Svechnikov) that later played a central role in the management of Russian arms exports.²⁰

The first General Director of Rosvooruzhenie was General Viktor Samoylov. Samoylov was believed to be a close associate of Vladimir Shumeiko, a senior industrialist who had been brought into the government as First Deputy Prime Minister by President Yeltsin in 1992 and given responsibility for the transformation of the Russian industry.

Samoylov was removed as General Director by President Yeltsin in November 1994 and replaced by Alexander Kotelkin.²¹ Kotelkin had been the director of the Main Department for Military-Technical Co-operation within the Ministry for Foreign Economic Relations. In this capacity it is believed that Kotelkin proposed an investigation into the book-keeping of Rosvooruzhenie.

According to public accounts of the investigation, a series of irregularities was found. Rosvooruzhenie had opened contacts with private trading companies in Russia whose task was to sell the products received from foreign customers through barter arrangements in exchange for Russian military products. Apparently these actions went beyond the legal authority of Rosvooruzhenie as established in its charter and were organised in ways that could lead to financial abuse. It was also apparently revealed that Rosvooruzhenie had sold fuel intended for Cuba on the open market for hard currency and concealed the proceeds from the

¹⁹ It is obviously not possible to provide more than the briefest sketch of developments in this section. For additional material readers are referred to the volumes Ian Anthony ed. *Russia and the Arms Trade*, (Oxford University Press: Oxford 1998) and Andrew Pierre and Dmitri Trenin, eds., *Russia in the World Arms Trade*, Carnegie Endowment for International Peace, Washington DC 1997.

²⁰ Svechnikov became the first Chairman of the State Committee for Military-Technical Policy, the coordinating body for high level deliberations about which states and end-users should be approved as authorized recipients of Russian arms and military equipment between 1994 and 1996.

²¹ The choice of Kotelkin was considered unusual because he held the rank of Colonel. He was rapidly promoted to Lieutenant-General, which is believed to be the first time that such a rapid advancement occurred.

sale.²² It should be kept in mind that both the legal basis and the administrative routines for Rosvooruzhenie were created in a short space of time and in a legal vacuum. They were not published.

This apparently revealed irregularities sufficient to persuade President Yeltsin to remove General Samoylov.²³ However, when the investigation completed its work and sent its report to President Yeltsin in October 1995, no charges were brought against Samoylov. During 1994, Rosvooruzhenie was mainly staffed by officers on secondment from other state agencies, notably the Russian Ministry of Defence.²⁴ On taking over Kotelkin made an internal reorganisation of the company and (in April 1995) replaced many of the existing staff with former GRU officers. At the time it was created, Rosvooruzhenie took control of bank accounts containing money accumulated by several trading companies that were dissolved at the same time. This money was intended to provide financing for enterprises engaged in production of arms for foreign customers.

The system of accounts used to manage the revenues from arms exports was maintained with Russian banks that were state owned and controlled. Foreign customers paid for Soviet and then Russian arms using accounts held in the Central Bank. After 1994 there was greater use of private banks to manage revenues from arms sales.

During this period the commercial banks also began to take an important role in the financing of production of arms for export. Banks would lend money to enterprises to permit production to begin against the expectation of repayment from revenues provided by foreign customers.

In 1997 President Yeltsin ordered an audit of Rosvooruzhenie that was carried out by the Main Control Directorate of the Presidential Administration. The audit team apparently reported directly to President Yeltsin. The inspectors are said to have found serious financial misconduct by senior managers at Rosvooruzhenie. Some believe that Boris Kuzyk and others on the Presidential staff were also implicated in financial misconduct. Based on the report, Yeltsin directed the General Prosecutor, Yury Skuratov, to begin a criminal investigation.

The report was not published and no charges were brought against either Kuzyk or Kotelkin. As noted above, Kuzyk is currently a senior defence industry executive. After being removed from Rosvooruzhenie, Kotelkin received a senior post within the Ministry for Foreign Economic Relations where his main task was advising Rosvooruzhenie on marketing strategy.²⁵

The audit team that investigated Rosvooruzhenie was led by Nickolay Patrushev, a close associate of Vladimir Putin. General Patrushev, a former KGB officer with the rank of Colonel-General, was subsequently appointed as head of the Russian Federal Security Service (FSB) after Putin became President.

²² David Stone, *Woken from Slumber: Rosvooruzhenie and Russia's Return to the World Arms Market*, unpublished manuscript, July 1997.

²³ Wilson, A., 'Turbulence at Rosvooruzhenie signals higher foreign sales', *International Defense Review*, July 1995, pp. 55-56.

²⁴ For further information see Major-Gen. Yuri Kirshin, 'The role of the Ministry of Defense' in Ian Anthony ed. *Russia and the Arms Trade*, (OUP: Oxford 1998).

²⁵ Viktor Litovkin, 'The Art of Selling the Motherland', *Obshchaya Gazeta* (in Russian), 25 May 2000, reproduced in *Daily Report-Central Eurasia*, (FBIS-SOV-2000-1031), 25 May 2000.

In August 1997, senior officials from Rosvooruzhenie were moved to other duties and a reorganisation of the system for managing Russia's arms trade was carried out. The statute of the company was changed through another Presidential Decree. This time the decree was published but many details of the organisation and procedures to be used by Rosvooruzhenie were still lacking. Rosvooruzhenie would, in future, report to the Ministry of Foreign Economic Relations rather than to the Presidential administration. Previously the President appointed and dismissed the General Director of Rosvooruzhenie and the Council of Ministers appointed by his Deputy. After August 1997 the President appointed and dismissed all senior management at state trading companies.

The new General Director of Rosvooruzhenie was Yevgeniy Ananyev. Ananyev was previously the director of the MAPO Bank, a financial institution that formed part of the industrial group associated with the Moscow Aviation Production Association (MAPO). Reforms made at the same time moved responsibility for shaping military-technical co-operation (including the management of the trade) away from the Presidential administration and under the control of the Russian Council of Ministers. Overall co-ordination of military-industrial issues was the responsibility of the Deputy Prime Minister and Minister of Economics, Yakov Urinson. Responsibility for supervising the defence industry was moved to the Ministry of Economy.²⁶

While the President retained the final decision making authority—including the right to appoint and remove senior executives at state trading companies—decisions were in effect prepared for him by a co-ordinating body under the Council of Ministers instead of being prepared mainly by individuals within his own administration.

Apart from the change in its statutes, Rosvooruzhenie also lost its position as a monopoly carrying out Russian arms trade on behalf of the state. Two other state trading companies, Promexport and Russian Technologies, were created by separate decrees. In general terms one can talk of a period in which the management of arms export policy was expanded to take in a wider group of agencies and individuals rather than being managed through a tight bilateral arrangement involving the Presidential staff and Rosvooruzhenie.

The main channels through which Russian arms exports were to be carried out—Rosvooruzhenie, Promexport and Russian Technologies—also reduced the extent to which industry was dependent on Rosvooruzhenie. For example, while the Russian Space and Aviation Agency agreed to market its products through Rosvooruzhenie, the Russian Agency for Control Systems—the state agency supervising many of the most important enterprises engaged in high-technology defence electronics production—agreed to sell its products primarily through Promexport.²⁷

During the period in which decisions were taken by the Council of Ministers there are relatively few public reports of alleged corruption that can be compared in scale with those

²⁶ Changes in Russia's arms export law made in 1996, 1997 and 1998 were broadly in line with the move away from Presidential control towards control by the Council of Ministers. Responsibility for export licensing was moved from the State Committee for Military-Technical Cooperation (a Presidential body) to the Ministry for Foreign Economic Relations. These decisions were not taken by the Ministry alone. Decisions initially rested on discussions within an inter-departmental coordinating council organized under the Council of Ministers. This body was abolished in 1998 and replaced by a Commission on Military-Technical Cooperation in which 9 ministries and agencies participated. Within the latter decisions were taken by majority vote, which took away the capacity of one agency to block a decision.

²⁷ *ITAR-TASS* (in English), 25 Feb. 1999, published at CNN.com, 26 Feb. 1999, *ITAR-TASS* (in English), 14 Apr. 2000, reproduced in *FBIS Daily Report-Central Eurasia*, (FBIS-SOV-2000-0414), 14 Apr. 2000.

prior to 1997–98. However, there are many strong criticisms of the lack of effectiveness of the inter-agency decision making system.

In November and December 2000 a fundamental revision of the system for managing Russia's arms exports was introduced. The net effect will be to greatly increase the influence of the Ministry of Defence within the system of arms exports and arms export control.

As Prime Minister, Vladimir Putin began to give great weight to perspectives put forward from the Ministry of Defence and the security services. The views of these actors were weighted more highly than those of others within the inter-agency discussion. After becoming President, Mr Putin initiated the drafting of a new system for the management of military-technical co-operation. The drafting process was carried out by a small circle of his advisers working with the Ministry of Defence and the security services and led to changes introduced by Presidential decree in November 2000.²⁸

The new system gives the Ministry of Defence the main role in forming and implementing arms export policy under the direct supervision of the President. The trading companies Rosvooruzhenie and Promexport were merged into one State Company, Rosoboronexport.²⁹ The details of how Rosoboronexport will work were clarified in January 2001. For the first time additional details have been published about how the state trading company responsible for arms export will manage its activities.

Supervision of the activities of Rosoboronexport will be carried out by the Ministry of Defence rather than the Ministry of Industry, Science and Technology. The Ministry of Defence has long advocated the consolidation of arms export policy in a single state organisation integrated into defence industrial policy making with the equipment needs of the Russian military uppermost. Design and production enterprises on the other hand have favoured a model that provides export revenues (in particular hard currency revenues) directly to industry rather than to industry via the government.

At the time of the reorganisation the government decided that currency revenue from exports should be used to support the defence needs of Russia, in particular the modernisation of the conventional equipment of the armed forces.³⁰ Revenues derived from export are expected to be channelled from Rosoboronexport to those enterprises considered essential to support the implementation of Russia's new military doctrine.³¹

This reorganisation of the management of arms export policy was followed in December 2000 by further changes in the overall Russian arms export system. The arrangements for export licensing were modified on 1 December. In future, the Ministry of Defence will dominate the licensing process. A Committee for Military-Technical Co-operation with Foreign States has been created but will be chaired by a Deputy Minister of Defence and will be subordinated to the Ministry of Defence. Export licences will be issued by the Ministry of Defence. In this way the views of other agencies will be taken into account but will not be decisive. That is, it

²⁸ When this new management system was revealed it came as a complete surprise to some of the agencies that were formally part of the inter-agency process for discussing arms exports.

²⁹ Russian Technologies had already, under a previous decision, been merged with Promexport.

³⁰ ITAR-TASS in English 8 Nov. 2000, in 'Russian PM wants currency revenue from arms exports to go toward defense', *Daily Report—Central Eurasia (FBIS-SOV)*, FBIS-SOV-2000-1108, 8 Nov. 2000.

³¹ The Military Doctrine of the Russian Federation was approved by Presidential Decree on 21 April 2000. It includes a chapter on military-economic principles one section of which deals specifically with military-technical cooperation.

will be possible for the Ministry of Defence to force a decision over the objections of other agencies.

President Putin still maintains direct supervision of arms export policy through a small working group. The members of this working group include the chairman of the Committee for Military-Technical Policy within the Ministry of Defence, the head of Rosoboronexport and his deputy and the chairman of the Committee for Military-Technical Co-operation with Foreign States (responsible for export control).

While these state trading companies, and in particular Rosvooruzhenie, were the main instruments for carrying out Russian arms exports during the 1990s they were not the only ones.

Exports from the inventory of the Russian armed forces

Between 1992 and 1994 the Russian Ministry of Defence had the legal right to dispose of material and equipment that it considered surplus through a trading company established for this purpose, Voentekh.³²

In July 1994, the right of the Ministry of Defence to conduct foreign trade in military equipment was taken away from the Russian military. The reasons why this decision was taken remain unclear. However, public accounts suggest that the explanation may be relevant to the discussion of corruption in Russian arms trade.

It is alleged that senior figures in the Ministry of Defence responsible for international military co-operation (possibly including the then Minister of Defence Pavel Grachev) were complicit in arms trafficking in Europe and in particular on the territory of the former Soviet Union.³³ Moreover, it is also alleged that large-scale arms exports to Armenia continued after the Voentekh company ceased trading. These allegations were investigated by the Main Control Department within the Presidential Administration and then by the Chief Military Prosecutor. The officer responsible for the audit on behalf of the Presidential Administration was Vladimir Putin.³⁴ In his report, which was given directly to President Yeltsin, Mr Putin apparently included the names of senior military officers involved in organising the transfers.³⁵

No charges were brought against senior officers. In April 1998, General Grachev was appointed as Chief Military Adviser to Rosvooruzhenie by President Yeltsin.³⁶ Grachev was expected to play a central role in the development of co-operation between Rosvooruzhenie and customers in the Commonwealth of Independent States.

The Russian Ministry of Defence was responsible for managing military-to-military co-operation through bilateral agreements with, in particular, the countries participating in the

³² Voentekh was established in October 1992

³³ Alexander Zhilin, 'Generals do arms business', *Moscow News* (in English), No. 13 7-13 Apr. 1995, Alexander Zhilin, 'The Marshal has come out of the trenches', *Moscow News* (in Russian) No. 32, 7-14 May 1995, Alexei Neznaev, 'General thirsts for trade in military hardware', *Moscow News* (in English), No. 18, 12-18 May 1995.

³⁴ *Moscow Interfax* (in English), 14 Apr. 1997, reproduced in 'Official Says Yeltsin Knows Names in Arms Sales to Armenia', *FBIS Daily Report-Central Eurasia* (FBIS-SOV-97-073), 14 Apr. 1997.

³⁵ The report apparently did not find evidence of arms transfers to Georgia, which was another allegation included within the scope of the investigation.

³⁶ *Moscow Interfax* (in English), 28 Apr. 1998 reproduced in *FBIS* (FBIS-UMA-98-118), 28 Apr. 1998.

Commonwealth of Independent States (CIS). This can include transfers of military equipment and technology. With the changes introduced in 2000, those elements of CIS military co-operation involving transfers of military equipment are increasingly likely to be brought within the system of management of military-technical co-operation through agreements between the specialised state trading companies in the countries concerned.

Exports from Russian industry

The Russian 'defence industry' is normally considered to include over 1600 enterprises and other entities.³⁷ A tiny handful of these enterprises have the right to trade in military equipment with foreign customers. This right extends to some of the products of enterprises that have received a trading licence but not to all of its products. To export military products other than those specifically listed in decrees that established the right to conduct foreign trade enterprises must work through state trading companies.

The first enterprise to receive the right to market and sell its own products internationally was the MAPO (Moscow Aviation Production Enterprise) that received permission to export MiG-29, MiG-23 and MiG-21 fighter aircraft in 1994. Subsequently the list of enterprises with such permission expanded to 12 by 1998. After 1998 several enterprises found that their permits to trade (which are time-limited and extended only subject to review) were not renewed. By 2000, 9 enterprises held such permits and this number may have been further reduced.

Enterprises that did not have permission to participate in foreign trade in military items were only able to export military equipment through state trading enterprises. The definition of military equipment corresponded with the national munitions control list that formed part of Russia's arms export regulations.

For an exporter the situation was (and still is) the following:

1. An exporter must ascertain whether its products are controlled according to the national munitions control list. This decision is made by a specialised department within the Ministry of Defence responsible for developing and reviewing the control list.
2. If the product is controlled by the national list the enterprise must examine whether or not it appears on the list of products that the enterprise concerned may trade internationally. If the product was contained in this list, the enterprise would be free to manage the export itself.³⁸ If it does not appear on this list or if the enterprise concerned holds no licence to conduct foreign trade in military items then the product must be traded through a state trading company.
3. If the product was not controlled by the national munitions control list the exporter would be free to manage the export itself.³⁹

³⁷ These are the enterprises grouped under the supervision of 5 state agencies that act as a point of contact between enterprises and other parts of the state apparatus: The Russian Space and Aircraft Agency; Russian Ammunition Agency; Russian Conventional Weapons Agency; Russian Control System Agency and Russian Shipbuilding Agency.

³⁸ It should be noted that the enterprise would still be required to apply for and receive an export license in order to ship the particular product concerned.

³⁹ It should be noted that if the item was contained in another control list under Russian export control law then the enterprise would still need an export license to make the transfer. Russia maintains 6 national control lists within its overall system of export control laws. However, the enterprise would be responsible for managing the implementation of the contract, including the financial aspects.

While most Russian exporters have no direct access to the overseas market, they also have limited control over the prices charged for their products. These prices are determined by the state through the Law on the Defence Order and through the negotiations carried out by Rosvooruzhenie.

Furthermore, the Russian defence industry has no control over the movement of money. Payments from foreign customers are made to the state trading company, which is responsible for the distribution of the revenues gained among enterprises.

Transparency in the Russian arms trade

During the first ten years of the Russian state it has been extremely difficult to establish any clear picture of how Russia conducts its arms trade. Based on the discussion above, a lack of transparency can be isolated as central to the discussion of corruption in the Russian arms trade. Allegations of corruption often appear to have been stimulated by the difficulty in accounting for the whereabouts of money generated by arms exports.

