

CRANFIELD UNIVERSITY

MICHELLE PATRICIA CHARLES

TRANSPARENCY AND ACCOUNTABILITY IN
DEFENCE OFFSET: A CASE STUDY OF THE UNITED
KINGDOM

SCHOOL OF DEFENCE AND SECURITY
Defence Management and Leadership

MScRes

Academic Year: 2016–2017

Supervisor: Professor Ron Matthews
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This thesis is submitted in partial fulfilment of the
requirements for the degree of MScRes.

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Abstract

In recent years, the global defence market has changed, shifting from a seller's market, with limited suppliers facing a high demand, to a buyer's market, in which growing numbers of suppliers compete for limited sales. In this intensely competitive environment, exporters sell arms not only on the basis of price and quality, but also on the attractiveness of the parallel offset package. Offset, crudely defined as 'reciprocal investment', is allegedly prone to corruption. This debate has sparked a global controversy, and likely changed European offset policy, albeit that no hard data exists to support the case that offset is tainted with corruption. A 2010 Transparency International Report argued that corruption is endemic in offset programmes, but the evidence advanced by the report confuses defence procurement with offset. Thus, the jury is still out as to whether corruption practices are part and parcel of offset arrangements. Accordingly, the purpose of this study is to determine the nature and extent of corruption in UK defence offset programmes. Due to the sensitivity of the topic, it was felt appropriate to focus attention on ethical compliance as the primary research objective, and its application to offset as the secondary goal. Senior representatives from three of the UK's top aerospace and defence companies were interviewed to establish the nature and degree of corporate ethical compliance at the corporate, national and international levels. Analysis of the interview data was framed against the 2008 Woolf Report recommendations. The overall research findings suggest that the UK companies operate a rigorous and robust set of ethical compliance measures, covering commercial activities, including offset. This supports a conclusion that broad-based UK defence-related ethical compliance procedures are some of the most stringent in the world. Whilst corruption allegations still surface, they are rooted in historical arms deals contracted before implementation of the Woolf Reports recommendations.

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Glossary

ADS	Aerospace, Defence Security and Space
AIC	Australian Industry Capability
BAES	BAE Systems
BPI	Bribery Payers Index
COLP	Compliance Officer Legal Practice
CPI	Corruption Perception Index
DESO	Defence Export Services Agency
DFID	Department for International Development
DIT	Department of Industry and Trade
DOJ	Department of Justice
DPA	Defence Procurement Agency
EADS	European Aeronautic Defence and Space Company
EDA	European Defence Agency
FCO	Foreign and Commonwealth Office
FCPA	Foreign Corrupt Practices Act
FDI	Foreign Direct Investment
GBS	Global Barometer Survey
GCC	Gulf Co-operation Countries
GCB	Global Corruption Barometer

GDP	Gross Domestic Product
GPA	Government Procurement Agency
IBE	International Business Ethics
IP	Industrial Policy
ITAR	Traffic in Arms Regulations
MOD	Ministry of Defence
NATO	North Atlantic Treaty Organization
NFA	National Fraud Authority
OECD	Organisation for Economic Co-operation and Development
OEM	Original Equipment Manufacturer
R&D	Research and Development
RRESI	Rolls Royce Energy System
SFO	Serious Fraud Office
SIPRI	Stockholm International Peace Research Institute
TI	Transparency International
UAE	United Arab Emirates
UK	United Kingdom
UKEF	United Kingdom Export Finance
USA	United States of America
WBES	World Bank Enterprise Survey
WBGI	World Bank and Governance Indicator
WB	World Bank
WTO	World Trade Organization

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Chapter 1

Trading in Murky Waters?

1.1 Introduction

In recent years, the global defence market has changed significantly, shifting from a seller's market, with a few suppliers meeting a high demand, to a buyer's market (with more suppliers than buying countries). Since the 1970s, as a result of increased competitiveness, offset, defined crudely as reciprocal investment, started to proliferate and became a popular and attractive option to boost employment and to support the economy, particularly those of emerging countries.¹ Offset is now a lucrative business, with reportedly some 130 countries worldwide having offset policies in place.² According to the Stockholm International Peace Research Institute (SIPRI) Gulf Cooperation Countries (GCC) are expected to spend about 1 trillion USD dollars on defence between 2013 and 2025.³ SIPRI also estimates that 105 billion USD dollars could be either reinvested or sourced domestically in the form of offset, creating more than 280,000 jobs, 84,000 in Saudi Arabia alone.⁴ This would result in an economic boost for Saudi Arabia and could potentially fuel demand for offset in other developing countries. So in more detail, what is offset? Most analysts define offset as an agreement where the buying country obliges

a foreign supplier to reinvest a proportion of contract value in the buying country, with the final aim being to improve its social and economic standards or its technological capabilities. Offset is divided into two main categories, namely direct and indirect offset. Direct offset relates directly to defence acquisition, whilst indirect offset is unrelated to the defence acquisition.⁵

Offset agreements can involve a wide range of reciprocal benefits, such as investing in Research and Development (RD), building new universities and facilitating technology transfer. Technology transfer, for example, is particularly attractive to countries that lack the expertise and the resources for manufacturing the product they purchase and require to import skills from overseas. The benefits from these opportunities accrue to the buying country, but sometimes it is not economically viable due to offset demands, that sometimes, exceed 100% of the main contract value.

Although offset represents an attractive investment opportunity and can be of tremendous gain, there are drawbacks to offset arrangements including its arguable susceptibility to corruption. Thus, offset has become a very sensitive topic.⁶

In earlier research, offset has been criticised for its lack of transparency.⁷ One of the biggest problems with offset is its complexity and ‘secrecy’. It has been argued by Transparency International that this lack of transparency is responsible for significant corruption risks.⁸ Offset is difficult to monitor because the offset costs⁹ are commonly hidden in the main purchasing contract and also they are not subject to a dedicated auditing process.¹⁰ Indeed, an earlier study published in 2013 found no publicly available audits of offset contract performance.¹¹ Transparency in defence offset arrangements is further hindered by the fact that the details of defence acquisition programmes are often obscured

due to national security.¹²

Another issue with offset is that to benefit from them, the buying country often has to contract external consultants and service providers. This can potentially create further opportunities for corruption, negatively impacting on the reputation of a foreign supplier. In 2013, law firm Latham & Watkins noted that ‘over half of all aerospace and defence industry enforcement actions involved bribe payments by third-party agents working on behalf of aerospace and defence companies’.¹³

Indirect offset has also attracted criticism. This is because it has a more flexible approach than direct offset, as it is unrelated to the subject of the acquisition, and thus more difficult to track. In addition to potential corruption risks, indirect offset also poses an economic risk, as it often remains impossible to establish the extent of the resulting benefits.

The performance phase of an offset can encourage corruption activity. Offset agents often have strong connections to national defence establishments. For example, they are usually former military personnel or public officials and may be tempted to solicit bribes in exchange for an award credit to offset the offset obligation.¹⁴ Also, the payment of bribes can take the form of payments into third party bank accounts. Moreover, each country has different offset demands and the award of the credit is not usually in monetary value, which makes it even more difficult to track and monitor and also less transparent.¹⁵

Government plays an integral role in a defence offset package. The attractiveness of the offset programme can be improperly used to influence the primary defence contract.¹⁶ For example, in 1999, South African government officials allegedly received bribes to help fund the election campaign.¹⁷ This highlights that poor transparency can potentially

lead to bribery and corruption in offset.¹⁸

International defence and acquisition governing bodies have implemented new policies to raise awareness of transparency in offset programmes. The European Defence Agency (EDA) for instance launched a code of conduct in July 2009 to increase awareness of offset programmes in European countries; all 25 countries were requested to voluntarily disclose their offset policies and guidelines public on the EDA website.¹⁹

Additionally, the Organisation for Economic Co-operation and Development (OECD) has criticised the UK for inadequacies in its bribery laws (UK Bribery Bill Draft). It has encouraged the UK Ministry of Justice to replace the existing framework to help fight corruption both, within the United Kingdom and in relation to international business.²⁰ An in depth research study carried out by Feinstein identified a number of key issues in the structure and methods of the arms trade.²¹ He argues that this is fertile ground for corruption and other illicit practices.²²

Although Transparency International has argued that offset is prone to corruption there is a lack of empirical evidence to support such arguments. Peter Platzgummer also mentions that there is a lack of quantitative data on corruption in offset, stating that only a few cases of corruption have been widely discussed.²³ All of the above problems raise questions regarding the need to establish the nature and extent of corruption in offset.

1.2 Research Questions

The main questions that lie at the heart of this study are: does corruption exist in defence offset programmes, and if so, to what extent?

1.2.1 Study Aim

The aim of this study is to explore the potential for corruption in UK defence offset programmes. To achieve the above study aim, the following objectives need to be achieved.

1.2.2 Enabling Objectives

This study's objectives are to:

- Offer a definitional taxonomy of corruption and analyse the implications of corruption
- Identify the nature and extent of corruption in defence and offset
- Determine whether corruption is associated with certain types of offset
- Assess the effectiveness of compliance, corporate ethics and regulatory control in the defence environment, especially in relation to offset
- Draw conclusions, and offer appropriate recommendations for government and industry to improve transparency and compliance

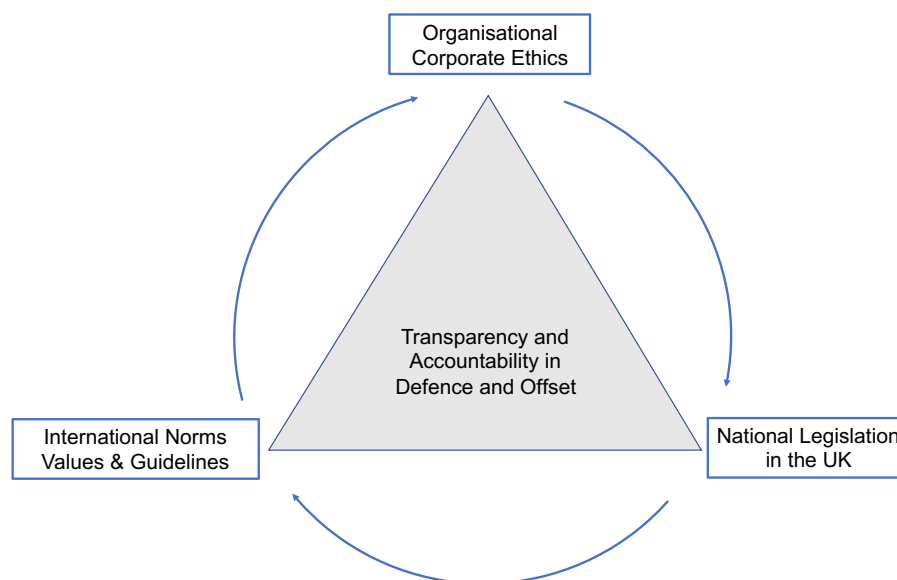
1.3 Study Value

The contribution of this study is linked to the fact that to this point there has not been any credible independent evaluation of the existence of corruption in defence offset. Offset in defence markets has attracted criticism globally, and, thus invited public scrutiny and speculation over the existence of corruption in offset programmes. However, there has been a lack of hard data to 'prove' that corruption is prevalent in defence offset arrangements.

1.4 Conceptual Framework

Corruption in offset is a controversial phenomenon, and it has proved difficult to determine if corruption exist in offset programmes. To assess the effectiveness of the ethical and legal systems employed to reduce the potential for corruption in defence offset, three levels of analysis will be employed. This study employs a conceptual framework, illustrated in Figure 1.1, to determine the nature and extent of corruption. Ethical compliance

Figure 1.1: Conceptual model



Source: author

and ethics is a fundamental feature of any organisation to protect and regulate behaviour of employees and other workers engaged in company project. The activities are considered to be critical functions and consequently also important in combatting and detecting corruption in an organisation. All employees have an obligation to understand their ethical role and engage ethically in day to day operations. An organization must have standards and procedures of conduct and internal controls in place to help deter criminal and improper conduct. This requirement is termed as a 'code of conduct', establishing

key principles and values that dictate expected levels of behaviour of an employee within an organisation. The code should also identify the clear channels for reporting misconduct and clarify the procedures to follow when the code is violated. These practices serve as the backbone to a company's operational conduct. All ethical requirements should be accessible to all employees, and need to be clear and effective.

The first stage in the conceptual model analyses the corporate ethical framework at an organizational level. The aim is to identify any weaknesses in the defence corporate ethical system. In order to evaluate ethical corporate policies, a number of interviews were held with the senior ethics compliance officers and Directors of governance at top UK defence companies to help identify the risks of corruption and the steps taken to safeguard the company brand.

UK defence companies have a legal responsibility to comply with the national legislative requirements set out by the UK government. Failure to comply leads to both reputational and financial risk.

The second level of analysis is an assessment of the national legislative framework that acts to ensure UK defence companies adhere to the UK governance requirements, reducing the potential for bribery and corruption. The UK legislative criteria aimed at combatting bribery is the Bribery Act, which is considered as one of the most powerful weapons to fight bribery in the UK and abroad. UK defence companies have an obligation to comply with all national anti-corruption practices. Part of the interviews undertaken will be devoted to establishing whether, and how, UK defence companies ensure compliance with the national legislative framework, principally the Bribery Act.

The UK aerospace and defence industry is the fourth largest in the world, and the third largest in Europe, with a global market share in 2016 valued at 6.4%.²⁴ This confirms the success of UK defence exports, at the same time, indicates the importance of UK's strong international export presence in countries across the Middle East, Asia, North America and Europe. Having said this, international compliance in defence exports is a critical issue. UK defence companies have an obligation to undertake business in foreign markets in an ethical manner whilst adhering to the national company policies and international compliance. Companies also need to be vigilant in detecting bribery and corruption due to the different political and economic geographical dimensions.

The third level of analysis aims to assess whether, and how, UK defence contractors achieve compliance with the legislative requirements and offset guidelines in overseas countries, so protecting the UK brand. It is important that ethical and legal compliance is achieved throughout the life cycle of business conduct, thus eliminating the risk of potential corruption.

1.5 Research Methodology

In this section, various research philosophies, research strategies and methodologies are presented, some of which will be deemed appropriate to the development of the research design in the present study.

1.5.1 Nature of Research

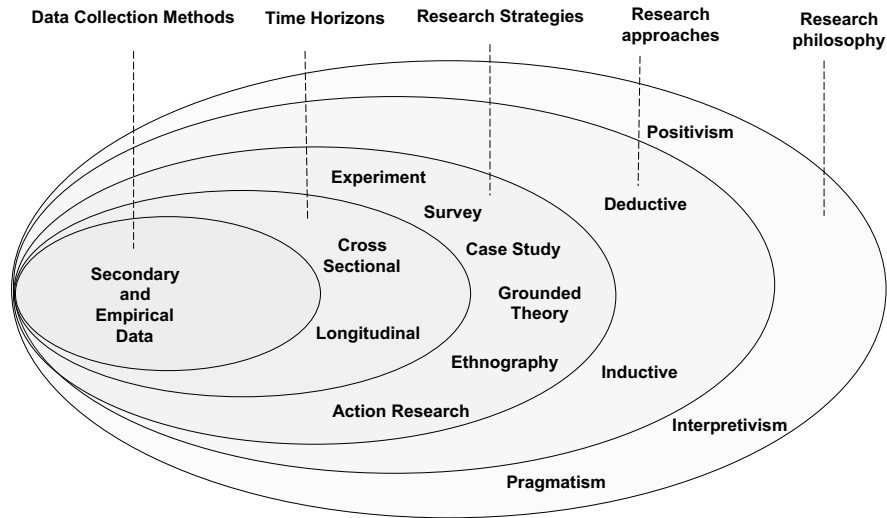
Understanding the nature of research and its purpose has attracted considerable interest. According to Walliman, research cannot be simply defined as the collection of data and

information.²⁵ Research is instead something that people undertake to discover, in a logical and a systematic way, the means of contributing to knowledge. Data collection is the process of inquiry and investigation, which is a part of the research that needs to be carried out with a clear purpose. Research has also been defined as an inquiry, consisting of two main elements: the process and the product.²⁶ The process is the area of inquiry and how it is fulfilled, and the product is the knowledge generated from the process and its evaluation. Research may have multiple objectives. According to Ghauri, these may include explaining, understanding, criticising and analysing.²⁷ Research philosophy is the study of the underlying philosophical assumptions in which researchers view the world, as well as the study of their own perceptions. The choice of a philosophical research approach is the reflection of the researcher's values and the methods selected to collect and analyse data are based on how the researcher believes the world can be seen. Research philosophies can be thought of as a lens through which a researcher can see the world. To conduct sound research, it is important to understand the assumptions that will form the research strategy and the reasons why a specific research method has been selected to develop the research design. The 'onion', as shown in Figure 1.2, is a diagrammatic framework developed by Mark Saunders on research philosophies and methods.²⁸

Higher Level Research Perspectives

For the purpose of this study, a subset of research perspectives has been carefully selected from the research onion in Figure 1.2. These higher-level research perspectives will be employed in the research process to help understand the study. It is a very important tool to understanding and carefully selecting a suitable research strategy and method when planning and carrying out research. There is a wide range of research philosophies and two of these (interpretivism and pragmatism) will be selected, emphasising flexibility.

Figure 1.2: Research options



Source: Mark Saunders et al, “Research methods for business students”, *Prentice Hall*, 2012.²⁹

The philosophical approaches are commonly reflected in the empirical research. The positivistic principle applies to the natural sciences, whereas, the interpretivist and pragmatist approaches relate to the social science.³⁰

Positivism: the positivist approach originally came from the natural sciences. This approach is concerned with observing and predicting outcomes. A positivist stance adopts what is referred to as scientific techniques to propose and test theories in a structured environment. The positivist tends to establish relationships between two or more variables. This involves the collection of data through quantifiable measures in a value-free and objective manner so that the researcher is not influenced by his values.³¹ *Interpretivism:* the interpretivist approach is a strategy of inquiry deriving from philosophy and psychology. Researchers interpret the experiences of individuals about a particular phenomenon through the individual’s experiences.³² The focus of this approach is the carrying out of

research through people rather than objects. Data are collected through the use of qualitative data by interviewing people and understanding the differing perceptions and experiences from a wider audience. Unlike the positivist stance, the researcher is value-bound on what is being researched a function of a particular set of circumstances and individuals at a specific point in time.³³ A qualitative study can be used to gain a richer insight into the problem and to understand the worldview through human participants. Therefore, this study requires an understanding of the nature and extent of corruption in defence offset programmes and needs to be understood from the researchers point of view which relates more to the interpretivist stance with its focus on human interests, meanings and understanding of what is happening in specific contexts. The *pragmatic* perspective adopts a worldview approach where the emphasis is placed on the research question and employs all a mix of research approaches to understand the problem.³⁴ This strand of philosophy incorporates both quantitative and qualitative methods and by using different approaches on the basis that they will be complementary.³⁵

1.5.2 Deductive vs Inductive Research

There are two key concepts that researchers use in research and these are known as the deductive and inductive approaches. Generally, the *deductive approach* is testing the theory through the means of empirical data.³⁶ This is when the researcher draws a theory based on what is known and this needs to be assessed through an empirical inquiry, which is the collection of data. This type of approach lends itself to a quantitative evaluation.³⁷ The researcher then needs to establish a collection data method to test the truth. By contrast the *inductive approach*, collects data to develop a theory.³⁸ This approach requires the researcher to provide empirical generalizations based on the data collection to develop a theory, and the data is linked to a theory through qualitative methods.

1.5.3 Research Strategies

It can be quite challenging to select a research strategy. The selection of a strategy can be guided through the research questions and aims. There are different research approaches to choose from in order to conduct a research study and these can be used for exploratory, descriptive and explanatory research.³⁹

Experiment

An experiment is an investigation in which a hypothesis is scientifically tested. In an experiment, an independent variable (the cause) is manipulated to carry out a test and allow further investigations. Saunders confirms that in the social sciences the validity of this strategy is difficult to be generalized because of the uncertainties of real life situations involve human subjects.⁴⁰

Survey

A survey is an exploratory way of conducting research of different behaviour and many disciplines. Experiments are carried out in a controlled manner, whereas surveys are more exploratory in nature, providing answers to research questions such as the 'how', 'why' and 'what'. Surveys are popular as they allow for the collection of a large amount of data over a sizable population which then can be further analysed to gain a better understanding of the subject area.⁴¹ This falls under the deductive approach. Surveys can take the form of a questionnaire or of structured observations such as an interview.

Case Study

The case study has been widely used in a wide range of disciplines including psychology, sociology, political science, business and social work. Yin defines a case study as

a research strategy for doing research, which undertakes an empirical investigation of a particular study, within its real life context using multiple sources of evidence.⁴² This is a method which encompasses a logical inquiry by using a prescribed data collection technique and data analysis making it a comprehensive research strategy. There are certain features that define a case study strategy as being reliable, this is when the research is able to evaluate multiple sources within the case study research which could provide answers to common questions. Case studies rely on multiple sources of information and this is referred to as *triangulation*.

Grounded Theory

Grounded theory is a strategy to understand the phenomenon under investigation. Researchers can employ various strategies which include comparative analysis, theoretical sampling and data collection. This approach adopts a combination of induction and deduction to build the theory.⁴³ In grounded theory, relationships between data are identified to develop questions and a hypothesis to test,⁴⁴ so that a new theory can emerge from data collection analysis. Identifying themes or issues from the collected data (coding) is key in grounded theory.

Action Research

Action research is a common approach used in the social science and can also be referred to as participant research. This strategy requires the researcher to be part of the organisation in order to diagnose a problem within the organisation, and then to propose a suitable solution to the problem. This involves a logical process of enquiry, monitoring, evaluation and actioning and can take place over time.

Ethnography

Ethnography is when the researcher becomes part of the study to understand the situation from an inside's perspective.⁴⁵

1.5.4 Pilot Study

In social science the term 'pilot study' can be used in two ways. One is to indicate a feasibility study, which is a trial run, and the other is to indicate a pilot study, which is a pre-testing of a particular research instrument.⁴⁶ The advantage of a pilot study is that it helps the researcher gain valuable insights into possible practical problems.

1.5.5 Time Horizons

Research can be undertaken in two different ways with respect to the research time frame, cross-sectionally or longitudinally. The cross-sectional study concerns a particular phenomenon that often employs a survey strategy, which takes place in the current time horizon.⁴⁷ By contrast the cross-sectional study is taken over a longer period of time in which people and events can be observed for longer and the researcher is able to exercise a measure of control over the variables been studied. This provides a deeper analysis of developments over a length of time.⁴⁸

1.5.6 Research Methods

The research method is a strategy of enquiry, which moves from the underlying assumptions to research design and data collection.⁴⁹ It is therefore important to identify the research methods to be used in a research project to also help with an understanding of the area of research. The most common classification of research methods identifies two

main options, namely the quantitative and the qualitative approaches. These are two traditional research methods play an instrumental role in collecting and analysing the data. Both offer the means of addressing a research problem but in different ways.

Quantitative vs Qualitative Methods

A quantitative methodology interprets the data by presenting it with the use of numbers as measurements or indicators of relevant variables to help researchers make sense of the research problem. Quantitative research makes use of questionnaires, surveys, and experiments to collect data that then can be interpreted in a statistical way. It focuses on the presentation of data in the form of a numerical or a statistical analysis. There is a clear distinction between the qualitative and quantitative methods. By contrast, a qualitative approach presents the data as descriptive narration with words, and attempts to understand the phenomena in their natural settings.⁵⁰ Qualitative research has an investigative and exploratory nature, due to the lack of knowledge about the problem. It used in research to used to understand the human experiences and perspectives of the problem. When using this approach, the researcher needs to be mindful that this method is open to bias and manipulation.

Interviews

An interview is a purposeful discussion between two or more people.⁵¹ Interviews are one of the one most widely used instruments in qualitative research. There are many types of interviews which can include, semi-structured and unstructured interviews. Interviews are carried out to help identify the key issues or links in the study. Structured interviews use questionnaires based on a set of planned questions and are conducted in a predetermined way. In this study's research, the interviewer has a set number of questions based

on topics the researcher wants covered in the interview. Semi-structured interviews will be used to collect quantifiable data that can be analysed. When interviewing, the interpretation of body language provides an important signal to understand the respondents' perceptions and feelings towards the question and the subject area.⁵² Researchers should be made aware of body movements and characteristics, non-verbal aspects of speech, or a delay in communication to responses.⁵³

Although the interview focuses on key topics, the interviewer has the opportunity to explore answers more widely. There is a predetermined list of questions, and the selected interview technique allows the researcher to gain an in-depth understanding of the study. This can be an effective way to gather detailed responses as opposed to telephone calls. The use of semi-structured face-to-face tends to have a limited number of pre-defined topics to discuss in an open-ended fashion. The advantage of such interviews is that they allow the researcher to seek clarity when answers are unclear. However, there are drawbacks to this research style. Due to the limited time, respondents are expected to provide an immediate response without the time needed for thought processing. In this research, this was minimised by providing the questionnaire in advance to respondents. Trust is an important feature in the interviewing process and could impact on the interviewing procedure in disclosing sensitive information. This can be minimized by advising the interviewees that all information is confidential, anonymised and saved in a secure database.⁵⁴

Secondary Data

Secondary data results from reviewing the previous literature and critically evaluating the work that has been carried out in the study area of the project.⁵⁵

Sampling

It is important to determine the sample size based on the research questions and aims of the project.⁵⁶ There are a wide variety of sampling techniques available that can be used, such as random sampling, theoretical sampling and purposive sampling. In random sampling the sample is selected randomly. According to Glauser and Strauss theoretical sampling generates a collection of data to develop a theory.⁵⁷ Purposive sampling involves using a non-probability form of sample which means that the researcher does not use a random sample. This form of sampling aims to select participants that are matched strategically against the population size. This type of sampling can include organizations, people and departments that need to reflect the aims of the project.⁵⁸ This type of sampling can be used in qualitative research, such as interviews and it is important for the researcher in selecting a wider population so that many individuals are reached to gain insights into the study field.

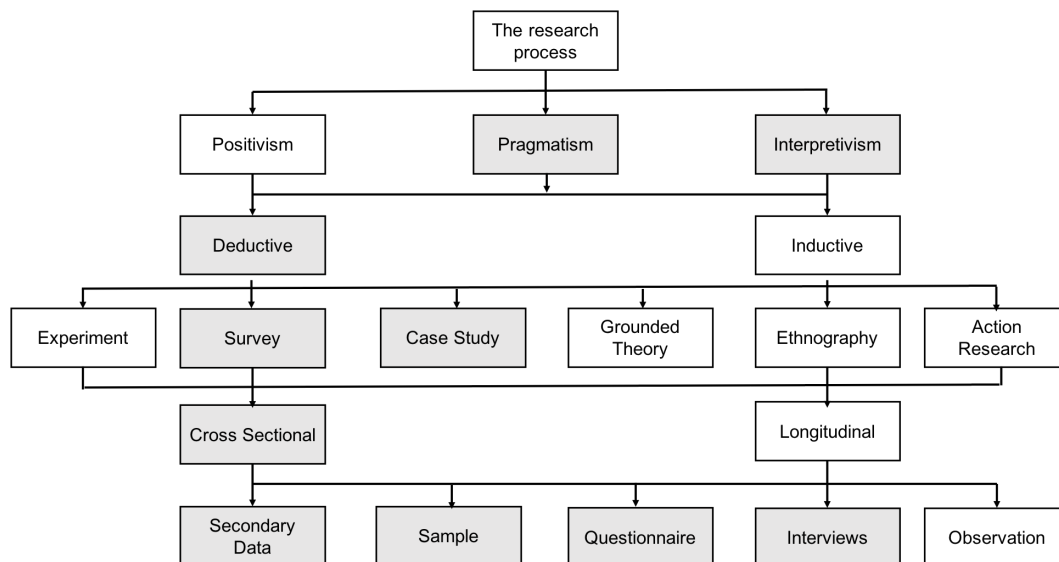
Questionnaire

The use of a questionnaire is a popular data collection method. The weakness is that answers cannot be controlled. The limitations of the research methods have to be considered when determining the results. The strength of this approach lies in its ability to collect a large quantity of data from a sizable population.⁵⁹ Thus it is key that answers provided by research subjects need to be answered without bias. The risk of surveys is that there could be a possible bias on how the interviewee answers the questions. Answers may represent a positive image and lie behind the truth. Questionnaires can be useful to measure the perceptions of people and attitudes towards a subject area. A large sample size carries the benefits of ensuring that the findings are more representative of the population.

