

Transparency International (UK)

Project PCOAT: “Preventing Corruption in the Official
Arms Trade”

Arundel Conference

June 8 – 10, 2004

CONFERENCE OVERVIEW

1. Background
2. Government perspectives
3. Defence Integrity Pacts
4. Industry frameworks and codes of conduct
5. Regulation and parliamentary oversight
6. Other topics
7. Recommendations



List of acronyms

COARM	Conventional Arms Exports Working Group
DII	U.S. Defence Industry Initiative
DIP	Defence Integrity Pact
DFID	Department for International Development, U.K.
DoJ	U.S. Department of Justice
EITI	Extractive Industries Transparency Initiative
FCPA	Foreign Corrupt Practices Act
IP	Integrity Pact
MoD	Ministry of Defence
NGO	Non-Governmental Organisation
PCOAT	Preventing Corruption in the Official Arms Trade
POLARM	Ad Hoc Working Party on a European Armaments Policy
TI	Transparency International

1. Background

The initiative to counter corruption in the official arms trade was developed over the period 2000-2003 in close association between TI(UK), with funding from DFID, and the Swedish Ministry for Foreign Affairs. The first phase of this project from January 2004 until July 2004, led by TI(UK), culminated in this conference at Arundel, Sussex, in June 2004. It brought together interested parties from defence companies, governments and NGOs to review the progress made in Phase 1 and to help chart the way ahead.

The objectives of the conference were:

- To bring together officers of European and US defence companies, representatives of governments and NGOs, to commence the development of a common framework for high quality standards of business conduct in international defence procurement
- To develop a common understanding across governments and companies of Integrity Pacts and to decide what modifications are needed so that they may be applied constructively by governments to international defence contracting
- To develop proposals as to how parliamentary and regulatory oversight of international defence contracting can best be strengthened

The conference was well attended with 6 defence companies, 5 governments and 6 NGOs represented from 14 countries. Day One comprised presentations by speakers followed by discussion and on Day Two, participants split into working groups for themed discussions.

Day One: Presentations were given on the following:

Session One: Government perspectives on integrity in defence procurement

Steven Shaw, Deputy General Counsel, Contractor Responsibility, U.S. Air Force
Air Vice Marshal David Hobart, Asst. Chief of Defence Staff, MoD, U.K.
Anne Charlotte Wetterwik, Swedish Ministry for Foreign Affairs

Session Two: Current defence industry codes: their strengths and weaknesses

Dominique Lamoureux, General Secretary, Thales
Howard Weissman, Deputy General Counsel, Lockheed Martin
Simon Webley, Institute of Business Ethics
Susan Côté-Freeman, TI Secretariat

Session Three: Integrity Pacts and experiences so far

Rosa Inés Ospina, Director, TI Colombia
Admiral Tahiliani, Chairman, TI India
Mark Pyman, Project leader, PCOAT project, TI (UK)

Session Four: Regulatory and parliamentary oversight of defence contracting

Roy Isbister, Saferworld
Professor Ravinder Pal Singh, Stockholm University
Judge Willem Heath, Heath Consulting

Day Two: There were working groups on the following:

Codes of conduct, parliamentary oversight and regulation, offsets, confidentiality & national security, Integrity Pacts, defence procurement and its reform and political pressure within the procurement process.

1. Conference opening address

Peter Eigen, Chairman of Transparency International, opened the conference, welcoming participants from the many countries and organisations. He emphasised the importance of fighting corruption in the defence industry and of how this was also a proliferation issue: expanding the arms trade beyond what was necessary for a country's defence. The fight against corruption was also finding new frontiers to address with the development of international terrorism. He finds that there is a growing coalition against corruption, given impetus by the signing of the UN Convention against corruption and the OECD Anti-Bribery Convention. Multilateral institutions were now much more active in this arena; the World Bank is now actively involved in the fight against corruption, and this work aligns with the work of TI. The World Bank announced in September 2003, for example, that they intend to use Integrity Pacts (IPs) in its projects.