The Russian defence industry has organised itself into associations of which the most important is the League of Assistance to Defence Enterprises. This association is able to collect information from its membership about the implementation of the Law on the Defence Order and about currency received as a result of participation in military-technical co-operation with foreign states. There appears to be a wide discrepancy between currency earnings as stated in laws and in public information from state agencies and the amounts of currency said to have been received by industry.

The question that is regularly posed by Russian industry is where could this money have gone? One possibility that should be considered is that there is no differential. The basis for public statements of the value of Russian arms exports is difficult to understand and impossible to verify. It is difficult to state with confidence how much money is earned.

A second possible explanation is that state trading companies behave unreasonably, in particular that they retain unjustifiably large sums to meet expenses rather than passing money to the industry. It could not be claimed that the Russian arms trade is transparent. A general difficulty should be noted in understanding the economic aspects of the Russian arms trade during the 1990s.⁴⁰ However, the situation in this area has gradually evolved over time.

Prior to 1994, very few figures were available from Russian authorities. Those that were available were rarely explained and so it was difficult to evaluate the extent of the items covered and the methodology by which they were constructed. Data expressed in currency units (usually US dollars) sometimes included a mix of different kinds of estimates and can not be seen as a proxy for currency revenues.

After 1994, the amount of public information has increased, in part because of the existence of Rosvooruzhenie to collect and collate information. Moreover, in the late 1990s the Russian authorities have begun to provide data in slightly disaggregated categories. These numbers have included values of certain bilateral arms trade relationships (notably with major customers such as China and India) and data separating currency receipts and other forms of payment.

⁴⁰ For a further discussion see Anthony, I. 'Economic dimensions of Soviet and Russian arms exports' in Ian Anthony ed. *Russia and the Arms Trade*, (Oxford University Press: Oxford 1998).

According to this published official data, by the mid- to late-1990s the currency derived from exports can certainly be measured in billions of US dollars per year. Over the period after 1996 credible estimates by Russian analysts put the total figure for currency revenues at around twelve billion US dollars.⁴¹

After 1998, Rosvooruzhenie in particular began to provide more detailed information about its activities under then General Director Grigory Rapota. The appointment of Rapota, a career officer from the Foreign Intelligence Service rather than the Military Intelligence community, was apparently influenced by the then Prime Minister Yevgeniy Primakov (himself a former head of the Foreign Intelligence Service). Rapota gave regular interviews in which he responded in some detail to questions about revenues gained from arms trade and how these revenues were distributed. After being removed as General Director of Rosvooruzhenie, Rapota was appointed as First Deputy Minister of Trade. While no longer having a direct sales function, Rapota continued to have a good overview of military-technical co-operation and continued to give interviews on the subject.

The system of providing information about military-technical co-operation was not institutionalised and depended on the actions of individuals. Whether these public disclosures have created precedents that will become routine remains to be seen.

President Yeltsin removed Rapota as General Director of Rosvooruzhenie in August 1999 and replaced him with Aleksei Ogarev. Ogarev was part of the so-called Kremlin 'old guard', having been the head of department within the Presidential Administration responsible for providing the President with advice on military-technical policy. In the Russian media this was interpreted as a decision prompted by the perceived close connection between Primakov and Rapota.

Ogarev does not appear to have had the confidence of President Putin (who was Prime Minister at the time the decision was made) and apparently he was not included in the discussions leading to a revised system for managing military-technical co-operation described above.

It is too early to judge the approach that will be taken towards information by the new state trading company Rosoboronexport that was created under the new system.

Observations and findings

The objective of this paper was to examine Russia's arms trade to try and answer the following questions. What kinds of sales practices are taking place? Are these practices corrupt? What actions are being taken to reduce the risk of corrupt actions? Looking back at the brief survey above, it is possible to see many problems that need to be resolved before a fully considered judgement could be reached about the extent and nature of corruption in the Russian arms trade. However, the material presented is suggestive of several problems.

Within general discussions of corruption in the arms trade the main emphasis appears to be placed on the interface between arms industries in the exporting state and the customer. In Russia, public authorities are effectively providing this interface in most cases. Moreover, the power that this role as interface between supply and demand provides is highly concentrated

⁴¹ For a discussion of recent Russian data see Konstantin Makienko, 'Preliminary Estimates of Russian Performance in Military-Technical Cooperation with Foreign States' in 2000', *CAST Journal*, Jan-Feb. 2001, pp. 5-7.

in a small group of closed agencies. The system is particularly vulnerable if the Presidency takes a relaxed view towards the activities of its staff.

Russia has revised its arms export regulations regularly and at certain times fundamentally after 1992. However, these regulations have always included the principle that authorisation to export controlled items should not be given unless a particular export is consistent with Russia's national security and foreign policy interests. From an official and from a legal point of view, arms exports have never been regarded as purely commercial transactions in Russia.

Another principle that has been constant since the adoption of the Russian Constitution has been the paramount role given to the President in shaping arms export policy. These principles give great power to individuals that carry influence with the President or that can act on the basis of Presidential authority.

Using the two different approaches to defining corruption discussed earlier in the paper, it can be seen that the judgement about whether actions by senior officials were "corrupt" depends on the definition used. Actions may have been taken by senior officials that were not technically illegal. At the same time, these actions may be seen as outside the boundaries of democratic values that the administration claimed to adhere to.

Decisions shaped by a small group of individuals without wider consultation may have been given a legal status because the decisions were actually taken by the President. If it could be demonstrated that the individuals concerned gained direct financial benefit from these decisions there may also be a case that they acted corruptly. However, investigations have usually been carried out by the Main Control Department within the Presidential Administration rather than by an independent institution. The results of the investigations have not been made public and the Public Prosecutor has not brought charges based on information received. If individuals gained indirect benefits from their decisions—such as lucrative positions within the financial or industrial sector—demonstrating a causal link would also require information that could only be provided through an independent investigation.

Public information is of great value because it raises a flag over issues that require further investigation. However, a survey of public information underlines that it will not be adequate as the basis for understanding the details of any event. Most information is generated after the breaking of a "scandal" and is the result of leaks by parties showing their dissatisfaction with a particular chain of events or circumstances. The information may be leaked by individuals that are engaged in political struggles in order to discredit opponents. The information is often provided by representatives of a defence industry that is demoralised, under severe pressure and highly dissatisfied with state policies. The available public information is at best a partial picture of events and at worst it is fabricated as an act of provocation.

The personal linkages between a small group of individuals operating with direct access to and support from the President, combined with legal statutes and procedures that were not transparent emerge as two important factors preventing greater understanding of the financial management of Russian arms exports during the 1990s.

In 1998 and 1999, Russia modified its arms export management system to include a larger number of agencies in the process of decision making. Senior individuals within this new system promoted a greater degree of transparency. During this period a smaller number of

allegations of corruption or illicit arms trafficking appear in the public sources. However, this system of greater consultation and openness has been criticised on the grounds that it reduced the efficiency of Russian arms exporting. Serious observers have written that the system was 'destined to failure because of its inefficiency'.

This observation that greater transparency reduces efficiency is not supported by the statistics produced by the official agencies. Military-technical co-operation with foreign states requires close co-operation internally between different interest groups if it is to succeed. In the medium term it is not logically the case that decision-making will be more effective because it is confined to a small group. However, the argument that greater consultation reduced efficiency did prove to be politically effective in the internal politics of Russia's arms trade.

In 2000 the system has once again become more closed and more hierarchical. A bilateral axis of President and Ministry of Defence now have an effective control over decision making and implementation in this area. The structural vulnerabilities stemming from concentration of authority and lack of transparency identified above remain.

There is little evidence that the present government intends to contribute to increasing transparency.⁴² At present the President places great reliance on agencies that he believes he can trust—the security services and armed forces.

While there is a lot of evidence that the present administration does place a high emphasis on examining allegations of corruption, it places equally strong emphasis on the efficient management of arms exports. The policy of the government is to maximise arms exports within the framework of what is permitted under current international norms.

There is evidence that the present Russian government recognises the need to conduct Russian arms exports within the rule of law. Looked at over time there has been evidence of progress in the management and control of Russian arms transfers. In particular, the process has been brought more under state control and can be seen as part of a wider process of institution building in Russia. However, it remains the case that in Russia power is still closely identified with individuals rather than offices or institutions.

It is the stated intention of Russia to ensure respect for international norms and agreements in its arms export policy. However, Russia does not appear ready to consent to the further development of a system of international norms and agreements and these are weak and incomplete in the area of conventional arms transfers. The process for arms export closely reflects the political realities in Russia, which might not be in line with the preferences of Western countries.

⁴² Russia's actions within, for example, the Wassenaar Arrangement and the UN Register of Conventional Arms can be pointed to as cause for concern on this point.

Workshop

Can the defence industry in the exporting countries be separated from the interests of national security?

Rapporteur: Paul Schulte

Workshop Notes

The group heard a presentation by Tim Garden. He argued that one should look essentially at the contributions of defence industry to security, rather than income and defence diplomacy.

Institutionally, the arrangement in the UK allows for what amounts to corruption. The Defence Export Services Organisation (DESO) is headed by an industrialist, who is largely paid by the defence industry. His remit is to maximise arms sales. The Ministry of Defence's (MOD) interest is to reduce unit costs by expanding production runs and the export base.

Logically, the Department of Trade and Industry (DTI) should run this, but it remains embedded in MOD and is run by MOD/DTI with minimum Foreign and Commonwealth Office involvement. Parliament has little power in its Select Committees and is more concerned with pork barrel pay-offs. Production runs are so small that costs do not come down - and MOD often has to buy products to help export them.

The system risks corruption: it is a revolving door requiring former officials to wait only 3-6 months before taking jobs in industries. Hospitality, perks and freebies need even further controls and academics too may be constrained by depending on the largesse of large companies.

His recommendations were:

1. Nations should never sell arms to any country with which they are not prepared to enter into a formal alliance treaty.
2. There should be full disclosure of all sales (including all prices), perhaps retrospectively but completely - including all offset deals.
3. There should be external audits of national costs and benefits and all subsidies for arms exports (which are greater than in any other sector).
4. There should be a tougher policy on personnel transfers and freebies.
5. As sole customers, governments can and should demand that all supplier companies publish an ethics policy statement (as in the extraction industry e.g. Shell/BP).

The discussion centred around whether there was in fact 'a politics of corruption' in the arms trade and if so, how provable, intractable and inevitable this might be. Some argued that the offset trade from arms contracts was part of the problem as it was very large and selectively a significant economic distortion (e.g. creating MBA course in Malaysia). Others felt that the concealed irregularities of weapons contracts themselves were so important that addressing offsets would be a distraction. Companies themselves seldom wanted to have to get into offset deals. They were forced to by the terms of the available contracts and the pressure from other competitors.

There was generally positive discussion of the overall impact of company ethics policies. It was asserted that these could work well and help encourage whistle blowers but that they needed to be kept up to date and signed off by top management each year. Defence companies with such ethics codes, especially in the US, were genuinely keen that their ethics based approach should be universally expanded. They believed they were commercially disadvantaged while others did not have to exercise the same scruples. But 'hot lines' on corruption probably would not work as they would be used to try to sabotage competitor's contractual successes.

Some participants emphasised a more structural concern: the determined maintenance of national defence industries amounted to corruption because of the efforts made to ensure national champion firms got key contracts under all circumstances whatever foreign competitive advantages might be. Yet national security no longer relied on indigenous arms industries. In the twenty-first century no one could reasonably anticipate prolonged total wars where military survival might depend on the national defence industrial base. Relative few jobs - at very high costs - were now involved. Defence Industries no longer spearheaded general economic advance. More explicit government criteria for defence industries policy might help.

There was disagreement on whether Europe-wide defence sector reorganisation would improve the situation. It might merely throw up pampered 'Euro champions'. Parliamentarians had shown little sign that they would become constructively engaged at a national or Euro level. Moralising based upon ideal economic models could not generate directly practicable improvements. Defence establishments would always tend to prefer close relationships with nationally based firms, believing that they would be more immediately receptive to specific national operational requirements. There was also a strong, perhaps ineradicable, element of potent national symbolism in arms procurement. Jobs preserved or created in such firms still mattered to national governments. The quality of military, civil service and defence industrial lobbying was very high (analogies were drawn with the strength of the farming lobby). Indifference to national origin of weapons was also a recipe for global domination by large, especially US firms, already benefiting from long production runs. To many, this would not be an obviously desirable outcome.

It was pointed out that political and diplomatic pressures also helped US firms. In addition, governments with intelligence information on how defence business was actually conducted throughout the world were unlikely to believe that self-denying individual gestures would much improve the situation. Part of the problem was that there is so much distrust in the field. So far, there are no generally accepted, verifiable, collective initiatives which could be seen to move the world's arms markets towards an ideal of perfect economic efficiency.

Workshop

Matching expenditure to needs in developing countries' military budgets

Rapporteur: Julia Saunders

The group began by asking what affects levels of military spending. Two factors were identified: the level of perceived threat (both internal and external) and the nature of procurement practices, including the degree to which they are under democratic control.

It was suggested that when the threat environment was external, this resulted in the desire to purchase large weapons systems, including weapons of mass destruction. When the threat was internal, the procurement concentrated on a different scale of expenditure, often devoted primarily to small arms.

On procurement practices, the group discussed cases where the military control their own procurement budget (e.g. Chile) by 'owning' industries and are therefore able to sustain otherwise unaffordable levels of defence spending. It was noted that the Chinese military was largely pulling out of such arrangements, which accounted for the increase in the official defence budget this year. Against this background, the issue was raised as to what link there was between excessive military spending and corruption.

The discussion then moved to the issue of making judgements about the military requirements of developing countries. Some participants took the view that in many cases developing countries had no external threats so did not need an army; they should prioritise human security and concentrate on developing a police force instead (e.g. as had been done in Costa Rica).

This view was strongly countered by those who argued that expenditure in developing countries had never yet met the real military needs. Also, military spending often included a large social element (e.g. military hospitals open to civilians, education of soldiers). The colonial powers had given Africa its armies, who were they now to say they should get rid of them? Many developed countries also faced no real external threats; should they too get rid of their armed forces? It was noted that the present time is characterised by unpredictable threats, rather than the more certain era of the cold war when one had a clear idea from where the enemy might come. Very few countries would feel comfortable without their own military protection. The counter argument was made at this point that developed countries could afford their armies; the burden fell primarily on poor countries to make the most difficult choices.

The point was made that asking developing countries to cut their military spending could be counter-productive. The example was given of Sierra Leone where a cut in spending resulted in a cut in the dole of rice for soldiers, which was a factor in the ensuing rebellion.

The discussion moved to examining what measures could help reduce corruption in military spending. The group discussed the acquisition of Gryphon aircraft by South Africa, which, it was argued, was a good example of excessive and inappropriate military spending by a developing country. If it turned out to be a decision influenced by corruption, what lessons could be learned. The active civil society and parliamentary system meant that the affair was

being debated in public and there was a strong likelihood that decision-makers would be held to account. This public scrutiny was key in achieving responsible spending. A suggested measure, therefore, was to support the development of civil society to assist in oversight in other developing countries.

The South African case also demonstrated the need to examine closely the role of offsets in clinching deals. These packages had the potential to be a cover for bribes.

Discussing the issue of aid conditionality, the group was divided whether this was a good tool or not. Some participants argued instead for incentives, for example help with the cost of disarmament, demobilisation and reintegration (DDR) projects, as was being done in Russia. Another view was offered that international aid should be made conditional on greater transparency in the military budget. Another participant suggested that whilst such restraint was preached to the developing world, the arms producers should look to their responsibility in offering large financial incentives to persuade developing countries to buy from them.

Workshop

Russian and transition economies' perspectives

Rapporteur: Patrick Cauthery

The main points arising from the presentation and discussion were as follows:

The issue of combating corruption was now being taken seriously in Russia. The President had recently raised the issue of corruption in his annual speech to Parliament. There is an estimated loss to Russia of US\$20bn per annum due to corruption.

A meeting between the Public Prosecutor, the Head of the Interior Ministry, and the Head of FSB also examined strategies for tackling the problem. They recommended that Russia should:

- Prohibit some offshore transfers of funds
- Increase transparency of corporate ownership
- Increase transparency in the banking sector
- Increase measures to restrict the outflow of currency from Russia
- Introduce measures to allow the repatriation of Russian capital abroad.

However, it was understood that the President favoured a more liberal regime of exchange controls. It is estimated that around 40,000 organisations (companies, banks, J.V.s etc) are controlled by criminals. Money is often laundered offshore, with Cyprus being a favourite destination.

The defence export industry in Russia is effectively headed by the President, who makes the key appointments and establishes the rules. There are three parliamentary committees with responsibility for defence exports, although in practice the role of parliament in controlling the arms trade is very limited. The press has few journalists with experience in this area and little funds to commission investigations.

The Russian defence industry had stagnated after the break-up of the Soviet Union due to:

- An ageing workforce
- No state purchases of new equipment planned until 2005
- government debt to defence manufacturers of US\$ 1billion

The reaction was to step up exports with the hope that the defence industry would pave the way in overseas markets for the Russian civil sector. Defence systems were often developed just for export markets, although the technical specifications would be reduced to comply with international regulations.