1.6 Research Design

A research design is a logical task undertaken to ensure that the evidence collected enables the researcher to fulfill the research. The research stance used in this research is shown in Figure 1.3 and falls between interpretivism and pragmatism, to understand and interpret human perceptions and views of subjects in the defence community. This can influence the research methods as to how the research should be undertaken, and the appropriate selection methods that can be employed to collect the data. The chosen research method is a case study consisting of interviews and surveys. This case study is framed by the ‘how’ and ‘why’ research question, by examining a subject within its context in order to understand the subject. However, before embarking on the case study, it was necessary to pursue content analysis, searching specialised newspaper articles and online sources to understand the problem.

Figure 1.3: Research Process

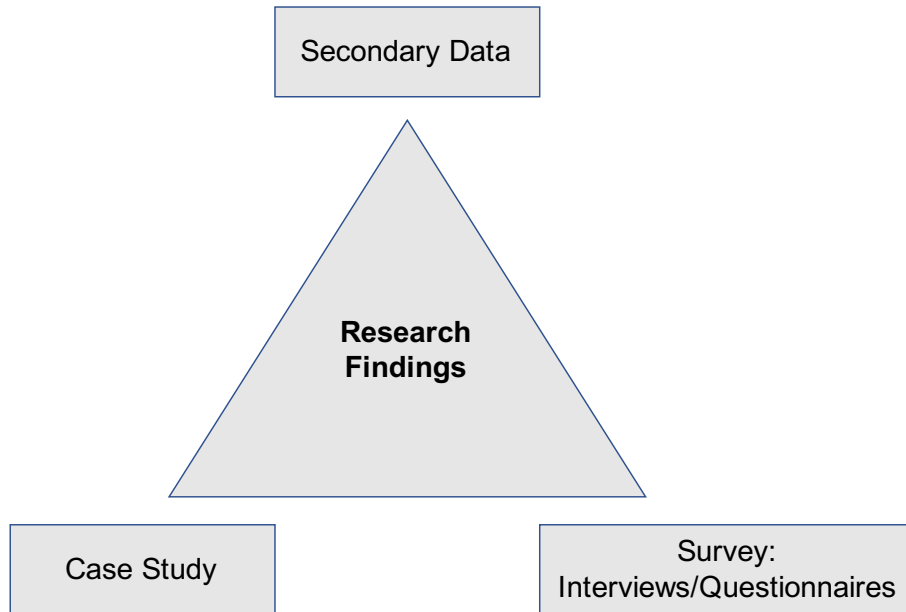


Source: Mark Saunders et al, “Research methods for business students”, *Prentice Hall*, 2012.⁶⁰

The deductive approach will be used by drawing on the literature in both corruption and offset to explore the boundaries of the topic. A case study approach of the UK aerospace and defence sector is adopted. In order to determine the potential for corruption in the UK defence, alongside offset programmes data will be collected through an empirical inquiry by means of semi-structured interviews. This study selected face-to-face interviews to allow the researcher to collect information about the attitudes and behaviours towards the subject. The present case study strategy of analysis uses data triangulation which is held to validate the accuracy of the data and findings.⁶¹ The triangulation tool is used to ensure validity of the research findings as it provides more than one source of evidence to cross-examine the research findings before a researcher is able to reach a certain conclusion.

Three converging lines of inquiry shown in Figure 1.4 will include three multiple sources: secondary data, a survey and a case study. In the case study analysis, relevant data were collected through secondary and primary sources: interviews and survey. Secondary data will be the key source of data in this research study. A literature survey will be carried out to review journals, specialized publications, governmental material, quality newspapers and published books. The semi-structured interviews were used with questionnaires to collect data. This conforms to the interpretivist research approach of using multiple methods in order to understand different views of phenomena and to explore the subjective aspects of the case study. A pilot test was run. Feedback was provided in the pilot test on the layout and structuring to ensure open-ended questions were placed before closed-ended questions. A set of predefined research questions were carefully designed to test the effectiveness of the defence ethical corporate framework, compliance and also to gauge an understanding of compliance effectiveness. A copy of this can be found in Appendix B Questionnaire. A sample was selected from the aerospace and defence sector.

Figure 1.4: Triangulation model



Source: author

A sample comprising the 11 leading UK defence companies was selected from aerospace and defence company population. Three of the biggest companies agreed to participate in the survey, representing a response rate of 27%. On the basis of their defence sales, these three firms account for between 40-50% of the UK aerospace and defence population.⁶² Although the number of survey participants are small, their size and contribution to the UK aerospace defence sales is disproportionately large, indicating that the survey findings is broadly representative of the population.

1.6.1 Interview Procedure

Firstly, due to the sensitivity of the subject, the interview process had to be carefully managed. Prior to each interview request, an introductory email was sent to the companies, on behalf of the researcher by the UK Aerospace, Defence, Security and Space Sector Group (ADS) to help gain access to contacts. Some companies expressed their willing-

ness to support the project, however, others expressed a concern on confidentiality. Each participant was provided with a follow up email explaining the nature of the research and the intended project aims with an attached copy of the questionnaire. Appointments were scheduled with each participant who confirmed with a map attached. Prior to accepting the interviews, a telephone call was requested by the companies to ensure confidentiality and additional details on the intended aims of the project were provided when necessary. The location of the defence companies varied within the UK. Out of the top 11 firms, 4 top firms accepted the invite to participate, with one cancelling two days before the interview date. An alternative contact was provided to the researcher to continue the meeting. The researcher immediately contacted the company notifying the key participant to establish contact, however, the company failed to respond back. Due to the project time constraints the interview could not be progressed. The researcher had to ensure the participants confidentiality was protected informing the participants that all data obtained would be strictly protected under the university's policies. All participants were provided an informed consent form immediately after the interview. One company refused to sign this. This provided a formal acknowledgement of confidentiality in handling the information. The participants were also given the opportunity to withdraw from the research, by providing a written notice within 7 days after the interview. During the interview, the body language and expressions of the participants were observed to be able to gauge if questions were difficult.

All hand written notes were immediately transcribed and keyed into the computer using the questionnaire document. A separate folder was set up and sub-folders were recorded in a systematic way by using an alpha code. All questionnaires were suitably hand coded and a designated folder for each respondent was generated and coded accordingly. Each participant was provided with an alphabetical code. Primary data, were ranked according

to theme headings based on the questionnaire. This was then analysed using Microsoft Excel. Coding allows the researcher to group similarities and differences together.⁶³ This was done to allow the researcher to understand the various narrative perspectives of the ethical framework and offset but also, to make sense of the participants views. The data were sorted and categories of information compiled. Some of the participants' responses were audio recorded to validate written notes and ensure accuracy and to avoid misinterpretation. The recordings were downloaded to a secure network as an MP4 file and later transcribed by selecting only relevant information. The transcribed responses were cross-checked against the written data. Corporate ethics in defence and offset were the central focus of the study, and company names cannot be disclosed due to the sensitivity of the study. Non-verbal communication in an interview for a researcher is just as important as responses, and this could give an indication on how the participants perceived the questions. It was always ensured eye contact was always maintained and that the interviewer's body language was such to communicate the respondents' openness and honesty.⁶⁴ The

Table 1.1: Top 11 UK defence suppliers

Company	Area of Study
Airbus	Corporate ethical framework
Babcock	Corporate ethical framework
BAE Systems	Corporate ethical framework
Boeing UK	Corporate ethical framework
General Dynamics	Corporate ethical framework
Leonardo	Corporate ethical framework
Lockheed Martin	Corporate ethical framework
QinetiQ	Corporate ethical framework
Rolls-Royce	Corporate ethical framework
Serco	Corporate ethical framework
Thales	Corporate ethical framework

Source: UK Aerospace, Defence Security and Space (ADS).

time allowed for each interview was between 45 minutes to 1 hour, however, some of the

interviews allowed for extra time. The location of the interview was at the respondent company office.

1.6.2 Time Horizons

A cross-sectional approach was employed to collect data using at a point in time.

1.6.3 Ethical Considerations

Ethics play an integral role in the research journey. Research ethics is a key ingredient which represents the appropriate standards of behaviour that need to be met throughout the life cycle of the research design phase, to ensure that no potential harm is caused to the participants. The nature of this study is sensitive and, accordingly had to be approached under the following conditions:

- (1) In carrying out the field research, the researcher introduced the university and explained the purpose of the research and intentions behind the data collection.
- (2) Ethics and offset are both of a sensitive nature and controversial topics. Due to the sensitivity of the subject, the participants had to be fully briefed on the aim of the research project. The researcher declared that all data collected would be treated with the strictest levels of confidence in accordance with the university data protection policy.
- (3) The questionnaire was also provided to give the participants an insight to the questions so that, if they were unsure of any information, they could seek clarity from the researcher in advance. The researcher had to clarify to the participants issues regarding the protection of data, offering a thesis copy to each of the participating companies.
- (4) An informed consent form was provided to each participating company once the interview concluded.

The following ethical considerations were taken into account throughout the fieldwork: participants must understand the nature of the case study and its implications; the existence of research risks to interviewees that could be harmful; data collection designed to ensure results are reported accurately and objectively; and any impact on privacy during data collection.

In order to carry out this study, prior approval was granted by the Research Ethics Committee of Cranfield University to review and approve ethical clearance for the fieldwork to be conducted.

1.7 Study Structure

Following the introductory chapter, Chapter 2 will construct a taxonomy of corruption. The aim of this chapter is to understand the definitional scope of corruption and the impact and cost of corruption. Chapter 3 then progresses to define and examine the nature of defence offset. This chapter will present the background knowledge of defence offset. Chapter 4 will critically analyse the extent of corruption in defence offset, globally. After this, Chapter 5 will examine the data obtained from the survey, using semi-structured questionnaires, to reveal possible weaknesses in UK offset compliance according to the conceptual model outlined in Figure 1.1. The closing Chapter will present conclusions from the analysis based on the findings. A set of recommendations will then be offered to promote policy improvements and suggestions for future research.

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Chapter 2

Concepts, Causes and Consequences of Corruption

2.1 Introduction

Corruption is a historical issue. Bribes were received in Egypt, and in Babylonian and Hebrew societies. In Rome, they were seen as a common feature of the election procedure for public office. Van Klavern argues that in modern societies corruption is common and that there is no separation between public and private interest.¹ He believes that corruption is a historical phenomenon and a problem that has never been dealt with systematically. In modern history, corruption existed in the 18th and 19th centuries. For example, in the 18th century, scandals were centred on prominent British figures in East India who became very rich through corrupt practices and who later returned to Britain to spread their corrupt ways. For example, Thomas Rumbold was a noble figure who sought to combine private interest and the means of state and company services, abusing his official position in India to gain personal advantage. On his return to Britain in the 1870s, his personal gains obtained through illegal practices led him to purchase a parliamentary seat through

deceptive activities. As a result of this, a parliamentary inquiry was opened and he was eventually fined for breaching public trust. Rumbold denied the allegations of corruption and it is believed that he attempted to bribe some individuals involved in the proceedings. Historians in England refer to this time as that of “Old Corruption”.² The term Old Corruption is used in a narrow sense to indicate the widespread use of financial benefits granted to British government officials to bribe, reward or buy privilege. It became an endemic feature of British politics in this period.³ The relationship between corruption and economic growth has attracted significant attention in the academic literature. Bardhan, for example, argues that

“although the requisite time-series evidence in terms of hard data is absent, circumstantial evidence suggests that over the last 100 years or so corruption has generally declined with economic growth in most rich countries.”⁴

Corruption is a complex subject. Against this historical backdrop, the aim of this section is to provide a conceptual understanding of the phenomenon. In order to understand the problem, the key features of corruption are identified by reviewing previous work carried out on the subject. The impact, consequences and causes of corruption are explored to offer a critical evaluation of the techniques used to measure the various forms of corruption. Chapter 1, has shown how offset has been criticized by Transparency International based on its lack of transparency and accountability.⁵

2.2 Defining Corruption

The 2016 Transparency International Corruption Perception Index (CPI) shows that in today’s world corruption has impacted on both rich and poor countries in many parts of the globe.⁶ Indeed, corruption has become a global phenomenon that has attracted widespread

interest in the academic sphere and the political front.

Corruption is an evil in societal behaviour and can be perceived as a malfunction of poor governance that reduces economic growth, lowers private investment and undermines a country's political and economic standards. It is a behaviour which deviates from the formal duties of a public or civil role and destroys trust in government, business, markets and countries. The battle to fight corruption has been challenging globally, and can be classified as a cancer with no existing cure, despite all the legal initiatives that have evolved, and are still constantly evolving, to stamp out the problem.

Although corruption remains, anti-corruption initiatives have registered some success. The UK Bribery Act was passed in 2010 as a legal framework to prevent bribery in commercial organisations and other criminal acts. The Foreign Corrupt Practices Act (FCPA) was introduced in the United States to rule on any form of corrupt practices. The OECD has also taken strong measures in eradicating corruption on a global scale by enforcing anti-bribery conventions to prevent, detect and investigate bribery. Forty one countries agreed to its conventions under which they are mandated to adopt the recommendations for combating bribery of public officials in international business transactions. Additional legal enforcement agencies, such as the FCO and SFO, have also designed a two year anti-corruption programme with Australia, Canada, the EU and the US to combat the "cancer" of corruption.⁷

Corruption encompasses various acts. It is difficult to determine a precise definition of corruption due to its complex and covert nature. A single definition of corruption does not exist in the literature, and there is an ongoing debate between different schools of thought to define corruption. So, how do these schools of thought perceive corruption?

Corruption can be defined in simple terms as unlawful and illegal acts which can take many forms, such as bribery, fraud, money laundering, embezzlement of funds, improper political contributions and nepotism. A common feature of these acts is that they all deviate from the organisational ethical practices and standards of behaviour.⁸

Transparency International, a world leading authority on corruption prevention, defines corruption as “the abuse of entrusted power for private gain” and this definition is commonly cited by a wide range of experts, academics, organisations and other anti-corruption bodies. The World Bank uses a more general definition of corruption as “the abuse of public office for private gain”.⁹ Heidenheimer and Johnston offer a three-pronged approach and argue that corruption can be associated with public-office-centred behaviour, implying that it is a deviation from duties in public office, and market-centred behaviour of civil servants, which causes harm to the public interest.¹⁰ A similar view was expressed by the UN Global Programme against Corruption that defined corruption as “*an abuse of public power for private gain that hampers the public interest*”.¹¹ Robert Klitgaard offers a broader definition of corruption as a set of: “*promises and threats*” and argues that it “*can be initiated by a public servant or an interested client*” and that it “*can entail acts of commission, and can involve illicit services which can take place inside or outside a public organization*”.¹² An alternative and comprehensive definition of corruption was proposed by Fitzpatrick who stated that corruption can be seen as a

“consensual crime shrouded in secrecy. The participants are willing, consenting and happy. Not a crime of passion, corruption thrives on secrecy and silence. It is only when a person feels cheated by a rare sense of duty and loyalty that he will report an instance of corruption. Rarely does a participant have an interest in revealing the deal. Few crimes are as hard to prove.

Perceived to be a victimless crime, it nevertheless has a devastating effect on our livelihood".¹³

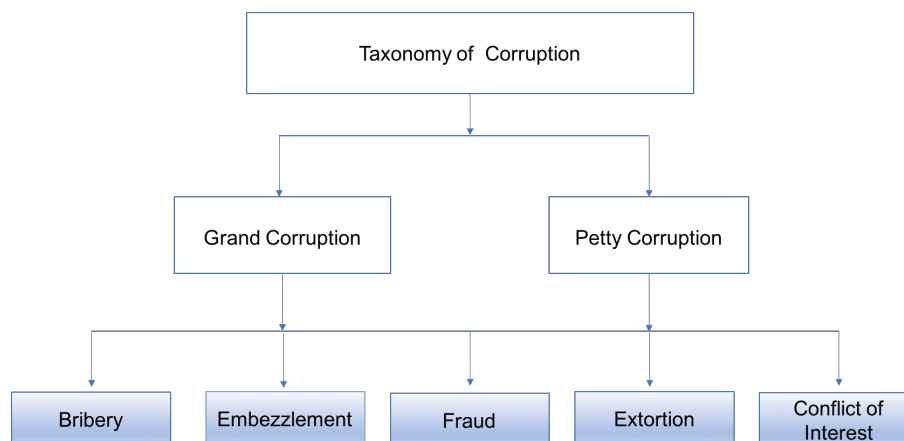
This definition supports the belief that corruption is a hidden crime that thrives under secretive environments. People involved in corruption cases are not often open to speak up, and as a result, corruption is very hard to prove. Although various definitions of corruption have been proposed, there is a general consensus in the existing literature to associate corruption with the abuse for public office.¹⁴ The next section will offer a definitional scope of corruption.

2.2.1 Taxonomy of Corruption

The 'c' word, corruption, encompasses many forms of illegal acts, which include bribery, embezzlement, fraud, extortion, conflict of interest and improper political contributions. The aim of this section is to provide a taxonomy of corruption.

Figure 2.1 shows a typical classification of corruption that can be used for a wide range of disciplines and that can be applied to the private and public sectors, nationally and internationally. Corruption can be classified into two main categories, petty corruption and grand corruption. Petty corruption consists of isolated transactions made by either public officials or individuals who can abuse their power to demand bribes and kickbacks, diversion of funds, or awarding in favour of a personal reward. It often involves governmental bodies with public officials that maintain a certain level of discretionary power and who can access public services and goods.¹⁵ Grand corruption, on the other hand, occurs on a much larger scale and involves vast sums of money. It can occur at a governmental level; for example, a supplier that solicits bribes from officials to secure a public contract.¹⁶ Jain describes grand corruption that involves political elite parties who abuse their power

Figure 2.1: Taxonomy of Corruption



Source: author

of authority in the decision making process of financial policies, defence contracts, construction and large infrastructure contracts.¹⁷ Both petty and grand corruption can include bribery, embezzlement, fraud, extortion and conflict of interest. The corrupt activities characterised under this taxonomy are illegal in most countries.¹⁸

The OECD describes bribery “as an offer or promise in order to influence a public official’s decisions to achieve a desired outcome”. Bribery is understood to be a paid amount of money that is given or taken between parties or individuals in return of a benefit. It is perceived as one of the most common forms of corruption.¹⁹ Benefits can be of a monetary value or intangible. For example, a bribe can be paid to an official by a supplier in order to win a contract.²⁰ Because bribery is an exchange between two parties, there is a supply side (the briber) and a demand side (the public official).²¹ Bribes can also be referred to as kickbacks, gratuities, sweeteners and pay-offs. Extortion occurs when an individual (the victim) is forced or threatened to pay a sum of money to someone else. For example, an official can be forced to make a corrupt payment to a person that uses some form of threat for the favour to be initiated.²² Extortion is an extreme version of bribery that in-

volves a force or pressure (unlike common bribery where engaging parties all consent to participate). Embezzlement is the theft of money or property by an individual who is not the owner and who, by virtue of his or her position, can gain possession of valuable items. An example of embezzlement on a grand scale is when an executive transfers a large sum of money into a private bank account after falsely claiming for the funds. Embezzlement can happen where there is a conflict of interest. Whilst bribery and extortion can involve two or more parties, embezzlement is a single handed act. Fraud is an economic offence that can deceive others, to gain an unfair or illegal advantage. Examples of fraud include counterfeiting, illegal trade, forgery and smuggling.²³ Conflict of interest is a “situation where an individual or the entity for which they work, whether a government, business, media outlet or civil society organization is confronted with choosing between the duties and demands of their position and their own private interests.”²⁴

2.2.2 Challenges of Measuring Corruption

Corruption is a very complex topic. It is often clandestine, illicit and sensitive in nature, and thus determining a single and appropriate methodology to measure it, is difficult.²⁵ Hard data are often challenging to acquire and, when available, have to be carefully analysed to avoid false and inaccurate conclusions. It is important to collect data from a wide variety of sources to obtain an accurate assessment and to remove any possible bias and potential error.²⁶ The question is how can corruption be measured if it is often concealed and hidden from the public eye? From the early 2000s, both the public and private sectors have taken significant steps to address corruption.²⁸ Since the 1990s, the number of available corruption indices that measure corruption have proliferated and some of these are indicated in Table 2.1. They include the Transparency International Corruption Perception Index (CPI) and the World Bank and Governance Indicator (WBGI). Alternative

Table 2.1: Measures of Corruption

Index/Survey Source	Definition of Corruption measured	Information Sources	Coverage	Interpretation
Corruption Perceptions Index (CPI)	Perceived corruption (composite) and some measures of corruption control	Statistical summary of expert assessments (e.g. expatriate business executives, senior business leaders, assessment by US, regional, and in-country experts)	Almost global depending on having sufficient sources. Annual (though not all data sources annual)	Cross-sectional ranking of perception of corruption focusing on business environment
Global Corruption Barometer (GCB) and related surveys by Transparency International	Bribe payments by households and public perceptions of corruption prevalence	Public opinion surveys and partial household surveys	69 countries in 2005, though not nationally representative in many cases	Comparative prevalence and amounts of bribe payments though quality of survey data needs validation
Bribe Payers Index (BPI)	Perceived willingness of companies from different countries to pay bribes, and sectors in which bribery most prevalent	Business experts	21 countries based on evidence from main emerging market economies. Last carried out 2002	Ranking of perceived willingness to pay bribes in different countries. Validity of perceptions and weighting uncertain
World Bank Enterprise Survey (WBES)	Bribe payments by firms	Surveys of businesses	62 countries, various years	Quantitative comparisons of bribe prevalence and cost

Source: Stephen Jones, "Measuring Corruption. OPM Briefing Notes", Oxford Policy Management, 2007²⁷

methods have been introduced to measure the actual experiences of corruption and an example of these is the Global Barometer Survey (GBS), the only worldwide public opinion survey that measures the perceived views and perceptions on petty corruption.²⁹ The Afrobarometer, the Latinobarometer and the Eurobarometer are alternative regional instruments that have been introduced to measure petty corruption in Africa, Latin America and Europe, respectively. Their aim is to capture public opinion on democratic and governmental issues by collecting data through household surveys. These surveys are useful tools in assessing the perceived level of petty corruption based on personal experiences.³⁰

The Transparency International CPI was the first instrument introduced to measure corruption in the 1990s and, today, is widely used by organisations, researchers and academics worldwide.³¹ It was originally introduced to measure public sector corruption and is a composite index that gathers data from organisations that engage with governments and businesses to capture the perceived level of corruption on a global scale by using surveys and expert opinions.³² The CPI is conducted on a yearly basis to assess global public sector corruption and ranks about 200 countries on a scale from 0 to 10, where 0 indicates a high level of corruption and 10 a low level of corruption. It captures information via a survey by asking questions related to bribery of public officials, kickbacks in public procurement and embezzlement of public funds.³³ However, it fails to provide a measurement of the volume of paid bribes, and it does not identify the actual causes of corruption nor the resulting impact.

The Bribe Payers Index (BPI) is a survey capturing data from the 28 world's largest economies, including the G20 countries.³⁴ It collects the views of about 3,000 business executives regarding their perceived level of bribery across the business and private sectors.³⁵ Each country is ranked on scale from 0 to 10, where 10 indicates a bribe-free

country and 0 a country where bribes are commonly received.³⁶

The World Bank survey collects data through interviews with enterprise owners and senior level managers in large and middle size organisations. It collects firm experiences from within the business environment and via government processes in relation to informal payments. The aim of this survey is to capture the percentage of firms that are likely to engage in bribes in order for them to accomplish a particular task.³⁷

Unfortunately, all these indices can only provide an estimate of corruption and determining an accurate measure of corruption is an ongoing challenge. The survey strategy is used to collect data on direct corruption experiences and to assess corruption. Surveys can be used to target a specific population group and to gather data through individual responses, interviews and questionnaires. The collected data can be based on an objective opinion that relates to previous experiences of corruption, or can be subjective and based on the individual's views and perceptions of corruption.³⁸ The results of a survey are used for monitoring and evaluating corruption and can assist in taking corrective measures and defining new approaches to fight corruption. For a survey to be valid, it is important to select a suitable representative sample of the population and this is a key aspect of the research process with respect to data validation.³⁹ For example, a sample of the general public that is unlikely to have direct experience with the public sector would not be a valid sample to study corruption in the public sector compared to people who have direct experience with governmental environments.⁴⁰ Each method used to measure corruption offer in different ways some strengths and weaknesses, and these are presented in Table 2.2. Perception-based indicators are arguably the most common methods used in assessing corruption. They provide subjective opinions and perceptions from experts and citizens in a given country.⁴¹ Composite indicators, instead, are used to quantify large statistical

Table 2.2: Strengths and Weakness of Corruption Instruments

Type	Strengths	Weakness
Global Corruption Barometer	It is the only worldwide public opinion survey to gather public views and experiences of corruption	GBC offers perceptions of people's experience of corruption in various institutions but fails to assess institutional framework
Corruption Perception Index	Measures corruption on a wide scale The index uses a large scope of primary sources Plays a large role in interest groups, lobby groups and campaign groups	The CPI does not provide a real form of measurement It only measures one form of corruption, which is public sector corruption
Bribery Payers Index	The data captured in this form of measurement is on the supply side of international bribery. It only focuses on bribery in the private sector	BPI does not measure institutional problems bribery. This index assess on how often bribes are paid, but does not provide volume and causes of bribery
World Bank Enterprises	This covers a wide variety of countries and the data collected is over a large scale and covers both direct experience and perceptions of corruption	The methods to gather the data have been modified and the coverage of the countries have been increased

Source:Adapted by author Sofia Wickberg, "How to Guide for Corruption Assessment Tools".⁴³

data in a single data indicator. This is a widely used measure (e.g. the CPI) that captures corruption from a global perspective that focuses on one particular form of corruption.⁴² Selecting the correct instrument to measure corruption largely depends on the type of corruption to be assessed.

2.2.3 Measuring Corruption: An Empirical View

Due to the nature of the topic, data from real cases of corruption are limited, and, therefore, assessments can often only be based on individual perceptions and experiences. Because studying corruption is a complex task, a clear understanding of the forms of corruption must be achieved before the phenomenon can be properly analysed. Corruption needs to be assessed in relation to its extent, place and trends, and all these need to be carefully taken into account.⁴⁴ For all these reasons, measuring corruption has become a controversial subject in the literature and has sparked off a lot of debate on what methods are reliable and valid. There is a strand of literature that criticises the available methods to measure corruption.