2. Welcome Speech

David Murray, Deputy Chairman of Transparency International (UK) and Chairman of the Strategy Committee for the PCOAT project, welcomed participants to the conference.

He opened by stating that TI(UK) currently has four industry-focused projects: construction and engineering; extractive industries; money laundering (particularly in relation to London), and the arms trade. He added that TI in general and this conference takes as a starting point that defence is a valid industry and does not challenge the right of defence companies to exist and to conduct their business. Instead, what TI is looking for is an improvement in some areas of business conduct.

He thanked DFID as the sole source of funding for this project which has allowed it to be fully staffed at the TI(UK) London office. He also mentioned that although the support from within defence industry for the project unfortunately is not unanimous, there are also companies that are supportive of the project's aims but are however, unable to be present. These are Boeing (US) and Rolls Royce.

3. Government Perspectives on Defence Procurement

The US perspective on good conduct in defence procurement is to place great emphasis on company ethics and good conduct programmes. To encourage the development of these, the US operates both a carrot and a stick. The carrot is in the form of reduced sentencing for those with good compliance programmes. For example, if a defence company has committed a misdemeanour but can show it has a full programme in place, this may prevent it from being indicted for corrupt activities. In this sense, "good practice" is considered more effective in the long term than a custodial sentence, and it is in government's interest to provide incentives for such programmes. On the 'stick' side, there is both prosecution under the FCPA regulations, and the threat of debarment. Uniquely in the U.S. debarment as a sanction works, but needs to be carried through with rigour to be effective. Debarred companies are listed in the Internet. Debarment must also extend to affiliated companies if it is really to take root, with the onus for compliance of regulations and standards placed on the parent company. However discretion in the debarment process by the Department of Justice (DoJ) is seen as an important factor because it enables dialogue with companies to be maintained during investigations (especially if an incident has taken place overseas) and encourages best practices. It was emphasised that ethics systems go beyond compliance; companies must have a proper and workable code of standards, owned and run by the CEO and Board and communicated throughout the company.

Two further issues were highlighted; first, the personal incentive for whistleblowers to come forward under the False Claims Act has given rise to a large number of cases which is taking up an increasing amount of management time and second, the growing pressure from the U.S. government to debar companies, which in turn has led to a reduction in the burden of proof for misconduct – now only 51 per cent in some cases.

The U.K. government perspective was that the public services in the U.K. are generally not predisposed to corruption although there may be cases of individual failure. This is generally borne out by the lack of criticism the U.K. receives from its trading partners. There is already a high level of oversight of the defence procurement and sales processes through parliamentary scrutiny, including the National Audit Office and the ombudsman system, as well as a strict system of export licensing. There is also a strict code and regulations regarding the giving and receiving of hospitality. The U.K. believed that allegations of wrongdoing on the part of U.K. companies were fully followed up.

Sweden reported that it does not have a system of debarment, however corruption is sanctioned in other ways. In addition, cases where there is sufficient evidence that corruption has occurred could be examined by a parliamentary group consisting of all political parties, although no such cases have yet been discussed. The main objective of this forum, which has since long been an important part of the national Swedish export control system, is to discuss and give counsel in forthcoming defence contracts and licences. The importance of good contacts and a working dialogue with industry was reiterated and the best place for anti-corruption criteria was thought to be national guidelines, although the EU and OECD criteria were also recognised as important. From the Swedish perspective a joint international undertaking to battle corruption in this trade was underlined as that approach would provide the best results. Development of the UN system and other international fora will be vital.

4. Defence Integrity Pacts (DIP)

Representatives from the wide cross section of TI Chapters provided valuable insights and lessons from their practical country experiences with setting up and managing Integrity Pacts (IP). These could be applied in varying degrees to defence contracting. While it was agreed that the IP is not a panacea, it has succeeded in focusing the discussion in the right direction: that of ethics in public contracting, and has proved itself as a good confidence-building mechanism. Some key characteristics of an IP were seen to be: a mechanism for bidders to air their concerns regarding the behaviour they expect from other bidders; the presence of a third party - an independent, technical expert examining the documentation; and the publication of bidding documents on the Internet. As part of an IP, sanctions need to be agreed in advance by all bidders.

