

## **‘Curbing Corruption in Defence Procurement’**

Notes from Round Table Meeting  
Hosted by Transparency International Croatia, under patronage of Mr.  
Stjepan Masić, President of Republic of Croatia  
Zagreb  
21 February 2007

See Appendix 1 for meeting participants list.

### **INTRODUCTIONS**

The meeting was introduced by Zorislav Petrovic, Head of Transparency International Croatia, who welcomed all to the workshop and indicated that there should be total openness during all stages of the acquisition process.

Davor Božinović, Head of Croatian Mission to NATO noted: that equipment interoperability was crucial; that Croatia was an active Partner within NATO; that therefore appropriate equipment was necessary; and there is a need to share information and to work together.

This was followed by a short presentation by Višnja Tafra, assistant to the Political Affairs Advisor from the Office of the President of the Republic of Croatia, who endorsed the need for sufficient equipment and who supported the current Transparency International initiative. Her introductory remarks are found in Appendix 2. She noted that a recent radar acquisition had questionable elements, but particularly within some of the contract annexes, and considered that procurement should be transparent as previously there had been excessive secrecy – citing the sole source purchase of military trucks as an example. She emphasised that exemptions from normal procurement procedure should be limited to as great an extent as possible, and accepted that exemptions are a source of corruption risk.

### **TI UK’s DEFENCE ANTI-CORRUPTION INITIATIVE (Mark Pyman)**

Mark Pyman noted that corruption is the most common reason behind a company decision not to bid ([Control Risks Survey](#)). He outlined some corruption risk areas in a defence establishment, presented some constructive tools, including competition.

### **DIRECTOR, ETHICS & BUSINESS CONDUCT LOCKHEED MARTIN UK (David Harris)**

The presentation majored on Corporate Policy Statements and Training with the Foreign Corrupt Practices Act being the main driver. The Company had 140 policies in the corruption arena together with others applicable to some other engaged countries. Employees were encouraged to consult the policies with further advice being available

from specialists if necessary. Guidelines were promulgated, and implementation monitored, and records were kept of all gifts and hospitality etc with even the ‘suspicion of a bribe’ having to be declared. Anti corruption was the responsibility of the Vice President and controller level and delegated downwards, with the VP reporting to the Board. Red flag examples were viewed as: high risk countries; excessive cooperation; and cash payments and cash requests.

Due diligence processes were used when employing foreign consultants, and contract length was for a finite 2 year term but termination was immediate upon agreement violation. This was necessary to protect the Company and its reputation and the entire anti-corruption process was backed up by a strong training package.

President TI Croatia requested the views of the VP representative from SAAB. SAAB used anti-corruption Directives and recognised the Lockheed martin headlines. Company policy was that all employees should undertake anti-corruption awareness training and how to undertake international relations. There were strict regulations in force for consultants who were only employed after several sifting processes, including due diligence. Additionally, advisors had to sign documentation as to understanding company policy and ethics guidelines and had to report all matters untoward.

#### **HEAD OF CROATIA STATE COMMISSION FOR SUPERVISION OF PUBLIC PROCUREMENT (Goran Matesic)**

Goran Matesic indicated that that the Public Procurement system was ‘young’ and that the ‘last fortress’ was the defence sector; secrecy could detract from competition but that public procedures should be implemented during arms procurement. Whilst there was a system to allow specific military equipment to be processed under special conditions, interpretation of the system should not be used unnecessarily to shroud some contracts - giving hygiene equipment as an example. In sum, he believed that the law should be used ‘sensibly’.

#### **LIBERALISED DEFENCE PROCURMENT IN EUROPE – (Martin Trybus)**

Martin Trebus outlined the competing frameworks applicable to defence procurement including: EU (EC and EDA); WEU (WEU Armaments Group); OCCAR (armaments co-operation agreements between major producers); and letters of intent. The EC Directive (2004) on the coordination of procedures for the award of public contracts was intended to enhance the openness of the European procurement market. However Article 10 notes that the Directive “shall apply to public contracts awarded by contracting authorities in the field of defence, **subject to Article 296 of the Treaty**”

Article 296 states “any Member State may take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material; such measures shall *not* adversely affect the conditions of competition in the common market regarding products which are not intended for specifically military purposes.”