The CPI, for example, has been criticised by many academics. Thompson argues that the CPI extracts perceived data rather than real data, because the views expressed in the CPI index are only based on respondent perceptions of corruption. He argues that corruption data should be collected using different sources, from a wide variety of backgrounds, to make the results reliable and unbiased. The CPI does not cover the average citizen on the street, who could potentially be a victim of illicit behaviour, and instead, opinions are based on experts. Thompson argues that experts' perceptions of corruption may be interpreted differently by other individuals as perceptions depend on previous experience, and may differ on the basis of class, gender and age.⁴⁵

Anderson and Heywood argue that the questions posed in many of the CPI surveys relate directly to business transactions, with the aim of understanding the nature of bribes paid in the public sector alone, and the results are largely based on western opinions. They argue that the CPI fails to identify the types of corruption because, for example,

it does not distinguish between grand and petty corruption and their effects.⁴⁶ Shah and Thompson argue that the CPI index relies on expert assessments of corruption, including feedback from expatriates, and therefore represents only a very small proportion of the population. They argue that as a result, this may lead to a poor understanding of corruption in a particular country. It is difficult to achieve an objective opinion of corruption as most people hold biased opinions of government.⁴⁷

2.2.4 Measuring and Understanding corruption at the Firm Level

There is widespread interest in measuring corruption and trying to identify its causes and consequences. A study carried out by Mauro found that high levels of corruption are often associated with lower levels of investment and growth and this discourages foreign direct investment and capital inflows.⁴⁸ Konold explores the public's perception of corruption in Senegal, by using public opinion and survey data from the Afrobarometer. This was part of a research network that conducts public attitude surveys on democracy, governance, economic conditions and related issues in more than 35 countries in Africa.⁴⁹ The respondents define corruption differently, depending on their individual beliefs. The way questions were framed allowed the respondents to reply "dont know" and, as a result, there were observations that could not be captured. It was found that questions based on direct corruption experiences were not a useful way to engage. The research shows that individual perceptions were tailored according to the surroundings and that perceived corruption varied significantly across geographic regions. The author also concluded that measuring corruption is challenging, due to lack of hard data, and because corruption often takes place away from the public.⁵⁰

Since the 1990s, the World Bank has used firm level surveys in various countries to iden-

tify and provide insights on the causes and consequences of corruption at firm level. As a result, in recent years, data from firm level surveys have been widely used by scholars, as an individual unit of measure to help researchers explore firms' experiences with corruption.⁵¹ When collecting firm-level survey data, researchers rely on two important factors: trust regarding the data received and trust with respect to the firms' responses. These surveys may lead to truthful responses, but, at the same time, could also produce non-random responses to information that are politically sensitive. As a result, the data obtained could be contentious.⁵² Politically sensitive research data were investigated by Jensen by examining non-responses and false responses.⁵³ It was found that individual responses could be perceived as difficult when they answer sensitive questions. He argues that it is important for researchers to consider the incentive of firms and the political environment when assessing corruption at a firm level because these could alter the responses to the questions asked. Jensen put forward a number of suggestions to deal with these issues, including the addition of descriptive statistics on the non-responses to the research document to show any bias.

The World Bank carried out empirical work in 72 countries and across more than 44,000 firms.⁵⁴ Results suggest that press freedom plays a vital role on how firms report corruption, and this can therefore be a significant issue for a country's economy. This judgment was also strongly supported by Jensen.⁵⁵ Press freedom is the ability to express ideas and opinions freely in a critical manner and without any interference and has an important role to play in reducing corruption.⁵⁶ Observations confirm that the lower is the press freedom, the lower are the firms responses, and the higher is the non-response rate. Jensen confirms that political governing countries were less likely to understate the level of corruption and this could potentially lead to an inaccurate assessment of corruption and unsound policy recommendations. It was also observed that non-responses can be useful to researchers

that use a firm-level survey technique strategy as they could indicate potential problems. Non-responses and potential false responses to politically sensitive questions can potentially provide insights on the business environment and on the levels of corruption.

The conclusions of the Policy Research Working Paper confirm that perception data are easier to obtain than direct data on corrupt deals, recognising that perceptions represent a challenge.⁵⁷ It is argued that perceptions are formed by what people think is taking place, rather than personal experience. When corruption is measured based on perceptions, there is no indication on what type of corruption is being measured. Perceptions are based on individual opinions, on what people perceive to be corrupt and this can differ from one person to another. For example, a person living in a corrupt country may not perceive an action to be corrupt as it represents accepted behaviour, whilst another individual in an honest country might hold the opposite view and consider the action to be corrupt. An individual's state of mind may affect the responses. Most critics argue that there exists a gap between perceptions of corruption and actual corruption (real corruption).⁵⁸

Additional research also concludes that measuring corruption is challenging because of the lack of hard data.⁵⁹ The United Nations Development Programme highlights that corruption can be measured using a variety of approaches, but also recognises it is challenging to assess large amounts of data, especially when different countries are compared.⁶⁰ Others argue that the use of aggregate indices, such as the CPI index, are useful to monitor levels of corruption in a country and to assess real forms of corruption.⁶¹

2.3 Nature and Extent of Corruption

The term globalisation was commonly used in the 1980s to reflect technological advances that make it easier and quicker to complete both international trade and financial transactions.⁶² The scale of international globalisation has dramatically risen since the 1980s, and previous research by the World Bank found that globalisation has led the developing economies to experience lower poverty and inequality.⁶³

As new companies enter the global market, the level of competition to explore markets in the emerging economies becomes higher and higher and this makes commercial life increasingly more challenging. Research conducted by the World Bank and the International Monetary Fund show that some foreign investors pay bribes to officials to win a contract in emerging economies.⁶⁴ The OECD also found that bribes are generally paid by third party agents to win contracts and almost two-thirds of the foreign bribery cases examined relate to sectors that involve contracts or licensing through public procurement.⁶⁵

Bribery is one of the most widespread forms of corruption. A survey carried out in 2007 shows that 43% of the respondents believe they failed to win business contracts over the previous five years due to bribes paid by the industrial competitors.⁶⁶ A Transparency International Report claims that managers regularly bribe public officials in order to win governmental contracts.⁶⁷ The World's largest survey, the Global Corruption Barometer 2017 aims to capture citizens' views and direct personal experiences in bribery in 119 countries. The findings suggest that bribery exists in all countries. The European Union had a 9% bribery rate whereas the Middle East and North Africa had an average of 30%. Whilst Latin America, Caribbean and Asia Pacific countries had an average of 28%.⁶⁸ An additional Transparency International Report found that 40% of countries still need to

improve their performance in international business transactions.⁶⁹

Table 2.3 shows a selection some of the cases investigated by the Serious Fraud Office (SFO). The SFO is one of the leading law enforcement organisations overseeing cases of foreign bribery. Reportedly, since 2006, the UK has had 11 active bribery and corruption cases, with a further 18 cases under consideration. In total, there have been over 150 cases of international bribery under investigation.⁷⁰ The SFO is investigating allegations that relate to fraud, bribery and corruption involving leading UK companies.⁷¹ These allegations relate to irregularities that concern third party consultants. The use of intermediaries calls for stronger and more effective due diligence and oversight of corporate compliance programmes.⁷²

2.3.1 Public Sector Corruption

Transparency International defines public sector corruption as: *“any kind of abuse of entrusted power for private gain that can take place within a government structure or government body”*. Public sector corruption includes various types of unethical act, such as bribery, embezzlement and fraud. For example, public officials could be bribed in the procurement process, while fraud could occur in bid evaluation and when invoices and contract obligations are processed.⁷⁹

Transparency and accountability are two important concepts that play a significant role in contributing to good governance in the public sector. Transparency can be described as assessing the achievements of a government for the citizens so that the information can be disclosed to the public. For example, external audit reports should allow for public access and disclose the company’s financial performance. This allows the public to gain trust in

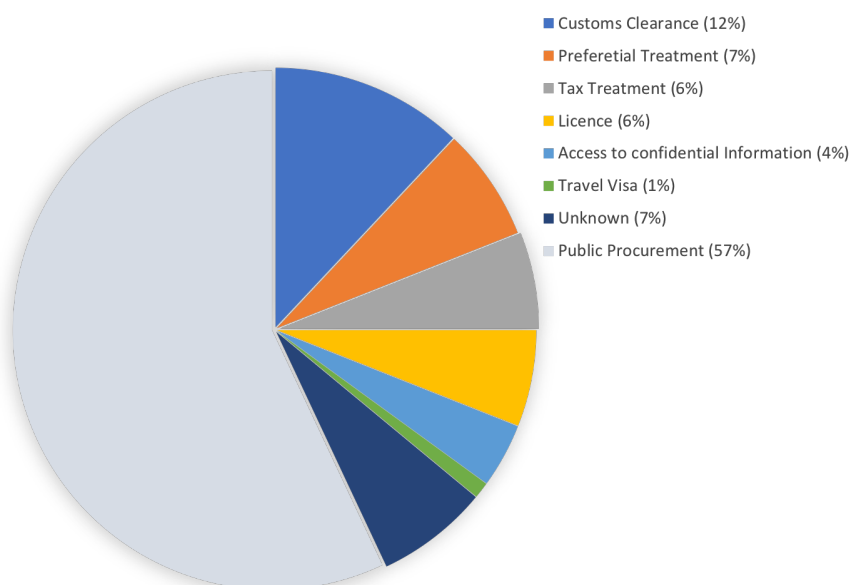
Table 2.3: Recent High Profile Foreign and UK national bribery investigations

Date	Company	Conviction
2014	Rolls-Royce PLC	The Serious Fraud Office (SFO) was investigating alleged corruption cases from 1989 to 2013 with two entities Rolls-Royce Holdings plc and United States incorporated subsidiary, Rolls-Royce Energy Systems Inc. The draft indictments include 11 counts covering multiple counts of conspiracy to corrupt under the pre-Bribery Act legislation, false accounting, and failure to prevent bribery under section 7 of the Bribery Act. ⁷³ The USA, Brazil and UK authorities reached a settlement with Rolls Royce. In January 2017, a Deferred Payment Agreement was reached and a settlement of 671 million pounds was agreed with Rolls Royce to settle the allegations. ⁷⁴
2014	Sweett Group	The Serious Fraud Office found that from 2012 to 2014 Sweett Group paid bribes estimated to GBP 500 000 to an official of the United Arab Emirates to win a contract valued at GBP 1 500 000. The company was charged under section 7 of the Bribery Act and pleaded guilty.
2016	Mondial	The investigation agency COLP found that two former executives of a defence company, paid an estimated \$200,000 to a US official to secure contracts in Afghanistan and Iraq valued at \$5,000,000. Both were charged under the pre-Bribery Act legislation and prosecuted. ⁷⁵
Ongoing 2016	Airbus Group	In April 2016, Airbus reported to the UK export Finance that it had found inaccuracies in applications for export support concerning the use of overseas agents. Airbus has an obligation to report any falsifying of information to the UKEF authorities. Following this self-disclosure, UKEF referred this information to the SFO. ⁷⁶ In August 2016, the SFO is investigating criminal allegations of fraud, bribery and corruption. The allegations relate to bribery irregularities of third party agents. ⁷⁷

Source: Implementing the OECD Anti-Bribery Convention⁷⁸

a company's services and provides an opportunity to raise any concerns about weak financial practices and corruption.⁸⁰ This is a paramount requirement for global businesses. A key component of good governance is ethics; that is, the set of values and principles which guide behaviour in business. An ethical framework fosters good governance and integrity in managing day-to-day business activities. Previous research in 2015 showed that 107 companies show little evidence of anti-corruption programmes and that 37% of the defence companies under scrutiny failed to provide any evidence of such programmes.⁸¹ Public sector corruption can be described as a failure in governance. This can be due to a spectrum of factors that includes the quality of public sector management, the nature of accountability and transparency activities between the government and the citizens, the legal framework and the level of transparency of processes and policies. An example of public sector corruption is when an employee deviates from the legal framework to receive a gift or a reward, or when information is concealed to seek monetary value.

Figure 2.2: OECD Percentages of Bribes Paid in Public Services



Source: Adapted from "OECD Foreign Bribery Report", OECD, visited online on 12 December 2017⁸²

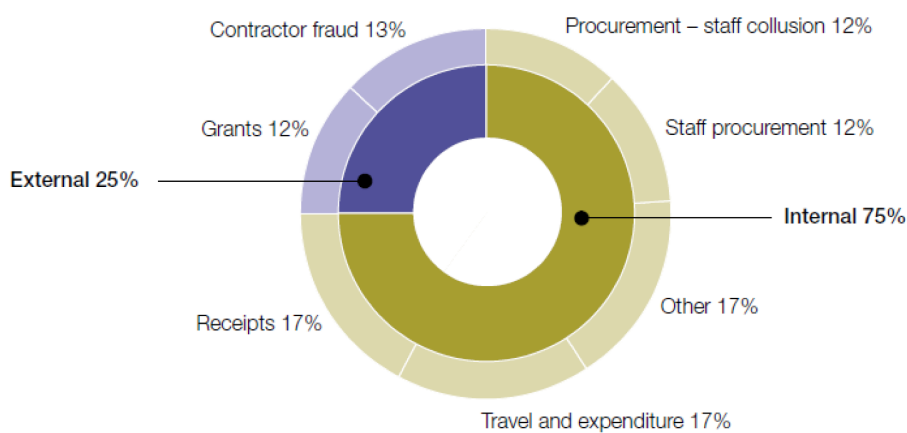
Public procurement is often perceived as corrupt and has been on the agenda of many anti-corruption organisations, such as Transparency International and OECD, in relation to programmes that develop policies to raise awareness of corruption on a global scale. The OECD analysed 427 international bribery cases and found that 57% of these involved bribes paid in public procurement. Figure 2.2 shows the percentages of bribes paid in public services. It shows bribes were paid in customs clearance (12%), tax treatment (6%), receipt of licences (6%), access confidential information (4%) and to travel (1%).⁸³

Public corruption is devastating and has a huge impact on state revenues. In 2004, the World Bank estimated that about \$1 trillion dollars is spent in bribes each year.⁸⁴ This loss of public funds, as result of increased expenditure, significantly hampers the economic growth of a country,⁸⁵ and increases distrust of governmental institutions, destroying public confidence in governmental and public administrative processes. For all these reasons, global corruption in the public sector requires more attention.⁸⁶ The 2016 Transparency International CPI Report indicates that public sector corruption is perceived as a global issue that needs to be addressed. It was found that corruption levels are perceived to be higher in countries that suffer poor functioning of public services, such as poor policing and judicial services. It also found that the existing laws are often violated and legal procedures undermined, particularly in countries belonging to Asia, the Middle-East and Africa. On the other hand, countries with robust monitoring procedures are perceived to have lower levels of corruption in the public sector.

Fraud and bribery are arguably a problematic feature of public procurement. The National Fraud Authority (NFA) estimates that approximately £2.3 billion is annually lost due to procurement fraud in the UK public sector.⁸⁷ So, how big is the problem? The

Department for International Development (DFID) carried out investigations of allegations of fraud. The fraud team received a total of 429 allegations between 2015 and 2016 (see Figure 2.3).⁸⁸ The Foreign and Commonwealth Office (FCO) found that, between 2015 and 2016, most fraud cases occurred on foreign soil, whilst only a small percentage of bribes involved staff in the UK. Most of the fraud that occurred internally involved only a few departments covering contracts and procurement (13%) (see Figure 2.3). A large number of fraud cases occur in countries with high levels of conflict and with fragile governments, including Afghanistan, Somalia, Syria and the Democratic Republic of Congo.⁸⁹ These are countries identified by the 2016 TI CPI index as suffering the most severe levels of corruption.⁹⁰

Figure 2.3: Fraud Allegations between 2015 and 2016



Source: National Audit Office Report Department for International Development, Investigation into the Departments approach to tackling fraud⁹¹

Impact of bribery

Bribes are a common form of corruption that occur both in the private sector and in local government. In 2016, the Institute of Business Ethics (IBE) claimed that the most prob-

lematical business ethics issues were bribery, fraud and money laundering.⁹² The 2011 Transparency International Bribery Index ranked 28 leading international and regional exporting countries in terms of the likelihood of their firms to bribe abroad. The results indicated that Russia and China were perceived as the countries most likely to pay bribes abroad, whilst the Netherlands, Switzerland and the UK were perceived as the least likely to do so. The overall results indicate that bribes were perceived as common across all sectors, with public works, contracts and construction sectors being perceived as the most corrupt.⁹³ Bribes were most often paid to low-level public officials: for example, to speed the delivery of an administrative process.

The impact of bribery on an organisation can be harmful. A study conducted by the Harvard Business School analyses the impact of bribery on corporate performance.⁹⁴ The aim of the study was to determine how bribery impacts on firms' operations across four areas: external business relations; interactions with regulators; public reputation; and the morale of employees. The outcome of the investigation shows that the morale of employees drops when organisations use bribery to gain success, and this also negatively impacts on reputation and stock market return. Other data from a survey were assessed by Pricewaterhouse Coopers, an organisation that advises services firms on legal issues. The analysis of this data, collected from 2009 to 2011, found that 10% of respondents (from a total of about 500) had reported that their firm was involved in bribery cases. Many of the respondents worked for companies with a reputation for bribery in countries like Russia, Ukraine and South Africa. In addition, the findings reveal that other countries such as Australia, the United Kingdom and the United States are involved in bribery but to a much lesser degree as compared to other countries.⁹⁵

2.4 Combating the ‘cancer of corruption’

In a speech, former President, James David Wolfensohn, of the World Bank, stated:

*“If the new compact is to succeed, we must tackle the issue of economic and financial efficiency. But we also need to address transparency, accountability, and institutional capacity. And let’s not mince words, we need to deal with the cancer of corruption”.*⁹⁶

This speech highlights that corruption is an economic danger and that transparency, accountability and the ability to strengthen processes and resources of organizations are all areas of significant concern.

Over the years, there has been a proliferation of global anti-corruption initiatives aimed at influencing individuals to carry out their duties in an ethical manner with the aim of discouraging illegal acts, such as bribery, embezzlement, fraud, conflict of interest and extortion. Conventions and regulatory frameworks have emerged, both nationally and internationally, to provide guidelines for governments, organisations, companies, stakeholders, contractors and officials to comply with the domestic and international laws and to promote good governance and eliminate risks of harm. Failure to comply with these regulatory laws could result in prosecution of offenders and fines against businesses. The UK Bribery Act is the legal initiative, launched in 2010, that the UK applies to all UK companies and to foreign companies that engage in business with the UK. Failure to comply with the UK Bribery Act results in significant implications, such as the payment of penalties. The UK Act places very strict requirements on all companies that operate in the UK, as well as stricter provisions on compliance.⁹⁷ The OECD Convention came into force in 1999 with the primary aim to criminalise international foreign bribery in business transactions. The convention includes 41 countries and introduced legislation to crimi-

nalise the act of bribing foreign public officials.⁹⁸ The Anti-Bribery Convention was the first legal international anti-corruption initiative to focus on the supply chain of foreign bribery.⁹⁹ In 1977, the United States became the first country to criminalise payments of bribes to US citizens representing companies and foreign government officials. The law was heralded as an important and necessary measure to restore public confidence in the country.

2.4.1 Causes and Consequences of Corruption

As previously discussed, corruption can have a devastating impact on the economy and stability of a country. Mauro confirms that corruption has a direct impact on the economy and affects both growth and development.¹⁰⁰ Countries with high levels of corruption have lower levels of investment and slower economic growth. The global challenge in reducing the cost of corruption is complex. The World Bank shows that over \$1 trillion is paid in bribes each year.¹⁰¹ The causes of corruption are influenced by a number of factors. Corrupt activities are generally associated with government and public officials, as they play a lead role in using their discretionary power to influence decisions and outcomes. In developing countries, corruption is perceived to be endemic due to the lack of institutional governance. For example, public officials have the power to issue permits, licenses and passports. Often the processing times to obtain these documents is lengthy, but a bribe can be paid to an officer to speed up the process. This results in abuse of public power for personal gain.¹⁰² There are a number of systematic features that have been identified that can encourage corruption. These are weak institutions, lack of accountability and transparency and lack of democracy. Weak institutions can foster corruption. They generally lack the control and monitoring systems to prevent it, thus creating a conducive environment for illicit practices. Corruption can thrive in conditions

where there is a general lack of accountability and transparency. Countries that lack democracy, experience high levels of corruption and this often results in a lack of trust in the government and a weak democratic system.

2.4.2 Correlation between Defence and Corruption

Corruption poses a significant problem in the defence sector, and allegations of corruption in this sector are commonplace. SIPRI reports that 40% of corruption occurs in foreign transactions involving arms deals.¹⁰³ Defence contracts are often drawn up under secretive conditions, and this makes the defence contracting process vulnerable to corrupt activities. Defence projects are capital intensive, and thus bribes can potentially be hidden in the contract. The lack of transparency and the secretive nature of arms deals can exacerbate the risks of corruption. Governments invariably play an instrumental role in purchasing arms. In 1985, the UK and the Saudi governments signed the government-to-government Al Yammah contract. A slush fund was used to entertain Saudi officials, and to offer holidays, fleets of sports cars, shopping and lavish holidays. Allegedly, £6 billion was paid in corrupt commissions through a network of agents and middlemen.¹⁰⁴ These serious allegations of corruption were the consequence of ineffective oversight, transparency and accountability. Defence firms are not always required to provide full transparency of their defence spending on national security grounds, and hence are potentially able to engage in misconduct. The secrecy that surrounds defence deals allows firms to create barriers to transparent oversight, leading to potentially corrupt practices. Offset is an inherent feature in defence contracts and has become very controversial. Such parallel arrangements have sparked a wave of concern in defence deals.¹⁰⁵

2.5 The Research Gap: is offset tainted by corruption?

An offset 'agreement' is an attachment to the primary defence deal, and may influence the ability to secure large overseas deals. Corruption in the arms trade has attracted considerable interest with the media. A 2010 Transparency International Report raised awareness of (alleged) corruption in defence offset. The Report was highly critical of offset, highlighting the most controversial cases, one them been the infamous South African arms deal. The 1999 South African arms deal has generated massive attention over the high volume of allegations of corruption in procurement and offset. As part of the offset deal, it was promised that 65,000 jobs would be generated in South Africa, providing employment opportunities that would create R104 billion in economic activity, each job estimated to have cost £107,000.¹⁰⁶ In 2010, the South African Department of Industry and Trade (DIT) confirmed that only 28,000 direct jobs had been created as a result of the offset arrangement.¹⁰⁷ The exact nature of corruption in offset remains unconfirmed in the South African arms deal. For example, the Swedish firm Saab had arranged to invest in the South African tourism industry. As part of the investment, Saab claimed \$3,383 in credits for every Scandinavian visitor from 2001 until 2011.¹⁰⁸ Saab was receiving millions of dollars in offset credits for a paltry investment estimated at \$3m. Holden argues that the nature of corruption in offset is hard to evaluate and measure, and suggests that the tendering process had been manipulated and allegedly tainted by corruption, leading to lack of transparency in the offset credit system and employment opportunities. The biggest challenges in offset is the lack of transparency and the complexities exacerbated by secrecy.

Defence offset has attracted criticism in recent years mainly due to the lack of data and hence debate on the existence of corruption in offset. Few empirical studies have

been carried out into corruption in offset. Peter Platzgummer conducted a comprehensive quantitative analysis into corruption in offset. He cited over 20 articles on alleged corruption, but found no examples to prove it had occurred. He argues that corruption occurs in procurement,¹⁰⁹ especially in the pre-contract phase, with bribes used as incentives to favour potential suppliers. In the South African case, allegedly high ranking officials were bribed by prominent suppliers to influence key decisions in the deal. The SFO documents state that “between 2000 and 2005, South African agents allegedly received over £70 million through BAES offshore marketing accounts”.¹¹⁰ In a separate Portuguese case, allegations were also made of corruption in offset. The corruption allegations centred on Portugal’s 2004 submarine purchase by a German company Ferrostaal and Thyssen.¹¹¹ Two investigations were begun: one was an inquiry into allegations of bribery in the main deal, and the second focused on the offset programme. Suspicions centred on the integrity of the offsets programme. According to a report, a number of problems occurred in the implementation of the offset.¹¹² There was forgery, but this related to a lack of transparency in the management of the acquisition process leading to a failure in the offset project.¹¹³ By 2012, offset was supposed to have been completed but by 2010 only 25% had been executed.¹¹⁴ In Germany, in December 2011, two former Ferrostaal managers were charged with bribery and corruption, involving Portuguese and Greek officials. Judicial prosecutions are still underway regarding the purchase of two submarines for the Portuguese Navy and related offsets.¹¹⁵

Corruption in offset remains a grey area in defence contracts, as it is difficult to ascertain where the corruption occurs. The 2010 Transparency International Report highlights the possible pathways of corruption in offset, but fails to provide solid evidence. All the alleged cases mentioned in the report are based on allegations of corruption and none have been proven. Most of the cases listed in the TI report reflect irregularities in the

arms-procurement process and failure of offset promises; however, as identified earlier, the main implications have been made against the lack of transparency in defence procurement. Although there has been a lot of speculation and public scrutiny over the use of offset, the evidence on corruption in offset is sparse, and certainly there is no evidence to prove that corruption is endemic. There is a need to carry out further work to confirm the extent of corruption in offset. So the question remains, does corruption exist in offset programmes? This study employs the case study of the UK, and explores the ethical framework of three major defence suppliers. Due to the sensitive nature of the study, the principal focus will be on the ethical framework, with a sub-focus on offset. The motivation behind this research is to provide national governments, companies and international bodies with information on the causes of corruption in defence. A set of policy recommendations will be suggested to improve the ethical frameworks to curb global corruption.

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Chapter 3

Weird and Wonderful World of Offset

3.1 Introduction

The Government of accountability: Frank Conahan in 1985 stated that offset has become a “fact of life in international trade and is likely to continue to be”.¹

Offset has become an important facet of the international arms trade. It is not restricted to the arms industry, but is also used in other industries, such as power generation, telecommunications and infrastructure projects.² The word “offset” for the arms exports industry has become synonymous with economic growth, opportunity, and in investment, inducement, cost-efficiency, access to new markets and the list can go on. Purchasing countries see offset as an opportunity to drive growth, development and investment into the local economy. Offset has become particularly valuable for emerging countries, such as South Africa, the UAE, Brazil and India.

Researchers for Transparency International and the researcher Platzgummer have criticised offset claiming, that it is a fertile ground for corruption due to its sensitive nature

and the lack of transparency. Such claims have sparked off allegations of bribery and corruption.³ Although offset is widely practiced, some nations, including the USA, consider offset agreements to be “market-distorting and inefficient”.⁴ Despite criticism, offset is commonly used in the defence industry, and more than 130 countries worldwide have offset guidelines.⁵

The arms trade has, indeed, become an attractive market, and millions of dollars are spent on defence contracts, as well as the parallel deals called “offset”. Offset indeed is thriving in foreign markets. A leading defence consulting firm called Avascent stated that cumulative global offset obligations had reached \$500 billion by 2016.⁶ Offset are big ticket deals for many countries. The military offset obligations are expected to increase from \$36.36 billion in 2012 to \$49.61 billion in 2021.⁷ The economic importance of international defence offset is growing and will continue to grow in the near future. In order to gain a better understanding of offset, it is important to consider its impact on global defence markets.

3.1.1 Offset Evolution

The fall of the Soviet Union in 1991 resulted in major changes and restructuring of the economic and political spheres including the international defence sector.⁸ With the end of the cold war, global military budgets shrank significantly as a result the drop in defence expenditure by member countries of the North Atlantic Treaty Organization (NATO) and former members of the Warsaw Pact .