A central point for discussion was the issue of whether a DIP can move forward without the consent of all three interested parties (i.e. exporting and importing governments and defence companies) and who should be the main driver. Some suggested the main driver should be the government of the importing country but the majority thought that as an IP is specifically in the interests of business, it should be the exporters (business and the exporting government) who should promote it. The suggestion was made to launch the DIP in COARM, stressing the importance of initiating a 'sales pitch' among seller countries. However, in addition to this, it was emphasised that importing governments must also enforce their anti-bribery laws. Since the number of principal defence companies (main-players) is small compared to other main players in other industries, participants agreed that the defence sector should prove easier in terms of implementing this kind of initiative than in other industries.

Defence procurement was seen as being particularly vulnerable to corruption. There are a number of reasons for this including the degree of secrecy employed; the ease with which technical requirements can be manipulated; multiple layers of subcontractors used; the complexity of defence contracts; the extensive use of agents; domestic government pressure; revolving door syndrome and offsets. A DIP must have features that take account of the special nature of the industry. These include: the role and composition of the independent monitor; the disclosure of agents' payments (to whom and by whom); defence company codes and offsets.

There was agreement that the next step was to work with individual countries to get some DIPs started with major defence procurements. Examples of possibly interested southern countries

were Colombia, India, South Africa. Examples of possible northern countries were Sweden, U.K. and Latvia.

It was noted that NATO countries generally have a very opaque system of defence procurement, and thus NATO countries may need to be addressed as a special case. It was felt that at the same time as developing DIPs in practice, the industry needed to come together to support DIPs as a whole.

5. Industry frameworks and Codes of Conduct

Globalisation was cited as the main catalyst for the changing regulatory framework and as this framework adjusts, greater transparency and traceability are required. The industry stressed that the risks for corporations of non-compliance have increased significantly. In addition, there was the added difficulty of harmonisation of regulations across different jurisdictions. The adoption of an effective (top down) ethical code and standards were thought to give a company a competitive advantage so long as a proper monitoring and audit regime are included.

The U.S. Defence Integrity Initiative (DII)'s "Six Principles", albeit at the lower end of the standards league, have all been agreed by signatory US defence companies who are bound by them. It was agreed that a similar framework could be adapted to include anti-bribery provisions (with an external monitoring system added). The Canadian industry code for the chemical industry was put forward as a possible model for this. The European codes were thought to be in harmony with the DII and therefore, in theory, adaptable to it.

It is evident that in the U.S. defence company codes are driven to a large extent by compliance requirements whilst in European companies codes tend to be value-driven, providing more general guidance and advice rather than specific actions. However, it was agreed that company codes must become part of the wider corporate culture and that training, feedback and auditing elements should also be included.

The possibility of using the already-developed TI Business Principles as the basis for a defence industry code was discussed. A generic document with the focus specifically on anti-bribery, it could be adapted to any company. Of particular benefits to the Business Principles are: a light support structure, the absence of a large number of lawyers and the existence of a third party for arbitration. Participants agreed that the use of these Principles could be written into the industry framework as a specific principle, or companies could benchmark their own procedures against them. External verification was proposed.

In the discussion, it was noted that the act of gaining confidence from other competitors is essential to the success of the code, rather than the specifics of the code itself. Thus a forum in which the code is developed and later kept up to date (as in the DII) is an important part of the development of the framework. Despite the risks of codes being seen as a 'PR exercise', codes were seen as a useful initiative even if they only address part of the problem. A new global framework (or "meta" code) for the defence industry would need to be argued through and companies must take full ownership of it.

6. Regulation and Parliamentary Oversight

The need to increase parliamentary oversight and accountability was stressed, especially if defence procurement processes globally are to improve. While the difficulties of military and commercial secrecy surrounding these processes were acknowledged it was thought essential to encourage political cultures to accept the democratic control and responsibility of Armed Forces as the norm rather than the exception. In addition, defence budgeting must develop a more professionally accountable financial regime, which in turn would enable greater parliamentary access and oversight (by the audit and accounts committee).