In the Russian defence industry there are a number of different ways that corruption can take place:

- State mediating companies, that act as middle-men between the manufacturer and buyer, often retained 50% of the value of the contract for themselves. This practice is no longer permitted.
- Using the banking sector to divert funds offshore.

- Regional lobbying whereby the Governor of a region will seek to influence the procurement of contracts for their region. This is not in itself corrupt, but may be potentially corrupted by using inappropriate forms of leverage.
- Bribery to the decision makers in the buying country.
- Trading in false end-user certificates to navigate around arms export restrictions to certain countries.

The following features were all seen as contributing to the likelihood of corrupt practices in the Russian defence industry:

- General poor economic situation
- Uncertainty caused by the break-up of the Soviet Union
- Absence of adequate anti-corruption control mechanisms
- Absence of defence equipment orders from the State
- Privatisation of manufacturing plants
- Absence of experience in sale of arms
- No possibility of offering offset arrangements or export credits.
- Negative reaction at home to US political pressures not to buy from Russia
- Absence of NGOs/ press with interest in tackling corruption.

Some suggested measures to combat corruption in the defence export sector, which arose out of the workshop discussions were:

- Establishment of a database of information to be shared between institutions with an interest in this issue
- Encourage the press and NGOs to take an active interest
- Parliament should take a more active role in scrutinising activity in this area
- Implement a code of ethics for government officials (whose incomes were often supplemented by bribes)

II. The effects of corruption in the arms trade in the developing world and on the political framework of exporting countries

The arms trade as a key factor in civil wars - The situation in Angola

Margarida Trinidad
Global Witness

Update on war situation in Angola

Angola has been at war since 1961; first in its struggle for independence (gained in 1975), and later in a fight for control between the main nationalistic groups: MPLA and the UNITA. After independence, the MPLA formed a single-party socialist government and the first elections were held in 1992. Jose Eduardo dos Santos from the MPLA won the first round, however Jonas Savimbi from UNITA rejected the result and went back to war. A peace agreement was put in place in 1994 - the Lusaka protocol – however UNITA repeatedly violated the cease-fire and the government continued to rearm. Tension escalated and the UN extended the sanctions imposed upon UNITA, which now apply to weapons, fuel, diamonds and mobility of UNITA officials.

Rearming - general

Both the government and UNITA have been rearming more or less constantly since not long after the peace agreements were put in place. It is believed that the weapon supply networks used by these two groups are different, although there are allegations of common weapon factories and possibly of common weapon brokers. On the UNITA side, the weapon procurement process has been under strict scrutiny by the UN Panel of Experts on the Sanctions and, although serious breaches have been reported, it is believed that overall UNITA is losing military power to the government. However, this talk will not focus on UNITA, but look at the ways the government procures weapons and to discuss its implications.

Rearming - government

The government's effort in weapon procurement to pursue the war has been characterised by lack of transparency and accountability. This is immediately visible by the lack of agreement in how much defence contributes to government expenditures. For example, for the IMF, defence is the largest expenditure and corresponds in average to 37% of government expenditure during the period of 1995 to 99. On the contrary, the government says it spent only 11% in defence from 1997 to 1998.

There is abundant evidence of weapon supplies to the government starting not long after the peace agreements. Some of these shipments, although not illegal, undermined the spirit of the peace process. Other weapons supplies raise yet more questions. Although Global Witness is

not questioning the legitimacy of the government to buy weapons, an area of deep concern is the fact that the government uses, at least in part, mafia-type networks for weapons supply and there is no accountability whatsoever in this process.

Examples of weapons procurement used by the Angolan government, which are of concern to Global Witness, are described next.

1. Pierre Falcone and Arcadi Gaydamak's network of operations were recently exposed in the media as the Angolagate scandal. These two men are suspected of engaging in arms brokering for the Angolan government through Falcone's company Brenco International. There is evidence of at least two deals, one in 1993 and another in 1994, with a total value of approximately US\$ 600 million. The arms brokering service provided by Falcone and Gaydamak to the Angolan government was possible due to a system of covert payments to politicians and other key personalities in France, including Jean Christophe Mitterrand, the son of the former French President, and to key individuals of the Angolan elite. President dos Santos himself recognised that the weapons deals took place and expressed full support of Falcone's activities in the "maintenance of democracy and the rule of law" in Angola. Falcone is under arrest in France since December and an international arrest warrant has been issued against Gaydamak.
2. 1998 was a critical year for the Angolan government. As the international oil prices fell abruptly, the Angolan government was short of cash but desperately needed money for weapons procurement. An easy solution to this problem for the second richest country in oil in sub-Saharan Africa, is to engage in oil-backed loans, thereby seriously compromising oil production for the next few years. A good example of this is the deal made with the Swiss oil trade company Glencore in 1998, in which the government mortgaged oil production in exchange for up-front payments adding up to approximately \$900 million. The deal did not meet basic standards of transparency indicated by the IMF, as the loan was directed to Sonangol and the Presidency instead of the Central bank or the Ministry of Finance. Several other loans have been concluded after this one.
3. By 1999, the government awarded the first ultra-deep water blocks on the offshore of the Angolan coast, which attracted major oil companies with the technical expertise and investment capital to develop these types of blocks. This allowed the government to raise up to approximately US\$ 900 million in signature bonuses, which are up-front payments by companies bidding for exploration of defined oil-rich areas or blocks. A high proportion of this, possibly up to US\$ 400 or US\$ 500 million found their way directly to the Presidency, again bypassing the Finance Ministry or the National Bank. These funds were earmarked for the "war effort", according to the Angolan Foreign Minister.
4. Another area of concern is the inclusion of equity partners in the ultra deep blocks which are unknown to the oil industry and are normally more related with arms dealing. This is the case of two companies - Prodev and Falcon Oil - which have 15% and 20% respectively of shares in TotalFinaElf's block 32 and Exxon's Block 33. In particular, Falcon Oil is a company reported to be controlled by Pierre Falcone and in which President dos Santos seems to have a personal interest. It is possible that both Prodev and Falcon Oil received their respective shares as "payments in kind" for services rendered (maybe weapons deliveries) as the Angolan government did not have the funds to pay with cash.

Meanwhile, the lack of transparency in arms procurements by the Angolan government continues and there are no signs that it will stop. Early this year, the Ukrainian freighter *Anastasia* was seized on the Canary Islands carrying weapons from a Russian factory to the Angolan government. The captain of the freighter told the authorities that it was carrying automobile parts.

Those examples show an obvious problem of corruption at the highest levels in the weapon procurement process. We can add to that two facts:

- First, the fact that in Angola the record of human rights violations is high, thus many of the weapons held by the government may be misused.
- Second, expenditure in the "war effort" is intimately linked to bad governance. The war effort is used as an excuse for basically no government investment in education and health programmes.

Therefore it is time to ask the question: What can we do about corruption in the arms procurement process and corruption in general? One way is to focus on how the government funds its war effort.

Angola is a major oil producer in Africa: the oil industry contributes to 80-90% of government income. Much of this income is generated by foreign oil companies by means of tax payments and additional payments to the Angolan government such as signature bonuses. This industry is relatively safe because most blocks are located offshore, and are thus relatively untouched by the war. Furthermore, the prospects for oil recovery in the near future are substantial.

Currently, Angolan state income is being subject to massive abuse by Angola's elite, and this is intimately tied to the process by which the Angolan government war machine is financed. However, it is impossible for the Angolan civil society to hold their government to account because there is a great lack of transparency about payments made to the government. How is it possible to demand accountability for government expenditure, if the basic information about government income is not available?

Global Witness believes that the companies operating in Angola that are not transparent about their payments to the Angolan government, are complicit in both the continued funding of a war and in the wholesale robbery of the state. Global Witness is calling on these companies to publish the kind of data that is already published in Europe and North America.

If all companies operating in Angola decide to render public the amount of money they are paying to the Angolan government, then they will not be at a competitive disadvantage towards other companies, because they will all be doing it together. To a certain extent the Angolan government depends on the expertise and investment potential of the "super major" oil companies, and therefore would be "forced" to accept transparency rules. At the same time, this will present immense benefits to the Angolan people because it will allow a close estimate of government income from the oil industry. This will help to build up a civil society in Angola which has the capacity to demand accountability from the government.

Although the focus for Global Witness is Angola, it follows that the companies should publish such payments for all their countries of operation, that is, that transparency should be common practice.

Since the publication of our last report, Global Witness has initiated a dialogue with oil companies in order to discuss the possibilities for the oil companies present in Angola to fully publish all payments made to the Angolan government. Various oil companies do recognise the need for greater transparency and recently the UK company BP-Amoco Group stated that it is going to disclose financial data on Angola, although without specifying when or in which format this will be done. Other companies have contacted Global Witness to clarify their current status in Angola.

A similar dialogue may be started soon with the banks involved in oil-backed loans to the Angolan government in order to discuss transparency measures that could be adopted.

The role of corruption in undermining the armed forces

General Ishola Williams

TI-Nigeria

Transcript

Corruption in the armed forces world-wide is systemic and endemic and it is something that is going to continue for a long, long time; as long as the armed forces exist. With respect to the armed forces in Africa, they face crises and conflicts all over the continent. Africa, therefore, in the short-term needs arms for the armed forces. So do the warlords, rebels, ethnic armies and criminals.

On Monday 26th of March, the Foreign Minister of Mozambique in an address said that when they had the big flood disaster in his country, the armed forces were completely useless. They were totally incapable of doing anything, and that was the same in the rest of Africa, except for South Africa. Even the military engineers who could have been useful during the disaster were short of equipment. This is the type of scenario not expected when the western donors keep talking about security reforms, defence transformation and national security and development.

Security reforms alone cannot reduce corruption in the African armed forces because, in fact, corruption in all forms has led to reaction rather than a pro-active stance. The arms trade and corruption is not government to government alone, it is not only the illicit trafficking of arms by multinational companies who are looking for political allies and warlords, but it is also corrupt African political leaders who share the loot with their military.

There is the example of Elf Aquitaine France with General Ngueso in Congo. With respect to the system of arms procurement, the Francophone is different from the Anglophone. In most Francophone countries they cannot afford to buy any equipment, and if they do, France and Belgium are the main suppliers. In Anglophone countries, British and US firms usually go through corrupt political middlemen or even Heads of State.

Having said that, one can still look at corruption in general terms in Africa. I am not talking about South Africa now because of the kind of illegal corruption that is going on. If you take Nigeria as an example, we spent a lot of money on the Liberian civil war, and a lot of the money went to the middlemen and contractors. When I became the Chief of Defence Operations, Training and Planning in the Ministry of Defence, the contract that was given to private airlines to fly our troops to Liberia and Sierra Leone with payment in dollars was cancelled. The Air Force had transport aircraft sitting in the hangars. They just needed a few spares to be able to get them to fly. But instead of spending the thousands of dollars on them, they were giving these millions of dollars to the contractors. I stopped the contract and transferred the money to the air force to get the transport aircraft fixed. That improved the capability of the Air Force to go on missions.

It is also common for western countries to put our leaders under pressure. I want to give another example of the British sales of Vickers tanks to Nigeria, in the early 80s. At that time we had a democratic regime in Nigeria. The Vickers factory had to be kept afloat. Of course,

the government of Britain had to put a lot of pressure on the President of Nigeria. Many of us were opposed to buying their tanks but in the end they were delivered. They are now useless to the Nigerian Army. We do not know whether to build a museum for them. The Vickers factory has long closed, so we do not have spares for them and those tanks cost millions and millions of pounds. I do not know whether we have finished paying for them now. So, you can see our pitiable situation.

But one thing I want to say about the whole issue of security and corruption is that it occurs to me that we are in an arena in which economic aspects are important. The second point is that African armed forces still have an important role to play; may you call them great demons or anti-democratic. In order to be able to fulfil their duties they need some sort of strength and need to protect their country's interests up to a certain point. But that point is always difficult to determine. The other alternative then, is to have an umbrella and if we have not got that umbrella then we have to accept national responsibility for security. So in Japan today, they spend 1% of the GNP on defence, because of the US umbrella, even though Japan may see threats from China. They would have spent more without an umbrella.

My third point is that if you have not got the military capacity and capability, you are entirely dependent on foreign supply for your defence system and your independence. The nearest alternative is to have partners and when these partners refuse to supply you, then you have to get what you want in any way or form and that is by going through illegal ways. Or somebody else gets the weapons for you and you have to pay any amount of money in order to get them. And therefore, to many African countries, if told that they cannot get arms from somewhere, they then go to get them from middlemen who are ready to share as kickback any amount in dollars. Some are encouraged by their governments. A Liberian Minister a few years ago in London said: "if you want power in Africa, what you need to have is dollars, millions of dollars and have guns, then leaders are forced to give up power in Africa." Many countries have gone this route.

On the other hand, democracy in itself does not reduce corruption, except with the two important components of transparency and accountability. And I can assure you of one thing: it does not matter whether the politician is yellow, white, green, blue or black. Every human being is tempted when there is plenty of money and when she/he has unchecked control over that money. If civil society is not strong enough to monitor, he or she can do whatever he or she likes. And that is happening in Africa in many cases.

Going back to the security issues, there are not many think tanks and therefore there is no serious analysis. Even after the analysis, you are not listened to. Creating awareness within informed civil society is a challenge because of attitudes and scarce resources.

What is also interesting is the emphasis today on security reforms by western donors, especially reducing the size of the armed forces and thus the running costs. In spite of non-homogenous studies, we are yet to know the optimum size of a national armed force in Africa. I want to give two examples with respect to Nigeria. Both the Minister of Defence and the Head of State are retired Generals. On taking office, they announced the downsizing of the armed forces without studies and public debate. Two years later, they have not yet done so because of internal and external commitments. The second example is the introduction of MPRI into the Security Sector Reform Programme. Both the military, including most retired officers, and civil society are against the idea. In spite of this, the MPRI is still there, but it is not clear whether the reforms they are carrying out are sustainable, change attitudes and

reduce corrupt practices. Home-grown problems need home-grown solutions with adaptation of foreign ideas.

In addition, there is the need for a holistic approach because defence expenditure can be hidden, for example, under the health sector. If the health sector is also corrupt then the problem remains. The need for a public sector approach to reducing corruption is obligatory. There is need for political space in order to have access to information and to protect genuine whistleblowers within the defence system. It has always been difficult to protect military whistleblowers, as was the case with the Moroccan Captain.

We must look at the figures in defence expenditure on their own, we must compare them with the social service sectors and in addition compare what is spent on acquisition, what is spent on military education, training, welfare and personnel costs.

Let me end by saying that, if you are a good dictator of a rich African country, you can get what you want and when you want it for your country. Mr. Gaddafi is a good example. The same goes for Dos Santos and Savimbi in Angola. In conclusion, corruption is systemic and endemic and will be so as long as there is no convention and sanctions through an International Court of Justice to control politicians, middlemen and multinationals who create incentives for warlords.

It is the politicians and defence industries who create space for corrupt soldiers in arms procurement. Outside procurement, corruption within the armed forces can be reduced to the minimum. Finally, a new Code of Conduct for the armed forces is essential as has been done in the Philippines.

**The impact of corruption in the arms trade
on the political process in the developed world**

Joe Roeber
TI-UK

Speech notes

Corruption in the arms trade has received virtually no attention from students and analysts of the industry. It is gossiped about but not taken seriously as a factor in the business. I have found no articles and only one book, a recent one, that treats it as no more than a guilty pleasure for serious students and analysts. It seems that, if they think about it at all, it is seen to be peripheral to their main concerns, which are strategy and materiel. For most people concerned with the industry, corruption is a cost of doing business, regrettable but inescapable. "No company would pay bribes if they didn't have to." I have been told by a senior man in the industry. In other words, it is something the arms sellers do against their will and, if they needed comfort, they might tell themselves it is something that happens downstream from their systems, away from the main centres of their own corporate and political lives - which are, if not irreproachably virtuous, at least subject to transparent systems of control within a culture that frowns on corruption.

Our basic premise is that it is wrong to see corruption as peripheral to the main concerns of arms procurement, and irrelevant to the decisions taken there. For an economist, it would be merely naive to bank on such a separation for it is axiomatic that, where decision-makers benefit from their decisions, the decisions themselves will be affected. He would only have to assume rational self-interest. (Which is to say, in the context of bribe-taking in arms procurement, commission-maximising behaviour.) It follows that corruption affects the amounts spent on arms and the quality of arms procurement decisions. But you already know this for it is the main subject of this conference.

There is another reason, more to the point of this paper, why corruption cannot be pushed to one side: it cannot be contained. Money does not flow safely downstream, along steep-sided channels to distant places. Some of it is liable to flow back in the form of what the French call "retro-commission". The reason is simple. Illegal or merely discreditable payments are not made out of audited accounts. They are made from unaudited slush funds, often held offshore in secret accounts, and these are a standing temptation. In the conditions of secrecy that define the industry, it is as possible to make payments in one direction as in another. Lets start with a general point.

"Slush fund behaviour"

Slush funds emit clouds of monetary pheromones that are irresistibly attractive to anyone standing near the money. As Peter Clark, the chief FCPA prosecutor in the DOJ said to me, "Unaccountable money generates greed." The money has no owner and no records. Individuals help themselves with impunity.