In recent years, however, global military spending has increased. A first spike was prompted by the 9/11 attack in 2001, which ultimately led to the wars with Iraq and

with Afghanistan.⁹ In 2016, world military expenditure rose to \$1,686 billion, equivalent to an increase of 0.4% compared to 2015.¹⁰

Today, conflict is rife. Regions experiencing conflict are Africa, Syria, Gaza, Iraq and other countries in the Middle East. The wars in the Islamic states continue and crises remain unresolved. International terrorists have proved that they are capable of striking anywhere to destabilize the traditional patterns of international security.¹¹

As a result of the global tension and increased conflict and terrorism in the Middle East, the supplier arms industry is under tremendous pressure. There is high demand in the defence market, making it an attractive business for foreign governments to purchase state-of-the-art weapons. A 2016 report lists the top countries in the military spending and these are shown in Table 3.1. The United States is leading in the world military spending with \$611 billion.¹² China is the second biggest spender, accounting for \$215 billion, followed by Russia (\$92.2 billion) and Saudi Arabia with \$63.7 billion.¹³ The UK is sixth, with \$48.3 billion, followed by Japan, Germany, South Korea and Italy.¹⁴ Defence procurement can take different forms that include indigenous projects, shared technology, development and production, licensed production and off-the-shelf purchases of a foreign product.¹⁶ The demand for indigenous arms is increasing both in the national and international markets. Predictions identify the GCC countries as the lead markets with a potential defence expenditure of \$1 trillion between 2013 and 2025.¹⁷ Saudi Arabia is expected to generate \$62.63 billion by 2021 in offset obligations.¹⁸ Countries require state-of-the-art weapons and ideally the expertise and technology to produce them to avoid outsourcing to offshore markets due to lack of expertise and defence capabilities.

After 9/11, the arms trade became more international, as a result of increased pressure

Table 3.1: Top 15 Countries' Military Expenditure 2016

Rank		Country	Spending, 2016 (\$ b., MER)	Change, 2007–16 (%)	World share, 2016 (%)	Spending as a share of GDP (%) ^b	
2016	2015 ^a					2007	2016
1	1	USA	611	-4.8	36	3.8	3.3
2	2	China	[215]	118	[13]	[1.9]	[1.9]
3	4	Russia	69.2	87	4.1	[3.4]	5.3
4	3	Saudi Arabia	[63.7]	20	[3.8]	8.5	[10]
5	7	India	55.9	54	3.3	2.3	2.5
6	5	France	55.7	2.8	3.3	2.3	2.3
7	6	UK	48.3	-12	2.9	2.2	1.9
8	8	Japan	46.1	2.5	2.7	0.9	1.0
9	9	Germany	41.1	6.8	2.4	1.2	1.2
10	10	South Korea	36.8	35	2.2	2.5	2.7
11	11	Italy	27.9	-16	1.7	1.6	1.5
12	13	Australia	24.6	29	1.5	1.8	2.0
13	12	Brazil	23.7	18	1.4	1.5	1.3
14	14	UAE ^c	[22.8]	123	[1.3]	[3.3]	[5.7]
15	15	Israel	18.0	19	1.1	6.7	5.8
Total top 15			1 360	..	81
World total			1 686	14	100	2.3	2.2

Source: SIPRI Online Factsheet April 2016 Trends Military Expenditure 2016, Nan Tian, Aude Fleurant, Pieter Wezeman and Siemon Wezeman¹⁵

from buyers and sellers, leading to a significant liberalisation of trade. Despite the decline in Europe, the arms trade was sustained by the rest of the world. Weapons were still procured and this led to a globalized industry. The arms trade became a competitive environment, shifting from a seller's market to a buyer's market. In order for companies to survive in such a competitive arms market, offset became integrally linked to the main defence contract, allowing businesses to make virtually irresistible offers with promises of lucrative, 'add-ons' called offsets.¹⁹

The evolution of offset began in the 1970s with a consortium of four NATO European countries, Belgium, Denmark, Netherlands and Norway looking to buy a replacement combat aircraft.²⁰ This created a competitive environment between defence suppliers, facing high intensity market pressure.²¹ Bespoke packages were custom-made to meet the specific requirements of buyers, and these included technology transfer, licenced production, co-production and research and development.

Today, offset is a big commercially sensitive business.²² Countries are demanding offset obligations in varying degrees. For example, Brazil typically requires 100% offset obligations, South Africa 50% and South Korea 30%.²³ So why do governments pursue offset? Offset is used by governments to partially justify their purchases of arms by highlighting the benefits accruing to the national economy through technology transfer and buy-back. They also use offset as a means to extract rent and achieve multiple objectives: for example, getting the best value for money through added benefits attached to the arms deal. These benefits can include acquiring new technology transfer, accessing new markets, supporting key industries and promoting strategic alliances with multinational companies.²⁴

Offset is an essential feature and a highly competitive feature of the global defence market as evidenced by an Airbus statement specifying that “*offset requirements are becoming more demanding and increasingly difficult to fulfill, particularly in light of low cost emerging country approaches*”.²⁵

In order to gain a better understanding of offset, it is important to consider the impact of offset in the global markets.

3.1.2 Global Proliferation of Offset

Each country has developed niches and strategies to develop defence capabilities via offset programmes. In the Middle East, offset is maturing.²⁶ The UAE's main objectives in acquiring offset programmes is to develop the economy in diverse areas by reducing its dependency on oil and seeking opportunities in fields such as health care services, solar energy and ship-building. This has led the emergence of new markets ventures in UAE industrial sectors that include shipping, aircraft leasing, fish farming, healthcare, agriculture, banking and education.²⁷ Saudi Arabia has since the 1990s enjoyed the benefits from multi-million dollar joint offset programmes.²⁸ Countries like Brazil, India and Indonesia use offset programmes to drive regional power ambitions by seeking investment in technology transfer to provide indigenous weapons.²⁹ In the case of South Korea, the government motives are aimed at developing a domestic production capability in all systems areas, and becoming self-sufficient in the manufacturing of arms domestically.³⁰

The European nations have been able to generate more offset than other nations. During the period 1993-2004, European countries were able to obtain offset valued at 99.1% of their defence imports, while non-European countries could only achieve 46.6%.³¹ Some 72.9% of the offset obtained by European nations exceeded 100% of the value of the weapon systems imported over 1993-2004.³² Further to this, a study carried out by the EDA on offset showed that Italy, Sweden and the Netherlands depended on indirect offset, whilst Spain, Finland, Portugal, Greece and Poland preferred direct offset. EDA also estimates that the direct offset value was 40% of the total offset in Europe and that indirect offset contributed 35%.³³

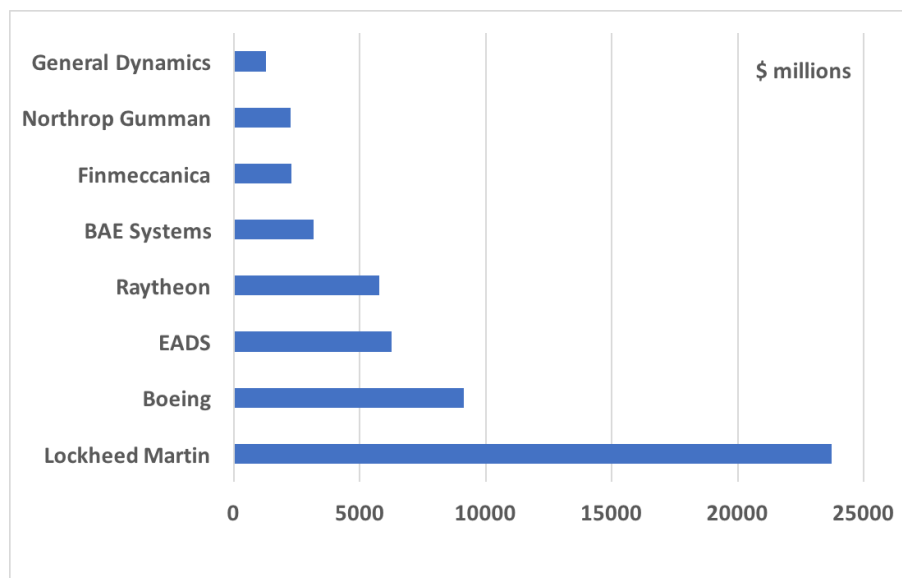
US firms account for 55% of the arms global market.³⁴ In 2016, BIS reported that nine-

teen US firms entered into 651 offset transactions with 26 countries.³⁵ The net value of these transactions accounted to \$5 billion in 2015 with total credit value of \$5.3 billion.³⁶ These offset transactions involved purchases, technology transfer and subcontracting.³⁷ Despite this, huge level of activity, the growing demand for offset has created a challenging environment for defence companies that have to fulfill offset obligations. Blenheim Capital, a leading provider of offset, reported that there are currently more than \$100 billion offset obligations outstanding globally and that in the next five years another \$150 billion obligations are expected to be generated.³⁸

Offset is an aggressive market, and the demands placed on defence companies are rapidly increasing. The World's leading defence manufacturers such as the US companies. Boeing, General Dynamics, Lockheed Martin, Northrop Grumman and Raytheon have total offset obligations up until 2022 of \$42 million.³⁹ The expected obligations for Lockheed Martin will generate a total of \$23,709 million as indicated in Figure 3.1, and European Aeronautic Defence and Space Company (EADS) is expected to incur \$6.27 million offset liabilities.⁴⁰

The next section is dedicated to a definitional explanation of the offset phenomenon. The information provided will explain the context of offset by describing its key characteristics. It will also aim to offer a perspective on the offset regulatory frameworks and policies.

Figure 3.1: Offset Obligations of Top Ten Global Defence Companies, until 2022



Source: Aircraft Industry Study 2014, The Dwight Eisenhower School for National Security and Resource Strategy, National Defense University, visited online on 9 December 2017⁴¹

3.2 Definitions and Context

3.2.1 What is Offset?

The US Arms Export Control Act and the International Traffic in Arms Regulations define offset as “*compensatory obligations which are acquired as a condition of purchase in either government to government commercial sales of defence articles or defence services*”.⁴² The word obligation implies offset is not a voluntary compensation but a mandated option, which is a requirement via a condition to purchase. Offset is interpreted across nations indicating that there is no universally agreed definition. For example, in the UK, offset was known as Industrial Participation Policy, South Africa uses the term National Industrial Policy and in Canada it uses the term Industrial Regional Policy. Industrial policy can be best described as a set of government interventions, which seek

to support or develop specific industries. These can include manufacturing, IT, research and development and other areas that stimulate growth and development. They may include the development of infant industries in the hope that through government assistance, countries can become internationally competitive.⁴³

Academics and experts have attempted to define the term offset and the prevailing definitions are as follows: “*Offsets are simply goods and services which form elements and services of complex voluntary transactions negotiated between governments as purchases and foreign suppliers. They are those goods and services on which a government chooses to place the label offset*”.⁴⁴

The words “goods” and “services” can refer to the exchange of goods and services in the form of monetary value or in the form of credits. This can often involve a wide range of activities outside the scope of the contractual agreement making the process fairly flexible, complex and vulnerable. The voluntary term suggests that the offset obligation is never forced by the purchasing country and making the offset arrangement optional for the buyer. However, in reality, offset is a condition imposed by the buyer on the defence vendor.

A more precise definition is offered by the US Department of Commerce Bureau of Industry and Security for which:

“An offset transaction directly related to the article(s) or service(s) exported or to be exported pursuant to the military export sales agreement”.⁴⁵

Matthews offered a definition that describes offset as:

“either direct or indirect to the primary defence contract the former being

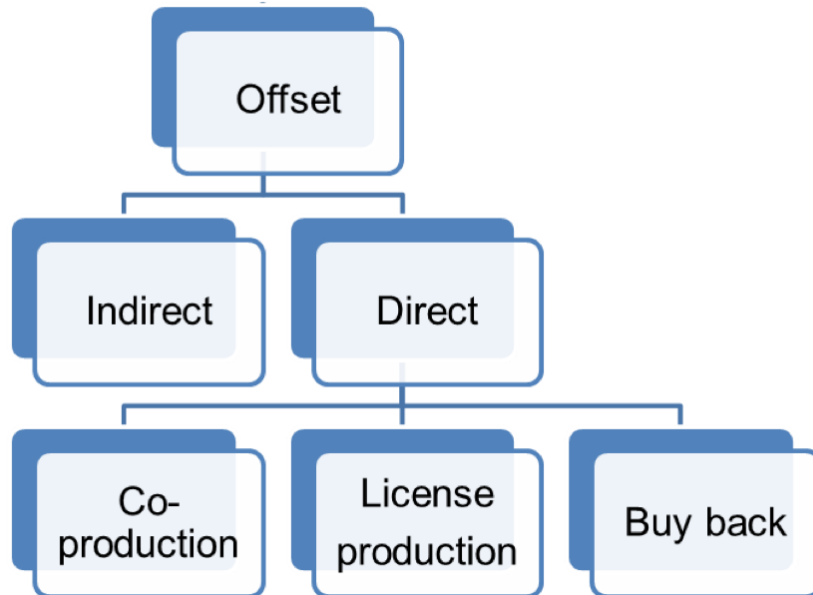
*where the offsetting investment creates ‘defense’ production capacity, often involving technology transfer, whilst the latter has regard to investment into the civil sectors of the buyer government’s host economy”.*⁴⁶

Based on the academic literature, definitions vary, but all definitions share a common view and relate to offset as a “condition of the sale” which makes offset involuntary. In its simplest form, offset can be described as a reciprocal arrangement between the foreign supplier and the purchasing country in which governments may oblige the foreign supplier to invest a percentage of the contract in the investing country in order to gain economic reward. The obligations placed by the purchasing government can be in the form of a specific project rather than a measured amount of the main contract.⁴⁷

Offset deals are seen as important commercial instruments in emerging markets. Firstly, emerging markets do not have the required skill base and infrastructure to develop aerospace and defence technologies.⁴⁸ For example, Asia and the Middle East require offset for a number of purposes including increasing domestic employment, obtaining the desired technology and promoting industrial sectors. Brazil, India, Turkey and South Korea have an interest in technology transfer in order to acquire the expertise to manufacture arms and have access to global supply chains in order to perform better internationally, and have access to the global markets.

The classification of these reciprocal benefits is shown in Figure 3.2.⁴⁹ Offset contracts can encompass a wide variety of compensatory arrangements which can be required by foreign governments. For example, offset can include co-production, licensed production, buyback, technology transfer, investments and training.⁵⁰ The type of offset required by a purchasing country is dependent on its economic goals. A company’s offset obligation

Figure 3.2: Offset Taxonomy



Source: Adapted by Ron Matthews “Lecture MBA Defence Economics The Arms Market” Cranfield University, Bedford, 30th June 2017.

is normally worth between 50% and 100% of the value of the main purchasing contract and can be direct or indirect. These arrangements can fall into two distinct categories, characterised as direct offset and indirect offset.

3.2.2 Indirect Offset

Indirect offset relates to goods and services that are unrelated to the main defence contract.⁵¹ These transactions take place when a foreign supplier creates commercial investment opportunities for the purchasing country. They can take the form of Foreign Direct Investment (FDI) and other mediums, such as investment, training, financing activities, mar-

keting, exporting assistance and technology transfer.⁵² The use of indirect offset provides the buying country with leverage for economic development, which can be potentially be generated by the offset programme to create a longer and sustainable environment. Indirect offset is a common requirement linked to military exports and is perceived to have attractive benefits for the emerging economies. In the United Arab Emirates, for example, indirect offset is more valuable as it reduces the degree of economic dependency on the oil industry by requiring vendors to invest in industries such as IT, healthcare and other sectors.⁵³ Kuwait and Saudi Arabia have also adopted a pragmatic approach, and use indirect offset as a conduit for investment into the local economy.

3.2.3 Direct Offset

Direct offset is a contractual agreement that can include goods and services which are directly related to the purchasing contract. These goods and services can either take the form of co-production, license production, buy back, technology transfer and financing activities (see Table 3.2). The purchasing country may oblige the vendor to manufacture part of the equipment in the procuring country and transfer technology to train the local workers on how to operate the equipment.⁵⁴ Direct offset is commonly used in countries like Australia, United Kingdom, Brazil, and Turkey. Turkey is a major purchaser of arms equipment from Western firms in order to strengthen its military capability.⁵⁵ In Turkey, direct offset is used to create exports, employment, skills, technology transfer and training. *Co-Production* refers to transactions that involve government-to-government agreements. For example, the US government permits the transfer of technology to allow foreign companies to manufacture all or part of US-origin defence articles.⁵⁷ *Licensed production* is a direct commercial arrangement that can take place between the supplier and the buyer. This is when the purchaser obtains a share of the production work that

Table 3.2: Offset Terminology.

Co-production	Transactions that are based upon government-to-government agreements authorizing the transfer of technology to permit foreign companies to manufacture all or part of US-origin defence articles. Such transactions are based upon an agreement specifically referenced in Foreign Military Sales (FMS) Letters of Offer and Acceptance (LOA) and a government-to-government Memorandums of Understanding (MOU). Co-production is always classified as a direct offset.
Licensed Production	Overseas production of a U.S.-origin defense article based upon the transfer of technical information under direct commercial arrangements between the U.S. manufacturer and the foreign government or producer. Licensed production is not pursuant to a co-production government-to-government MOU. In addition, licensed production almost always involves a part or component for a defence system, rather than a complete defense system. Licensed production transactions can be either direct or indirect offset.
Technology Transfer	Transfer of technology that occurs as a result of an offset agreement and that may take the form of research and development conducted abroad, technical assistance provided to the subsidiary or joint venture of overseas investment, or other activities under direct commercial arrangement between the defence prime contractor and a foreign entity.
Investment	Investment arising from an offset agreement, often taking the form of capital dedicated to the establishment of a foreign entity unrelated to the defense sale or to expanding the U.S. firms subsidiary or joint venture in the foreign country. Investment can be either direct or indirect.
Training	Generally includes training related to the production or maintenance of the exported defence item. Training, which can be either direct or indirect, may be required in unrelated areas, such as computer training, foreign language skills or engineering capabilities.
Credit Assistance	Credit assistance includes direct loans, brokered loans, loan guarantees, assistance in achieving favourable payment terms, credit extensions, and lower interest rates. Credit assistance specifically excludes the use of banked offset credits (credits that exceed the requirement of the offset agreement and are permitted, by the terms of the agreement, to be applied to future offset obligation). Credit assistance is nearly always classified as an indirect offset transaction but can also be direct.

Source: “Offset Definitions”, Bureau of Industry and Security (BIS), visited online 20 November 2017⁵⁶

occurs place in the supplier country. The manufacture of the articles needs to be granted by the vendor. For example, parts purchased by the vendor can be manufactured in the purchasing country. The contractual arrangement will include the design and technical expertise of the engineers to manufacture the components. These direct commercial arrangements can also be referred to as licensed manufacturing agreements or technology transfer agreements. Most of the largest arms importers, such as Turkey, South Korea and India are particularly keen in acquiring licence production.⁵⁸ *Buy-Back* is when a firm agrees to purchase products from the importer beyond the agreed amount. For example, the exporter may transfer the technology and will agree to purchase a proportion of usually equipment-related items from that firm.⁵⁹ In direct offset purchases there are also a variety of other arrangements that can take place within the contract, as indicated in Table 3.2, which include technology transfer, investment, training and credit assistance.

3.2.4 Nature and Objectives of offset

There are a number of reasons why offset is used by governments and suppliers. Offset plays an important role for governments. It is perceived to be cheaper than off-the-shelf purchases (though in reality this is not the case) and hence governments can use it to justify expenditure. Governments may also seek offset to acquire the technological know-how to promote the country's defence development. Moreover, governments use offset policy as a way to extract rent and achieve multiple objectives.⁶⁰

However, is offset economically viable? This is a difficult question, and most academics find it challenging to answer due to the complex and hidden nature of offset.⁶¹ It is often difficult to establish who really benefits from offset programmes.⁶² The South African (SA) arms deal was an example of offset failure. The South African government agreed a

Rands 29.9 billion South African arms deal acquisition programme for its armed forces.⁶³ The deal was expected to generate economic benefits to the local economy, including the creation of 65,000 jobs over a period of seven years, leading to growth and investment in the South African defence industry.⁶⁴ This ambitious arms deal was worth Rands 104 billion and included high-tech purchases of corvettes, helicopters and submarines from Germany, Italy, Sweden and the UK. The result of the arms deal could have led to a positive effect on the South African (SA) economy. However, the overall economic benefits of the programme remains unclear, though likely far lower than anticipated.

Offset programmes are seen as lucrative investments for a country's economic and industrial base. However, recent trends indicate that indirect offset is becoming more prevalent in the developing economies.⁶⁵ This type of offset is likely to provide the goods, technology and research and development, training skills that can enhance the productive capabilities of the country's industrial infancy base, and be utilised for future use. In particular, technology transfer is considered as important for the emerging industries as it provides the skills to manufacture defence related articles. Moreover, the use of indirect offset by the importing country creates stronger leverage for economic development, which in turn creates a longer and sustainable production runs, not just a one-off transactions.⁶⁶ For example, in Saudi Arabia, offset programmes are regarded as key instruments to drive economic growth and investment in the economy. The main objective for the Saudi government is to create private sector business projects and mutually joint beneficial partnerships with foreign entities.⁶⁷ A key factor has been technology transfer to enhance defence capabilities. Technology transfer is a key offset objective for many other countries. For example, South Korea and Japan have secured the transfer of important technologies from the US under offset agreements, enabling them to develop their own defence self-sufficiency. Governments seek to transfer new technology into the do-

mestic economy. The transfer of technology has two major incentives: one is to stimulate growth and the other is to drive investment in the local economy. Moreover, acquiring new technology skills is seen as an opportunity for buying into new markets that have been difficult to access.

3.3 Legal Norms of Offset

In order for purchasing governments to procure contracts, there are often contract restrictions imposed by the government to which buying countries need to abide. Such practices are legal norms. All export countries are mandated to follow these requirements that dictate the trade practices in the purchases of arms. However, prescriptive offset policies have been frowned upon by the advanced countries.

3.3.1 US Perspective on Offset

The United States (US) perceive offset negatively and thus adopts a hands-off approach in such transactions. The US government recognises offset to be economically inefficient and trade distorting and forbids governmental agencies entering into any offset arrangement with US firms in the sale of defence goods and services to foreign governments.⁶⁸ This opposing view of offset is based on the judgment that parts manufactured abroad result in jobs losses for the US. The second concern is that if technology transfer occurs, it will erode the US military industrial base because it increases competition from foreign contractors.⁶⁹ Therefore, the government encourages buyers to source weapons domestically and limits the use of foreign products. Common judgments are also shared with the European Defence Agency (EDA) and World Trade Organization (WTO) both hold conflicting views on offset trade practices.

3.3.2 Europe and Offset: End of an Era?

European governments have used offset to promote industries within the defense industrial base. The European Defence Agency (EDA) was established in 2004, with the main aim of providing support to European Member States (EU) in improving the robustness of defence capabilities. In July 2004, the implementation of the code of conduct was launched, seeking the 26 member states to participate in the programme on a voluntary basis,¹ to participate in the programme with the exception of Romania.⁷⁰ All participating countries are required by the EDA to publish their offset policies and practices.

All EDA member countries should provide information on offset obligations. The purpose of this regime was to raise transparency and accountability in offset programmes among member nations, and evolve a free market in defence trade across the EU.⁷¹ The code of conduct is a non-binding, and a voluntary code that applies to all states. The intended aim of the Directive is to evolve a free market in defence trade. The EDA code is the first legal instrument in addressing offset practices directly. Member states need to protect their national security by keeping information discreet when purchasing arms and should not go beyond the limits of what is necessary. The EU holds a negative view on offset practices, considering them to be an illegal practice that violates the principles of primary EU law.

3.3.3 The World Trade Organization (WTO)

The WTO deals with the regulation of trade between participating countries, and governments to ensure they comply with the rules and policies governing the trading of goods

¹EDA member states include Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, United Kingdom and Norway

and services. The WTO is made up of 160 members which covers about 95% of world trade.⁷² Emerging countries play an important role in the WTO. The organisation ensures that developing countries are provided with special attention and ensures that their best interests are taken into account in relation to trade with other countries. The Government Procurement Agreement (GPA) of the WTO establishes a framework of rights and requirements that each signatory must embed into its local laws, regulations, procedures and practices for public procurement. The agreements include numerous provisions giving developing and least developed countries “special and different treatment”.⁷³ The WTO shares similar views as the European Defence Agency and the US Government regarding offset. The WTO forbids the use of offset in government procurement but has placed an exception on developing countries.⁷⁴ The main objectives of this important legal framework is to safeguard developing countries’ balance of payments, ensuring that they have adequate reserves. It also promotes the development of domestic industries in areas such as licensed technology, investment requirements, counter-trade and similar requirements.⁷⁵ The rationale behind this legal initiative is to enhance activities that are in their infancy stage.

A second set of exemptions is based on the grounds of national security. Defence purchases can range from small arms purchases to radars and weapons systems worth billions of pounds. Therefore, countries need to ensure that their national security interest is protected when procuring weapons systems.

3.3.4 Offset Policy Spectrum

The practice of using offset policies first started in the industrialised countries in the 1950s.⁷⁶ Since then offset has proliferated and polices have become a feature of countries

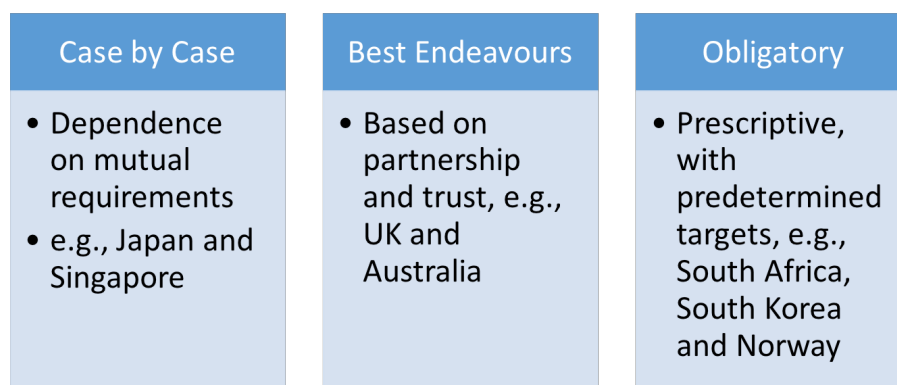
using offset programmes. Offset is attractive to many advanced countries and economies, motivating them to set national policies in the use of defence offset. These offset policies have been embedded in the form of a policy and goals determined according to the industrial and economic infrastructure needs of a particular country.

Offset policy has been a challenge in some countries, such as India. India is one of the world's largest arms importers and has regularly revised its defence offset policy. The latest policy was introduced in 2016 and superseded the 2013 defence policy. According to The Defence Procurement Procedure (DPP) the objective of the Defence Offset Policy is to create a leverage by acquiring capital acquisitions. To main initiatives of this policy was to develop the defence industry creating capacity for research, design and development relating to defence products and services. The second aim was to encourage development in sectors like civil aerospace and internal security.⁷⁷

Offset policy is complex. Steve Schooner states that "*there is currently broad consensus on issues such as the need for transparency, integrity, and accountability in defence procurement*". Yet on the offset issues, consensus is a long way off. There is no agreement internationally and countries are nowhere near reaching a general policy in offset.⁷⁸ Further to this, there is no defined offset policy or international regulation governing procurement contracts in the defence or civil sectors and therefore no single offset guideline.

Countries often use different strategies to deal with offset programmes based on economic and industrial needs. For example, France has focuses on prioritising key sectors through clear national and sector level visions. Finland focuses attention on the ICT sector. Singapore uses a direct government intervention approach to promote growth. Korea and Taiwan have been focused on export objectives.