In respect of the U.K., it was stated that ‘corruption’ should be given more serious consideration in export control matters than hitherto: to date it seems to have been virtually ignored. For example, as well as a company being refused a licence if corruption is uncovered, follow-on sanctions should also be implemented. At issue is the review and reform of the EU Code of Conduct. Whilst there is limited appetite for a 9th, anti-corruption criterion, it may be possible to insert a corruption clause into the present criterion 8. It should be made explicit that an export license would be refused where there is reason to believe that corrupt practices have occurred. In addition, it was considered that there is room for more transparency in publishing agents' fees and for increased parliamentary accountability for company misdemeanours; for example, credit should be withdrawn from export credit agencies where corruption is found.

As well as support, there was also opposition to the idea of placing anti-corruption criteria in export licences. The two reasons given against were difficulties associated with enforcement (in particular the possibilities of investigation of a third countries level of corruption) and sufficient regulatory frameworks already being in place. The U.K. government expressed the view that it would not be possible to deny the issue of a licence purely on the basis of the anti-corruption criterion. It was suggested that national guidelines are the best place for export rather than EU Code or OECD. Alliance building is needed especially in the EU context.

The groups felt that there was already enough anti-corruption legislation in many countries therefore it was better to focus on real enforcement of this, particularly through the OECD Convention. Similarly, support for ensuring that key legislation like Freedom of Information Acts should extend to not allowing exemption for defence procurement issues. The groups supported the extension to other countries of the U.S. system of debarment.

7. Other topics

Improving defence procurement processes: Participants agreed that there was great scope for improvements and reforms to defence procurement processes. There was support for the involvement of teams that go out from countries to assist in strengthening country procurement practices i.e. capacity building. A multi-sector steering group could be formed, perhaps involving the NATO parliamentary assembly and support from a high level of buyers and sellers could aid getting such schemes off the ground. The idea that TI could create a ranking of the quality of defence procurement in countries was also raised.

Political pressure: Pressure to influence the outcome of a contracting process was acknowledged as a real issue. For the importing country, issues of regional and internal prestige, competitive edge, defence diplomacy with and fear of sanctions from, an exporting country all

provided barriers to proper procurement. Some partial solutions, such improved transparency within government processes, strengthening the reputation and quality of the procurement process, and increased media awareness, were proposed. Regionally, the formation of a “Procurement Alliance” of willing countries could be effective, having been tried in one area.

Offsets: There was considerable discussion on offsets, particularly the risks of corruption in execution. A distinction was drawn by the industry between direct and indirect offsets. The former were regarded as having appreciable value, while the latter were often considered complex and time-consuming, as well as being more open to corruption. There was agreement on the need for a wider monitoring of the management of offsets.

8. Recommendations

A number of recommendations were distilled from the conference proceedings. In addition, TI(UK) has developed a suite of proposed actions to address each of these.

1. Implementing Defence Integrity Pacts

The Conference recommended that Defence Integrity Pacts (DIP) now be applied in real situations. Initially, it is recommended that two early applications be identified, one in a southern country and one in a northern country. Potential countries are South Africa, Colombia or India as southern countries and Latvia, U.K., and Sweden as northern countries. The DIP should be tailored to suit individual country needs, applied early and for the duration of the contract.