Some stories follow, intended to illustrate behaviour rather than to make a point about the arms business specifically:

The Enterprise, Sekord and Hakim:

The investigation of the Iran-Contra affair included an exhaustive analysis of the accounts of a purposely obscure operation known as The Enterprise. Arms were procured by the CIA and sold to Iran through it at huge profit. The purpose was to fund an unaccountable arm of the CIA able to operate out of sight of Congress, and The Enterprise had airplanes, pilots and storage depots for trade into Nicaragua - arms in and, some say, drugs out - for the purpose. The funds generated were kept in Switzerland, well out of sight of US authorities. The men who ran the company on behalf of the Colonel Oliver North and the CIA (they included an ex-Air Force General, Dick Sekord) paid themselves a lot of money: \$12.2 million was made in profits of which \$5.5 million went into the pockets of the principals. The money was sitting in a secret account, out of sight of anyone. It was a slush fund. Why not take what they could?

The temptations of covert operations:

Stories abound of the way the funds made available within the CIA for covert operations have been diverted for private profit. The involvement of the CIA in the drug trade, providing individuals with an entry into private enterprise, has been documented by Alfred W McCoy in "The Politics of Heroin: CIA Complicity In The Global Drug Trade" (Lawrence Hill Books). At a more humble level, several million pounds disappeared from the slush funds operated by London's Metropolitan Police for their covert operations. In both cases, the funds were secret and unaccountable.

Senior managers of big arms companies:

An old hand in the arms game has said to me, "Look where they retire." He had in mind the large houses in warm places where some of his senior managers ended up. Could they have afforded it on their salaries?

Le Floch Prigent and Elf's payments:

The long-drawn investigation of the affairs of the French oil company, Elf, turned up many examples of the way unaccountable funds can be pillaged by those put in charge of them. The first phase ended in May this year (2001) with the sentencing to jail of 6 defendants, including a former Foreign Minister. In the course of the investigation, it became apparent that such state companies - Elf has only recently been privatised - were routinely used as a source of covert funds by the French political classes, including the provision of well-paid "no-show" jobs for their friends. It was almost inevitable that senior managers in the company itself were tempted to help themselves. In the course of investigation, evidence emerged of doubtful consulting contracts, commission payments and the purchase of a ritzy flat in a fashionable part of Paris, allegedly for "*un notabilité Africain*" but in practice only used by the company's boss.

The money is there, why not take some of it? Who is to know? It is inherently impossible to know how widespread this practice might be. I can only say it is a powerful, perhaps irresistible, temptation. It is not enough to say, as apologists for the arms business will say, that the industry is run by honourable men obedient to the highest professional standards. Someone will always be found to take the opportunity. Once that happens, the integrity of the

organisation is imperilled because the individuals concerned, being rational men, will act to increase their benefit and this may well be at the expense of corporate objectives.

Political corruption

These funds exist nominally to buy influence in the importers. They also provide opportunities to buy favours from people of influence in the exporting countries. Covert payments are made into party funds to get changes in government policy.

This is a far more damaging possibility and the real subject of this paper.

Dumas and Thomson CSF:

In 1991 the French defence company, Thomson-CSF obtained an order from Taiwan for 6 LaFayette class frigates, worth FF14.6bn (\$2.5bn). The problem was that French government policy, laid down by President de Gaulle, forbade the sale of French arms to Taiwan in the interests of relations with China. Policy had to be changed. Elf was already employing Christine Deviers Joncours, the foreign minister's girlfriend, to open the backdoor into the ministerial office. Her services were offered to Thomson. Policies were changed and the order was approved. Elf paid FF65mn (or FF110mn? the amount is disputed) in commission to Deviers-Joncours. In fact, the money for those payments may not have come from Thomson, which refused to pay Elf - the case has yet to come to Court - but it is not disputed that Thomson paid \$500 million, 20 per cent of the contract total, to middlemen and influential people in Beijing and Taipei and as *retrocommission*, it is alleged, in Paris.

Thyssen, Schreiber and the CDU:

The CDU scandal of 2000 started to unravel with an arms deal. In 1990, the Saudis ordered 36 Thyssen tanks of which 18 were approved for export. After some resistance by the responsible departments was overcome by pressure from the ruling CDU, German government policy was changed. Soon after the change, DM 1mn in cash was handed to the treasurer of the party in a Swiss car park. The episode led to an outcry and the disgrace of ex-Chancellor Helmut Kohl.

Elf's "responsables et politiques":

The oil company kept a number of influential people on no-show jobs, paid from the company's Geneva subsidiary. There may have been more than 100 paid to sweeten relationships with salaries of FF30-80K/month plus credit cards. Other payments included favours to Mitterand's friends - including ex-Prime Minister Edith Cresson (consulting work) and Mitterand's doctor and golfing partner, Francois Raillard, who lived rent-free in his house after Elf had bought it.

Aitken and Thatcher and Al Yamamah:

The British government has for 15 years successfully suppressed public discussion about the huge commissions paid on the Al Yamamah arms deal with Saudi Arabia, the largest arms deal ever made by the UK. Between 30-35 per cent of the total (£40 billion by the time the contract ends) is alleged to have been paid out in commissions. Enormously the greatest part was paid to the Saudi sponsors, most of that to the Saudi royals. British interests were also implicated in newspaper stories, including the Prime Minister's son, Mark Thatcher, and a Cabinet Minister, Jonathan Aitken.

We are unlikely to know the reality, but it is clear there is a risk. Is it a risk that can be tolerated in a democratic country? Corruption in any system destroys democratic institutions. *This* is true of all corruption *but it is* especially true of arms because the level of corruption in the arms trade is greater and secrecy covers a multitude of sins. What are the risks?

The greed of individuals is found everywhere. It is prudent to assume that unscrupulous individuals will be tempted to pillage slush funds and prudent therefore to find ways of minimising the opportunity.

The real hooker is party/campaign donations. Political parties are different: they are getting money for a cause, not for individuals. Yet, if the sources of the money are not disclosed, it is not possible to be sure what the deal is. Even with declaration, as in the US, we do not know the deal - though we can guess. And without transparently-audited accounts, it is not possible to be sure where the money goes. The rubric "contribution to party funds" covers research staff, campaign costs and headquarters. In the case of Helmut Kohl, though nobody has suggested that he was personally corrupt (in the sense of pocketing money for his personal use), it seems to have covered payments to regional and other party bosses to secure their allegiance. (The CDU car-park payment, mentioned above, was split 3-ways; totally at discretion of party treasurer, Kiep. Nixon's heavy-fingered secretary, Rose, was paid \$100K for her help in CREEP.) But this is not really the point. Corrupt use of party funds is not an issue peculiar to money obtained from the arms trade. Whatever is to be done about that would be the same whatever the source of the money.

Where the arms trade is peculiarly dangerous to political systems is its corruptibility and the convergence of interest between the industry and government. The consequences are almost beyond reckoning. When you see government policy up for sale, the democratic process is in real danger. The stories about changes in French government policy as a result of influence brought to bear on a Foreign Minister, or in German government policy as a result of payments made to the CDU are not proven but *but they convince me*. Add to those the stories surrounding Bofors in Sweden, Al Yamamah in the UK, and Agusta (the Willy Claes affair) in Belgium... There may not be a pattern but there are grounds for concern. It is in the nature of these things that very few stories of this sort will ever reach the light of day and it is fair to ask how many of them have not been discovered.

The risk is high enough for the governments of arms-exporting countries to feel under threat, and to want to act. Unless, for whatever reason, the governments choose not to act. If so, they will present their refusal as being in the public interest, but we are never likely to be told why. This is the heart of the problem, for the enemy is secrecy and the addiction to it of those who would govern in the dark. It is the antithesis of democracy and the enabling condition for corruption.

The nature of the market for arms

Joe Roeber
TI-UK

There is unquestionably a market for arms in the crudely minimal sense of there being contact between potential buyers and potential sellers and a medium of exchange for transactions. But this does not tell us much about the nature of the market. It is in fact a very peculiar market, the most imperfect market I have come across. This is not a judgement on the participants; it is a consequence of the structure of the market. Consider the more complex rubric used as the criterion for the existence of a free market: a willing buyer; a willing seller; able to buy and sell in the presence of alternative suppliers and markets; with perfect information; in the absence of other considerations.

There are willing buyers and willing sellers but not much else. Take the second criterion, which has to do with continuity. The pattern of ordering in the industry is extraordinarily discontinuous, bunched and sporadic. At any moment, there are usually only one or two out of the many scores of potential buyers in the market for a given bill of goods. Given endemic (if declining) over-capacity, buyers have the power to impose conditions on sellers - hence, bribery apart, the offset arrangements, that have become such a prominent and wide-spread feature although they are extremely unwelcome to sellers. So it is not an even bargaining situation. The last criterion does not apply either: "other considerations" are always present. Even without concerning ourselves with issues of corruption, the trade in arms is intensely political; who gets what and how much they pay are not usually pure market decisions.

These things may be true of other markets. It is the lack of information that is so peculiar to the arms trade. Markets are popularly considered to be negotiating forums. They are not: 90 per cent of what happens in a market is the mobilisation and use of information; 10 per cent is negotiation. The defining problem with the market for arms is, of course, the secrecy that cloaks all aspects. Even without that peculiarity, information would be difficult to come by. The goods traded are technically complex, transactions are heterogeneous and incommensurable. The result is an almost complete lack of transparency. Without that a market can hardly be said to exist, certainly not a "free" or "open" market as defined above.

I can illustrate the point with a simple analysis of unit costs over the 20 years to 1990 of 15 weapons systems, taken from a list compiled by SIPRI. The numbers are somewhat historical but there is no reason to assume that the nature of the market has changed since they were assembled. The highs and lows were expressed as a percentage of the average unit cost of the weapons system. For all 15 groups of weapons, taken as a whole, the high was four times the low. The simplicity of this analysis would be open to strenuous objection except that, in averaging price ranges of disparate goods, we are measuring price *behaviour* rather than averaging price levels, which would be meaningless. A more telling objection is that an analysis of a time series of unit sales prices of a given system takes no account of the effects of inflation, contract design, technical change and re-design. These objections are cogent, but do not affect the central point. Whatever the causes of price variation, unless they are understood and their effects on price can be rationally analysed, the result is no price transparency. I speak here as a non-technical outsider, a representative of something that should concern us: oversight.

In the most extreme individual case of the analysis, Israel paid one-tenth for Hawk missiles in 1982 what the UAE had paid a year earlier. This was obviously a political decision. governments of exporting countries play a large role in deciding who is to get which weapons and, particularly in the USA, what they will pay for them. With such extreme price variation, there can be no such thing as a "correct price" for a Hawk. Another sort of Hawk (the BAE Systems jet trainer) has figured in the latest arms-buying scandals in India and South Africa. The prices paid in India are said to have been considerably higher than deliveries to other countries; in South Africa, they were higher than the competition which is again a different point. The prices paid for an F-16A in the analysis were in a range of 53% to 330% of the average price. The people selling may know what the "right price" for a F-16 is, but how much do the buyers know about unit costs in a market of that sort?

Not all military goods are the same. I have been talking about the complex end of the range. Simpler, less technical goods (MBTs, APCs, small arms) are more like those in other markets. There is nothing very sinister about this state of affairs. Lack of price transparency is not peculiar to arms; on the contrary, it is a familiar commercial objective. An efficient market is the enemy of trading margins and companies work hard to build walls around their profits. Given half a chance, manufacturers will engineer price confusion when it does not exist. Arms producers succeed because they can package their deals in ways that defy comparison. For example, contracts for the supply of the main item may or may not include the provision of spares, training, infrastructure and guarantees of continuing supply - all of which have price implications. There is no end to the ways in which the core cost of the item nominally being bought can be obscured. For most other markets, this strategy could not succeed - mainly because of the openness of the markets (no secrecy) and the comparability of the goods traded. Try as hard as they can and, in spite of all attempts at obfuscation and segmentation by their marketers, markets have trading ranges of a few per cent. In the efficient financial and commodity paper markets, the range is measured in fractions of one per cent. Even in undeveloped markets, it is likely to be no more than 10-20 per cent. When the trading range is hundreds of per cent, as with arms, there is no transparency, no means of comparing prices paid, no "willing buyer, willing seller, able to buy and sell without other considerations in the presence of alternatives." In short, there may be plenty of competition but there is no market.

The point is an interesting one, but it is the consequences that concern us. It is often said that there are no secrets in the business; that anyone who wants to know, can find out. This only applies to those at the centre, above all to the competitors in a market. Buyers also know because they are given information by the competitors. But they will hide their knowledge behind secrecy, in the national interest, of course. More to the point of this study, even when they do know - perhaps as a result of the marketing efforts of competing suppliers - how can anyone with responsibility for oversight of defence purchases evaluate the effects on purchase decisions of hidden payments? (As when 10% or 20% has been added to cover bribes and commissions to politicians and generals.) The point is this: Where the prices are not known, any price will do and, within such wide margins, any amount of corruption is possible.

Workshop

Case study from South Africa

Rapporteur: Paul Ingram

The Latest Corruption Scandal in South Africa

This is a scandal that is still playing out. The following are notes mainly from contributions from participants involved in the issue within South Africa.

The South African government

When the ANC took over the government, it set about tackling a closed and corrupt system. It set high standards for itself, and was praised around the world for its courage in introducing more transparent systems. However, there were some corners that escaped reforms, one relevant to our discussion is the agents facilitating arms deals. Many of the agents who were the very same sanctions-busters from the apartheid era were still involved in government procurement.

The Arms Deal

The deal, worth between 32 billion and 50 billion Rand (not including interest that is likely to be paid on the loans necessary to finance it), is said to involve around 110 billion Rand of off-sets with 65,000 South African jobs (the figures quoted are those identified by participants). There is an open debate around what the legitimate defence need is. After all, there is no major threat to South Africa. Its defence expenditure is far greater than all its neighbours... several times over. Rather than seeing itself as the regional power policeman, South Africa has an opportunity to play a positive regional impact.

On the other hand, there is a legitimate debate over the process of the contracts. It seems that the deal involves significant over-pricing. Swedish Gripen aircraft, normally costing \$32 million were costed at \$65 million in this deal: British Hawk aircraft, normally £15 million were \$43 million in this deal. What is more, the offsets were to be arranged after the end of the contract, at the discretion of the suppliers, and may never materialise, if the experience of other countries is anything to go by. Why should the South African government have got into this deal? It seems that kickbacks and corruption could be a major explanation.

Kickbacks Scandal

There are several allegations which we did not go into in detail. Two weeks before this conference, the Chief Whip was implicated in receiving gifts associated with the deal. A week later five previous ministers were also implicated. It was not likely to end there.

Cover Up

As questions built up over the deal, the Parliamentary Public Accounts Committee called for an investigation by the four relevant authorities: the Ombudsman, the Auditor General, the National Director of Public Prosecutions and the Heath Special Investigation Unit. The last was the only body constitutionally capable of looking at the validity of procurement

processes, and starting the process of setting aside the contracts. The government, keen that the contracts remain standing, blocked the Heath Unit, and then wound it up.

Consequences

Though inward investment in South Africa has been hit hard by the prevalence of criminal activity throughout the country, there were also strong indications that this latest scandal had worsened the situation. The reputation of the government, and South Africa as a whole, has taken a hit.

Lessons learned

We are still within the scandal as it unfolds. However, several lessons can already be learned:

- a) There has been a lack of care to avoid corruption within the government. The Head of Defence Procurement has a brother who is head of a company involved in the contract, as well as others involved in politics.
- b) Instead of seeking to deal with the corruption, the government has sought to limit the damage by cover-up. The cover-up has itself taken over as the main scandal.
- c) What about the bribe-payers? There may be calls for prosecution in Sweden if it can be shown that Swedish company representatives engaged in bribing after the OECD Convention was ratified and absorbed into Swedish law.
- d) There may at some point be a renegotiation of the offsets deal.

Workshop

Problems and limits in linking military expenditure to aid conditionality

Rapporteur: Anke Hoeffler

Our workshop did not have a discussion leader, but two general statements started a very lively and controversial debate. The first proposition was that the most corrupt countries are the ones that never publish any data on defence spending. Following on from this, the suggestion was made that international aid agencies should not lend to countries that do not disclose their military budgets.

The first hotly debated issue was the conflict risk in resource rich economies. Participants felt that resource rich countries have a much higher risk of conflict. On the one hand resources are a highly taxable commodity and rulers do not have to develop democratic systems characterised by an impartial and competent administration. The income generated by natural resources helps to finance autocrats and their cronies. These regimes do not have a long-term perspective, because they know that their wealth provides an incentive for rebel movements to capture some of the rents. In resource rich societies rebels will find it also easier to finance conflicts once they have captured some of the mineral or other natural commodity sources.

From this topic the debate moved on to suggest that donors find it very difficult to judge the military budgets of recipient countries. First, the data on military expenditure is patchy and allocations to the defence budget are unclear. Expenses for policing and the paramilitary are often hidden in other parts of the budget. Second, donors currently have no method of systematically analysing the external and internal threats a recipient country faces. However, in many cases donor agencies refuse aid in the knowledge that the recipient country wants to spend a large proportion of the budget on the purchase of fighter aircraft or other imported arms.