Figure 3.3: Offset Policy Spectrum



Source: Adapted from Ron Matthews and Irfan Ansari, “Economic Orthodoxy v Market Pragmatism: A Case Study of Europe’s Abandonment of Defence Offset”, Public Finance and Management, Southern Public Administration Education Foundation, vol. 15, no 4, pp.378-404, 2015.⁸⁰

Due to the nature of offset, there is no “one size fits all approach” and therefore the complexity of the process is couched within the policy. Some countries have a case-by-case approach, others a ‘best endeavours’ model and still others an obligatory approach. This is best demonstrated in Matthews’ policy spectrum model in Figure 3.3 which captures all the main policy approaches.⁷⁹ The national offset policy spectrum ranges from a flexible case-by-case approach to a mandatory approach. A number of countries started with one strategy and over time and experience have used different approaches to suit their economic objectives. The first approach is the case to case approach which allows for more flexibility. The strength of this approach lies in its adaptability to the complexity of acquisition technology, contract negotiation and compromise. It is, for example, a model used in Japan and Singapore.⁸¹

The second policy approach is best endeavours, which was favoured by the British and Australian governments. In the UK, it incorporated three essential characteristics based on partnership, trust and supplier commitment.⁸² The UK industrial participation policy was introduced in the 1990s by the Ministry of Defence (MOD), under the strict guidance of the Defence Export Services (DESO). When the policy was active,⁸³ the main aim of the Industrial Participation policy (IP) was to stimulate work and business opportunities in order to maintain and possibly expand the employment of skilled personnel,⁸⁴ in particular those engaged in high-value manufacturing, aimed at maintaining the competitiveness of the UK export defence industry in terms of price and quality. It was also established to secure access to the international defence markets and generate long term partnerships with offshore companies.⁸⁵ The offset requirements are focused on direct offset, including co-production, technology transfer, capital investment and joint ventures. The IP model contributed to the vitality of the UK defence and aerospace supply chain, providing vast opportunities for UK defence suppliers to compete globally from a position of strength in the production line and high-technology systems. The industrial strategy was beneficial for the UK. It provided a healthy revenue stream for defence firms and created demand, as evidenced by Matthews.⁸⁶ The UK is the third largest defence exporter in the world.⁸⁷ The primary concern of the IP was to ensure that UK's defence procurement delivered value for money. It recognized that this would not be achieved by simply acquiring the goods or equipment at lowest cost, but to ensure long term gains in return. The IP adopted a flexible, yet demanding approach. The offset obligation was set at 100% of the main defence contract and no penalties applied for non-performance of offset demands.⁸⁸ Responding to the 2009 European Defence Procurement Directive, the UK IP policy was abandoned in 2012.

Australia's offset policy model changed in 1992 from a voluntary to a mandatory approach. However, today, Australia has no official offset policy but the Defence Industrial Policy is embedded in the Australian Industry Capability (AIC). Under this scheme, there is no penalty fee charged for offset non-fulfillment and no multipliers.⁸⁹ Australian companies are allowed to bid on contracts or work in partnership with large multinational companies. The goal of this strategy is aimed at developing an Australian industrial defence capability through partnership.⁹⁰

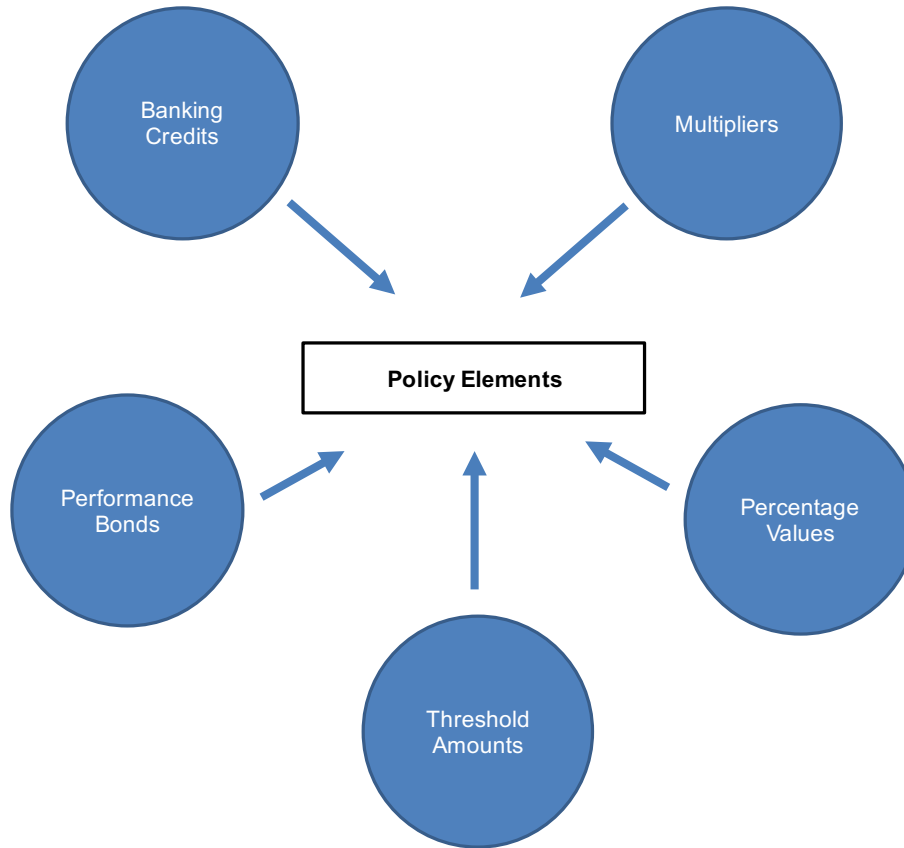
The third approach is obligatory. The model imposes regulations which include penalties for non-performance of offset obligations. This approach is common in government acquisitions where staff lack the experience and skills to deal with offset.⁹¹ Multipliers are also imposed by the vendor and are used as incentives to channel investment into certain areas, such as technology transfer.⁹² The 'US Buy America' Act attempts to protect US businesses and labour by establishing a price preference for domestic end products and construction materials in foreign arms acquisitions. This approach is inflexible when compared to the other approaches.⁹³

3.4 Offset Policies

Offset programmes involve a wide range of policy elements and each country employs different approaches in the execution of offset programmes. Countries that purchase defence equipment use policy elements known as multipliers, penalties, credits and performance bonds. All these methods are captured in Figure 3.4.

Multipliers are an essential feature in the execution of offset programmes and purchasing countries acquire multipliers as an incentive to attract buyer countries with certain types

Figure 3.4: Offset Policy Elements



Source: Author

of offset. According to BIS, a multiplier is “a factor which is applied to the actual value of certain offset transactions to calculate the credit value earned”.⁹⁴ It is often difficult to satisfy the offset requirements from the purchasing country so foreign sellers seek to pay attention to arrangements that will earn them multipliers. Where multipliers are provided, the contractor can also request to expand the list of items eligible for the multiplier. The multiplier adds weight, in terms of value, to certain types of offset activities. These multipliers can vary from 0.1 to 5.6.⁹⁵ In the Nordic countries, multipliers values have dropped from 20 to 0.5.⁹⁶ A multiplier can focus on technology transfers, infrastructure investments, education and training programmes. India requires a 1.5 multiplier for offset with

small to medium sized, firms and a multiplier of 3 for technological acquisition within defence-related research and development organizations.⁹⁷ In some purchasing countries, multipliers are not applied. According to statistical data released in 2003, the percentage of transactions that did not include multipliers was 83% in Europe, 85% in North and South America, 76.6% in Asia and 87.9% in the Middle East and Africa.⁹⁸ In offset contracts, there are clauses whereby a purchasing country can penalise the non-performance of offset obligations. These are known as penalty charges. When offset obligations are not successfully met within the expected time frame, countries can impose penalty charges. The former offset policy of the United Kingdom did not include penalty charges if the vendor failed to achieve its commitment.⁹⁹ In Poland, by contrast, the offset provider will be liable for liquidated damages. New Zealand also requires liquidated damages as penalty charges.¹⁰⁰

Credits are another practice used in the execution of offset process. There are two ways in which credits can be used. In the first case, credits are earned before the offset contract is signed whilst, in the second case, credits are earned when a company exceeds its offset obligations. When an excess credit is obtained, it can be banked by the company and can be used for the future. Credits can be transferred to another offset obligee but prior approval needs to be granted by the country's original offset obligor.¹⁰¹ Credits usually are valid up to three to five years.¹⁰² In the Nordic countries, credit banking is widely accepted but cannot be transferred to a third party and must be used within three years.¹⁰³

Some countries require a certain *threshold amount* for an offset commitment. The threshold amount is a percentage of the main purchasing contract value, above which it will acquire an offset commitment. In the UAE, for example, the threshold is \$10 million dollars over a five year period.¹⁰⁴ A *Performance bond* acts as a guarantee that allows the

customer to make a claim in the event of a failure to perform its obligations, as defined in the contract. The contract can include penalties and liquidated damage compensations for losses that have been incurred by the customer as a direct result of the failure of the exporter to perform in accordance with the contract. Countries may require performance bonds, bank guarantees, or penalty clauses relating to liquidated or non-liquidated damages in offset agreements. In Brazil, the bank guarantees are allowed on a case-by-case basis for a five year period.¹⁰⁵

In India, when the period for discharge exceeds the period of the main contract, the vendor is required to furnish a performance bond in the form of a bank guarantee. This amounts to the full value of the un-discharged offset obligation falling beyond the period of the main procurement contract. When a vendor fails to fulfill an offset obligation, a penalty is assessed that may be paid by the vendor or recovered from the bank guarantee of the main procurement contract.¹⁰⁶ Countries require *Offset Percentages* sometimes up to 100% percent of the value of the arms contract. For example in the UK, the offset requirement percentage was valued at 100%.¹⁰⁷ Similarly in Germany, Netherlands and the Nordic regions (Denmark, Finland, Norway and Sweden). In India, the offset discharge is set at a minimum of 70% of the offset obligation.¹⁰⁸

3.5 Does offset work?

At this point the question that arises is whether offset works as intended. This is a question difficult to answer. The primary goal of offset programmes is twofold. One is the fulfilment of the purchasing country's defence needs. The second requirement to stimulate growth and investment opportunities in the purchasing country's economy. For buyers, offset represents investments into emerging countries and are seen as a way of acceler-

ating their own aerospace and defence development. From a seller's perspective, offset can help expand new defence technology opportunities requiring the skills to manufacture weapons. Offset can also provide access into new emerging markets. Although offset offers social and economic opportunities, it can also pose challenges.

The unique nature of offset packages makes it difficult to evaluate offset performance. Moreover, the deficiency of public data on offset performance poses a significant problem from an evaluation performance perspective, especially for a buying country. No country reveals performance result of their offset programmes, globally, via the BIS Report.¹⁰⁹ The BIS report publishes data on offset transactions for the US Martin argues that the main problem with offset is the lack of public data. The availability of data and hence all resulting analyses are reliant on the goodwill of industry and government to discuss such matters.¹¹⁰ Willett and Anthony argue that the lack of standardised data is one of the difficulties of finding instruments to measure such a complex activity.¹¹¹ The growing number of offset programmes adds to the problem scale. Finally, defence contractors are reluctant to give away such highly sensitive commercial data.

The biggest challenge faced by purchasing states is not only whether companies can fulfill their offset obligations but also if they can deliver in the expected time frame. The potential impact of this challenge is on a reputational and ethical risk. The risk for a supplier is the loss of credibility and the financial loss that can put future business at risk. This is because the buyer can also refuse partial delivery from the main contract. Companies should ensure that they have the capacity to deliver offset programmes.

The UK Boeing AWACS programme experience in the 1980s proved to have a negative impact on employment and the generation of new work. The evidence suggests that

the UK agreed an offset of 130% but very little new work resulted from this project.¹¹² Boeing estimated that the offset package would create an estimate of 40,000 man years of work over a period of eight years but instead statistics showed a total of only 37,500 man years of work sustained in the UK industry.¹¹³ The Al Yamamah deal between the UK and Saudi Arabia was another failure. The deal aimed to deliver 75,000 jobs in Saudi Arabia, but only 1,600 jobs were created with just 300 of these being filled by the Saudis.¹¹⁴ There have also been cases in Malaysia where findings concluded that it was difficult to measure and evaluate the effectiveness and efficiency of the offset its offset programmes.¹¹⁵ Offset in Malaysia did not promote research and development.¹¹⁶ Access of technology has proved to be difficult due to the export regulations imposed by the Original Equipment Manufacturer (OEM).¹¹⁷ A prime example of this happened when Malaysia bought 300 APCs from the Turkish company, FNSS Savunma Systems, which then became involved in a protracted process of referral with its US technology partner to ensure that the US International Trade in Arms Regulations (ITAR) were not infringed.¹¹⁸ During Malaysia's offset programmes, less than 100 new domestic jobs were created from work packages linked to the country's acquisition of British, US, German, Russian, Italian, South African, Polish, French, Brazilian and, Turkish weapon systems.¹¹⁹

India's experience in the 1980s with the licenced production of tanks, aircraft, and naval vessels led to delays, cost overruns and failures.¹²⁰ For example, the Vijayanta tank relied heavily on imported components and production did not deliver for the 1965 war with Pakistan. This resulted in India purchasing tanks from the Soviet Union, and evidence suggests that this resulted in increased prices.¹²¹ India had to agree credit arrangements with western countries to cover the foreign exchange burden. Moreover, the Soviet Union imposed conditions on India for licence production, and was reluctant to provide technical information.¹²²

Offset can have an impact on the buying countries and selling country in terms of cost. Offset can impose added cost on suppliers, particularly in the transfer of technology. Such cost can lead to an increase in prices of defence goods and services that can impact on the defence budget. In Finland and Sweden, mandatory offset imposes an additional cost in terms of penalty charges.¹²³ The Finnish Hornet audit found indirect offset to be costly. The Finnish government paid an additional cost of 3 to 6% of the defence contract¹²⁴. Overall, the defence offset goals were in question, and it was difficult to ascertain if the benefits of offset were greater than the cost.¹²⁵

Offset can work in the emerging countries and offer benefits that they would have not achieved, such as access to new markets, gaining technology skills for production and building relationships with suppliers to secure future business. However, the true economic cost of benefit of offset is difficult to estimate.

3.6 Summary

Offset plays a pivotal role in defence contracting. The proliferation of offset has increased since the 1970s. About 130 countries have used offsets and industrial policy to achieve economic development objectives. Governments use offset to justify purchases of arms by highlighting the benefits that contribute to the vitality of the national economy. Purchasing governments can choose to stimulate areas of investment. These areas can include technology transfers, buy-backs, employment and investment opportunities. Moreover, offset is a complex subject and gauging the true economic value of offset is difficult, due to the lack of empirical evidence. Thus, the question remains, is it the supplier or the vendor that benefits most from an offset programme. The main goal of this chapter is

to provide the nature and global developments in offset programmes. The chapter evaluated the main characteristics of offset programmes and global policy initiatives. The next chapter will aim to provide insights into the nature and extent of corruption in defence, identifying the potential vulnerabilities of corruption that could potentially impact defence procurement.

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Chapter 4

Nature and Extent of Corruption in Defence and Offset

4.1 Introduction

Gupta argues that defence procurement is a channel that can potentially divert funds, and have a significant direct impact on military expenditure.¹ Corruption in defence is not endemic, but it undermines political trust and breaks down political stability. The World Bank (WB) estimates that about \$1 trillion is paid in bribes each year.² This is a concern when national security becomes a veil to hide corrupt activity. The most common forms of corruption occur in the defence sector in the form of bribes paid to middlemen, kickbacks, embezzlement, fraud, manipulation of contracts and inflated commissions paid to third party agents.

The defence sector is unique. Governments have the autonomy over the defence budget and can choose to drive key investments in certain areas, such as technological development, research and training by strategically selecting suppliers, partners and contractors

that can contribute to the defence industrial needs a country. The decisions made by government are surrounded in secrecy, making arms deal prone to corruption. The defence industry has been given “special” treatment compared to any other sectors like IT and the oil industry. This is because arms contracts tend to be clouded by high levels of commercial and national security under which government and military personnel are exempted from public scrutiny.³

The defence industry is a competitive industry with new business, particularly in the emerging markets. Some vendors offer lucrative deals, such as offset to differentiate bidders. However, the problem is that a tranche of countries are perceived to have critical levels of corruption and this may impact on offset.⁴ It has thus become a controversial subject due to its opaque nature. Newspaper headlines cry out “offset deals spark calls for transparency”.⁵ Leading defence companies face the danger that offset can be used to channel through bribes by purchasing governments. Recent defence corruption scandals show that existing practices and regulations are perhaps inadequate in preventing corruption in arms deals. Leading defence manufacturers, such as BAES, Rolls Royce and Airbus have been under scrutiny by the Serious Fraud Office (SFO) over illegal practices, such as bribes, fraud and conflicts of interest involving arms deals worth million of dollars. These illegal acts highlight the possible inadequacies of defence ethical compliance practices when dealing with exports.

Contractual arrangements, such as offset come with a number of ethical considerations, regulatory controls and costs that are imposed both by the buying country (importer) and the selling country (exporter). Allegations of offset corruption have spiked concerns regarding ethical practices in the defence trade, especially with middlemen operating in the international and domestic market. Certain countries have made attempts to curb corrup-

tion linked to third party agents. For example, in 2012 India banned the use of agents acting for contractors over allegations of graft.⁶ The Indian MOD cancelled the Rolls-Royce contract due to allegations of \$3.1 billion bribes.⁷

A 2010 report by Transparency International (TI) argues that offset raises the potential for corruption in defence.⁸ The Report argues that the enabling factor leading to corruption is the high level of secrecy in defence and the lack of transparency making offset a fertile ground for corrupt practices. The Report also recognises that because the arms trade can involve high levels of expenditure, bribes can easily be hidden in the costs of offset packages, especially in developing economies that lack the auditing and monitoring infrastructure, and are characterised by poor governance.⁹

Although many allegations of offset corruption have been cited in newspaper articles, they are often vague and evidence is lacking. However, corruption is likely endemic in the procurement process rather than the offset contract? A clear understanding of the distinction between alleged corruption in defence procurement and the offset programmes is needed. There is an obvious lack of quantitative data on corruption, and obtaining evidence is not straightforward.¹⁰

4.2 Definitional Framework of the Arms Trade and Transparency

The aim of this section is to offer a definitional explanation of the various terminologies that will be used in this chapter:

*Arms transfers can be defined as the shipping of purchased arms goods and services from one country's government to another, or from a government to certain individuals. Goods and services include a wide range of equipment that can be used for storing, launching or servicing arms.*¹¹

The US Arms Control and Disarmament Agency offers a comprehensive definition of arms transfers as

*“Weapons of war, parts ammunition, support equipment, and other commodities designed for military use. Dual-use equipment when its primary mission is identified as military. The building of defense production facilities and licensing fees paid as royalties for the production of military equipment. Military services such as training, supply operations, equipment repair, technical assistance and construction are included where data are available”.*¹²

Yet, there is no universal globally agreed definition that exists. In some cases, international organizations define arms transfers as “dual-use goods”. Dual use goods can be referred to as goods that have both military and civil purposes.¹³

Transparency, is the voluntary disclosure of information on defence spending. Transparency is the release of defence spending information by governments. This can allow public scrutiny of government spending activities to ensure that public funds are not misused. This fosters public trust in government and promotes good corporate governance. Publishing data and processes should be reliable, comprehensive, clear and up-to-date, making the process transparent and less susceptible to corruption. Arms transfer information should be made publicly accessible to make the process open and transparent, and also to provide trust and confidence in government expenditure.

Players in the arms trade include states that the United Nations classify into two major categories: developed and developing countries. This classification is based on economic status, such as the GDP per capita income.¹⁴ Developed countries (advanced nations) include countries like the United States, Canada, Western European countries, Japan, Australia and New Zealand. These countries tend to have relatively high per capita income, high levels of growth and security, sound infrastructure, good health care and medical facilities, and are more technologically advanced than most other countries. Whereas developing countries tend to have lower levels of economic development. The World Bank describes these countries as having poor educational facilities, lack of medical care facilities, an unequal distribution of income and high levels of unemployment and poverty.¹⁵

Defence procurement can be defined as the process of obtaining a wide variety of goods, services or works that are required by authorities to perform their day to day duties. For example, these goods and services can relate to stationery, IT equipment and defence related purchases such as submarines, fighter jets, missiles and many more items required to protect the national security interest of a country. The UN defines procurement as:

*“goods and services manufactured which is intended to be used for military purposes, which include defence equipment which can include submarines, fighter jets, armored vehicles, munitions, missiles, and other services, it could also be argued that defence procurement narrowly defined also covers the procurement of “dual-use” technologies for example technologies that could be used, in both military and non-military purposes”.*¹⁶

The next section will discuss the features of defence procurement and the various vulnerabilities that are associated with corruption risk in the procurement life cycle.

4.3 Nature of Defence Corruption

Defence procurement is considered to be a particular area for corruption and fraud.¹⁷ In 2016, fraud in the UK's private sector cost an estimated £144 billion, and procurement fraud was estimated to be £127 billion.¹⁸ Procurement payments are large purchases, with limited scrutiny due to national security concerns.¹⁹

The Head of the Nigerian Bureau of Public Procurement claimed in 2009 that 90 % of bribes in the Nigerian public sector were channelled through the defence procurement system.²⁰ Moreover, trillion of dollars spent on public contracts involving complex processes provide further opportunities for graft to take place. There have been efforts in Nigeria to tackle corruption, and a new system has been implemented whereby government employees are able to track cost and expenses on contracts to ensure that contract prices are not inflated.²¹

Defence corruption presents challenges not only for poor countries (see, CPI 2016), but also has a direct impact on rich countries where perceived levels of corruption are lower. The infamous Agusta Westland helicopter scandal attracted worldwide attention. It had regard to inadequacies of India's procurement processes, and, at the same time, raised issues on the ethical conduct of western defence companies. In 2013, several Indian politicians and military officials were accused of accepting bribes from Agusta Westland in order to win the \$750 million Indian contract for the supply of 12 Agusta Westland AW101 helicopters.²² The former CEO of Agusta Westland allegedly received \$51 million in bribes to secure a new fleet of helicopters.²³ In India, the former air force chief, SP Tyagi received bribes from Agusta Westland as part of winning the 12 AW-101 helicopters deal.²⁴ In October 2013, India suspended the supply of 12 helicopters to Agusta

Westland because of bribery allegations.²⁵ In early January 2014, India decided to cancel the helicopter deal as it breached the pre-contract integrity pact which bars commissions and bribes to middlemen.²⁶ Thereafter, India scrutinised the procurement policy, and in 2016 revised it with the main aim to place responsibility and pressure on the OEMs to enhance transparency in their existing overseas contractual relationships in India.²⁷

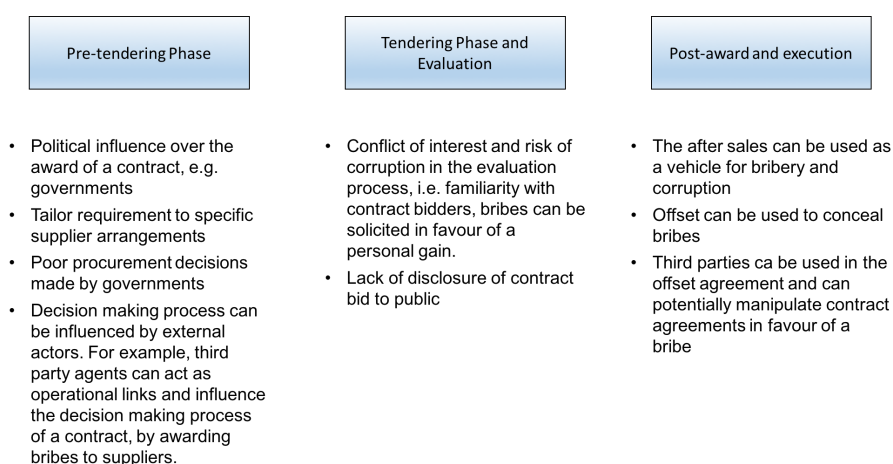
Major concerns relate to unethical acts by senior management. The abuse of authoritative power seems to be misused by senior officials, where bribes are paid to middleman to secure multi- million dollar defence deals. The case of the sale of a German submarine to Greece is an example of where top level senior officials paid bribes to Greek officials to secure defence contracts. Former Greek defence minister was jailed after being found guilty of receiving an Euro 8 million bribe from the German company, Ferrostaal.²⁸ Bribery is not unfamiliar in the defence arena. Corruption in UK defence is a major concern. In 2016, the UK Defence minister revealed that 44 allegations of corruption had been referred to law enforcement agencies.²⁹

4.3.1 Tracing Pathways of Corruption in Procurement

Defence procurement comprises multiple phases, including large technically complex contracts with high levels of expenditure and secrecy. The components of complex weapon systems are often manufactured by many companies working in different countries under different national regulations, with multiple people involved in the process, such as sub-contractors and procurement agents. This creates multiple opportunities for individuals to commit to engage in illicit practices that can heavily impact on the defence contract costs, through bribery, fraud, embezzlement, kickbacks and many other forms of corrupt behaviour. Secrecy and national security are legitimate concerns for states, but they are

also misused to obstruct government and military transparency, leading to vulnerabilities in the procurement process. There are a number of procurement phases that can be subject to corruption, from the initial start of the pre-tendering phase, the tendering and evaluation phase to the end phase which is the post award phase. Figure 4.1 highlights the possible risks of corruption that feature in the procurement life-cycle.

Figure 4.1: Tracing Pathways in the Procurement Life-Cycle



Source: Adapted from “Offset in the aerospace and defence industry”, International Forum on Business Ethical Conduct for the Aerospace and Defence Industry (IFBEC), visited online on 22 November 2017.³⁰

Pre-tendering: This phase can be improperly influenced by government, seeking to obtain illegal benefits.³¹ The award of contracts can be directed to specific beneficiary companies in order to receive a bribe or a kickback. In addition, the technical specifications for a tender can be manipulated to favour a specific company through the solicitation of bribes.³² For example, in the Agusta Westland deal the former Air Defence Chief Tyagi allegedly manipulated the tender requirements in order to obtain the deal.³³ Further, the service ceiling for VVIP helicopters was tailored to meet the specific requirements of the deal, from 6,000 metres to 4,500 metres.³⁴ This decision was then contested by the secu-

rity authorities based on the grounds of national security. This was done to allow Agusta Westland to obtain the helicopter deal.³⁵ The decision-making process can also be influenced by external actors. Government can make poor decisions and may not necessarily acquire weapons that are beneficial for a country's strategic needs.

Tendering phase and evaluation: In order for companies to win a defence contract, they need to submit a tender or a bid, and this is an important phase of the defence procurement cycle. Agents can have direct communication with government; for example, in Indonesia, agents and brokers are frequently consulted by government procurement officials during the development of technical specifications for required equipment.³⁶ Corruption can be solicited in the form of bribes to influence assessment and selection of these bids. This can either take place between the bidding firms, offset authorities and third party's agents.³⁷

Post-award phase: Once the main deal is concluded, an agent's services can be extended in the post award contract and retained for the main contract. The after sales contracts can potentially also be used as conduits for bribes. According to the Indian media, part of the Agusta Westland offset arrangement was contaminated with bribery. Allegedly, Agusta Westland, reserved Euro 70 million to be transferred to companies through middlemen.³⁸ As part of the deal only 30% would be used for engineering services and media handling while the remainder of the deal would be used for bribes.³⁹ This demonstrates a lack of scrutiny and oversight given to defence contracts thus allowing corruption to contaminate the defence contract.⁴⁰ Discharge of offset obligations can act as an entry point for bribery. Due to the nature of indirect offset, contractual conditions lie outside the main contract and thus can allow a number of third parties and partners to structure other transactional arrangements and projects. Additional requests can be made and solicited through the

means of bribes.⁴¹

4.3.2 Determinants of Procurement Corruption

The previous section explored possible corruption pathways in the procurement process. This section will aim to explain a few of the contributing potential factors that can lead to corruption risk in the procurement cycle. These include contracts, conflicts of interest, process complexity and weak oversight controls, though there could be many more detrimental factors contributing to corruption risks in defence.