Thus, although the EC Directive required for appropriate procedures to be applied together with advertising, Article 296 allowed members, under certain strict conditions, to 'protect their essential interests' covering weapons production and trade.

There were various interpretations of how this should be implemented. Some member states were less stringent than others. The EC's view that Article 296 should be invoked far more rarely than has been the case was recently strengthened following its success in the "Commission versus Spain" case, in which the EC argued that "Spain has not demonstrated that the exemptions provided for by the Law are *necessary* for the protection of the essential interests of its security. [...]. It follows that the VAT exemptions are not *necessary* in order to achieve the objective of protecting the essential interests of the security of [...] Spain".

The EC's Interpretative Communication of December 2006 called for a narrow interpretation of Article 296, for it to be specifically **invoked** by the Member State, for the National security situation to be proven by the Member State, for the exemption to be necessary, and for exemptions involving national security possibly to be subject to judicial review.

There were 27 separate defence markets in the EU therefore a single market did not exist. The EDA code of Conduct 2005 was: voluntary; intergovernmental; on a reciprocal basis; was applicable from 1 Jul 06; had a threshold of 1m Euro; should ensure equal treatment and transparency; have appropriate selection and award criteria; subject to a single internet portal; and derogations including national security. He believed that member states did not want the Commission to be too active but considered that it could be strengthened by the inclusion of military expertise.

## **NATO OVERVIEW (Adrian Kendry)**

Adrian Kendry outlined NATO values in the transition from Partnership to Membership status of the Alliance and believed that these were applicable to Croatia. Values built effectiveness within institutions, and transparency and openness led to major economic gains.

He stated that "NATO's values (democracy, the rule of law, transparent and effective governance) in the development and deepening of Euro-Atlantic security and stability, are entirely consistent with, and supportive of, the aims and values of Transparency International." The great TI contributions, along with other organisations such as SIGMA, were appreciated.

In the NATO context, 2007 was an important year for Croatia. Croatia had demonstrated capability as a security provider, especially in Afghanistan, and its support for the workshop was important along with continued procurement reforms.

He emphasised that NATO's resource requirements needed to dovetail into its current and future capability with procurements being on a transparent basis. NATO was not viewed as supranational, as 95% of the defence budgets remained national.

He postulated that by 2050 the average age of Europeans was likely to be 53, whereas the average age in the US would be 38 – the disparity being the result of imbalance in immigration demographics. Therefore the social, and in particular pension, budgets would be under increasing pressure. As Croatia was increasing its defence budget by 300% from 2006 it needed to ensure that it achieved value for money; thus all of the issues (TI and NATO) would appear to come together to promote defence reform.

### **BEST PRACTICES IN DEFENCE PROCURMENT (Dominic Scott)**

This presentation covered the principles of good procurement (not just defence), assessed particular corruption vulnerabilities in the different stages of defence procurement and presented potential tools and solutions to the problems. Transparency in offsets, oversight of the procurement process, competition, transparency in dealings with agents, and publication of complete defence budgets were all flagged.

### **OFFSETS (Mark Pyman)**

Offsets are a particular corruption risk. TI UK would like to see them banned. Mark Pyman outlined ways to enhance oversight of offsets.

### **INTEGRITY PACTS (Alan Waldron)**

Air Commodore Alan Waldron gave an overview of Transparency International UK's experience of implementing Defence Integrity Pacts in Colombia and Poland.

### **DISCUSSION**

Mate Raboteg, State Secretary for Defence observed that it was a pleasure for him to participate and that he drew 'good lessons' from the presentations. He confirmed that no modernisation of Croatian forces would be without transparency and 'better' resource management. Some of the current processes supported transparency, such as the EU and NATO membership action plans as well as the National Plan. The Long Term Development Plan (publicly available and outlining major equipment plans for the next 10 years) would be undertaken in conjunction with the Ministry of Economy. Other plans flowing from the main ones would be subject to evaluation.