We also debated whether conditionality works and whether aid policy should be based on conditionality. If aid is fully fungible, the recipient's budget will have to be monitored closely and effective restraints have to be placed on the government. The credibility of reforms has proven to be low in many cases. In order to obtain development assistance, countries are inclined to accept a variety of reforms but are then later inclined to renege on the earlier promises. This time inconsistency problem has proven difficult to solve. Some participants argued that the recent arrest of Slobodan Milosevic was a good example that conditionality can work, while others suggested that the arrest was mainly motivated by the recent revelations changing public opinion in Serbia. The workshop could not agree on whether conditionality works nor could we agree on whether it is right for donor countries to impose conditions. Some argued that conditionality was a form of neo-colonialism and that no country has the right to impose its morals on other countries. On the other hand, participants argued that taxpayers in donor countries had a right to demand that development aid is spent on the eradication of poverty rather than on expensive arms imports. Donor governments would also be negligent if they knowingly supported countries with excessive defence budgets.

This led us to discuss the dilemma many aid agencies face. Social and economic development is not possible in war situations. Therefore some suggested that military aid to governments in

civil wars was called for. Sierra Leone and the most recent British involvement were cited as one example. Many unstable and civil war countries need a well-trained army to carry out police functions and to deter civil war. However, a number of participants were not convinced that "peace first, development later" was the right way to provide poor countries with development assistance.

The workshop also debated the role of arms producers and dealers. Can and should private companies be asked to drive the ethical debate? It was suggested that ethics goes beyond the law and that it was reasonable to expect companies not only to act within strictly defined legal boundaries but also to ask them to be bound by ethics. Indeed, many companies have now mission statements including ethical directives.

To sum up, we had a lively debate and although we disagreed on the fundamental issue of conditionality we felt that there was a need to develop more sophisticated systems to assess individual countries' conflict risk so that donors can make co-ordinated and well informed choices with respect to the allocation of development assistance. There was also agreement that the strengthening of civil society can help to combat excessive spending on the military and that aid agencies should endeavour to strengthen indigenous monitoring capacities. Finally, it was stressed that existing international instruments of arms control, both on the export and import side should be used more extensively and that there ought to be stricter controls on compliance. The UN arms register and the EU Code of Conduct on arms exports were quoted as examples.

Workshop

Significance of the OECD Convention for the arms industry

Rapporteur: Anne-Charlotte Wetterwik

This workshop addressed the effect the OECD Convention on Combating Bribery of Foreign Public Officials has on the arms trade. The group had a very useful discussion on the short time set out for debating this issue.

Professor Pieth initiated the discussion by giving a thorough presentation of the 1997 OECD Convention and the Recommendations added to it. There have been doubts whether the Convention will be applicable to the arms trade with its specific nature. The aspect of national security has always given the trade a special status and the question has been whether or not this status also entails special treatment in matters concerning the Convention. In the course of the discussion it soon became clear that the arms trade does not constitute an exception either in legal terms or in the spirit of the convention. The legal status has also been officially confirmed in other fora.

The formally binding treaty of December 1997 criminalises the act of bribery of foreign public officials. The Recommendations decided upon in May that same year draw up a set of rules covering the practical matters of the trade - the where, why and who. The Recommendations can be described as the soft law in comparison with the more forceful ban of bribery that exists in the Convention. The most effective and dynamic component of the convention is the aspect of peer pressure.

Since the adoption of the Convention in December 1997, 31 of 34 states have ratified and incorporated the treaty into their own national legislation. A candid summary of the first evaluation phase is now published on the internet. Whereas the first evaluation phase focused on surveying the disparity of the various written national laws, the next step will be of a more practical nature. The second phase of evaluation will contain such actions as on-site inspections, case studies and overviews of company codes (including bonus systems and agent contracts).

It still remains to be seen whether peer pressure will be an effective tool. In the event that peer pressure does not have the desired effect, the second evaluation phase may need to examine more direct ways of sanctioning members that do not adhere to the Convention. Throughout every stage of implementation only partners/peers can apply adequate pressure on non-complying member-states. It is therefore important that no country falls behind in the implementation process. Political repercussions provoked by criticism among peers may serve as an effective constraint and the risk of losing valuable trade from other member states within the OECD framework should be adequately high to promote compliance. From this perspective, a country runs the risk of paying a high price for breaking the rules set out in the Convention.

The group discussed the problematic and sometimes grey area of defining corruption. Should tied aid and non-transparent agreements between heads of state be considered to be corruption? Another area that remains to be investigated to a greater extent is the question of arbitration. Since there is neither a supranational form of arbitration, nor any international rules of debarment, enforcing the Convention still relies on national legislation. However, as

the initial negotiations of the Convention came to a more forceful result than was expected, there ought not to be greater obstacles for a possible further development in the matter of arbitration. Export credits is yet another area that should be incorporated into the recommendations.

The fact that the Convention only covers active, and not passive, bribery was discussed. The UN treaty on corruption that is in preparation will most likely cover both passive and active bribery. Furthermore, both the Council of Europe and the OSCE incorporate both sides of bribery in their work on corruption. Conclusively, the group agreed that as other fora will occupy themselves with passive bribery, it is better if the OECD Convention remains unchanged and forceful. However, what remains to be solved is the aspect of non-OECD member compliance. A few important exporters are not OECD members, a fact that might affect the efficiency of the convention.

Representatives from industry initiated discussion on the implications of the Convention for business. As an example of what implications a strong regulatory system can have for the industry, the US Foreign Corruption Practice Act (FCPA) was described in detail. Among other things, the FCPA gives the authorities the right to go through the books of any company in question. In addition, companies are obliged to keep every stage of the decision-making process under close surveillance to ensure compliance. A majority of companies, Lockheed Martin for instance, have therefore developed comprehensive compliance codes and red flag warning systems.

According to the OECD Convention, intention to bribe has to be proven. This system does not exist within the FCPA. As the authorities have the right to go through the books, due diligence can be proven. The OECD has yet to incorporate such a system of due diligence into the Convention. The process has already started in the banking world, therefore a similar development within the OECD can be considered as very likely. Corporate liability in conjunction with proven intention might be a possible development.

The use of facilitation payments/grease money should also be included into the problem of defining corruption. Paying to expedite a service is not as obvious a case of bribery as paying someone to break the law of a country. Both the OECD and the FCPA clearly exempt facilitation payments for the reasons stated above. Yet there is a very fine line between what is allowed and what is forbidden.

Another aspect that touches on the problem of defining corruption is the fact that certain countries, for instance Saudi Arabia, require a 5% commission paid to a national agent assisting in any deal rendered within Saudi borders. This method might be questionable, but still no Saudi laws are violated. Offset deals are another example of how fine the line is that separates corruption and common business. An offset deal can be just the bilateral agreement as intended as well as a means of channelling funds for potential bribes.

A question was raised on how the OECD authorities will be able to achieve functional equivalence in the vast variety of national laws. It will be difficult to build a common standard that will be equally applied in all countries adhering to the convention. National trademarks, such as plea-bargaining in the American system, will probably remain. Some parties of the group showed concern that leaving too much up to the national legislation might make governments refrain from 'frying the big fish'. Other members of the group, with experience of the American system, assured the group that such an escape clause does not

exist. The FCPA has limited the possibility of making exceptions in the US system. The FCPA may also function as an amplifier for the Convention as it gives American negotiators a forceful incentive to push for a more strict international way of handling corruption.

As a conclusion a few points were made. Every company as well as the governments involved in the arms trade need to review every procurement situation to investigate whether the competition is fair and if payment for services rendered can be considered reasonable. Detailed compliance programmes can be of help. The second implementation/evaluation phase of the OECD Convention will reveal to members where the potential potholes are. This phase also has to include a closer evaluation of the aspect of national security, as well as how to induce other states outside of the OECD to follow the convention. Talks with major non-OECD members such as China and Russia should be initiated and the level of OECD awareness needs to be raised.

III. Key considerations in policy development

Managing US arms exports through the FCPA

Howard Weissman
Lockheed-Martin

Transcript

I am going to talk about Lockheed-Martin's Foreign Corrupt Practices Act (FCPA) compliance programme: how we try to train our employees and our consultants to avoid corruption. I believe, and Lockheed-Martin believes, that the work that TI has done in the past is critically important in helping to spearhead the OECD Convention. You have already achieved, I think, something remarkable. I do not know how many people, five or ten years ago, would have believed that a convention of this sort was possible. Yet through efforts of this organisation something remarkable has already been achieved. Not content to rest on its laurels, TI is continuing to push to ensure that the Convention is implemented properly, signatories take meaningful steps to enforce it within their jurisdictions, and to broaden the scope of the convention by getting other members to be part of it.

As a US company, we have some history in the area of FCPA requirements. In the 1970s, for example, we were investigated ourselves. Because of our past problems, we are deadly serious about doing this right, and as a matter of our corporate culture we have a commitment to doing it right. When we do interviews with potential employees or consultants, we make sure that they share these views because if they do not, we do not want them to work with us. So as a US company with this history and as a company that cannot afford to have further problems in this area we are obviously very pleased with the entry into force of this Convention and we applaud TI's enormous past contribution to ethical and legal conduct and the ongoing battle against corruption. Especially as a US company that has been subject to the FCPA and a great deal of scrutiny in the US defence industry, we are obviously happy at the prospect of a level playing field between US and European companies. We are mostly happy because we believe that, for the reasons that have been mentioned here over the past day or so, combating corruption and trying to eliminate it in international business, in arms transactions and in all transactions, is the right thing to do. We believe that it is in the best interests of the developing countries and their people and we also believe that it is in the best interests of the OECD signatory countries and their companies and their people. I think that the effect of bribery and corruption is corrosive to the recipients and it is corrosive to the values and ethics of the givers.

I will talk particularly about our policy. The CPI is something we use on our training programme. As you see, I have marked certain countries where we have a great deal of interest, current business, or where we are trying to do business. We have some at the upper end of the list and we have some where the prospect of encountering corruption is very real. So we have an extensive training programme in our company for all people who are involved in international business. We point out that employees are going to encounter corruption when

doing business internationally. Therefore they need to be sensitive to the issues and be able to identify a problem when one arises.

The FCPA was enacted as an US statute in 1977, has been extensively amended, in part because of scandals involving a number of US companies, including mine. It was substantially amended in 1988, and again in 1998, to bring it into conformity with the OECD Convention. It makes it illegal in the US to corruptly give or offer money or anything else of value, in any amount, directly or indirectly to an agent or intermediary, to a foreign official or political party or candidate to obtain or retain business. There is a second piece of this law, which is the accounting and record keeping provisions, which are designed to make transparent the funds and off-the-books accounts that are so important as vehicles for paying bribes.

An important part of the enforcement effort is through the Securities and Exchange Commission (SEC). In a recent case involving IBM Argentina and IBM in the US, IBM-US was not charged with the violation of the anti-bribery provisions of the law, based on the fact that there was no evidence that it had knowledge of the actions of its Argentine subsidiary. However, it was charged with the violation of the accounting and record keeping section of the law, and it entered an agreement and paid a fine. Commentators at FCPA conferences are now talking about this as an example of the strict liability of US companies on the accounting side of the FCPA. Penalties under our law are heavy: over \$2 million per violation for the company and \$100,000 and jail time up to five years for individuals. These penalties can be increased under the guidelines, and individuals can be subject to criminal liability, regardless of whether a company is prosecuted or convicted. If an individual is convicted under the law, the company is prohibited by law from paying the fine.

Lockheed-Martin has two policies to deal with this. One is expressly called compliance with FCPA. We train our people to comply and to understand what the law requires. We also have another policy which deals exclusively with the retention, the use and monitoring of international consultants. The purpose of that policy is also FCPA compliance. Our policy, which is the basic normative statement to all of our employees as to how we are going to behave, is that we are going to comply with US and foreign law.

Our policy applies to the Lockheed-Martin Corporation, all of its subsidiaries, whether they are domestic or foreign and their officers, our officers and employees. So when we go to Indonesia and Nigeria we expect our people to do business the same way as they would do it in the United States or Great Britain. Our policy is enforced contractually through a clause in the contract of our distributors, agents, brokers, consultants, representatives, and anyone else who may have contact with a foreign customer and is hired or retained to help us win or keep business or facilitate business.

With respect to joint venture companies, if it is a subsidiary which we do not wholly own, our policy does not directly apply to them. However, if it is an affiliated company that we control with more than 50% ownership, we require that they adopt a policy which is substantially similar to ours. If we do not have control, we still aim to ensure that they have adequate controls and that they are taking the necessary steps to ensure FCPA compliance. One of the advantages of the OECD Convention is in dealing with our foreign partners. Previously, when we demanded an FCPA clause, they could reply that they were not subject to the FCPA. Now we can tell them that their employer or country is part of the OECD Convention, and it has

either enacted a law or is going to enact a law that will require that they are subject to the same rules that we are. This has already made many more willing to comply.

Our policy is implemented within our company. Any of our employees or anyone working on our behalf should know what the law says regarding the FCPA, giving them a basic understanding of the provision, penalties under the law, and definitions of key terms such as who is a foreign official, and what constitutes knowing or knowledge under the FCPA. For a criminal statute under US law you need knowledge to commit a violation, but awareness of a high probability, based on all the facts and circumstances, that a bribe is going to be paid, is enough to get convicted under the FCPA. There are warning signals, which we call red flags, and which we will return to at the end.

Our policy also talks about government instrumentalities, because our law applies not only to a corrupt payment made to a foreign official of the actual government but to employees of government owned companies. That applies whether it is wholly or partially owned by the government. For example, Alenia is a subsidiary of which approx. 36% is owned by the Italian government. We treat employees or officials of Alenia as foreign officials for the purposes of our policy.

The policy also describes the basic provisions of the accounting and record-keeping controls. There is a limited exception and two affirmative defences in the FCPA. The limited exception is for facilitating of grease payments. These are low level payments made to functionaries for ministerial acts not involving a discretion to award or to retain business. Given the fact that these are corrupt payments and certainly illegal in the countries where they are being made, our basic rule is to prohibit them but recognise that there are certain circumstances where you are stuck and if you do not pay either you cannot leave the country, you cannot get your material out of the country or you may be in danger. We do make an exception under certain extenuating circumstances.

There are also two affirmative defences under the FCPA. One concerns reasonable expenditures to promote products. For example, if we want to invite an official from Greece to come to our plant in Syracuse to look at radars these rules deal with, when is it permissible and how can we invite that official? What we can provide for him? Can we pay, or offer to pay, room and board? Can we offer to pay transportation?

The key in every case for us is determining that it is lawful under the laws of the official's country and ensuring that it is done in an open, disclosed and approved way within his system, as well as making sure from our standpoint that the expenses are reasonable and that the purpose is bona fide. For example, a trip to Syracuse cannot be done via Paris, San Diego, and Orlando with the official's wife and children. Last year, our Justice Department was involved in something very similar to that, involving a US company in Massachusetts that brought an Egyptian official to the US twice, paid for him, his wife and children to fly first class from Egypt, gave him per diems in the amount of 150% of the normal per diem in advance and then paid for his expenses while he was in the US, and structured a trip to Massachusetts, to a suburb north of Boston, via, in one case, Paris and Orlando, and in another case, via San Diego. When the Justice Department found out about it, they thought it was a little excessive and they prosecuted the company. They charged them with a civil violation of the FCPA and the company pled guilty, entered into a consent agreement and agreed to a very heavy penalty.

The other affirmative defence under our law is the defence for payments to foreign officials that are lawful under the written laws of that official's country. A strict adherence to our company directives and legal requirements is of greater value to the corporation than any business that we may lose. In interviewing our consultants, we tell them that we are serious about compliance. We would rather lose a contract and not have business than violate the law of our country or their country. I think the acid test with this is actually losing business. You could have the world's best compliance programme, you could have the best code of ethics in the world, but if you are not actually training and requiring people to follow it and then following through at the highest level, then any programme is just a pile of paper.

There are some cases where we have lost business. I have been involved in giving advice that has kept us away from winning contracts and, as sad as we are to lose a contract, nobody wants a contract that is going to sacrifice the reputation of our company. The operational directions prohibit payments to foreign officials, party officials or candidates, except as permitted under our guidelines, which are a part of this policy. They prohibit the facilitation of grease payments, except those permitted under our policy again. No hospitality, gifts, entertainment, or mementos can be given to a foreign official outside the scope of policy. There are rules restricting the use of corporate aircraft for foreign officials.

We have financial and accounting directions, which fall within the responsibility of our corporate controller. There are a number of specific provisions: for example, we will not maintain numbered bank accounts, we will not make payments into anonymous or numbered accounts, or third party bank accounts. We will not make payments in cash, we are not going to create false or fictitious invoices or other misleading documentation. We prohibit any kind of sham transaction. We do not make payments to a consultant outside the country where he is doing business for us.

We have a process of internal certification through which the responsible officer of each business unit of Lockheed-Martin has to certify annually to the controller that his or company or business unit has complied with the FCPA and our policy. These reports go to the Audit and Ethics Committee of our Board.