Contracts: Defence contracts are often very large in monetary value and are kept secret, providing an opportunity for illicit practices. Contracts are often technically complex instruments. The main defence contract usually incorporates offset which itself is highly complex, as it leads to a wide range of activities outside the contractual arrangement. Offset contracts also are given less attention than the main purchasing contract, and this make them more prone to corruption risk.⁴²

Conflicts of interest: During the bid evaluation, there could be a conflict of interest between the supplier and the bidder, and this can potentially harm both the main defence deal and offset contract. High corruption risks are present when there is a lack of open competition for procurement awards and when bidders are favoured, leading to an unfair bias in assessment.⁴³ Former Air Chief, Tyagis cousins and their firms were allegedly received Euros 1.05 million from Agusta Westland UK to favour the deal.⁴⁴ In addition, key Indian individuals were middlemen, who were cousins of the former Chief defence official, and were closely connected in this deal.⁴⁵ This creates conflicts of interest and opportunities for corruption, which ultimately may favour the award of a contract to a

specific industrial entity.

Process Complexity: procurement of defence equipment can include a variety of individuals and agency bodies who are actively involved in the procurement. For example, this can include governments, agencies, suppliers, brokers and many more figures that play a part, both from the demand and supply side. Procurement decision-making can also be led by a small group of technically specialized individuals who hinder oversight by agencies that may not be effective or have may lack the required skills in managing the process.

Military spending: procurement spending should be aligned with defence policy goals. Defence policies should be clear and the military goals of the country and be linked to military spending. However, many countries lack defined defence policies stating the security needs of a country which can lead to poor budgeting decisions.⁴⁶ Countries in the Gulf region experience conflict, during these times quick decisions need to be made and quick expenditure is crucial, but rapid decisions could lead to poor oversight, lack of accountability and a less rigorous focus on value for money in defence spending. Countries in conflict can be used by suppliers, brokers, and middlemen to achieve a quick gain, and they may see strategic urgency as a lucrative opportunity to bend the rules.⁴⁷

Monitoring and weak oversight: in many of the developing countries, and generally in less democratic governments, there are weak controls and oversight on defence matters by parliament. Weak controls and oversight facilitates the risk of corruption and waste. For example, a lack of defence budget transparency has posed serious problems on the African continent.⁴⁸ A problem facing such countries is the continuous supply of bribes from more developed countries.

4.4 Rich arms exporters vs Poor arms importers

There is no single definitive rule on what constitutes military spending and as a result, the degree of transparency, and the way countries calculate military expenditure, differs. Thus, transparency in public reporting on arms expenditure for some countries continues to be a challenge. The aim of this section is, therefore to, identify key issues and causes of military public spending. The levels of transparency will also be determined in both poor and rich countries, both from the import(buying side) and the export(selling) perspective. Table 4.1 shows the principal exporters and importers of major weapons between 2011 and 2015.

Table 4.1: Principal exporters and importers of major weapons, 2011-15

	Exporter	Global Share (%)	Importer	Global Share (%)
1	USA	33.0	India	17.0
2	Russia	25.0	Saudi Arabia	7.0
3	China	5.9	China	4.7
4	France	5.6	UAE	4.6
5	Germany	4.7	Australia	3.6
6	UK	4.5	Turkey	3.4
7	Spain	3.5	Pakistan	3.3
8	Italy	2.7	Vietnam	2.9
9	Ukraine	2.6	USA	2.9
10	Netherlands	2.0	South Korea	2.6

Source: SIPRI Yearbook 2016, Armaments and Disarmaments and International Security⁴⁹

4.4.1 'Big Five' arms exporters

The biggest five arms exporters in the world are United States, Russia, China, France and Germany.⁵⁰ The UK is positioned as the sixth largest defence exporter in the world,

with its market share estimated to be £7.7 billion (US 12 billion dollars); that is 4.5% of the estimated market share of global defence sales.⁵¹ Saudi Arabia has consistently been the UK's top export market for the last five years, receiving two-thirds of the UK arms exports in 2015.⁵² The defence procurement climate has evolved and many western countries have shifted to invest in the emerging economies due to the cuts in defence budgets in the Western sphere. For example, oil-exporting countries, such as those in the Middle-East have increased military spending, albeit their governance controls are poor. In 2015, the US agreed defence contracts with some of the most vulnerable countries, such as Saudi Arabia, Iraq and in South Korea. In 2015, the US signed multiple agreements with Saudi Arabia to provide munitions and arms accessories such as the Patriot PAC-3 missiles costing over a billion dollars.⁵³ More recently in 2017, the US government sealed a multi-billion dollar investment with Saudi Arabia. Western countries are increasingly providing arms sales to countries that have high levels of corruption according to the 2016 CPI index. The Gulf States, for instance, are ruled by the monarchies enjoying both the political and economical power and, as a result, there is a lack of judicial scrutiny leading to weak governance.

A 2015 Transparency International study on Defence Anti-Corruption Index assessments of national defence establishments identified five key corruption risk areas, dividing them into political, financial, personnel, operational and procurement risks.⁵⁴ According to the report, the United Kingdom was the only country with an 'A' rating amongst the G20 countries, indicating that corruption levels in the UK are perceived to be low. The Report found that the UK's financial transparency and accountability controls were effective, hence its procurement corruption risk is low. The findings also indicated that the UK showed strong parliamentary scrutiny in defence institutions. However, concerns were raised relating to the arms controls on exports to emerging economies, indicating poten-

tial issues with control mechanisms. The UK and the USA are perceived to have high levels of transparency in managing defence budgets though France, a top arms exporter, revealed weaknesses in procurement and operations.⁵⁵

4.4.2 Developing Nations as Arms Purchasers

Developing countries in Africa, Asia and South America are less-affluent nations and are the main purchasers of foreign arms. In 2015, the value of all arms transfer agreements with developing nations was 65.2 billion dollars.⁵⁶ Developing countries are largely dependent on foreign arms deals due to a number of factors which include the lack of technological expertise, skills and resources to manufacture weapons. The costs involved in manufacturing defence weapons are high, so governments of developing countries often prefer to purchase arms abroad.

The 2016 CPI index showed levels of corruption in these countries to be critical, and is due to a number of reasons, including poor performance, lack of oversight and weak legislative procedures.⁵⁷ Developing countries also fail on audit procedures. All these problems can lead to huge risks in the misuse of public funds. Countries that have a robust legislative framework, and well established policies, are likely to function effectively and minimize the risk of corruption.

The procedural functions of the importing developing countries appear, in general, to be weak. For example, India does not have a dedicated independent body which is responsible for ethics, neither does it have a well developed anti-corruption system.⁵⁸ Countries like China and Thailand also do not make use of external organisations to undertake proper audit functions.⁵⁹ Qatar and the United Arab Emirates, two of largest military

spenders fail to publish their military budgets. Defence budgets in these countries lack oversight. Corruption puts security at risk, as funds and sales of weapons can be diverted to fuel conflict. This lack of public scrutiny helps increase corruption within the procurement system, in which arms deals primarily go to the companies selling the weapons. Saudi Arabia was the third largest global military spender in 2015, and publishes only a single annual budget figure, with no specific details explaining the expenditure.⁶⁰

In addition, Gulf regions continuously face conflict. For example, Iran is a fragile state fueled with political tension and instability. Systematic corruption is thus likely, and is a key part of the economic social and political context. TI reports that conflict is one of the main drivers of corruption and fragility. Most of the recipient states that are exposed to conflict and tension lack transparency in arms acquisition.

The G20 Report analysed data for 17 developing countries, including India, South Korea, Pakistan, Bangladesh, Sri Lanka, Thailand and Cambodia. The countries analysed in the Report contributed to an estimated \$432.7 billion on military expenditure in 2014.⁶¹ The G20 report shows that out of these 17 countries, only six published their defence budgets, 77% per cent revealed fractional budgetary information and 50% provided no information to their legislatures.⁶² All countries examined had no oversight from a legislative committee. Moreover, nine out of the 17 countries examined, had defence organisations with an interest in businesses relating to the country's natural resources.⁶³ Also, it was found that none of these countries had any control mechanisms, such as adequate audit procedures. This confirms that there is certainly a lack of clarity in emerging countries' defence expenditure.

4.5 Offset and Corruption Risk

4.5.1 Offset Actors

It is important to understand the role of the main actors in the offset process before diagnosing the risks of corruption. The offset model involves four key actors. Governments are the sole providers in defence and they play a pivotal role in the offset decision-making process. Governments can use their authority, and can authorize officials to deal with defence contracts. The supplier is involved in the execution phase of the offset obligation, and is known as an obligee who negotiates and delivers the offset requirements. Third parties also play an integral role in the facilitation of the offset programme. They have the necessary expertise and skills, and provide support to the buying country to engage with commercial partners on the projects, and interact with the offset authorities. Consultants are also used as specialists and assist in providing technical support and advice and development in the offset process. Third parties can involve a wide variety of participants such as offset executors, brokers, companies and R&D centres, which engage in the process providing orders, technology or training to offset beneficiaries.⁶⁴

4.5.2 Risk Factors

Offset transactions attract a spectrum of risk. Indirect offset is perceived to be a common goal in the GCC countries, boosting the local economy by directing investments into capital projects and joint ventures in the civilian sectors such as the electronics, pharmaceuticals, health-care, education and the ship building industry.⁶⁵ However, as previously discussed, indirect offset poses a potential corruption risk because they are negotiable and open-ended with respect to the purchasing country. Such arrangements are selected on a case-by-case basis, and offer unique compromises. Moreover, offset policies vary

across nations, in efforts to create investment opportunities that stimulate growth in areas outside the main contractual agreement. For example, investments can take place in the promotion of tourism, building of factories, selling part of the sales of local production in the vendor's home country, and many other economic areas boosting initiatives unrelated to the arms deal. Against this backdrop, the next section will provide the potential risk features of offset, such as secrecy, politics, suppliers, third party agents, credit awards all of which create opportunities for corruption.

4.5.3 Dangers of Secrecy

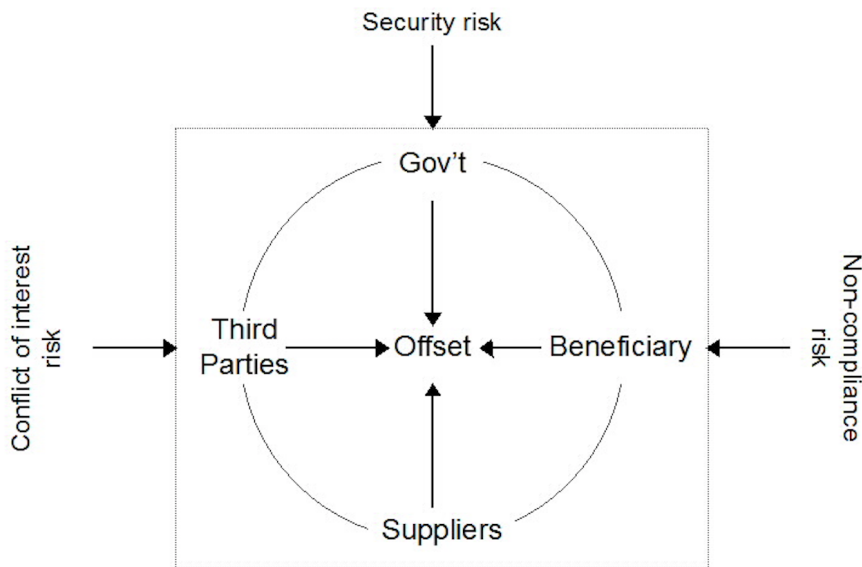
Secrecy, is an enemy of defence transparency. This keeps government processes, decisions and actions hidden. This can lead to a security risk that can heavily impact on the defence procurement process of the contract. Governments are protected from disclosing public expenditure information and this can lead to a negative outcome on arms deals. Deceptive activities are likely to occur in closed environments. Allegedly, BAE Systems ran a network of hidden cash payments in a number of countries amounting to billions of pounds from 1980 to 2010.⁶⁶

4.5.4 Political Risk

Governments play a critical role in arms purchases and may use offset to exert influence in the award of contracts for vested interests.⁶⁷ Governments decide on the goods and services that meet the national interest needs and the degree of expenditure. Governments, can determine the levels of defence capabilities and can also select defence suppliers. However, large defence purchases can be politically motivated to achieve gains in return for contracts. Also governments determine the competition in a contract, and the winners and losers. Moreover, offset transactions can be easily steered to other areas of vested

personal interest to benefit the political needs of a country. The 1999 South African arms deal not only highlights the inadequacies in defence procurement but shows that the government exploited its interest to win over political support and as a result failed to meet the expected objectives outlined in the offset contract. Politicians can solicit bribes and divert funds that are allocated to the offset package.⁶⁸ Governments can also use payments as bribes to pay suppliers and to award contracts. Allegedly in 2010, BAES was accused of paying millions of pounds in bribes to Saudi royalty for a contract worth around billions of pounds to supply Tornado and Hawk jets.⁶⁹ Corruption can take place at every stage in the procurement process, because politicians can use their discretion to drive decisions leading to a political risk (see Figure 4.2).

Figure 4.2: Offset Risk



Source: Author

4.5.5 Suppliers

A supplier is a person or a company that provides goods or services to other companies. In the defence sector, the supplier is a provider that supplies goods or services to the procuring country. A supplier can offer payments or benefits to the buyer in order to gain access to a contract in the offset package. The private sector plays a major role in the supply side of corruption.⁷⁰ Supplier companies are making benefits available to political officials: for example, through the form of bribes. The main supplier companies may use the offset package as a vehicle to offer benefits (bribes) in return for access to defence contracts, leading to a non-compliance risk (see Figure 4.2).

4.5.6 Third Party Agents

Agents can potentially harm the contract, as agents and brokers can manipulate the process by ensuring that the specifications favour their clients' products. Third party agents can often play a pivotal role in defence transactions and perform a wide range of functions. In some countries, agents play a central function in securing the sale needs of a defence company. Their functions can include building and maintaining new relationships with public officials and decision-makers, accessing new potential business in regions, particularly where a market is difficult to access, complying with the relevant governance, assisting with project facilitation, licensing and advising countries.⁷¹

Third party intermediaries have caused concern for many firms. The emergence of new legislation for controlling bribery in the UK and US has prompted firms to take effective measures when employing third party agents. Due diligence checks were conducted with third party agents. Third parties and intermediaries represent the most vulnerable area for corruption and a challenging area for defence firms to combat corruption. For example,

the leading European aircraft consortium, Airbus, had made a number of questionable payments to third party agents which had been facilitated through bribe payments to public officials and politicians to secure arm deals.⁷² Airbus allegedly paid bribes to Canadian politicians to induce Air Canada to purchase a large number of Airbus rather than Boeing jets.⁷³ In Greece, Airbus paid 41 million Euros in bribes to Greek officials to secure the purchase of 20 NH-90 helicopters.⁷⁴ German authorities suspect that bribes were paid to enable the company to obtain contracts worth 3 billion Euros (2.3 billion pounds) in Saudi Arabia and Romania.⁷⁵ In October 2017, Airbus admitted to the UK authorities that it had uncovered discrepancies in its disclosures about the use of middlemen paid to win commercial export deals.⁷⁶ Also, it violated US governing rules for defence exports known as the International Traffic in Arms Regulations (ITAR). Airbus has been urged to reform its policy practices by providing additional information on third party agents used to win export deals valued at \$ 500,000 dollars or more.

In certain countries third party agents are prohibited. In the case of India, the hiring of defence agents has been banned due to allegations that surfaced against the former government over the purchase of 410 FH 77B Howitzers from Bofors of Sweden.⁷⁷ However, some countries apply different approaches to third party agents. For example, the UAE has a formal directive in place for defence companies seeking contracts with its Armed Forces. Under this directive, agents are not allowed to participate in defence contracting.⁷⁸ In order to bid on government contracts, foreign suppliers need to be represented by a commercial agent or a corporate Limited Company.⁷⁹

The offset project and its implementation is often carried out by third parties. Agents may also have close relationships with government officials, and are usually former military officers leading to conflicts of interest. A conflict of interest is the abuse of individual

by, for example politicians and public officials for private ends. This arises when decisions made are not fully aligned with the expected goals of the government or agency with which they are associated. This may take the form of unlawful actions for services rendered, by exploiting the use of sensitive information both internally and externally in order to achieve personal reward. In a similar way, politicians may take illegal action that is designed to benefit their party at the expense of the wider public. For example in 2010, the deal struck between Agusta Westland and the Indian Defence MOD was tainted with bribery and corruption allegations against key politicians linked to key middlemen players with corporate firms. Further, *The Hindu* newspaper cites that a British citizen had allegedly received 60% of the total contract from Finmeccanica, the subsidiary to Agusta Westland.⁸⁰ It is believed that the British employee had close ties with the Indian Defence forces. This was due to his father, a British businessman closely connected with India between the 1980s and 1990s, and close to the Congress party.⁸¹ Today, more generally third party agents are controversial subject and many cases of alleged corruption have involved the use of middleman.

4.6 Corruption: Gauging the Extent of the Problem

Corruption in the defence sector is a global phenomenon which has attracted media attention in newspapers, articles and in the academic sphere. Corruption in the military is a problematic feature of poor countries. The extent and scale of defence offset corruption has been widely reported and documented by Transparency International.⁸² In addition, offset corruption is extensively reported by the media and often described in terms of, “scandals” and “allegations”. A 2010 TI Report focuses on alleged corruption in defence and offset, but vague provides no evidence to suggest that corruption exists in offset.⁸³ One of the most controversial UK corruption cases is Saudi Arabia’s Al Yamamah con-

tract with the UK's biggest British defence BAE Systems. The infamous South African arms deal was also linked to alleged corruption scandals in offset. The published report by the South African Commission Inquiry in 2015 reports that concerns were raised on how Ferrostaal managed the offset projects but the report Debevoise and Plimpton Report concedes that there was no evidence of any wrongdoing.⁸⁴ The report suggest failings in the procurement processes lacked transparency and accountability. In the audit findings some of the procedural processes in the procurement of the arms purchases were not followed by Armscor.⁸⁵ In his case study, Haines argues that there were “substantial hidden costs associated with offsets”. Despite such arguments there is a lack of evidence to prove corruption.

Misleading claims against offset have sparked off a wave of concern in the defence arena placing offset in an unfair light. The reality is that whilst offset can be used as a vehicle of corruption, there is a lack of data to prove that corruption actually exists (see Table 4.2).⁸⁶ For example, in the case of the 1999 South African Arms deal, the Seriti Commission stated that corruption did not occur in the arms and offset deals due to the insufficiency of evidence provided.⁸⁷

There is a need to assess the global nature and extent of corruption in UK defence alongside offset programmes. According to the academic literature, little attempt has been made to gauge the significance of corruption in offset as opposed to procurement. This study has sought to examine newspaper articles, online reports, specialized articles and websites, such as trace compendium, and the Department of Justice and Serious Fraud Office was referenced to supply data. The data extracted are presented in Table 4.2, with findings categorized according to key trends in procurement vs offset, type of corruption, and proven vs alleged corruption in rich vs poor countries. The scope of this analysis

covers the past 12 years.

Table 4.2, suggests that corruption is omnipresent, and has had an impact on both developed and developing countries. Bribery is an ongoing problem in the developing countries when dealing with foreign suppliers from the developed countries. Corruption is common in the developing world and more prevalent in developing countries than in rich ones. By contrast, people from less developed countries are faced with the difficulty of establishing an honest administration and a transparent political environment. Also, proven cases of corruption appear to be entirely associated, with defence procurement. The purchase of weapons occurs in a buyers' market, where production capacities are higher than demand. Tenders face limited scrutiny and, as a result, contractual details are not transparent, leaving a window open to corruption. This area lacks transparency, from the tendering phase to the end phase of the contract. Corruption cases appear to be contested on the procurement side, in particular, via the awarding of contract in the pre-tender phase. Bribing of officials in foreign markets seems to be a problematic feature for most countries, suggesting that companies fail to monitor actions of agents abroad when dealing with foreign governments. This certainly raises questions over the levels of integrity and compliance practices in place for third party agents with vendor companies. The main agents behind corruption in such cases have been executive levels of management, such as Chief Executive Officers(CEO), or political figures, who have engaged in illicit practices and initiated the funnelling of bribes and lavish items using taxpayers' money. Top level management has a duty to set an example to staff and practice regarding good ethical behaviour. Yet senior executives abuse their public roles in office in condoning malpractice and failing to meet the expected ethical behaviour set out in the company's code of conduct. The majority of bribes have been facilitated by means of offshore accounts.

Table 4.2: Nature and Extent of Defence and Offset Corruption

Year	Case	Country	Recipient State	CPI Index 2016	Corruption		Proven/ Not Proven	Nature
					Proc.	Offset		
1999	1999 South African Arms Deal	South Africa	Developing	45/176	✓	✓	Not proven	Bribery, Conflict of Interest, Fraud
2001	Tanzania air traffic control system	Tanzania	Developing	32/176	✓		Proven	Perjury
2002	Darylann Case	USA	Developed	74/176	✓		Proven	Bribery, Conflict of Interest, Fraud
2003	EADS corruption scandal with Vienna	Austria	Developed	75/176	✓		Not proven	Bribery and Fraud
2004	Greek Submarine Sale	Germany	Developed	81/176	✓		Proven	Bribery, Fraud
2007	Nigerian Fraudulent Arms Deal	Nigeria	Developing	28/176	✓		Not proven	Fraud, Bribery, Embezzlement
2009	German Submarine Case	Portugal	Developing	62/176	✓	✓	Not Proven	Bribery

Year	Case	Country	Recipient State	CPI Index 2016	Corruption		Proven/Not Proven	Nature
					Proc.	Offset		
2010	VVIP Helicopter Scandal	India	Developing	40/176	✓		Proven	Bribery, Money Laundering
2016	Airbus Fraud Allegations	France	Developed	69/176	✓		Ongoing	Bribery and fraud
2010	Rolls Royce	United Kingdom	Developed	81/176	✓		Proven	Bribery
2012	Finmeccanica manager arrested in graft probe	Italy	Developed	47/176	✓		Proven	Bribery
2013	South Korea's Purchase AW-159 helicopters	Korea	Developing	53/176	✓		Proven	Bribery
2013	Atlas Elektronik GMBH	Greece	Developing	44/176	✓		Proven	Bribery and tax evasion
2014	Scandal Rocks Indonesia/Philippines	Indonesia	Developing	37/176	✓		Not proven	Bribery
2016	Embraer	Brazil	Developing	40/176	✓		Proven	Bribery

Source: Author (See Appendix C for full list of weblinks consulted).

4.6.1 Summary

This chapter has undertaken a critical review of corruption risk in offset and has identified the possible pathways that corruption risk can filter through the life cycle phase of procurement. Defence procurement is a contested area with numerous corruption scandals. It presents many challenges to both the importing and exporting countries. Table 4.2 highlights the nature of corruption, and clearly indicates that defence procurement is a vulnerable area that can negatively impact both rich and poor countries. The evidence suggests that corruption occurs in defence procurement rather than offset. The main determining factors leading to unlawful behaviour is due to the hidden nature and complexities that surround the procurement of large arms purchases. Corruption seems to be an inherent feature in particular with developing countries due to laxity in the legislative process, ineffective governance in security and defence, and a lack of transparency and scrutiny over decisions and defence budgets. Weak controls and oversight facilitate the risk of corruption leading to waste in cost.

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Chapter 5

UK Case Study: Ethical Compliance in Relation to Offset

5.1 Introduction

Corruption in the UK can be traced back to the 19th century when funds were siphoned from taxpayers, and the solicitation of bribes by officials was common practice. Since the 19th century domestic and international legislation has evolved to combat the cancer of corruption. Modern anti-corruption practices are embedded in what is called a code of conduct. Nevertheless, it has been argued by academics that there is still a lack of effective tools developed to control bribery and corruption, involving especially the benefits paid to public officials.¹ This has become a problematic feature in domestic companies that operate overseas.²

Since the 1970s, there have been a number of high profile cases of corruption involving UK defence industry, including malpractice. For example, BAES allegedly facilitated a number of corrupt deals on a global scale involving public officials in Saudi Arabia,

Tanzania, India, Romania and South Africa.³ Both the UK Bribery Act and Foreign Corrupt Practices Act (FCPA) were breached, and there was a deliberate failure to meet US compliance standards. Also, Rolls-Royce and BAES suffered the stigma of corruption allegations for many years, caused by deficiencies in compliance standards and weak anti-corruption systems. Rolls-Royce admitted to falsifying accounting procedures by concealing illegal payments to officials to win contracts in Indonesia, Thailand, China and Russia. These payments totalled an estimated \$500,000 dollars spanning the years between 1989 and 2013.⁴ This has not only damaged the global reputation of Rolls-Royce, but has also impacted the company financially. A hefty settlement of £671 million was negotiated by the US, Brazil and UK authorities over bribery and corruption allegations.⁵

Over the years, these cases have contributed to a questioning of the standards of integrity and compliance in the UK defence sector. Transparency International argues that many defence companies are lagging behind in terms of ethical corporate standards, leaving the door open to corruption. A 2015 survey conducted by Transparency International suggests that defence companies in Asia-Pacific, Middle-East, North Africa and Central Asia provide no evidence of ethical and anti-corruption policies.⁶

UK defence companies are required to regulate employee behaviour to meet the core values and expectations of the corporate code of conduct. This requires all defence employees, public officials, stakeholders and suppliers to conduct themselves ethically in day-to-day business operations. The code of conduct contains corporate principles that the International Business Ethics (IBE) forum recommends, based on integrity, fairness, respect and openness. Businesses are required to do what is right by adopting these values.⁷

In this regard, reputation is key to a company's performance, and failure to protect the

“brand” is likely to lead to financial and reputational damage. Moreover, a strong reputation of an organisation can differentiate its products in highly competitive markets, where buyers trust a corporate brand. Companies want to drive long-term economic investment and maintain long-standing relationships with customers via a trusted reputation in the commercial sphere, based on its corporate ethical standards.

The top 10 global weapon importers, Saudi Arabia, India, Qatar, USA, Australia, Canada, UAE, Iraq, Brazil and Egypt⁸ seek added benefits called offset from their arms imports. Offset has forced defence suppliers to invest in such deals, providing customer countries with numerous potential benefits. Due to the changing economic and political landscape, UK defence arms exporters need to assess the level of risk to ensure that they protect their brand in foreign territories. The challenge is that countries have different regulatory frameworks, and are governed in different ways, often characterised by a lack of transparency. For example, in Qatar, there is no formal regime in place for dealing with offset.⁹ In addition, and more generally, there are no particular policies that govern contractors in (foreign markets) except for procurement procedures. There are also no restrictions relating to former government employees working in the private sector.¹⁰ The Transparency International 2015 survey suggests that Western companies in Asia-Pacific, the Middle-East, North Africa and Central Asia are failing to meet robust ethical standards. Many states in these regions have strong trade relations with UK defence companies, and UK exporting companies need to comply with the relevant laws and regulatory controls. This highlights the obvious fact that UK defence companies should manage business with high level of integrity to mitigate possible corruption risks.