The equipment programme would be accomplished in accordance with rules and regulations; however, some procurements resulting from the recent war had not been undertaken along these lines and experts were needed to assist in the transparency process. As to offsets, there could be several ministries involved due to the wide range of interests. He confirmed that Croatia was co-operating with foreign companies as strategic

partners, but cautioned that there were two sides to corruption, those that initiated it and those that supported it. He believed that there should be few secrets in Croatia as it was not a superpower but one with a NATO membership goal; however, operational use or capacity could attract security caveats. The process was now to transfer from a 'war army' to a small professional modern force with the transition encompassing people, equipment and training etc and believed that it could not be achieved 'non transparently'.

Developed countries do not, he believed, like offsets; however, there were different perspectives in Partnership/consumer/emerging countries, and in these offsets were viewed as an economic/development driver. The dimension of any offset package was of prime concern and should favour modern technologies and multipliers which were necessary to develop the Croatian economy.

The former Defence Minister of Croatia observed that the State Audit Process (in place for 10 years) had been debated in Parliament recently and he believed that the approach to defence should not be any different to other processes. He gave examples of previous contracts for food which had been classified secret and considered that 'we should now turn a new page and support the State Secretary'. However, he noted that the lack of true will to implement the change could be a problem.

Mark Pyman's final word was how encouraging it was that such a meeting could take place at all: this reflected very well on Georgian society. Zorislav Petrovic of TI Croatia concluded the seminar by observing that public sector procurement was improving but noted that he hoped the round table would speed up the process and he believed that, overall, the climate had changed.

## **APPENDIX 1**

### Meeting participants

- Davor Božinović, Mission of the Republic of Croatia to the NATO, Head of Mission - Ambassador
- Višnja Tafra, President of the RoC Office, assistant to the Political Affairs Advisor
- David J. Harris, Director, Ethics & Business Conduct Lockheed Martin UK
- Goran Matesic, Head of Croatian State Commission for Supervision of Public Procurement Procedure
- Martyn Tribus, University of Sheffield United Kingdom
- Tomas Blennmark, SAAB group
- Bo Norlin, SAAB Group
- Victor Jackovich - GD and Steyr
- Urs Engeli, Mowag
- OSCE – H.E. Todd Becker, Deputy Head of the OSCE Mission to Croatia
- Adrian Kendry Senior Defence Economist and Acting Deputy Director, Defence and Security Economics Directorate, Political Affairs and Security Policy Division, NATO HQ

Guests:

- Lt. Colonel Burkhard Michael Kühnapfel, Defence Attaché,
- Constantino Longares Barrio, Delegation of European Commission in Croatia
- Fulvio Bianconi - Delegation of European Commission in Croatia
- Lt. Colonel Richard Van Den Anker, Defence Attaché,
- H. E. Lars Fredén Swedish Foreign Ministry
- Counsellor Johanna Orth Swedish Foreign Ministry
- Laura Stojić Finnish Foreign Ministry
- H.E. Marie-Johane Roccas
- H. E. Marcus Kaiser
- Colonel Ovidiu Iosif, Romanian Defense Attaché
- H. E. Elisabeth Walaas
- H. E. Sir John Ramsden UK Foreign & Commonwealth Office
- Dijana Matijaš- USA embassy

Ministry of defence Republic of Croatia

- Mate Raboteg, State Secretary
- Željko Idek, head of procurement department

## **APPENDIX 2**

21 February 2007

Curbing Corruption in Defence Procurement

Roundtable meeting

Comments by Višnja Tafra, Office of the President of the Republic of Croatia, assistant to the Political Affairs Advisor

*Mr. President of Transparency International Croatia, distinguished members, Excellencies, distinguished participants of the round table, representatives of the media*

It is with pleasure that the President of the Republic of Croatia has accepted the patronage of the round table discussion today titled «Reducing the risk of corruption in military procurements» not only because as the Commander in Chief of the Armed Forces he orders the use of the Armed Forces, and this can not be efficient or successful unless the Armed Forces are appropriately equipped and trained, but also because he has, on several occasions, publicly pointed out the lack of transparency in the procedure of the procurement of military equipment.