We have hospitality guidelines, and they are always a battleground for us because it is difficult to draw clear boundaries. Can you put a foreign official on a corporate jet to bring him from one place to another because there may be no convenient commercial service to that place? If you have to go from one city in Oklahoma to some city in Western Texas, you just cannot get convenient flights within the time period required. We get these questions and until they have been run through this process and determined to be permissible under our guidelines, we cannot give a foreign official anything, whether it is a meal or entertainment or a gift. These rules only apply to gifts to foreign officials or officials of government-owned companies but there are general rules also for domestic officials in our Code of Ethics.

In conclusion, we have ways or recognising risks, which we call red flags. These red flags include: (1) excessive or unusually high compensation requested by an agent or representative. For example, a Malaysian woman came to us for an opportunity in Malaysia and said she needed 15% commission, although our company never paid more than 5% anywhere. (2) Requests for increases and compensation may have legitimate reasons, but this must be well documented. (3) Requests for payments to third countries or third parties are another red flag. (4) Requests for payment in cash or bearer instruments are obviously another one. (5) Lack of facilities or qualified staff: this one should be obvious too, where you have

an agent, or a proposed agent or a defence contractor who has no office and no staff. (6) Use and abuse of shell companies is the same thing. (7) Lack of experience or track record with the product or industry: we were approached by someone in Thailand, who wanted to represent us for something regarding the Thai Air Force, but he turned out to be a jewellery salesman. I knew there was a problem when I read his references because they said, 'this guy sold me a very good ring'. He had had a jewellery business on US air bases during the Vietnam War and had continued in that business. Not a good sign. We were also approached by someone who turned out to be a dentist who had a dental office in the US. Now, why would you use that guy to sell me a high-tech electronic avionics device unless you needed dental work? We try to teach our people to recognise these warning signs.

Allegations related to integrity (8) are a common occurrence in some countries. They should always be taken seriously and checked. (9) Close relationships to government officials are often a problem. In Thailand, the jewellery salesman was being promoted by a Thai Air Force Officer. Every time our representative came into the country the Air Force Officer asked whether the man had been signed up as an agent yet. That is a red flag. Also if there is a close family relationship (10), if the agent is the brother of the customer, again it has to be checked. There may be no wrong-doing involved, but you have to check.

(11) Violation of local law or policy: if you have an agent who wants to be paid on a commission basis for the sale of an armament in Saudi Arabia or in Egypt or the UAE where local law or police prohibits such commissions on defence-related sales, again it is a red flag.

These are red flags. They are not necessarily violations, but they all have to be checked. The last thing to show you is the process we go through in selecting an agent. If our company wants to hire someone at the company level, we require an application from the person, get references and check them, get a disclaimer letter making it clear to him that he is not authorised to do anything for us, and will not receive a dime, until we have a written contract, we check compensation to make sure that what we are offering him is within what is reasonable both for our business and the country, and we check with our embassy as to whether the company has a good reputation. Then we make sure that we have a current legal opinion from that country so that we are paying him in accordance with the law for activities that are lawful in that country. Our regional vice-president, our representative in the field office who knows that region has to sign off on the applicant before we go forward with him. It is approved by corporate business development. The final check is done in Bethesda at headquarters. Our consultant hiring process is centralised. We do not hire an international consultant except through the corporation, through the corporate headquarters in Bethesda. We do a personal interview with every consultant and we do refreshers on a two year basis.

Thank you very much.

Managing European exports through the European regulatory framework

Bertil Hellstrom
Ericsson

Transcript

Ericsson has a very similar set up to the one just described for Lockheed-Martin for choosing agents and conducting business. We may not do it on as large a scale as Lockheed, but we also have a code of conduct. I will speak about exports from a Swedish perspective and talk about export control and how that is enforced in Sweden. I will refer to what we call codes of conduct. I will also talk some minutes about the political aspects of the arms trade.

Let me start with a new legislation in Sweden, which came into effect in 1993, and which foresees the possibility for a company and also for the government to make reviews of what we are doing in the export market. We have a dialogue with the authorities to inform them about our activities in the export market and products that we are launching. The legislation is in force and it works very well. We know from the industry side what is expected from us concerning reporting, and we have regular dialogues. Of course it is at the discretion of our government to approve or disapprove of where we can sell and where we cannot. However, it has nothing, really, to do with corruption; there is no specific corruption element.

We have no legislation as to foreign corrupt practices. But in the companies, and I would say this goes for all Swedish defence companies, we have our own strong rules and regulations, very similar to Lockheed's. This covers how to select agents, how to conduct business, what is reasonable and what is not. Some of you might expect that we are approached each and every day by clients asking for bribes. That is not the fact, at least not from my perspective. We are not dealing with weapons, but with radar, avionics and communications equipment. It is something that happens but very rarely I would say.

We have internal reviews, as Lockheed does, and a centralised office in the organisation where we handle all these issues. For our subsidiaries in over 140 countries around the world, we use our industrial contracts to enforce compliance. We have internal monitoring and self-regulatory rules and regulations. We do not really need and we do not ask for government legislation.

Coming to the aspect of government fees. We were talking about a handful of major defence producing countries in the world. We have the United States, the UK, France, Sweden, Israel, Spain, South Africa, Germany, Russia, Italy and China. There are differences in the amount of political input which goes into arms sales by these countries. The United States enforce a political pressure when it comes to arms sales and have a foreign policy of supporting friends and allies not only with local contacts but also defence system sales. So you can have tremendous political pressure regardless of whether you have stiff legislation on export sales. But 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, which disadvantages countries which cannot work like that.

I can think of one example: two years back we sold an early warning system to the Hellenic air force. Ericsson is practically the only company in the world that operates the kind of system needed there. The reaction from the US government was to try to kill the deal because it was not compatible with their interests. We cannot really leverage that. The only thing we can do is to offer the best quality and the best performance, and often much cheaper: one fourth or one fifth of the price, if you compare it. So one has to consider this aspect of how to factor in the influence of big governments. There is also a past history when it comes to post-colonial relationships between two countries. For example, the British-Malaysian relationship, the British or the French relationship with Africa, this kind of historical connection creates bonds and institutionalises relationships.

Thank you.

Hellstrom's diagram of major defence producing countries

USA

UK FRANCE

GER SWE ITALY ISRAEL SPAIN SOUTH AFRICA

RUSSIA CHINA

Corruption and the arms trade – The role of the United Nations

Nazir Kamal

UN Disarmament Secretariat

May I start by thanking Transparency International for inviting the Department for Disarmament Affairs to participate in this conference. Jayantha Dhanapala, the Under-Secretary General for Disarmament Affairs, could not be here because of his prior commitments but I can assure you of his great interest in the theme of this important conference. I should also like to add that the views I will be expressing are entirely my own, rendered in a personal capacity.

I shall touch briefly on the importance of the issue, the value of the global arms trade, the role of the United Nations (with some reference to the two UN arms transparency instruments), and what can or might be done with particular reference to the United Nations.

Importance of the Issue

Sporadic disclosures, circumstantial evidence, informed gossip and investigative reporting by journalists suggest that there is considerable corruption in the global arms trade. This would not be surprising, given that corruption per se is widespread in many countries, and the veil of secrecy that surrounds the defence sector in most countries makes it easier to conceal malpractices in the buying and selling of arms.

Concepts of good governance and of transparency and accountability have engaged the attention of the international community in recent years. But greater attention needs to be focused on combating corruption, including corruption related to the trade in arms. Issues of transparency and accountability bear particular relevance to military expenditure and arms transfers as there is far less transparency and accountability in this murky area than in other areas of public expenditure. Openness on military matters is also important because defence spending in many societies takes up a sizeable chunk of the central government budget, and the acquisition of arms often constitutes a significant share of defence spending.

Corruption also inflates the price of purchased equipment and accessories, thereby increasing the tax burden on citizens. 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. Domestic subsidies on the supply side to make the prices of military equipment more competitive are also at some cost to the taxpayers.

Developing countries on average spend around 13 percent of their central government budget on defence, which in many cases greatly overshadows their average spending on social and human development. A large number of countries, mostly from the developing world, actually spend well over 10 percent of their national budget on defence. This contributes to chronic budget deficits and crippling debt payments.

The potential scope for corruption in arms trade is considerable in view of the level of global spending on arms transfers.

Value of Global Arms Trade

According to the US Congressional Research Service Report of 18 August 2000, world-wide deliveries of major conventional arms during 1992-99 totalled more than US\$296 billion (in 1999 prices). Of this, more than US\$195 billion was spent by the developing world, while more than 90 percent of these deliveries originated in the industrialised world.

On an annual basis, world-wide deliveries of major conventional arms in 1999 totalled nearly US\$40 billion. Nearly 69 percent of this was spent by the developing world. Thus, if the remaining years of the 1990s are added to the 1992-99 estimate, we would be looking, most probably, at a figure closer to US\$350 billion (in 1999 prices) spent on the arms trade in the last decade that has just gone by.

The value of arms deliveries would be significantly higher for that decade if we were to put together the estimates by the International Institute for Strategic Studies as mentioned in their *Military Balance*. The approximate total for the 1990s (in 1999 prices) would exceed US\$450 billion.

Recent trends in the arms trade indicate that the business of buying and selling armaments will grow in the immediate years ahead, as a number of countries engage in a process of force modernisation. This means that the current decade, most likely, will overtake by a substantial margin the value of conventional arms trade witnessed in the preceding decade.

As a general rule, the value of specific arms transactions will be greater in view of the higher prices of newer or more sophisticated equipment and related support systems. In theory, this would raise the temptation for corruption greatly. Significant developments in weapons technology will ensure that the trade in armaments will continue to register high levels of spending.

Role of the United Nations

The issue of corruption in arms trade is not, or at least not yet, on the agenda of the General Assembly or the Security Council. However, the Security Council has on occasion taken decisions that bear some relevance to this issue. Thus, for example, the Council remains engaged in efforts to halt the illicit trade in diamonds that has helped fuel the civil conflict in Sierra Leone. In March this year, it decided to take punitive measures against Liberia, including the prohibition of sale of diamonds emanating from Liberia, whether or not of Liberian origin. It is widely believed that diamonds not only help fund the purchase of arms but also enrich some political leaders who are involved in facilitating the sale of arms.

Earlier, in 1999, the Security Council established a panel of experts to investigate violations of its sanctions against UNITA forces in Angola. The report of that panel implicated the leaders of some regional countries in kickbacks, mainly paid in diamonds, for their services in facilitating prohibited arms deliveries to UNITA. As can be seen from such examples, the Security Council's involvement has been linked to upholding its arms embargoes aimed at

terminating specific conflicts. It has not been directed at corruption related to the legitimate trade in arms.

Unlike the issue of corruption, the question of arms transparency and openness on military matters has been on the agenda of the United Nations for many years. In 1980, the General Assembly established a standardised instrument for reporting military expenditures on a voluntary basis. Then, in 1991, in the wake of the Gulf War, the General Assembly established the Register of Conventional Arms, encouraging all States to participate in this transparency instrument.

Arms Transparency Instruments of the UN

At the time of its establishment, the underlying goal of the UN instrument for reporting military expenditures was to underscore the need for reducing global defence spending, particularly to enable more resources to be devoted to social and economic development. This instrument is important in itself as a transparency measure, but it has made very slow progress. The average number of States participating each year in this instrument is around 35, with very low participation from developing countries. Some industrialised countries have also not participated or have participated inconsistently. In total, some 56 countries have reported to this instrument at least once over the past five years. The UN Secretariat, with the assistance of some governments, is now engaged in a stepped up effort to encourage wider participation and to increase familiarity with this not-so-well-known instrument.

Progress has been more encouraging for the UN Register of Conventional Arms. Since 1992, when this instrument became operational, more than 150 States have participated at least once. On average, thus far, over 90 countries submit their returns to the Register, which covers seven agreed categories of weapon systems, comprising battle tanks, armoured vehicles, combat aircraft, attack helicopters, naval vessels and missiles/missile launchers.

It has been roughly estimated that the Register is able to capture more than 95 percent of the global arms trade in these seven categories and that it also covers transactions involving more countries than report to the Register. However, the overall participation level is far from universal and not all major producers, importers and exporters participate in this instrument regularly. One notable absence is China, which suspended its participation several years ago, over the issue of the United States reporting its arms sales to Taiwan in the Register. This is a bilateral issue that remains to be resolved.

When the Register was established, it was envisaged as an instrument that would help to achieve a number of related objectives: reduce dangerous misperceptions about the intentions of States, enhance confidence, ease tensions, discourage destabilising and excessive accumulation of armaments, and eventually contribute to restraint in military production and arms trade.

The potential of the Register to serve or contribute to these confidence building and arms control objectives would depend not only on how many countries participate in it consistently but also in the further development of the Register. The UN Secretariat, together with some governments, has already initiated a process of encouraging greater participation. As far as the further development of the Register is concerned, this will depend on the outcome of the

next review of the Register in 2003 by a group of governmental experts appointed by the Secretary General and on advance preparations for that review.

The UN Secretariat, drawing its mandate from the regular General Assembly resolution on the relationship between disarmament and development, has also been engaged over the past two years in organising panel discussions and symposia to address a host of issues of contemporary relevance, including transparency and accountability, security sector reform and the issues of military expenditure, armed conflict and development. These activities, which are somewhat constrained by financial limitations, take place under guidance from the high-level Steering Group on Disarmament and Development, which the secretary-general established in 1998 and of which the Department for Disarmament Affairs is the co-ordinating body.

Briefly then, while arms transparency issues are an important and integral part of the United Nations agenda, neither the Security Council nor the General Assembly is, as yet, seized with the issue of corruption in relation to the trade in arms.

There are, however, partial exceptions to this, such as the examples cited earlier with respect to arms embargoes. The UN has also been involved in addressing the role of brokers and other agents involved in illicit trafficking in small arms and light weapons. The Secretary General has expressed himself strongly on this issue. In his 1998 report to the Security Council on Africa, he highlighted the role of unscrupulous arms merchants in fuelling conflicts in that continent, urging the Security Council to address this issue urgently. He also proposed that the UN should be given a role in publicising information regarding such merchants of death and destruction.

In 1999, the General Assembly mandated an Expert Group study encompassing the issue of brokers and other agents that are able to exploit deficiencies in national laws. The Expert Group was unable to agree on specific recommendations. It is an issue that will now be addressed by States when they meet in July for the United Nations Conference on the Illicit Trade in Small Arms and Light Weapons. The absence of consensus in the Expert Group report suggests that progress on this issue may not be easy. Yet, the issue is here to stay and the follow up process after the Small Arms Conference may provide better opportunities to overcome some of those difficulties.

What Can or Might Be Done

One possibility that has been raised informally is whether the United Nations could provide advisory technical assistance to governments, upon their request, to help decision making on arms procurement. The underlying idea being that some governments may require expertise in order to optimise their decisions regarding arms that would be most appropriate and cost-effective for their legitimate national security needs. In this way, they could avoid excessive expenditure and be better able to take decisions unaffected by lobbyists working for suppliers. On closer scrutiny, however, it would seem that any such role for the UN may not be politically feasible or desirable. Any advice by a UN panel would require access to national intelligence in order to make a threat assessment, which may not be forthcoming or whose veracity may be contested by other countries. More importantly, arms procurement decisions arising out of this process may be rejected by neighbouring or adversarial countries as being ill-advised or ill-intentioned, if not detrimental to their national security. Being an impartial,

inter-governmental body, it would not be advisable therefore for the UN to risk such an outcome. It would be better to consider such an idea outside the UN framework in view of the sensitivity of the matter and the risks involved.

In the politically sensitive environment of the General Assembly, it will not be easy to win consensus for putting the issue of corruption in arms trade firmly on the United Nations agenda. However, there might be prospects of obtaining the support of a simple majority of States, which could serve as a basis for building more support in subsequent years. For this, an organised effort would need to be made by some sponsoring States, including a few influential governments. If this can be done, the issue would find its way onto the UN agenda and, at a minimum, it would receive an international profile.

As far as the Security Council is concerned, that apex body might take cognisance of this issue if it could be demonstrated that corruption in arms trade poses a threat to international peace and security. Perhaps a more difficult problem to overcome would be the sensitivity of the issue in a forum whose resolutions are binding on Member States and where any of the five permanent members could kill such an initiative through a veto. Some States may also contend that the subject matter is intrusive on their domestic jurisdiction.

It would therefore seem that a draft General Assembly resolution might offer a likelier way of putting the issue on the UN agenda. One initiative could be to mobilise support for a draft resolution that calls upon Member States to furnish a detailed list of arms dealers with whom they maintain a relationship, and to disclose any arms agreement above a certain level of value. The United Nations Secretariat could collect and publish such information, as it does with respect to data and information provided by participating governments to the two UN transparency instruments, discussed earlier.

Put succinctly, it would be less difficult for the UN to deal with transparency issues than with corruption.

Another United Nations forum is the Economic and Social Council, whose members are appointed for three-year terms by the General Assembly. This body adopts reports and can recommend conventions on a range of economic, social and human rights issues. Interestingly, the first initiative by the United Nations to seek a reduction of global military expenditure with a view to allocating more resources for economic and social development came from ECOSOC, back in 1953. Corruption, including financial malpractices in the arms trade, has a significant bearing on development. In theory, therefore, this UN body could be explored as a possible medium through which to promote the issue of corruption in the arms trade. A very large number of NGOs are also affiliated to ECOSOC, some of which may find the issue particularly relevant to their work. The 56-member ECOSOC votes by a simple majority.