Alleged corruption involving multinational corporations, such as BAES and Rolls-Royce, illustrate the difficulties faced by UK defence companies in exporting arms and agreeing

linked offset programmes. The infamous Al Yamamah deal brought focused the spotlight on the ethical conduct of UK defence firms, and represented the turning point for ethical corporate compliance by UK defence exporters. BAES has been widely criticized both by the media and anti-corruption agencies over its poor ethical performance in foreign arms deals. The controversial Saudi case has highlighted the weaknesses in compliance with UK governance and legal requirements, allowing corruption to occur in overseas sales.

To date, two global organisations have conducted research into the risks of corruption in offset programmes. In 2012, Transparency International conducted an investigation to review corporate due diligence practices, not least to identify defence corruption risks in offset procedures.¹¹ In 2015, the International Forum Business Ethical Conduct (IFBEC) established a working group on offset to examine bribery and corruption risks in defence offset programmes.¹²

Following these introductory comments, it is the purpose of this study is to answer two main questions. Does corruption exist in defence offset programmes, and if so to what extent? Due to the sensitivity of the topic, the thrust of this research programme is to assess the nature and effectiveness of corporate compliance in relation to offset programmes undertaken by UK defence contractors. This dissertation has therefore taken a different approach from Transparency International and IFBEC, and aims to assess the ethical corporate framework of UK defence companies based on the conceptual framework illustrated in Figure 1.1 (Chapter 1). Three levels of analysis have been employed to assess the effectiveness of ethical corporate frameworks in the UK defence sector.

This chapter starts by highlighting the existence of corruption, and the failings of ethical compliance in big multinational UK defence companies. This leads to the analysis

of the UK as a country case study. Interviews were conducted with three top UK defence firms to assess the nature and effectiveness of their corporate ethical frameworks, especially in relation to offset programmes. Firstly, the effectiveness of corporate ethical compliance was explored at the company level. Then, national legislation was identified, especially the legislative processes that defence companies incorporate within their ethical frameworks. Finally, the effectiveness of international laws and regulations was explored.

5.2 Evidence of UK Defence-Related Corruption

The UK has a world class reputation in defence manufacturing innovation and design and is a major player in Europe and the United States, as well as globally in aerospace and defence sales.¹³ Despite a world class reputation in defence exports, UK policies and procedural processes have consistently appeared to fail in export dealings. Failings of compliance and violations of laws have been a problematic feature since the 1970s. BAES has allegedly been at the centre of corruption in countries such as South Africa, Tanzania, China and Indonesia.¹⁴ Similar allegations have also dogged the UK's lead aircraft engine manufacturer, Rolls-Royce.

The next section highlights the poor ethical behaviour demonstrated by world class UK defence exporters. Corruption has plagued the defence sector over the past decades and has significantly impacted on defence procurement deals worth millions of pounds. The main actors involved in these alleged corruption cases are governments and senior officials that network in countries which have high levels of corruption. The following section offers a historical review of past and present unethical behaviour amongst UK defence companies when selling arms to foreign countries.

5.2.1 Case Study: BAES

In 1985, the UK Government won a large export contract with the Saudi government, called the Al Yamamah arms deal. BAES made payments amounting to hundreds of dollars to third party agents to gain favour for these defence contracts. The arms deal was valued at £43 billion.¹⁵ In addition, a slush fund of £20 million was used to entertain Saudi officials.¹⁶ As a result, in 2004, the Serious Fraud Office opened an investigation, and two years later a decision to stop the case was taken by Tony Blair (UK Prime Minister) on the grounds of national security, ostensibly because Saudi Arabia had threatened to withdraw all its investments from the UK.¹⁷

In a 1999 case, the South African government purchased helicopters, submarines, warships, amounting to billions of dollars. The deal included several European countries signing contracts totalling around 30bn Rand (£4bn), as a means of upgrading South Africa's defence forces.¹⁸ The deal involved companies from the UK, Germany, Italy, Sweden, France and South Africa. However, BAES had a significant role and influence in part of the deal, because it used its agents working in South Africa. Reportedly BAES set up a £100m fund, in 2007-08 to bribe South African politicians.¹⁹ Illegal payments, such as bribes, were used to persuade the South African authorities to purchase British Hawks instead of cheaper alternatives. South Africans have faced no charge over links with BAES; however, intermediaries have been prosecuted over parts of the South African arms deal.²⁰

In another BAES case, the company signed a contract in 2001 with the Tanzanian government to supply radar systems valued at £28 million.²¹ Funds were loaned from Barclays Bank to finance the cost of deal. However, the World Bank confirmed that the deal was not

financially cost effective for Tanzania as much cheaper options were available.²² Prior to October 1999, an agreement was drawn up between BAES, Merlin International Ltd and Envers Trading Corporation. Merlin a Tanzanian company controlled by a BAES Tanzanian agent agreed that the company (Envers) would receive 1% of the contract value from BAES based in Panama.²³ Also, an estimated 30% of the contract value would be received by Red Diamond, an offshore company.²⁴ In August 2007, a criminal case was filed in Tanzania, charging the BAES Tanzanian agent with perjury and lying under oath in connection with the radar deal.²⁵ Later, in 2010, the SFO opened an investigation over the Tanzanian radar deal. BAES admitted failure in keeping proper accounting records relating to a £12.4m payment to a Tanzanian middleman for “marketing” purposes.²⁶ A settlement was reached with BAES paying £30 million as a penalty. The was a charitable payment to Tanzania.²⁷ In January 2003, the Romanian government engaged in a government-to-government deal, valued at £116 million, to purchase two-ex Royal Navy frigates.²⁸ This was one of the largest deals negotiated by Romania, whose government had historically proven to be corrupt, especially in arms deals.²⁹ The *Guardian* reports that a third party agent allegedly received £7 million by BAES to fix the deal.³⁰

In the early 2000s, the Czech Republic and Hungary decided to acquire new major combat aircraft. The Czech Republic selected a bid valued at \$1.8 billion. Later in 2002, the deal was cancelled due to a massive flood. Funds were acquired by the government for reconstruction. Negotiations still continued but for a smaller purchase. In 2004, the Czech government signed a deal worth \$750 million. This represented a lease contract for 14 Gripens over 10 years. Similarly, in 1991 the Hungarian government decided to lease 14 Gripens at a value of \$500 million.³¹ One of the reasons behind this purchase was a Swedish offset offer of 100% of the \$500 million deal.³² Part of this investment included 30% investment into the Hungarian industry.³³ Later, an inquiry was opened by the SFO in

2004 to investigate BAES's secret offshore accounts, and investigators found commission payments to a subsidiary Red Diamond account in the British Virgin Islands. A BAES's agent, a husband of an Austrian politician, allegedly received millions in secret payments from BAES for promoting the deal.³⁴ An estimated £4 million was paid into overseas accounts.³⁵ Further, the *Guardian* newspaper stated that the deal was orchestrated by a former high ranking civil servant of the UK MOD, who had been employed by BAES.³⁶

According to the *Guardian*, the SFO charged a former BAES agent, Count Mensdorff, for conspiring with others to give corrupt payments to officials and agents in the Czech Republic, Hungary and Austria as inducements to secure the arms deal.³⁷ Legal documents reveal that BAES had made a number of payments to various offshore companies and third party intermediaries that were not subject to scrutiny and review. BAES admitted to using "marketing advisors" to conceal payment checks in order to secure defence sales.³⁸ BAES had facilitated a number of disguised payments and failed to disclose the origins of these payments. BAES pleaded guilty to conspiring to defraud the United States and falsifying statements in contravention of its Foreign Corrupt Practices Act (FCPA) compliance programme.³⁹ In addition, BAES violated US export arms regulations, the Arms Export Control Act (AECA) and International Traffic in Arms Regulations (ITAR) through falsely filing applications for export licenses for the sale of Gripen fighter jets to the Czech Republic and Hungary.⁴⁰ This resulted in the US Department of Justice (US DOJ) imposing a fine on BAES of \$400 million.⁴¹

5.2.2 Case Study: Rolls-Royce

In 2012, postings on the internet raised concerns about the corporate ethical conduct of Rolls-Royce.⁴² This attracted global scrutiny, including the attention of the Serious Fraud

Office. Between 1991 and 2005, Rolls-Royce paid more than \$36 million dollars to agents in Thailand to help secure engine sales to Thai Airways.⁴³ Rolls-Royce and Rolls-Royce Energy Systems (RRESI) bribed foreign officials in return for contract awards, equipment, products and services.⁴⁴ Rolls-Royce also admitted to hiring advisers in various countries to secure contracts through the payment of bribes. Between 2003 and 2013, RRESI, a subsidiary of Rolls-Royce paid an estimated \$9.32 million dollars in commission payments and \$1.6 million dollars in corrupt bribery payments to a Brazilian official to help RRESI win a contract with a Brazilian company called Petrobras.⁴⁵ In Indonesia, Rolls-Royce allegedly paid £1.8 million and gave a Rolls-Royce Silver Spirit car to an ‘individual’ in exchange for contracts to supply Trent aero engines to Garuda Indonesia. In addition, Rolls-Royce bribed a representative of a competing company to deliberately submit an uncompetitive bid on a contract Rolls-Royce later secured.⁴⁶

Corrupt payments have also been made to Angola. In 2008, Sonangol, a multinational oil and gas company, put forward bids for a development project in Angola. Three projects were awarded to Rolls-Royce and RRESI. In total, bribes of £2.4 million payment were paid to agents.⁴⁷

Further, Rolls-Royce failed to prevent bribery in relation to the extension of a £5m cash credit to China Eastern Airlines (CEA) in exchange for purchasing aircraft engines in 2013.⁴⁸ Part of these funds were used for lavish extracurricular activities, including four-star accommodation. A middleman hired by the company paid bribes to Chinese public officials, though Rolls-Royce later pulled out of both deals.⁴⁹ Following the damage caused to its global reputation, Rolls-Royce announced in talks with the SFO that it is been strengthening its internal compliance procedures since 2008.

The criminal activities that took place from 1989 to 2000 activated internal scrutiny over Rolls-Royce compliance and anti-corruption procedures. In 2013, an independent external expert was appointed to review Rolls-Royce's internal policies and procedures.⁵⁰ The main goal of the initiative was to modify weak areas and adopt a new improved compliance programme. As a result of the corruption offences, compliance needed to be modified on the internal controls to ensure an effective system of internal accounting. In addition, anti-corruption compliance programmes were employed, and robust policies and procedures implemented to effectively detect and deter violations of the Foreign Corrupt Practices Act.⁵¹ Since then, there has been a significant change in corporate compliance standards, including the publication of a new Code of Conduct ensuring that employees understand the expected level of corporate behaviour required by the company.⁵² This code was supported by a number of policies, including a revised intermediary policy, and additional compliance checks, including external review diligence processes.⁵³

Nevertheless, in 2014 Rolls-Royce was embroiled in further controversial allegations; this time involving Indian Ministry of Defence. An investigation revealed that Rolls-Royce had paid bribes to Hindustan Aeronautics Ltd to the value of £48 million.⁵⁴ Indian law bans the use of middlemen or advisers to obtain government deals. Legal practices were violated in India.

In 2017, the SFO concluded that Rolls-Royce was involved in a number of bribery and corruption offences, leading to serious ethical breaches of law in multiple countries (see Table 5.1).⁵⁵ The failure to secure corporate compliance was an area that needed much attention by Rolls-Royce. The main perpetrators linked to these unlawful acts were “middlemen”, who have been influential in the solicitation of bribes in a number of highly corrupt countries (CPI 2016). The Serious Fraud Office stated this was one of its largest

investigations that ultimately led to a heavy financial settlement of £671 million by Rolls-Royce. The DOJ agreed to a three year DPA to settle the charges. Part of this US agreement covers the conduct of Rolls-Royce (in Brazil, Kazakhstan and Thailand).⁵⁶ Rolls-Royce was charged with violating anti-bribery US laws (FCPA), but because of the settlement, the prosecution was discontinued. Rolls-Royce Energy Systems (RRES), an indirect subsidiary of Rolls-Royce, paid between 2000 and 2013 an estimated \$35 million in commission payments to bribe foreign officials. Part of the bribery payments were paid by UK and US based Rolls-Royce employees, who assisted in providing secret information to secure contracts in countries (Thailand, Brazil, Kazakhstan, Azerbaijan, Angola, Iraq).⁵⁷

5.2.3 Reputational Damage from Corruption

There is a fear that corruption is endemic in UK defence companies. Previous cases and existing egregious evidence indicate that corruption has persisted since 1989 through the 2000s amongst the leading UK defence exporters.

The Rolls-Royce case negatively impacted on its financial performance, leading to consequential financial effects in the supply chain, a loss in the company's competitiveness with key markets, a significant fall in the share price due to financial penalties imposed on the company, a heavy impact on shareholder confidence, major restructuring in identified weak areas, incurred by costly investigations and a potential weakening of the Rolls-Royce financial covenant for pensions.⁵⁸

Corruption allegations not only weaken the credibility of UK defence companies but question the integrity standards of UK defence companies. It suggests a strong need to

Table 5.1: Summary of alleged Rolls-Royce Corruption Activity

Agreements to make corrupt payments to agents in connection with the sale of Trent aero engines for civil aircraft in Indonesia and Thailand between 1989 and 2006.
Concealment of the use of intermediaries involved in its defence business in India between 2005 and 2009 when the use of intermediaries was restricted.
An agreement to make a corrupt payment in 2006/7 to recover a list of intermediaries that had been taken by a tax inspector from Rolls-Royce in India.
An agreement to make corrupt payments to agents in connection with the supply of gas compression equipment in Russia between January 2008 and December 2009.
Failing to prevent bribery by employees or intermediaries in conducting its energy business in Nigeria and Indonesia between the commencement of the Bribery Act 2010 and May 2013 and July 2013 respectively, with similar failures in relation to its civil business in Indonesia.
Failure to prevent the provision by Rolls-Royce employees of inducements which constitutes bribery in its civil business in China and Malaysia between the commencement of the Bribery Act 2010 and December 2013.

Source: Case No: U20170036, “Approved Judgment between Serious Fraud Office and Rolls-Royce PLC”.⁵⁹

strengthen internal compliance procedures in bribery. Corruption tends to be associated with large defence procurement contracts and the level of scrutiny of such arms deals is open to question. Agents and middleman have been closely linked to procurement contracts, and the historical evidence indicates that bribes have been a problematic feature since the 1980s. However, is this still the case? Are UK defence companies failing to take adequate measures to deter corruption, especially, refraining from the use of agents? Have UK defence exporters recognised the problem by significantly tightening up their ethical compliance procedures? Have the anti-corruption laws stamped out corruption? The purpose of this study’s fieldwork was to answer these questions.

5.3 Adequacy of UK Ethical Compliance Procedures

UK exporters are major players in the international export market. Accordingly, these companies are expected to promote high ethical standards through transparency, accountability and corporate integrity. To test whether UK defence companies are meeting their ethical responsibilities, a questionnaire was circulated to 11 UK based defence companies. A copy of the questionnaire can be found in Appendix B. The list of companies was provided by the ADS Group. The sample of companies included Airbus, Babcock, BAES, Boeing UK, General Dynamics, Leonardo, Lockheed Martin, Qinetiq, Rolls-Royce, Serco, and Thales. Of the 11 defence exporters that were contacted by email, three leading export companies accepted the invitation to participate in the survey. Whilst this is only a 27% response rate, the three participating firms represent between 40-50% of the arms sales of the 11 sample companies.⁶⁰

5.3.1 Corporate Ethical Compliance

Ethical policy frames a company's culture, its behaviour, actions and the level of expectations required by the company. This guiding corporate policy is based on the code of conduct. The code puts in place internal controls to manage ethical and compliance standards in an organization. Defence companies are increasingly expected to have a global ethical corporate policy in place to guide employee decision making processes. Ethics is a practice which extends beyond compliance, and has legal requirements. The central focus is on individual behaviour, distinguishing right from wrong, by executing the values and principles embedded in a company's code of conduct. This code will be based on honesty, transparency, accountability and integrity and influences how a business operates, both internally and externally (suppliers). It is a fundamental feature of corporate policy that needs to be embedded in a firm's culture, along with procedures to safeguard

the company against corruption, so protecting its international brand.

Corporate governance in the UK has always emphasised corruption awareness, co-operating with international governments to curb corruption. The UK government recognises that corruption is an issue on a global scale. In May 2016, the UK government hosted a global summit to advocate awareness and tackle corruption by addressing problematic issues in the UK, such as corporate secrecy, government transparency regarding compliance abroad - including efforts to strengthen enforcement laws governing domestic companies.⁶¹ Despite such concerted efforts, ethical concerns are still at the forefront, with high profile corruption scandals linked to public officials, indicating in the UK. These cases have attracted global attention, impacting negatively on the reputation of defence suppliers. The effectiveness of corporate compliance procedures is therefore critically important in the ethical functioning of a company as it provides a framework for organizational leadership.

The answer to question 1 (in the survey questionnaire) as shown in Table 5.2, confirms that all companies publish a statement of values referred to as the global 'code of conduct', and it applies to all levels of staff, including (Chief Executive Officers) CEOs, contractors and suppliers. All respondents confirm that this code has a set of moral principles that serve as a reminder to all employees that they must act with integrity. The most striking result to emerge from the interviews is that company C was the only company that attached a supplier code of conduct to every purchase order, so to minimize potential risks of corruption. All respondents offered the code of conduct in multiple languages accessible by all employees, whether employed locally or at the international level. This policy was in line with the Woolf Report's recommendation one.⁶²

With reference to question 2, company B, has not changed its core values since 1995.

Table 5.2: Survey Questions of Ethical Compliance

Section B: Ethical Corporate Compliance	Company A	Company B	Company C
1. Does your company publish a statement of values on corporate ethics, of business conduct, honesty and transparency which set out the principles, accountability and integrity?	Yes	Yes	Yes
2. Has your company's ethical policy been revised? If so, why? When was the last review?	Yes	Yes	Yes
3. Number of employees in compliance	1000	80	140
4. Is offset subject to ethics policy? How is offset incorporated into your ethics policy?	Yes	Yes	Yes
5. Does your company use third party agents in offset projects? If so are they subject to your company's compliance policy?	Yes	Yes	Yes
6. Is a risk assessment carried out on external offset business decisions? What are the processes in place to monitor the ongoing compliance in offset activities?	Yes	Yes	Yes
7. What internal control mechanisms do you have in place for reporting ethical misconduct? Is this reviewed by an internal or external committee?	Yes	Yes	Yes

Source: Author.

The interviewee for B stated *“we do not feel the need to change the values, because this is a clear statement of values outlined in the code of conduct. Employees faced with an ethical dilemma can refer to the core values set out by the organization”*.⁶³ This demonstrates that the core values are clear and effective for the employees to understand, when faced with ethical dilemmas. Interviewee A reports *“that the code of conduct is up for review and any revisions will be released in 2018”*.⁶⁴ Interviewee B confirmed that the last update of the code of conduct was in 2014, *“the three years are up, so it is now under review, and towards the end of 2017 a refreshed version will be out”*.⁶⁵ Interviewee C confirmed that the *“global code of conduct gets reviewed every three to four years, as*

a matter of its good practice, and it is an evolving process, with the last review taken in 2016, and is currently under review due to good practice".⁶⁶ This is evidence to suggest that all three companies review their code of conduct every three to four years and this has been consistently applied. It was also noted that those companies which have headquarters in the US have to also comply with the US Defence Industry Initiative (DII), based on a number of self-governing principles. All companies confirmed that their code of conduct was currently under review. This suggests that companies have not changed their code of conduct due to business needs, but as a requirement of good practice.

Reference to Table 5.2 question 3, interviewee A, reported that it has *"thousands of employees working in compliance across the company and this includes the export compliance, ethics teams and legal compliance"*.⁶⁷ Interviewee B, confirmed that *"in the UK, there are an estimated 20 strong team of compliance officers, and this includes part time ethics officers. There are also an estimated 50-60 ethics employees in the US, and this includes lawyers"*.⁶⁸ Interviewee C reported that *"the UK compliance team comprises 40 full time members and an estimated network of about 100, which includes international officers"*.⁶⁹ Data show these numbers vary across companies, and the amount of resources in place for ethics differs vastly, and are not dependent on the size of the company. Overall, all companies demonstrate that compliance is a key function of the legal department.

In response to question 4, Table 5.2, the answers of all three respondents was yes. Interviewee A confirmed that offset policies have to be in accordance with the code of conduct.⁷⁰ Interviewee B stated that its *"ethics policy is separate from offset policy. The code of conduct is for all employees acting on our behalf, such as offset brokers and agents, and there is an expectation in the policy, that all will act in line with the expected standards, and the anti-corruption policy with respect to giving hospitality to public offi-*

cials, bribes".⁷¹ This interviewee indicated that its website shows that its offset policy is in full compliance with the company's zero-tolerance approach to bribery and corruption as set out in section 4 of its Global Code of Conduct, and the company's Anti-Bribery and Corruption Policies.⁷²

Interviewee C stated that "*offset is done in compliance with the company's anti-corruption policies*".⁷³ There was no significant difference between the responses of the three companies with respect to offset policies being aligned with anti-corruption policies. Importantly, all three respondents confirmed that their companies have a dedicated offset policy in place, governing strict ethical guidance to employees dealing with such arrangements. Third party agents, brokers, and all those dealing with offset are required to adhere to corporate policy requirements. Offset potentially attracts a spectrum of corruption risks, as indicated in Chapter 4, and require companies to prioritise anti-corruption policies and procedures.

Cautious responses to question five were noted. Third party agents are a central feature of overseas sales, and are also employed to assist in discharging offset arrangements. Agents have featured prominently in defence corruption allegations involving foreign defence sales worth billions of pounds. All three companies replied yes to question 5, in Table 5.2. Interviewee A stated that "*all offset advisors are given rigorous training and are continuously monitored*".⁷⁴ "*Due diligence checks are applied to all agents and third parties, and all commissioned payments are closely monitored, with no payments transferred to offshore accounts. Ethics training is carried out annually, and the work of third party agents is reviewed by an external lawyer*".⁷⁵ Interviewee B confirmed "*due diligence is undertaken on consultants every two years and ethics training provided every year*".⁷⁶ Interviewee C stated "*advisors are subject to an advisor policy and this sets out*

clear guidance and provides in-depth rules. All advisors are vetted under rigorous checks by the group's advisor panel, with all payments to advisers being scrutinised by the financial department and are subject to strict accounting controls. A strict-reporting system and in-country visits monitor the work of the advisors. There are also two independent, in-company, experts that monitor the advisor process".⁷⁷

Due diligence is a proscribed approach that all the surveyed defence companies undertake to reduce potential risks prior to engaging in business relationships. An evaluation of an agent is a crucial part of the due diligence process, as working with unscrupulous agents can lead to ethical, reputational and financial damage. All respondents indicated that explicit policies and practices are in place to evaluate agents and advisors to mitigate potential corruption risk. Also, all three companies conduct due diligence checks and undertake ongoing training of advisors, including subcontractors. Importantly, all third parties are also subject to ethical training, periodically indicating that employees understand the expected boundaries of legal and ethical behaviour, both internally and externally.

The use of an internal committee was a common approach that all three companies had *in situ*. However, there were differences, some use an external committee whilst others use an in-house committee. A principal finding to emerge is that company B stated that occasional site visits are carried out on advisors as part of the monitoring procedure.⁷⁸ Generally speaking, interviewees reveal that all companies possess compliance and monitoring procedures for vetting agents. These control procedures ensure that third party agents are closely monitored with adequate checks as required by the Woolf Report recommendation 12.⁷⁹

In response to question 6 in Table 5.2, interviewee A reported that *“risk assessments are carried out regularly and thoroughly and reviews on decisions are done internally and approved by senior levels of management. This is monitored throughout the life cycle process of offset activities”*.⁸⁰ Interviewee B stated *“there are ongoing financial checks and due diligence checks on suppliers”*.⁸¹ Interviewee C stated that *“this is an ongoing procedure and factors that are considered are the political and economic country risks”*.⁸² The company responses to this question were generally vague with, companies failing to specify the processes for meeting compliance in offset activity abroad, signaling a potential weakness in this area.

With reference to question 7 in Table 5.2, interviewee A reported that *“there is a dedicated ethics helpline and this can be accessed from anywhere in the world.”*⁸³ *All reports are reviewed by an external committee and a call number is provided, which ensures anonymity. Follow-up is assured within 28 days, with bribery and corruption cases escalated to a member of the executive committee to oversee and investigate the problem”*.⁸⁴ Interviewee B stated that *“there are designated ethics officers who are trained to investigate certain cases, and if there is a major fraud or corruption issue, senior management will be notified immediately, including the Vice President. Depending on the outcome of the case we have a duty to report this to an external agency, only if certain laws have been violated. There is a checklist we have to follow to notify certain individuals. Also, all investigations need to be reported to senior individuals in the organization”*.⁸⁵

Interviewee C stated that *“a dedicated ethics line is open to all employees with regard to misconduct, and this can be accessed both nationally and internationally.”*⁸⁶ *A caller message number is provided to the caller on the progress of the case, and there is an option for anonymity.*⁸⁷ *All ethics officers are provided with a standard script, screened*

by external organization called 'Navex'. In corruption cases the same process is involved and depending on the nature of the case, it is escalated to the appropriate departments, and dealt with by an in-house legal team, triggering the appropriate levels of action".⁸⁸ Interviewee B confirmed that it has an ethics website explaining how to contact the ethics officer.⁸⁹ There is a dedicated corporate email inbox messaging system but employees are also encouraged to contact the company to report any unethical behaviour".⁹⁰

All survey respondents confirmed effective reporting channels to offer guidance and support to employees that are faced with ethical dilemmas. All three companies have adequate monitoring mechanisms in place, such as an independent committee to oversee corruption cases. This ensures that cases of corruption are screened by a committee, and satisfies the Woolf Report's recommendation 16.⁹¹ The importance of confidentiality is highlighted by all respondents; it encourages whistle-blowers to report unethical activity. The ethics lines can be used as an effective metric for companies to identify weak areas and improve their compliance procedures.

The leading British arms supplier, BAES, has faced immense criticism relating to its internal procedural processes and ethical conduct activities. For example, in Tanzania, BAES admitted to failing to keep proper accounting records.⁹² In parallel, widespread media coverage of the Al Yamamah deal cast the spotlight on allegations of corruption. An inquiry was opened by the DOJ, and BAES pleaded guilty to making false statements to the US government agencies and was fined \$400 million dollars for criminal conduct.⁹³ Consequently, as part of its plea agreement with the DOJ, BAES agreed to design and implement an independent compliance committee to review ethical practices.⁹⁴

Following the controversies surrounding the Saudi Arabia corruption allegations, BAES

was forced by the DOJ to scrutinize its policies and practices. This led to the formation of the Woolf Committee, comprised of independent external experts. The Woolf Committee identified a number of weak areas and a list of 23 recommendations were formulated to provide BAES with the highest ethical standards for day-to-day commercial activities.⁹⁵ The aim of this Committee was to ensure that BAES operated in an clear, open, transparent and accountable manner in all business activities with its domestic and international customer countries.⁹⁶ After a comprehensive review of its ethical standards, BAES has markedly improved its ethical standards over the last 10 years. In 2008, the Woolf Report radically sharpened BAES ethical procedures, and this ignited a revolution in the ethical development of the company's framework. In this context, the Woolf Report, more broadly, has increased the vigilance of UK defence companies to reform their ethical policies and reduce the potential for corruption.