It is thus my pleasure to welcome you here, today on his behalf. His not being attendant here today, due to a business trip, does not lessen his interest in this subject. On the

contrary, he is grateful to the organizers of the Round Table for organizing it at the moment when the Republic of Croatia is facing the process of the selection and purchase of significant military equipment of great value. The moment is opportune to introduce the Croatian public to the procurement of military equipment, to leave behind us, never to come back, the heavy burden of the lack of transparency in the procurement of armament from the times of the Homeland War and the post-war period. As opposed to other countries, Croatia gained the experience in military procurement during the hardest, wartime conditions. As it is known to the Croatian public, many illegal processes were occurring during the armament of the Croatian Army, in the most difficult moments of the defence of the homeland. The extent of these illegal and inappropriate activities is still not fully known, but the President of the Republic will insist on shedding light on all of these events. The citizens of Croatia are familiar with the fact that particular cases regarding the procurement of military equipment are still being heard by the Croatian courts.

This is precisely the reason why the initiative of Transparency International to talk about and discuss these matters should be supported, together with the transfer of the experience from other democratically developed countries.

The new security challenges impose the need to transform the Armed Forces and modernize them to create the new abilities. Subsequently, many countries today are in the process of procurement of military equipment and armament, and the military industry is gaining a new impetus with some of its products. The transition states of the Middle and Eastern Europe are undergoing an especially large transformation, replacing one system of values with another. Along with the necessary processes of the democratic consolidation, the need to create the military and security abilities increases. The situation such as that one leads to the following:

Firstly, large military procurements are being carried out under the conditions of inadequate administrative and professional capacities of the transitional countries. A good example of this is the purchase of the radar system in the Republic of Croatia. The system was purchased without providing the conditions for its set-up. As the result, all the deadlines failed to be met, and many appendices were added to the contract, whose benefit for Croatia is more than doubtful.

Secondly, the transitional countries are facing the aforementioned corruption in most segments of the society. Military procurement is not deprived of that, either. Moreover, the larger the value, the more likely the suspicion of corruption is.

Thirdly, it reduces the possibility of the development of the industrial cooperation, which should be a necessary outcome of the foreign military procurements.

In most cases the military procurements are surrounded by secrecy, and the public often reacts to such situations with increased suspicion of the legitimacy of the whole process. Therefore, it has to be stressed that transparency should be the basic principle of each public procurement procedure. Furthermore, the number of legal exceptions existing

within the regulations concerning the procurements for the purposes of defence and national security should be reduced. These exceptions are based on the old practice of the excessive secrecy that used to accompany each military procurement. However, more often than not, it was the case that under a label of confidentiality, that is, under the application of the exception, was a purchase that should have been under the regulations of the public procurement act. Let us consider the case of the direct purchase of military trucks in the negotiating procedure with one bidder, after the previously conducted contract award procedure was nullified. Even if everything had been done legitimately, the procedure would have caused suspicion and doubts.

The excess secrecy is not as necessary today, as it once was, because: Firstly: There has to be a stronger responsibility to the citizens for the transparency of military procurements; secondly: Military procurements are mostly carried out with the foreign partners who offer their products to other potential clients anyway. Thus the need to conceal the technical-tactical characteristics of particular weapons is unnecessary. It follows that the conclusion can not be made that the excessive secrecy can be in favour of those who decide on public procurements solely on the basis of political and not professional arguments, not to mention the space for the possible corruption.

I believe that, at the round table discussion today, we will be able to hear about the experiences of other countries, the recommendations and solutions for the possible control of military equipment procurement procedure, since it is evident that the procedures that were made exceptions to the Public Procurement Act de facto in the Republic of Croatia are not entirely under the legal control; I believe we are to hear more about this from the president of the committee for the public procurement procedures control. Thank you.