Perhaps more could be achieved through some other multilateral institutions that are engaged in international financial assistance and economic aid. In recent years, there has been a great deal of emphasis by these institutions on good governance and on structural reforms and adjustments to improve the integrity and performance of various institutions of the State, which in many developing societies stand weakened by corruption, bad governance and other internal problems. Structural reform could be extended to cover openness on military matters. After all, corruption is a major public concern in many developing societies, where it is a significant drain on scarce resources, and where the loss of public confidence in the political

process can contribute to instability. Corruption in arms trade, as indicated earlier, is widely believed to be rampant and therefore much needs to be done to reassure the public on this as well.

One measure, though modest, could be to persuade loan-receiving or aid-recipient countries to participate in the two UN instruments on military transparency. Another measure could be capacity building assistance to strengthen national mechanisms for transparency and accountability of military expenditure and arms transfers, borrowing from the experience of other countries that have gone some distance in that direction.

In developing countries that have embraced democracy, it would help to strengthen the role of parliament on military matters. The role of the legislature on defence issues has been weak in most cases and therefore correcting this deficiency would contribute to a strengthened democratic system. In this regard, the Inter Parliamentary Union could play an important role in terms of both advocacy and exchange of experience. The IPU was among the first to call for international regulations on the conventional weapons trade. The IPU's agenda already includes support for transparency on military matters and for greater participation by governments in the UN Register of Conventional Arms.

It would be very useful if a non-governmental body could collect and periodically disseminate published information regarding convictions, indictments, allegations and investigative reporting on corruption in the trade of arms. Such an Organisation could, at the same time, mobilise international support to discourage governments from being highhanded towards investigative journalists and other individuals that are prepared to divulge information regarding corruption in high places.

These above-mentioned ideas may not provide any reassurance against corruption in the arms trade but they would help to put decisions affecting the use of public funds for defence in the spotlight. Furthermore, any effort to combat corruption would be facilitated by progress towards greater transparency which in turn would help accountability on military matters.

I would like to conclude by saying that, ideally, the trade in arms should be made as distinct as possible from the trade in economic goods and services. Perhaps, if a promising start can be made towards combating corruption in arms trade, it may be possible at some stage to consider measures to treat the trade in arms on a strictly non-commercial basis, with rules, regulations, laws and mechanisms that are different from those governing everyday commerce.

The "Integrity Pact" (IP) of Transparency International
The concept and the present applications

Michael H. Wiehen
Transparency International

Background and Objectives of the Integrity Pact (IP)

1. The Integrity Pact (IP) is a tool developed in the late 1990s by Transparency International (TI) to help governments, businesses and civil society to fight corruption in the field of public contracting. IPs are developed for contracts to which one of the parties is a central, local or municipal government, a government's subdivision or even a state-owned enterprise (the Authority). The other parties are the usually private companies interested in obtaining such a contract, or in charge of implementing it.
2. The contract and the IP may cover the planning, design, construction, installation or operation of assets by the Authority, the sale of public assets (as part of a government's privatisation programme), the issuing by the Authority of operating or extraction licenses and concessions, as well as the corresponding services such as consulting services and similar technical, financial and administrative support services. Whenever possible, the IP should cover all the activities related to the contract from the preparation of the earliest alternative choice and design documents, the bidding and contracting proper through the implementation, up to the completion and operation.
3. The IP will establish contractual rights and obligations of all the parties to a government contract and thus eliminate uncertainties as to the quality, applicability and enforcement of criminal and contractual legal provisions in a given country. This means that applying the IP concept can be done anywhere without the normally lengthy process of changing the local laws.
4. The IP is intended to accomplish two primary objectives:
 - (a) to enable companies to abstain from bribing by providing assurances to them that
 - (i) their competitors will also refrain from bribing, and
 - (ii) government procurement, privatisation or licensing agencies will also commit themselves to prevent corruption, including extortion, by their officials and to follow transparent procedures; and
 - (b) to enable governments to reduce the high cost and the distortionary impact of corruption on public procurement, privatisation and licensing.
5. Beyond the individual contract in question, the IP is of course also intended to create confidence and trust in the host country's public decision making process in general, a more hospitable investment climate and public support for the government's procurement, privatisation and licensing programmes.

The Authority's Commitment

6. Under the IP, the Authority as an entity and those of its officials involved in the specific contracting or project commit to the following:
 - No official of the Authority will demand or accept -- directly or through intermediaries -- any bribe, gift, favour, or other advantage for him/herself or any other person, organisation or third party related to the contract, in exchange for an advantage in the bidding, bid evaluation, contracting and implementation process related to the contract.
 - The Authority will make publicly available all necessary and appropriate technical, legal and administrative information on the contract.
 - None of the Authority's officials will disclose confidential information to a bidder or the contractor providing the bidder or contractor an undue advantage in the procurement for, or implementation of, the contract.
 - All the Authority's officials involved in the bidding, evaluation, contracting and implementation of the contract will disclose in an appropriate form any conflicts of interest in connection with the contract. It would be highly desirable that they also disclose their and their family's assets in the same way.
 - All the Authority's officials will report to the appropriate government office any attempted or completed breaches of the above commitments.

Bidder's or Contractor's Commitment

7. The bidders for the Contract (or the contractor implementing the Contract) pledge the following, in the name and on behalf of their CEO (or at least the CEO of the national subsidiary of the company):
 - They will not offer, directly or through intermediaries, any bribe, gift, favour, or other advantage to any official (or a relative or friend of his/hers) of the Authority in exchange for any advantage in the bidding, evaluation, contracting, and implementation of the contract;
 - They will not collude with other parties interested in the contract to impair the transparency and fairness of the bidding, evaluation, contracting, and implementation of the contract;
 - They will not accept any advantage in exchange for unprofessional behaviour;
 - They will disclose all payments made to agents and other intermediaries, who in any case should not receive more than fair pay for legitimate services. This disclosure should be made preferably by all bidders at the time of bidding, but at the very least by the winner of the contract at the time the contract is finalised.
8. Consultants commit themselves not only not to pay bribes in order to obtain a contract, but also to design and administer, as the case may be, the project or project components in a manner that is non-discriminatory, assures wide competition and does not offer advantages to a specific bidder.
9. A highly desirable supporting element for the bidders' or contractors' commitment would be proof of the existence and application of a company-internal code of conduct forbidding bribery and other unethical behaviour.
10. It is evident that, if even one of the competitors does not sign the IP, there is no basis for the pact altogether. However, experience up to now has not yet convincingly demonstrated whether it is better to make the signing mandatory from the start or

whether one should negotiate the IP with the competitors until agreement is reached on a pact that then will be signed by everybody.

Sanctions

11. In case of violations by officials of the Authority, these shall suffer appropriate, predetermined disciplinary or criminal sanctions. Such sanctions may include removal to other functions and dismissal from office.
12. In case of infractions by a bidder, the sanctions should include some or all of the following:
 - denial or cancellation of contract,
 - forfeiture of the bid and/or performance bond,
 - appropriate liability for damages to the Authority and the other bidders; the concept of "liquidated damages" providing for a pre-agreed percentage of the contract value as the amount of "damages" payable is the easiest to enforce; and
 - blacklisting for future biddings (for a period appropriate to the severity of the infraction); this sanction usually is the most effective.
13. Whereas the application of sanctions cannot be based on suspicion alone, it should not need a full criminal conviction (because that would unduly delay the sanction and make it ineffective). Guilt can generally be assumed on the basis of a "no-contest" statement by the accused party or if, on the basis of the available facts, there are no material doubts.

Disputes

14. In order to avoid the uncertainties of national jurisdictions, disputes over the IP should be resolved through international or, where appropriate, national arbitration. The IP would define the venue and procedure.

Monitoring and Supervision

15. A maximum of transparency and easy public access to relevant information all along the various steps leading to the contract and throughout its implementation are the basis for the successful design, set-up and implementation of an IP. This would include the design and the basic parameters of the investment, pre-selection and selection of consultants, bidding documents, pre-qualification of contractors, bidding procedures, bid evaluation (including the main reasons for selecting the winner), contracting with the winning contractor or supplier, and contract implementation.
16. It is highly desirable that there be a forum in which representatives of Civil Society can monitor and discuss all official decisions. At the present time, the Internet provides a nearly ideal platform. Public hearings are also an effective tool. Of course, access to legitimately proprietary information should remain restricted.
17. However, to monitor systematically and in detail the above processes, Civil Society may delegate these activities to entities professionally equipped to do this, e.g. a professional company, a suitable government office with no involvement in the supervised procedures, a Transparency International National Chapter, or another NGO.
18. While a clear and unrestricted oversight and monitoring role for Civil Society in any country is highly desirable, it is understood that in some countries the government

may not yet be prepared to allow Civil Society such a role. In those cases the oversight and monitoring function could be performed in one of several ways:

- The government employs an "Independent Private Sector Inspector General" (or IPSIG), a private sector company or individual, who would of course come with the necessary expertise; such an arrangement can be acceptable provided the IPSIG is given not only full access but also has the contractual right to seek correction of any procedural problems or improprieties and, if no correction takes place, to inform the public of the impropriety. Or
 - The government commits itself to provide full public disclosure of all relevant data regarding the selection and implementation process. This would include inter alia a statement, that the evaluation criteria announced in the invitation to tender were fully applied, a list of the bidders and their prices, a list of the bids rejected, including the grounds for rejection, the major elements and aspects of the evaluation process and the specific reasons for selecting the winning bidder.
19. The ultimate result of such monitoring and supervision should be a statement at the end of the process that the procedure was clean and did not lead to any incidents related to possible corruption, or -- if this was not the case -- what incidents occurred, how these were dealt with, and what the outcome was in the various cases.

Lessons from Experience

20. In judging the suitability of the IP concept one should take into account that since February 15, 1999, the "OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions" makes bribing a foreign official a criminal act in all states that have ratified the Convention (at this writing, 25 out of 34 signatory states, but the remaining 9 signatories are likely to follow soon), and in most of those countries the tax deductibility of bribes has now also been abolished. Bidders from many countries thus face a fundamentally different legal situation from the one they had operated under for years, and they should be prepared to enter into agreements designed to provide a "level playing field" for all competitors irrespective of whether they come from countries bound by the OECD Convention rules or not.
21. A fascinating and possibly highly relevant recent development is the use in several countries of the Internet for total transparency of procurement. In Mexico, all public procurement activities countrywide are recorded and made available in great detail through a website that is accessible to everybody. In Colombia, a State Contracting Information System (SICE) is also widely accessible. Similar electronic information systems are being applied in Chile and South Korea. The high degree of transparency achieved through this real-time access to public decision making clearly reduces the opportunity for manipulation and should enhance the willingness of officials and bidders alike to commit to a corruption-free contracting procedure, such as through the IP.
22. The political will to reduce corruption and to revive honesty and integrity in government contracting is a sine-qua-non for success. That is why TI recommends starting any IP process by establishing the existence of that political will – at the highest available political level. Experience to date shows that it may be easier to establish and nail down that political will at the municipal level than at national government level.

23. A global overview of IP experience at a workshop held in June 2000 in Bogota, Colombia, bringing together practitioners of the IP from many countries, indicates that the IP concept is sound and workable. One of the strengths of the concept seems to be that it is flexible enough to adapt to the many local legal structures and requirements as well as to the different degrees governments are willing to proceed along the lines set forth here.

Integrity Pacts at Work

24. Integrity Pacts are now being used, with some degree of flexibility, in Argentina (City of Moron), Colombia (about 15 at state, provincial and municipal levels), the cities of Bergamo, Genoa and Milano in Italy (municipal contracting in general), and in Seoul/Korea (in the latter case in conjunction with a high degree of transparency through the Internet). Essential elements of the IP are being used in the municipality of Bhaktapur/Nepal, in Panama and in the municipality of Avellanada/Argentina. At a recent major privatisation in Bulgaria, the Civil Society monitoring was highly effective and successful, as it had been in several privatisations in Colombia, Panama and elsewhere. The IP concept is presently being considered in several other places. The recent Report of the World Commission on Dams recommends the IP as a tool for bringing integrity and transparency to the contracting for large projects (not just large dams). More detail may be found at the TI Website www.transparency.org.

Conclusion

25. The Integrity Pact concept is sound and workable. We have convincing feedback from both sides – governments as well as major international contractors and suppliers – that the IP can be an important instrument in reducing the need as well as the opportunity for corruption and thus bringing more integrity and more efficiency into public contracting of all kinds. Governments desirous of getting rid of corruption see it as an effective additional tool. Private companies, after learning all about the IP, often are strongly supportive, since in the end, corruption is felt to be risky, expensive and degrading. TI would be pleased to assist any authority interested in applying the concept.

Assisting countries in procuring military equipment

Ian Anthony
Arms Control in Europe

I. Introduction

The starting point for the SIPRI study on arms procurement decision making was the assumption that states will continue to see the preparedness of their armed forces as a central element in their security policy.

The preparedness of the armed forces requires the acquisition of quantities and types of equipment tailored to the specific security needs of each state. However, few countries are able to develop and produce all of the equipment needed by their armed forces. In future it is likely that only one country—the United States—will be in a position to achieve anything approaching autonomy in meeting its defence needs. To a significant degree, all countries will be dependent on foreign suppliers to meet their defence needs. By extension, they will be acquiring equipment that was not designed and developed specifically for the environment in which it will be deployed.

The broad conclusion from the project was that an extremely heterogeneous group of countries all felt that they could benefit from an international and inter-disciplinary dialogue not only about arms procurement issues but about broader questions related to defence planning and management.

While states wish to acquire the best possible equipment to meet their needs, they want to acquire it at the lowest possible cost. Reconciling these two objectives is the main task of arms procurement decision making. By extension, there can not be a place for corruption within an efficient procurement decision making system because corruption will tend to have one of two effects (it may have both since they are not mutually exclusive). Corruption may lead to a decision to acquire equipment in quantities or of types that are not best suited to the needs of the defence forces. Corruption may act as a price premium. Either outcome reduces the efficiency of the procurement decisions taken.

The Europe-wide commitments made by governments to develop democratic systems of government bound by the rule of law and to manage their economies according to the principles of market economics have stimulated a wide ranging discussion of all aspects of security policy across the Euro-Atlantic area. Defence management reform has become one important element of the discussions that take place within the European co-operative security system that has evolved after 1989.

In the context of arms procurement decision making, activities of the North Atlantic Co-operation Council (NACC) and its successor the Euro-Atlantic Partnership Council (EAPC) can be noted. Similarly, activities within the Partnership for Peace, the NATO-Ukraine Joint Working Group on Reform, the NATO Economics Colloquium as well as a host of bilateral initiatives between different European states can be pointed to. For those countries with the

intention to become members of NATO, the Membership Action Plan includes a significant element devoted to defence management.

While countries in other parts of the world do not operate within the same security policy environment as their European counterparts, there is evidence that a number of non-European countries wish to make their defence decision making procedures more open and more accountable to the wider society. In evidence, the country project teams assembled during the SIPRI project on arms procurement decision making benefited from participation and support from officials.

Of the non-European countries that participated in the project, several have recently embarked on reforms intended to move away from authoritarian and towards more democratic forms of government. Chile, South Africa, South Korea, Taiwan and Thailand could be cited in this context. Other non-European countries within the project—India, Israel, Malaysia and Japan—have a longer history of democratic government. Nevertheless, many of the participants from these countries also felt that their procurement systems lacked elements that could contribute to better decisions about what to buy and how to buy it.

Conducting a dialogue on these issues could be a valuable, if indirect, support to efforts to minimise corruption in those countries that participate.

II. Findings

The arms procurement decision making project identified a series of barriers to greater openness and accountability. Some seem more relevant than others to the discussion of corruption in the arms trade. However, all are briefly noted below.

- Public indifference and acceptance of military autonomy in the area of national security.
- Enduring influence of personal relationships rather than institutions and organisations.
- The dominance of a threat scenario approach in defining defence needs.
- A corresponding lack of structures for co-ordinating defence decisions with other foreign and security policy interests.
- Lack of public data that allows an analysis of the implications of procurement programmes for government expenditure and the national budget.
- Inadequate design within the budget processes and cash management systems of states.
- Lack of methodologies and structures to evaluate the technological implications of procurement choices based on domestic production.

It is also found that the general findings are inter-related in some ways. To a certain extent public indifference is a product of lack of information or lack of easy access to information. This may in turn be influenced by the absence of an independent and inquisitive media and civil society, which may be a reflection of the dominance of a small and closed circle in decision making.

More specific findings include the following:

- Political and financial accountability norms need not undermine military security provided that these norms are tied to procedures and structures developed in co-operation with the military.

- Those countries with large investments in arms procurement have a particular responsibility to demonstrate that military security requirements do not outweigh the needs of public accountability.
- Arms procurement decisions require a certain degree of confidentiality. Elected representatives need to devise criteria and methods by which these valid requirements can be harmonised with the need for accountability.
- Creating a cadre of experts including a range of different expertise and that is independent of government is a precondition for effective legislative oversight.
- Public accountability in arms procurement benefits from a wider culture of accountability, including the existence of institutions and organisations specialised in carrying out the audit of public policy.