5.3.2 National Ethical Compliance: The UK Bribery Act

The aftermath of the BAES bribery and corruption scandals led to unprecedented scrutiny of UK laws by the OECD's anti-corruption compliance policies.⁹⁷ The OECD expressed dissatisfaction with UK conduct and urged it to address deficiencies in its laws on the bribery of foreign public officials.⁹⁸ Further to this the OECD Working Group argued that failing to take effective measures, including comprehensive legislation, will undermine the credibility of UK legal frameworks, potentially triggering the need for increased due diligence over UK companies and their commercial partners. The aim was to reduce corruption, particularly in developing countries. Thus, the UK has taken significant actions to enhance the detection of corruption and foreign bribery. The Bribery Act sets out the minimum acceptable behavioural standards. It also addresses the consequences of failure to comply with the law resulting in imprisonment and penalties. Against this backdrop,

this section presents the survey's findings regarding 'national' UK ethical compliance.

In response to section C question one in Appendix B (Questionnaire), interviewee A stated that *"its company complies with the UK Bribery Act, and the raft of other legislative governance and guidelines, such as the OECD, the Foreign Corrupt Practices Act, and US rules. When it comes to jurisdiction, the US and UK are the major players"*.⁹⁹ Interviewee B stated that it complies with the legal requirements, arguing that *"there are two principal jurisdiction laws that need to be complied with, the FCPA and the UK Bribery Act"*.¹⁰⁰ Interviewee C confirms that the *"legislation followed is the UK Bribery Act. This demands compliance in the UK; however, the FCPA is the equivalent legislative practice in the US, and on an international level, it is the Combating of Foreign Bribery guidelines(OECD)"*.¹⁰¹

The UK Bribery Act introduced in 2010 is a strong legislative instrument, providing guidance to UK companies to combat foreign bribery offences. Today, it is seen as one of the major guiding enforcement laws that UK defence companies adopt in the compliance framework. A common observation is that the UK Bribery Act is the regulatory legal requirement that companies must adhere to when dealing with offset requirements on an international level. In principle, having strong anti-bribery laws guide companies to refrain from engaging in corrupt practices. UK defence companies highlight that they are mandated to conform to the most important international anti-bribery regimes, which are the Foreign Corrupt Practices and Combating Foreign Bribery (OECD). Yet, the danger is that UK companies may circumvent anti-corruption laws by using intermediaries to secure contract deals worth millions of pounds. As discussed in Chapter 2, the prominent anti-corruption polices (UK Bribery Act and OECD) advocate that foreign bribery in international transactions be criminalized.

With reference to Appendix B (Questionnaire) in Section C, question 2, all respondents replied yes. One interviewee commented that *“legislation is difficult and a complex area”*.¹⁰² The responses to this question reveal that there is a certain degree of complexity in the legislation. With reference to Appendix B, Section C, question three, only one respondent replied *“that when designing policies and procedures, the legal requirements such as the UK Bribery Act are embedded in the policies and procedures. This is an ongoing process to ensure that we meet the expected compliance requirements.”*¹⁰³

5.3.3 International Laws and Regulations

There is a plethora of international compliance requirements that UK defence companies need to adhere to when pursuing defence arms sales in foreign countries. UK top defence companies operate in international markets including Saudi Arabia, United States, India and Australia, and access to international markets presents challenges for defence companies. In addition, each nation has legal regimes that can vary from nation to nation. Consequently, the UK Bribery Act, Foreign Corrupt Practices Act (FCPA) and Combating Foreign Bribery (OECD) act as guidance to eradicate bribery and corruption when contracting with governments and companies with overseas countries. UK exporters are mandated to comply with anti-corruption policies set out by these customer countries. Thus, the reduction of bribery and corruption has become a well-established and increasingly important global requirement. This third level of analysis aims to assess whether, and how, UK defence suppliers seek to be compliant with foreign legislative requirements to reduce corruption, whilst simultaneously protecting the UK’s international reputation. The below section presents the survey findings in international laws and regulations in relation to offset.

In response to section D, question 1, in Appendix B, interviewee A indicated that, “*compliance is dealt with by top legal firms, and all legislation is covered by them. These legal firms will notify us of any contravention of legal requirements*”.¹⁰⁴ Interviewee B confirmed that “*each offset obligation will generally have one or more people who are responsible for ensuring that the company is kept abreast of local laws. We also have country teams who will report to corporate central office of any changes in particular countries’ offset policies and laws*”.¹⁰⁵ Interviewee C stated that “*there is a central team, which is dedicated to monitoring changes in offset policies and laws, and appropriate actions are followed to update policies and procedures accordingly*”.¹⁰⁶ All companies surveyed reveal that dedicated teams deal with compliance changes in laws and offset policies. With regards to changes in offset policies, this falls directly under the remit of the compliance department. Importantly, there are dedicated teams placed in certain countries who report directly to headquarters with respect to identifying any deficiencies in the legal framework on offset. The responses to question 2 in section D in Appendix B were covered in Table 5.2 question 5.

In response to section D, Appendix B, one interviewee stated that “*we comply with the laws, country policies and procedures*”.¹⁰⁷ Offset obligations in the UK will be monitored to ensure that offset is consistent with customer offset policies. There are independent assessors who oversee and monitor the foreign contract. There are a number of processes that we have in place to monitor the offset programmes to ensure they are in line with the countries’ offset policy requirements.¹⁰⁸ Interviewee B stated that “*there is a big in-house legal team to ensure compliance with customer countries’ policies, and are committed to protecting the company brand in all offset obligations. A senior committee oversees adherence to offset policy, and the preference is to work and contract within UK and US*

*laws, rather than local laws. If that is not adequate, then the ultimate decision is to withdraw from doing business”.*¹⁰⁹ Interviewee C stated that “*there is a central team, which is dedicated to monitoring changes in offset policies and laws, and appropriate actions are followed to update policies and procedures accordingly*”. All respondents revealed that compliance and policies is a central focus in protecting the brand in overseas countries.

5.4 Summary

Overall, all survey companies demonstrate that compliance to local and international laws is at the forefront of corporate policy. All three respondents confirm that there are adequate measures and processes in place to safeguard the company against potential bribery and corruption risk. To support this, in particular one interviewee pointed out that if a potential ethical risk is identified during the contract process all negotiations will cease immediately. Leading UK companies are recognizing the potential risks in conducting business in overseas markets. The survey firms are pioneering positive change by embedding anti-bribery policies into their ethical frameworks to drive out corruption, thus protecting the ‘brand’. All survey firms confirm that they couch offset policies and overseas legal requirements into the ‘code of conduct’ in accordance to the Woolf Report.

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Chapter 6

Conclusions

6.1 Introduction

This chapter is arranged into four main sections, and begin by summarising chapters 2 to 4. The discussion firstly focuses on the nature and impact of corruption, identifying the key causes and consequences of corruption. It highlights the emergence of corruption indicators that have proliferated over the years. The nature and key characteristics of offset are then examined, especially the varying offset approaches that countries have in place. A comparative evaluation of the different policy perspectives of governments is undertaken, from the perspectives of the UK, Europe, World Trade Organisation and USA. Finally, the dissertation analyses the nature and extent of corruption in both defence procurement government and offset, including a discussion of the global cases of defence corruption.

This closing chapter focuses on drawing conclusions for the study, derived from the findings of the analysis conducted in Chapter 5, and to a lesser extent Chapter four. Three critical areas of analysis have been employed to assess the effectiveness of ethical corpo-

rate frameworks in the UK defence sector. These levels of analysis play an instrumental role in corporate compliance to guide employee behaviour in business activity in relation to offset, and to avoid potential corrupt practices. Firstly, the effectiveness of corporate ethical compliance was explored at the company level. Secondly, national legislation was identified, especially the legislative processes that defence companies incorporate within their corporate ethical frameworks. Thirdly, the effectiveness of international laws and regulations was explored. Based on the findings of the research, policy recommendations will follow, along with future work to be carried out in the field of defence corruption.

6.2 Chapter Highlights

The scholarship underpinning this study sought to highlight the relationship between corruption and the abuse in public office. Corruption is a subject that can be contested due to its hidden nature, but a major problem is that no single definition of corruption exists. Corruption encompasses behaviour that is illegal, and can take several forms, such as bribery, fraud, money laundering, and embezzlement of funds, improper political contributions and extortion. The causes and impact of corruption, and measures to combat it are central issues that are increasingly on the national and international agendas of policy makers and organisations. Paulo Mauro confirms that corruption has a devastating impact on the economy, as it affects growth and development. There is a need to understand the causes and consequences of corruption. This may be helped by constructing a typology. Two main distinctions can be drawn between petty corruption and grand corruption, with the latter including unlawful acts of bribery, embezzlement, fraud, extortion and conflict of interest. Corruption is a complex topic, due to its clandestine nature, and there is no single approach to measuring the phenomenon.

The emergence of corruption indicators has proliferated over recent years to measure and combat corruption. The first single measure of corruption was developed in the 1990s, and is termed the Corruption Perception Index 2016 (CPI). The CPI is an instrument commonly used by many organizations and academics. There have also been numerous anti-corruption initiatives in multiple jurisdictions, such as the FCPA, UK Bribery Act and OECD. Corruption is difficult to measure, however, not least because measures focus on ‘perceptions’ of corruption. The interest in measuring corruption at firm level prompted insights into the underlying causes of corruption at firm level. For example, the World Bank used a firm level survey in various countries to assess the actual experiences and perceptions of corruption. The OECD has analysed 427 international bribery cases and found that public procurement is one of the most vulnerable areas of corruption. Public procurement is a vulnerable area of corruption risk due to large contractual expenditures, increasing opportunities for risk to enter into the contract. However, public sector corruption can have a major impact on state revenues, and a devastating impact on the world’s economies. In the political arena, it undermines democracy, good governance and can negatively impact on economic growth.

The contemporary emergence of offset was influenced by the economic and political climate following the collapse of the Soviet Union in 1991. At the end of the Cold War, global military budgets shrank significantly. This resulted in increased pressure from arms sellers, and the arms market re-invented itself from a seller’s market to a buyer’s market. In order for companies to survive in this competitive environment, lucrative additions, called offset, became a common feature in defence markets.

Governments use offset to justify their purchases of arms by highlighting the benefits that contribute to the vitality of the national economy. Purchasing governments can choose to

stimulate areas of investment. These benefits can include technology transfers, buy-backs, employment and investment opportunities. The proliferation of offset has increased since the late 1980s. Purchasing countries are demanding offset benefits in varying degrees.

Corruption in the UK defence sector is a major concern. Defence is a unique environment, which is shielded from public scrutiny. The OECD argues that procurement is one of the most vulnerable areas for corruption, with almost 50% of bribes worldwide paid in this sector. Procurement is a complex area which comprises of multiple phases involving large technically complex contracts, and multiple people in defence contracting. Governments play an instrumental role in the arms procurement decision making process, and may use offset in the awarding of contracts.

Offset is a unique reciprocal arrangement that can potentially attract a spectrum of risk, leading to potential corrupt activity in defence and offset contracts, as bribes can be solicited in favour of a contract award. In addition, third parties may secure lucrative contracts worth millions of pounds in exchange for illegal gains. Proven cases of corruption appear to be entirely linked to the defence procurement contract. The most common problem identified is the bribing of foreign officials. This suggests that companies are consistently failing to meet their compliance requirements. Moreover, in recent years there has been increased attention in corporate compliance due to the prevalence of corruption in defence. In 2016, the UK minister of Defence (MOD) revealed that 44 allegations of corruption in defence had been passed to law enforcement agencies, with four of these involving the bribing of foreign public officials.

Offset is reportedly prone to corruption, sparking a global controversy, even though no hard data exists to support the case, one way or the other. A 2010 TI Report focuses on

alleged corruption cases alleged in defence and offset, but the lack of evidence fails to 'prove' such corruption is a problem. The thrust of this research has thus been to determine the nature and extent of corruption in UK offset arrangements. This has been achieved by interviewing senior representatives from the UK's top aerospace and defence suppliers to establish the degree of corporate ethical compliance, national and international regulations and legislation, especially with regard to offset contracts.

6.3 Conclusions

As evidenced in Chapters 4 and 5, there have been numerous cases of corporate corruption in UK defence and aerospace sector over the last decade. This has led to hefty fines, and damaged the international brand of some of the country's most iconic brands, including BAES, Airbus and Rolls-Royce. Corruption is still a common occurrence in UK defence deals. Past ethical behaviour demonstrates weaknesses that have been identified in compliance and practice. For example, leading aero-engine supplier, Rolls-Royce has been penalised for indulging in many illegal acts, such as funnelling bribery payments worth millions of pounds across international continents.

6.3.1 Conclusions: Corporate Ethical Compliance

All three companies in the UK sample introduced formal ethical codes of conduct, and for one of the firms this code has percolated down to embrace its suppliers. Importantly, all three companies ensure the importance of ethics and integrity. The research findings indicate that companies review their ethical procedures every three or four years, though one company has not changed its ethical code since 1995.

Corporate legal teams work closely with the ethical compliance executives, and a zero-tolerance approach to corruption is mandated and clearly communicated to all levels of employees, including CEOs. Companies have created global ethical helplines encouraging whistle-blowers to report ethical concerns with guaranteed anonymity. There are effective monitoring mechanisms in place to oversee compliance and reduce, even eradicate cases of corruption. The monitoring is carried out by an external committee.

Alleged and actual corruption tarnishes a company's brand. Accordingly, following the 2008 Woolf Report recommendations, this study's sample companies introduced a rigorous and robust set of ethical compliance measures that cover commercial operations, including offset. This supports the conclusion that broad-based UK defence-related ethical compliance procedures are some of the most stringent in the world. Whilst corruption allegations still surface, they are rooted in historical arms deals contracted before implementation of the Woolf Report recommendations.

6.3.2 Conclusions: National and International Legislation

Foreign bribery is an inherent feature of international transactions involving UK defence companies. This raises serious ethical and political concerns. UK executives of the three sample defence companies highlight that US laws, Foreign Corrupt Practice Act and Convention on Combating Bribery of Foreign Public Officials in International Business Transactions are embedded in their policies and anti-corruption policies. There is therefore adequate governance in place to monitor corrupt practices, including offset. Overall, all the sample companies recognise that compliance with international laws is important to business success.

The three sample survey companies recognise the need to protect their brand when contracting with overseas countries, especially those with demonstrably weak ethical compliance regimes. The UK company interviewees state that strong measures are in place to ensure that corruption is suppressed. These measures include due diligence investigations carried out on both third parties and offset beneficiaries, imposing strict controls over their activities. Importantly, all sample companies adhere to the Woolf Report recommendations, the UK Bribery Act and overseas legislative requirements, particularly those of the US, but concern is expressed at the technical complexity of the legislation.

The UK companies also adhere to customer country legislation and regulations pertaining to procurement - including offset policy requirements, such as India's ban on the use of agents, and corporate-in-house legal teams monitoring overseas customer compliance procedures. The companies' offset teams comprise multifunctional members from across their organisations. These will be senior management, who are tasked with reviewing every aspect of the offset arrangements to ensure that the company is acting in an ethically 'clean' manner. Significantly, the interviewees recognise that overseas sales and offset deals are within the remit of both US and UK ethical compliance legislation and, as such, the companies ensure that they operate according to international laws and norms of best practice ethical behaviour.

6.3.3 Conclusions: The Global Context of Corruption

Defence is a field of endeavour prone to corruption. Military products are sensitive, but so too are the promotional activities surrounding the deals. This especially affects offset, because it offers the defence vendor the opportunity to gain a competitive edge. Thus, secrecy in negotiations is a hallmark of offset, due to the fear that the competitive advantage

will be divulged to other companies. (Chapter 4.2 section 1.3.2)

Corruption is not a mono-problem, but appears in different guises. These different corruption pathways, as they have been categorised in this dissertation. (Chapter 4, section 1.3.1), include contractual malfeasance, government conflicts of interest, fraudulent activity due to over-complexity, weak oversight and monitoring mechanisms and the uncontrolled use of Third Party Agents. Often the perpetrators of corruption will make deliberate and concerted efforts to restrict transparency. An important finding is that corruption and bribery in particular is a problem isolated largely to arms procurement rather than offset arrangements (Chapter 4 Table 4.2). Of course, the evidence is derived from secondary data, but nevertheless it acts to disprove the Transparency International findings contained in its 2010 Report that offset is an inherently corrupt trading device. Interestingly this research highlights that corruption is not confined to poor states, possessing inefficient accountability, transparency and audit processes, as it has been shown that there are obvious dangers of fraudulent behaviour in states characterised by a high Corruption Performance Index (Chapter 4, section 1.6).

6.4 Policy Recommendations

A series of recommendations have been drawn from the conclusions:

- The code of conduct plays a critical role in the functioning of an organization's ethical compliance practices. The applicable laws and regulations are underpinned in the code of conduct to protect all employees deviating from their assigned duties. Defence companies should update the code of conduct annually. Companies need to ensure that global risks are identified on a continuous basis and the implementation of these risks

should be aligned with the code of conduct and embedded in their anti-corruption policies. Further, changes the international laws and regulations should be publicly accessible to all employees and communicated internally in a clear manner.

- Offset has been unfairly criticised in the past, but there needs to be acceptance that such contracts do carry the potential for corruption. The problem is that the lens of transparency in developing countries, where most of the offset deals are located, is far more opaque than in advanced countries. More work needs to be done on developing a common methodology that will subject such deals to greater scrutiny.

- The publishing of guidelines aims to enhance the reputation of an organisation and decrease the risk of corrupt activities by raising employee awareness of the specific laws and procedures. However, the policies presently in place are insufficient to regulate the expected behaviours. Companies should enforce stronger vigilance and introduce effective monitoring mechanisms on high value projects, and all business activities carried out by third parties should be closely scrutinized by an independent external department.

- It is one thing to have a full spectrum of compliance measures in place, but it is another matter entirely to ensure that employees fully understand all aspects of the relevant UK and US legislation. The interviews reveal a degree of intimidation felt by the interviewees with regard to the complexity of the legislation. It is therefore essential that UK defence companies have regular briefings and awareness training so that a comprehensive and ongoing understanding of ethical compliance legislation is achieved.

- The UK Bribery Act is a strong piece of legislation to deter corruption but cases of bribery and corruption are still prevalent in the UK. This questions the effectiveness of

the present regulatory framework that helps to protect companies against illicit practices. This is a clear signal that legal policies need to be tighter in relation to foreign bribery. Stronger criminal sanctions should be enforced on companies that violate the laws set out in foreign customer countries.

- Employees might not be comfortable with reporting misconduct to the ethics line manager but they should be encouraged to report ethical concerns openly. Therefore, defence companies should create multiple open reporting channels of communication to facilitate the raising of ethical and compliance issues. This should provide employees with clear and written instructions on how to access these advice lines from a specific location.

- Corruption is a worldwide problem that affects all countries and all sectors. The reporting of questionable behaviour is therefore critical to the success of a company's ethics and compliance programme. It should be in the interest of government and companies alike to effectively tackle corruption. All defence organizations should make it their priority to provide an ethics and compliance training programme, which provides clear guidance, effective measures, comprehensive reporting mechanisms and clear accountability.

6.5 Future Research

Offset is an increasingly important strategic tool in the global export market. It is seen as a key enabler for international growth and development. However, offset is a controversial subject, with limited field research into the nature and causes of corruption. Hence, this study is one of the very few empirical studies of corruption in offset. Further work needs to be carried out, especially in the areas below:

- Corruption in defence is a deeply troubling phenomenon for all countries. It adds cost to defence projects, degrades market share values, reduces shareholder value due to the hundreds of millions pounds paid in heavy fines as well as damaging a company's brand for years to come. More research is required to clarify the nature and extent of the problem, and guide government policymakers towards developing appropriate coping strategies.

- This study has shown that offset has been unfairly stigmatised through unsubstantiated allegations of endemic corruption. with reference to (Chapter 4, Table 4.2) clearly demonstrates that near 100% of proven defence corruption is linked to malpractice in procurement, not offset. Whilst offset is a sensitive area, not often aired in public debate, there is a need for further research to demystify the subject. This research should be directed at identifying the ethical weaknesses of implementing awareness of offset programmes in high CPI states.

- An underlying principle of the present study is the acceptance that corruption has the potential to infect offset programmes, but that the scale of the problem is no worse and indeed, probably better, than corruption in defence procurement. This judgement is supported by the research findings, though it is conceded that they are primarily based on evidence trawled from the secondary literature. There is a fear, however that corrupt practices may be prevalent, but undiscovered, in overseas contracts implemented in foreign countries, where ethical compliance regimes are non-existent or in a lamentable state. Transparency International is developing a template to be used by stakeholders to ensure that corruption in offset is identified and eradicated. Analysts, observers and researchers in defence offset should be encouraged to further research this area, and make their own contribution to the debate. There is a paucity of studies examining corruption and offset, and those that have been undertaken are non-empirical and influenced by stereotype

comment rather than by primary research. The search for the truth on the nature and extent of corruption is challenging, but this fact should not act as a barrier to expanding the boundaries of knowledge.

Appendix A

Template email to participants

Dear Sir/Madam,

Following Brinley Salzman's email and the researcher's telephone call, I would like to thank you for your response and willingness to participate in this research study. I am studying for a Masters by Research at Cranfield University. The research project will aim to examine the corporate ethical policies alongside offset programmes.

This research has been reviewed, approved and granted ethical clearance through the Research Ethics Review Board at Cranfield University. All the data collected will be data-protected ensuring confidentiality. This will be used for research purposes only. The data will be accessed only by authorised users in accordance with the Data Protection Act (1998). You can be assured corporate anonymity is guaranteed. However, participation in this study is voluntary and you can wish to terminate the interview at any given time by advising the researcher. It will involve a semi-structured interview of approximately 30-45 minutes and this will be held at the company's location. The interview will be based on the attached questionnaire. On completion of this project you will be provided with a

copy of the original thesis.

I would be grateful, if you could confirm a date within the coming weeks. If you have any questions please feel free to contact me.

Thank you for your co-operation in this research project.

Regards,

MSc by Research Student

Appendix B

Questionnaire

Semi-Structured Questionnaire in the Defence Sector

Title: Corporate Ethical Frameworks in UK Defence Companies

The aim of this research project is to examine the effectiveness of ethical compliance, especially in defence offset programmes.

The term 'offset' is an arrangement between a UK supplier and the buying country, in which the UK Company invests a proportion of the contract in the investing country to generate economic value and broader goals of the country. This can either take the form of direct or indirect investment purchases.

Business 'ethics' refers to the application of ethical values based on key principles which include integrity, honesty, fairness, respect, transparency and accountability.

Confidentiality

All information obtained will be for research purposes only. This is to confirm that you have given your voluntary informed consent to participate in this research project. If you wish to withdraw at any time, then you can opt to terminate the interview and information provided will be deleted immediately upon your request. The data will be stored securely accessed only by authorised users in accordance with the Data Protection Act (1998). All information you provide will be data-protected and treated with the strictest level of confidentiality. Please note that all corporate names will not be mentioned in this thesis. On completion of this project you will be provided with a copy of the original thesis.

Section A: Company Data

1. Assigned Case No:	
2. Respondent:	
3. Company:	
4. Number of Employees:	
5. Year Company Started:	
6. Products or Services:	
7. Date and Place of Interview:	

Section B: Ethical Compliance

Q 1. Does your company publish a statement of values on corporate ethics, which set out the principles of business conduct, honesty, transparency, accountability and integrity?

Answer:

Q 2. Has your company's ethical policy been revised if so why? When was the last review?

Answer:

Q 3. Number of employees working in compliance?

Answer:

Q 4. Is offset subject to ethics policy? How is offset incorporated into your ethics policy?

Answer:

Q 5. Does your company use third party agents in offset projects? If so, are they subject to your company's compliance policy?

Answer:

Q 6. Is a risk assessment carried out on external offset business decisions? What processes are in place to monitor the ongoing compliance in offset activity?

Answer:

Q 7. What internal control mechanisms do you have in place for reporting ethical misconduct? Is this reviewed by an external/internal committee?

Answer:

Section C: National Legislation

Q 1. What national legislation does your company comply with when dealing with offset?

Answer:

Q 2. Do you think that there is adequate national governance in place for offset programmes?

Answer:

Q 3. How does your company ensure that corporate compliance standards are in line with the UK Bribery Act?

Answer:

Section D: International Laws and Regulations

Q 1. How does your company keep abreast with changes in laws and offset policy? How do you communicate this to your staff?

Answer:

Q 2. Does your company extend your ethical compliance policy for agents? What are the processes involved?

Answer:

Q 3. How do you protect your brand when dealing with overseas customer countries laws?

Answer:

Section E: Areas of Improvement

Q 1. How do you monitor your ethics policy to ensure that it is working effectively in regard to offset? Ethically, can offset be improved?

Answer:

Q 2. What recommendations would you suggest to ensure offset are managed effectively.

Answer:

Appendix C

Sources for Table 4.2

C.1 Notes

Procurement is goods and services that are procured by company and this case this would be defence purchases which include defence equipment. Corruption Perception Index 2016 based on expert opinion from around the world, the Corruption Perceptions Index measures the perceived levels of public sector corruption worldwide. Higher ranked countries indicate that these countries have a higher levels press freedom, robust integrity levels and high levels of transparency in public expenditure, where a countries with lower scores indicate that these countries are perceived to have poor levels of governance, press freedom is lower and judicial systems and transparency are weak, these countries face higher levels of corruption in the form of bribery and extortion (https://www.transparency.org/news/feature/corruption_perceptions_index_2016).

C.2 List of consulted weblinks

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Appendix D

Informed Consent

INFORMED CONSENT FORM

Title of the Project:	Transparency and Accountability in Defence Offset Programs
Name of the Researchers:	Michelle Charles
Researchers' Contact Details:	Cranfield University, Defence Academy of the United Kingdom, Shrivenham, SN6 8LA Michelle.Charles@cranfield.ac.uk Telephone Number: 01793 785822
Participant No:	
Date:	

1. I confirm that I have been informed about the aim and objectives of this research project and agree to give my inputs.
2. I understand that all personal information that I provide will be treated with the strictest confidence and my name will not be used in any report, publication or presentation. I have been provided with a participant number to ensure that all raw data remains anonymous.
3. I understand that the information I provide will be used by Cranfield University for the purpose of research only. The data will be stored on a secure network accessed only by authorised users in accordance with the Data Protection Act (1998).
4. I understand that the results of the research may be published in scientific journals, and an anonymised version of the data may be published in support of these results.
5. I understand that I am free to withdraw from this project at any stage during the session simply by informing a member of the research team, for whom contact details have been provided. I also understand that I can also withdraw my data for a period of up to 7 days from today, as after this time it will not be possible to identify my individual data from the aggregated results.
6. I understand that the discussions will be audio recorded and transcribed for analysis. The analysis will be only used for this research and for no other purposes.

I confirm I have read and fully understand the information provided on this form and therefore give my consent to taking part in this research.

Participant's signature:		Date:	
Participant's name:			
Researcher's signature:		Date:	

One copy of this form must be given to the participant and one copy held by the researcher.

Debriefing

Thank you very much for your time today to assist with this research. As mentioned earlier the data provided by you will be treated confidentially and you are free to withdraw or change your responses for a period of up to 7 days from today. If you need to change anything you can let us know by contacting us through email or phone (details are on the first page of this form).

If you are happy for us to contact you by email or phone at a later date if we have missed out important points or need to clarify any of your responses, please complete your contact details below.

Thank you

Participant's contact details:	
Tel:	
Email:	

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