Proposed Actions:

- i) Actively engage exporting governments on the merits of supporting DIPs, suggesting that the DIP could be launched in fora such as COARM, NATO, the Wassenaar Arrangement and maybe in other export control regimes. This, in some cases, may require a redefinition of mandate.
- ii) Publicise DIPs widely and particularly to importing governments:
 - Produce a smart, formal booklet on anti-corruption in defence contracting and the use of DIPs
 - Speak at relevant conferences about DIPs, and provide articles for publication
- iii) Work closely with TI chapters to promote the application of DIPs in their governments
- iv) Discuss with multilateral institutions on ways to fund the DIP independent monitors
- v) Establish firm links with interested governments, through personal visits similar to those undertaken in Phase 1
- vi) Discuss with interested governments whether they might act as the sponsor of an inter-governmental initiative in reducing corruption in defence procurement; for example, using the Extractive Industries Transparency Initiative (EITI), sponsored by the U.K. Government, as a possible starting point model

2. Developing a Framework Code of Conduct for the Defence Industry

A critical mass of defence companies should come together, with the support of TI(UK), to develop a strong framework code of anti-bribery and corruption measures for the entire industry. The use of a framework, based around a modest number of principles, as in the DII approach in the USA, would serve as a good basis for bringing the whole industry on board. Signatory companies can later align their own organisations to this framework.

Proposed Actions:

- i) Build on the energy of the major players in Phase 1 of the PCOAT project, to rally the defence industry to develop a European and a global framework; facilitated by TI (UK) as required
- ii) Work with a few European exporting governments and their national companies, to develop a strong European position that is fully supported by the governments: possibly the U.K., France and Sweden in the first instance
- iii) Approach the CEOs of major European defence companies to make a statement of intent at an appropriate public forum. One possible forum to make public the existence of this initiative could be the Paris Air Show in July 2005
- iv) Encourage the G8 countries to take a clear position in combating corruption and improving transparency in defence procurement. This could be done by a statement at next year's G8 summit, and through appropriate preparatory work with government in advance of that
- v) Develop a more detailed understanding of 'who owns who' in the defence industry and the composition of typical consortia

3. Exporting Country encouragement of their industry

The conference recommended that exporting countries be strongly associated with this initiative given the importance of their role. TI should work with European exporting Defence Ministries and their export support organisations to promote strong anti-corruption practices as an important platform for the common competitiveness of European companies.

Proposed actions:

- i) Work with the U.K. Government, particularly the Ministry of Defence and others to bring all large U.K. based exporting companies into the fold of companies supporting a global industry framework. The U.K. is an important exporter, and it hurts both the U.K. and the global credibility of the defence sector if U.K. companies are not fully involved
- ii) Approach the 'Letter of Intent' group of countries and companies in Europe (France, U.K., Sweden, Italy, Spain, Germany), to propose the establishment of a sub group devoted to establishing and maintaining a strong framework of anti-corruption standards across this group

- iii) In co-operation with national ministries of defence, meet with defence companies and the defence industry associations to discuss the implications of the changing laws on bribery and corruption and the opportunities this may create for competitive advantage

4. Strengthening anti-corruption measures in regulatory requirements

The conference debated moves to place anti-corruption assurance more centrally in the arms control regimes, both at national and international level, providing they were carefully targeted, rather than generally adding to the bureaucratic burden. Although there were mixed views, TI concluded that this was an important area to develop further into practical proposals. The conference supported the need for OECD Convention signatories to enforce the Convention more energetically.

Proposed actions:

- i) Work with COARM and POLARM to strengthen anti-corruption measures in EU arms control regimes
- ii) Stimulate OECD Anti-Bribery Convention signatory countries to investigate credible allegations of wrongdoing by defence companies and enforce as required
- iii) Maintain pressure on the regulatory environment around arms exports, notably to strengthen the EU Code of Conduct in respect of anti-corruption measures, preferably in the form of a 9th criterion

5. Reforming Defence Organisations and Processes

The Conference supported moves to strengthen anti-corruption measures and reform initiatives in defence procurement processes.

Proposed Actions:

- i) Enter into discussions with the NATO Secretariat and the European Defence Agency on improving transparency and anti-corruption measures in NATO and EU procurement processes
- ii) Assist groups that provide assistance on defence procurement reform (for example the Defence Advisory Teams based in the U.K.), with advice on the anti-corruption requirement of such reform
- iii) Develop a set of principles related to procurement processes which would embody a definition of best practice
- iv) Explore the development of a defence procurement index for countries which focuses on the vulnerabilities to corruption