III. Approaches to procurement decision making

Do governments buy the right things in the right quantities? Who should make the decision about which specific acquisitions are needed to achieve overall national security objectives? To what extent should decision makers be required to explain the choices they make? To whom should this explanation be given? In addressing these questions, arms procurement decision making processes should not be seen as a technical issue that is separate from political matters. The process should present decision makers with a framework that helps them to understand the choices available to them and sufficient information to make an informed choice.

Decision-makers with a deep knowledge of defence issues are rare. Officials responsible for procurement decisions therefore need to be closely connected with higher defence planning. If decision-makers with no specialist knowledge are offered a narrow range of choices or offered partial information by experts who have their own policy preferences, they are not able to make an informed choice. Therefore, all of the necessary agencies within the defence procurement establishment should contribute to a common net assessment of requirements.

There seem to be few if any general principles that can be identified across the full sample of countries. Even among states where responsibility rests with a specialist procurement agency acting on behalf of the government (and not on behalf of the armed forces) there is no uniform way in which these agencies are organised or in their relationship with other key actors.

The procurement agency may be part of the civilian authority within the Ministry of Defence or it may be an agency outside the Ministry. Some procurement agencies “hold the ring” between those who use equipment (the armed forces), those who pay for it (the finance ministry), those who develop it (either government research establishments or companies in the private sector) and those who produce it (domestic or foreign companies). The procurement agency is the only actor with a full picture of events—or the least incomplete picture. However, in this model the responsibility of the procurement agency is to negotiate with a series of separate actors, each of which has authority in a discrete area. This approach places a stress on contracts since reopening written agreements and finding a new consensus between parties in a somewhat decentralised system would be a major undertaking.

In other cases the procurement agency internalises some functions. The agency may include elements that focus on the needs of users and producers. The procurement agency (the customer) may be represented in, for example, state-owned producers along with the finance

ministry (the financier) and the armed forces (the user). This approach produces an effect more like a web in which the perspectives of users, suppliers and financiers are not only functionally linked but also reflected in the procurement organisation.

Some procurement processes emphasise partnership between consumers and suppliers over an approach based on the enforcement of contracts. This places a high emphasis on common purpose and trust among the different agents engaged in the process and raises the importance of personal relationships and networking between individuals.

Another area of divergence among procurement processes is the approach to establishing user requirements. In some cases the different branches of the armed forces have an institutional arrangement that forces them to discuss issues with each other before raising them collectively with political decision-makers. In other cases each branch of the armed forces conducts separate discussions with a responsible agency.

The armed forces may be confined to describing their requirements in terms of a mission they need to perform or a threat they need to counter and not directly linked to the procurement agency in this respect. The procurement agency itself may influence the trade off between alternative packages of equipment to meet the requirement. Alternatively, the armed forces may define both their requirements and the mix of equipment needed to meet them. The procurement agency would secure the identified items at the best price among the range of possible suppliers. Finally, in some cases there may be no specialised procurement agency and the armed forces may be responsible for acquiring their own equipment.

All procurement agencies depend heavily on professional advice from the armed forces. However, the relative impact of the procurement agency on overall force structure (and therefore its significance for foreign and defence policy) would be altered by the decision over which procedures to adopt. The relationship between the agency and the military (buyer and user) can also be affected by whether a procurement agency is staffed by general military officers, officers trained in equipment procurement or civilian specialists.

The relationship between procurement and spending (buyer and financier) also seems heterogeneous. Arms procurement may be seen as one part of overall government procurement and subject to the same budget procedures. Alternatively, defence ministries may be left alone to manage their budget. In some of these cases defence ministries are either freed from procedures applied to other government procurement processes or they may enjoy simplified procedures. This flexibility is justified under the argument that programmes are long-term and expected to undergo considerable modification throughout their lifetime.

As a general statement, it seems that the number of programmes where the price paid by the consumer is a more significant factor than the production cost is growing. To a greater extent than previously, price ceilings need to be respected, if necessary through reduced performance and numbers procured.

Some procurement processes are responding by trying to hold suppliers to account for performance through the terms of contracts and by trying to quantify costs that reflect failures by the supplier (rather than modified decisions by the buyer). Estimating the cost of major defence equipment is acknowledged to be difficult and many of the project participants question whether the methodological tools exist to make a serious evaluation of programme

participation from agencies and individuals whose expertise is relevant or necessary to achieve the stated objective. Moreover, a finding of the SIPRI project was that in some cases it is questionable whether participants in such projects can be identified in many countries. In particular this is a problem where there is no academic or NGO community interested in this aspect of public policy and where there is no independent and inquisitive media.

This suggests that the most likely way forward is a combination of different approaches targeted on countries where the conditions exist for progress to be made.

These would be countries:

- where there are indications that corruption in the official arms trade is a significant problem;
- that are interested and able to engage in co-operation;
- where there are indications that resources can be mobilised to implement projects that are identified.

Workshop

The formal international regulatory environment.

Rapporteur: Gillian Dell

The workshop covered the question:

Are there anti-corruption measures specific to the arms trade and should they be introduced as reforms to existing initiatives such as:

- Anti-corruption conventions now in force
- new measures adopted by export credit agencies
- the EU Code of Conduct
- the UN Arms Sales Registry?

This session addressed the coverage and adequacy of the OECD Convention and the possible role of a UN Convention. It also looked at the role to be played by the EU Code of Conduct and COARM process and the role of the UN Arms Register and UN Agenda. The session did not include any prepared presentations but proceeded on the basis of knowledge already acquired, as well as brief interventions from Mark Pieth, Chairman of the OECD Working Group and from Nazir Kamar of the UN Disarmament Secretariat

OECD Convention

The initial point made about the OECD Convention was that no arms trade-specific change was needed in order to improve its coverage of the arms trade. Mark Pieth pointed out that there is no national security exception under the Convention in the broad sense although there is always the possibility of a narrow exception under international law, in recognition of vital national interests. Article 5 of the Convention rules out stopping a case for political reasons, with a narrow exception. See Note 27 of the Commentary.

A number of suggestions were made to improve the impact of the OECD Convention:

1. Possible extension of the Convention to include civil as well as criminal law remedies e.g. exclusion from procurement and export credits. Civil law remedies are currently left open to governments, but referred to in the May 1997 Recommendation.
2. Possible addition of key signatories notably Russia, China and Israel. The question here is, will it be possible to assure the core compliance of these countries with the Convention? One of the participants stressed that unembarassable states could undermine the whole process.
3. Strengthen enforcement of national legislation implementing the Convention. There was considerable concern about adequacy of national enforcement and potential disparities in the rigor of enforcement. Concerns were raised about unembarassable states; about lack of resources for enforcement; and about lack of exporter confidence in enforcement elsewhere leading to non-enforcement in their own state. It was pointed out that the OECD is quite optimistic about ensuring enforcement. Development of common industry standards was raised in this connection. (See point 4 below) Further ideas put forward to strengthen enforcement of the Convention included:

- How is the arbitrator determined?
- How is evidence of non-compliance established?
- Companies that sell poor products have no interest in signing, do they?
- What does one do with them?
- How could an arbitrator really develop the technical competence to make a decision, suggestion?

The proceedings in case of dispute would possibly be on the basis of civil arbitration with a specialised judge or with the ICC arbitration process.

A system for debriefing the loser is important. That seems to be standard practice in the UK. Should use it in the major countries first to really test it. The key question is not what is the third party watchdog; the question is what is needed to ensure that the process has been respected?

External pressure was widely recognised as a motivating factor for change.

Workshop

How can developing countries be assisted most effectively with arms procurement decisions?

Rapporteur: Phil Mason

1. General Williams vividly described the arms procurement problems faced by many developing countries, drawing on Africa for examples. There were six key dilemmas:
 - i) To know what arms are needed, a country needs to be clear about the uses for which the arms are required, but there is increasing difficulty in knowing clearly who/what the enemy/threat is. It is no longer always or necessarily external.
 - ii) Few African countries spell out their defence policies in formal documents. (One counter-example, South Africa, is regarded as an exemplar in participative and transparent defence policy planning.)
 - iii) Arms are usually procured in crisis conditions against immediate urgencies rather than under longer-term, structured planning.
 - iv) In many places, countries are not required to have procurement capacity as overseeing external partners undertake this on their behalf.
 - v) The legacy of peacekeeping missions - much equipment is often left behind and absorbed, resulting in fragmented and inappropriate stock locally.
 - vi) Constraints imposed by sellers (e.g. sanctions) often make decisions for buyers on what to buy from whom sub-optimal.
2. Overall, there is often neither *technical capacity* nor the *policy environment* for coherent, structured and long-term procurement. Without this, the propensity is to procure short-term, from whomever is willing to deal. Such factors not related to capability needs, including corruption, condition choices.
3. The group reviewed current developments in the reporting of arms procurement contracts by supplier countries. 12 of the 15 EU countries publish annual reports, of varying detail. The relevance to detecting corruption in procurement was acknowledged as very limited.
4. Dr Anthony reviewed the results of the SIPRI study. This highlighted four barriers to transparency in arms procurement decisions (which point to possible solutions for improving performance):
 - i) The frequent acceptance of military autonomy and expertise and, in consequence, the shutting out from decisions of other technical and policy influences.
 - ii) The high degree of personal influence of individuals in the decision-making process.
 - iii) The dominance of the traditional threat-scenario approach to decision-making rather than the more modern task-based approach.

- iv) Lack of horizontal structures across government for decision-making. Arms procurement remains highly vertical, within the Defence Ministry domain with little take-in from other parts of government.
- 5. Options for methods for arms procurement usually varied between:
 - i) A procurement arm handling procurement for all parts of government;
 - ii) A specific defence procurement arm of government;
 - iii) The armed forces procuring directly.
- 6. Budgeting and financial management also presented a common obstacle. Few governments adopted a budget as a management tool to control expenditure and commitments. More often, procurement budgets represented the aggregate of individual spending decisions. Few governments also took into account a long-term view. Short-termism, and little allowance for contingencies, led to frequent emergency decisions which set budget planning off-track. There was also concern about the frequency with which military expenditure was off-budget, and especially where militaries had their own income sources with which to purchase. Reforms in financial management had the potential to lead to better procurement decisions.
- 7. In considering any assistance, it would be important to have three factors - an indication that corruption was a serious issue; evidence of political will for co-operation and reform; and resources to implement any work that was defined. A note of caution was issued - it would be illusory to expect any form of blue print for all countries. Each would present different problems and require different solutions.
- 8. Two 'easy' wins would be to encourage moves to task-based assessments for procurement decisions, and to promote broader structures in governments for decision-making, in particular to include other key stakeholding departments (Foreign Affairs, Finance) in the military expenditure debate.
- 9. In the broader context, reform of arms procurement decisions needs to be seen more holistically as part of increasing the accountability of governments. This means going beyond the narrow arms-buyer/arms-seller nexus to incorporate these relationships in the wider good governance agenda. The role of development agencies in this was potentially important, but would rely on the willingness of governments to accept military issues as a legitimate area of engagement for external agencies (hitherto generally off-limits).

Lastly, who should/could make the political weather on this to push the agenda forward? TI occupied a convincing position to do this.

Programme of the conference

Thursday 5th April

- 17.00 Registration
- 20.00 Dinner in the College Hall
Welcome Address by Laurence Cockcroft, Chairman of TI-UK
Introduction to the themes of the Conference

Friday 6th April

- 7.45-8.15 Breakfast in the College Hall

Plenary Session

8.30-11.00

Setting the framework

Conference procedures and output : Frank Vogl, Conference Chairman, TI Board of Directors

Key Findings of the Stockholm Conference

Mr Paul Beijer, Ministry for Foreign Affairs and Trade, Sweden

The impact of military budgets on development

Anke Hoeffler, Dept. of Economics and Statistics, University of Oxford (in collaboration with Professor Paul Collier, Director of Economic Research, World Bank)

Strengths and weaknesses of the economic case for the defence industry

Samuel Brittan, Financial Times

Impact of the changing strategic environment on the structure of the defence industry

Terence Taylor, Deputy Director, International Institute for Strategic Studies

Discussion

- 11.00-11.15 Coffee

Workshops

11.15-12.30

Can the defence industry in the exporting countries be separated from the interests of national security?

Chair: Tim Garden

Rapporteur: Paul Schulte, UK Ministry of Defence, Head of Non-Proliferation

Matching expenditure to needs in developing countries' military budgets

Chair: Admiral Tahiliani, Chairman, TI- India

Discussion Leader: Terence Taylor, Institute of Strategic Studies

Rapporteur: Julia Saunders, Oxfam

Russian and transition economies' perspectives

Chair: Ian Anthony, SIPRI

Discussion leader: Vadim Kozyulin

Rapporteur: Patrick Cauthery

12.20-13.00

Report Back

13.00-14.00

Lunch in the College Hall

Plenary Session

14.00-16.15

The effects of corruption in the arms trade in the developing world and on the political framework in exporting countries

Chair: George Moody Stuart, former Chairman, TI-UK

The arms trade as a key factor in civil wars

Margarida Trindade, Global Witness

The role of corruption in undermining the armed forces

Gen. Ishola Williams, Chairman, TI-Nigeria

Impact of corruption in the arms trade on the political process in the developed world

Joe Roeber, Author

The nature of the market for arms

Joe Roeber, Author

16.15-16.30 Tea

Workshops

16.30-18.30

Case study from South Africa

Chair: George Moody-Stuart, TI-UK

Discussion leaders: Judge Willem Heath and Patricia de Lille

Rapporteur: Paul Ingram, Oxford Research Group

Problems and limits in linking military expenditure to aid conditionality

Rapporteur: Anke Hoeffler, Oxford Institute of Economics and Statistics

Significance of the OECD Convention for the arms industry

Discussion leader: Prof. Mark Pieth, Chairman of the OECD Working Group on Bribery in International Business

Rapporteur: Anne-Charlotte Wetterwik, Swedish Ministry for Foreign Affairs.

18.30- 19.00

Report back

19.30-21.00

Formal conference dinner in Hall

Saturday, 7th April

Breakfast in Hall

Plenary Session

8.30-11.00

Key considerations in policy development

Managing US arms exports through the Foreign Military Sales programme and the FCPA.

Howard Weissman, Lockheed-Martin

Managing European exports through the European Regulatory framework

Bertil Hellstrom, Ericsson

The EU Code of Conduct in Arms Exports

Paul Beijer, Ministry for Foreign Affairs and Trade, Sweden

The current and potential role of the UN

Nazir Kamal, for the Under-Secretary General for Disarmament, UN

11.00-11.15 Coffee

List of Participants

Ian Anthony, Project Leader, Arms Control in Europe

Paul Beijer, Ministry for Foreign Affairs, Sweden

Samuel Brittan, The Financial Times

Patrick Cauthery, Export Credit Guarantee Department, UK

David Chuter, Department of Defence Studies, King's College, London

Laurence Cockcroft, Chairman TI-UK

Robert Neil Cooper, Dept of Politics, University of Plymouth

Gillian Dell, Transparency International

Patricia de Lille, Member of Parliament, South Africa

Therese Delpeche, Senior Research Fellow, CERI, Paris

Jacques Delphis, Thales (former CSF Thomson)

Benny Dembitzer, Conference Organiser

Lotta Fogde, Minister of State for Foreign Affairs, Sweden

Fredrik Galtung, Transparency International Secretariat

Johnny Grimond, Foreign Editor, The Economist, London

Dennis Harlin, SAAB Sweden

Judge Willem Heath, Special Investigation Unit, South Africa

Bertil Hellstrom, Ericsson

Nancy Higgins, Chief Ethics Office, Lockheed Martin

Anke Hoeffler, Oxford Institute for Economic Research

Roy Ibister, Saferword Project

David Ignatius, Executive Editor, International Herald Tribune

Paul Ingram, Oxford Research Group

Nazir Kamar, Political Officer, UN Disarmament Secretariat

Vadim Kozyulin, PIR Centre for Policy Studies, Moscow

Ambassador Lennart Klackenberg, Swedish Ministry for Foreign Affairs, Stockholm

Dominique Lamoureux, Secretary General, Thales International (former CSF Thomson)

Matthew Maguire, UK Department for International Development (DFID)

Phil Mason, Governance Department, UK Department for International Development (DFID)

George Moody Stuart, Member of the Board, TI UK

David Murray, Vice-Chairman, TI UK

Professor Robert Nield, Trinity College, Cambridge

Professor Mark Pieth, University of Basle, Chairman of OECD Convention Party on Illicit Payment

Jeremy Pope, Executive Director, Transparency International

Joe Roeber, Author

Julia Saunders, Researcher, OXFAM

Paul Schulte, Head of non-proliferation, MOD

Joanna Spear, Dept. of Defence Studies, King's College

Admiral R.H. Tahiliani, Retd Admiral, Indian Navy

Mark B Taylor, Programme Director, the FAFO Institute, Oslo

Margaride Trinidad, Global Witness

Terry Taylor, Deputy Director, Institute of Strategic Studies

Frank Vogl, Vice-Chair, Transparency International

Anne-Charlotte Wetterwik, Swedish Ministry for Foreign Affairs

Howard Weissman, Assistant General Counsel, Lockheed Martin Corporation

Michael Wiehen, Board Member, Transparency International

General Ishola Williams, Secretary General TI -Nigeria

Adrian J. Worker, Raytheon

